Swiss GAAP FER conversion

Tailored for your financial statements
Scope of action and practical design options

2nd edition 2023

Swiss GAAP FER conversion

Tailored for your financial statements

Dear Readers

In Switzerland, Swiss GAAP FER ("FER") are an attractive alternative to international accounting standards. In recent years, FER have become established not only among traditional small and medium-sized entities, but also among a significant number of listed entities as well. The advantages of FER are, in particular, clarity, the numerous design options and reduced implementation and application costs. Nevertheless, a true and fair view of the entity's financial position, cash flows and results of operations is provided to readers of the financial statements.

In addition to the aforementioned advantages, various circumstances may lead entities to decide to launch a FER conversion project:

- Listing on SIX Swiss Exchange,
- Increase in transparency and creation of an economic basis for the management of the entity (as internal management reporting),
- Preparation for the entity's disposal,
- Creation of a financing basis (bank requirements, covenants).

Just like the tailoring of a custom-made suit, a conversion project must ensure a perfect fit for the presentation of an entity's financial statements. The entity's financial position and results of operations must be disclosed as accurately and meaningfully as possible. In order for management to make sound decisions in the context of the implementation, the basis for the scopes of action and design options is determined as part of a FER conversion project.

This publication provides support for determining a sound decision-making basis for accounting policies. In this connection, a concrete FER conversion project serves as an illustrative example. This example sheds light on the critical accounting policies that KPMG's Accounting Advisory Services Team ("KPMG AAS") has frequently observed in the practical implementation of conversion projects as well as in other advisory and audit engagements. Potential considerations and solutions for defining the accounting policies are presented in this context. The second edition of the publication reflects the provisions of the revised FER 30, which has to be applied by entities with a financial year beginning on or after January 1, 2024.

We hope you find this document interesting and informative – either in the context of a conversion or as a reference for application questions. Please do not hesitate to contact our motivated team of specialists if you have further questions.

Best regards,

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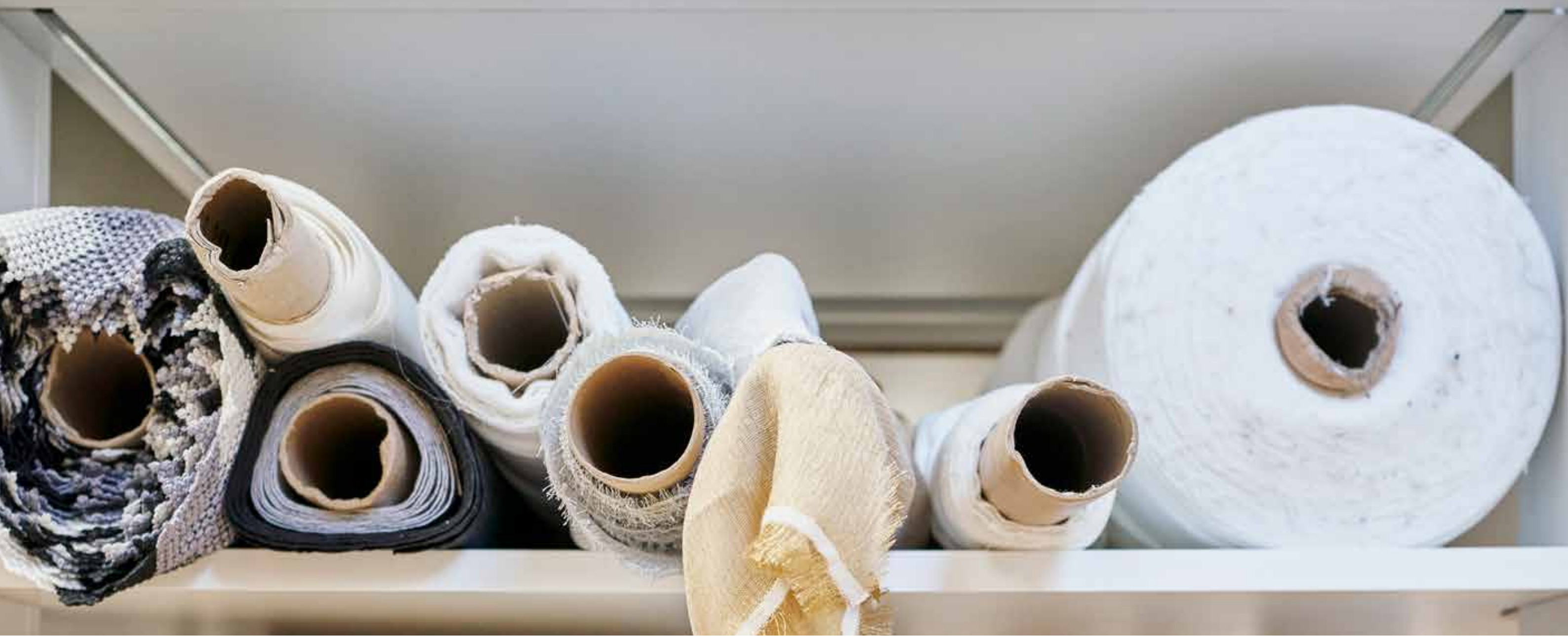

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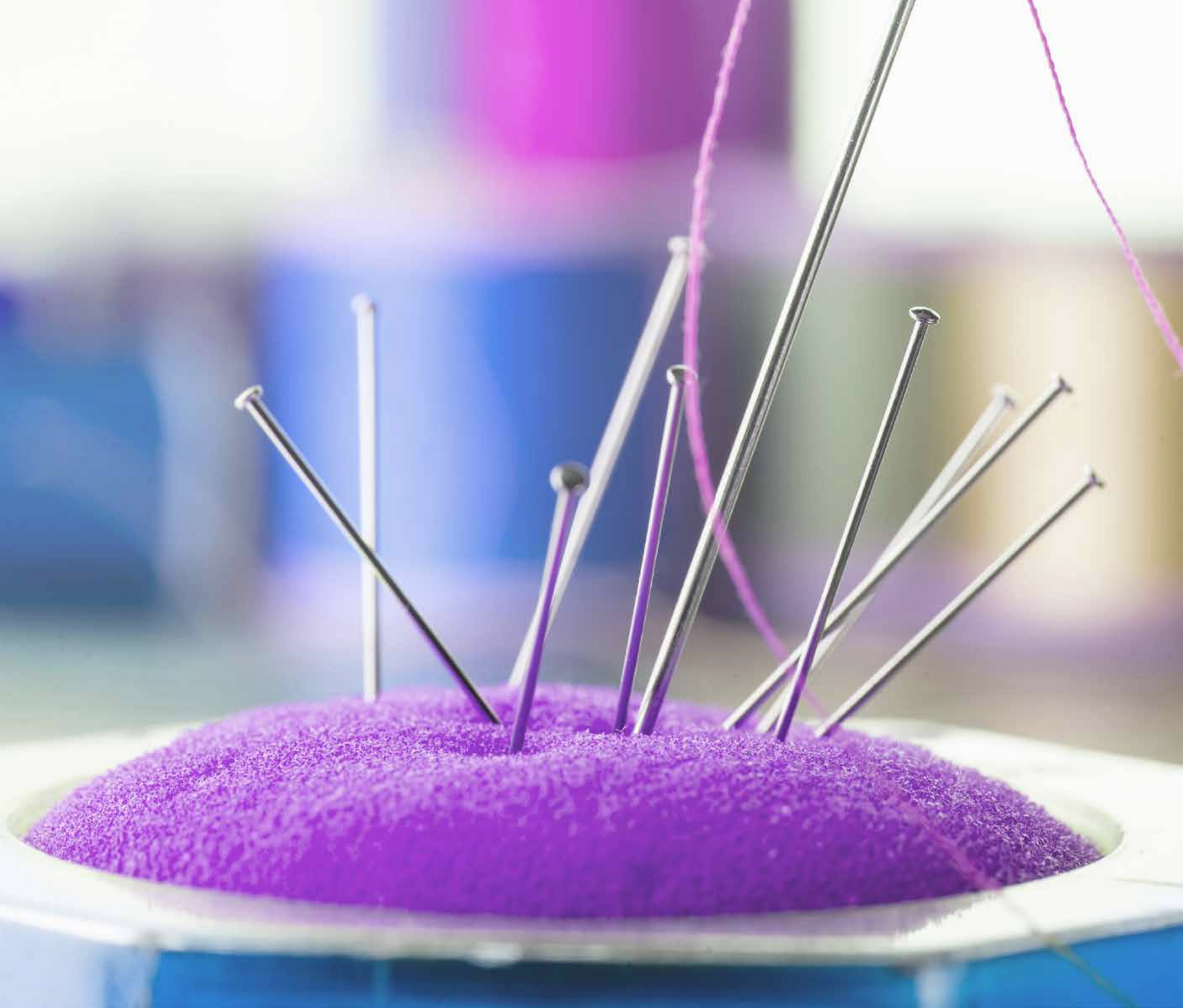
General information about this publication

In the context of the conversion project, DroneStar AG ("the Company") will have to deal with various issues for which there are no explicit accounting policy choices or (clear) provisions in FER. In this respect, the following definitions are used in this publication.



1. Definitions

Direct accounting policy choice

This publication mentions a direct accounting policy choice when FER explicitly contain two or more potential options for accounting, presentation or disclosure. These are accounting policy choices in the strict sense.

Indirect accounting policy choice

In this publication, an indirect accounting policy choice is an option that results from the formulation in FER. These are accounting policy choices in the broader sense.

An example of an indirect accounting policy choice is the following provision in FER 10: *"Intangible assets generated internally can only be recognized as an asset if they meet all of the following conditions at the time of initial recognition […]."* Since the standard contains the wording "can only be recognized as an asset," no obligation to capitalize as an asset can be derived from the formulation even if the conditions are met. In this concrete example, FER users indirectly have the option to capitalize the intangible assets generated internally and to amortize them over their useful life if the applicable conditions are met. On the other hand, corresponding costs could be recognized as an expenses for the period in which they are incurred.

Practical accounting policy choice

Because of the concept on which FER are based, certain detailed issues are not addressed concretely. In such cases, the interpretation of FER financial statements generally gives rise to scopes of action. Consequently, an established practice concerning specific issues has appeared in relation to the interpretation of FER.

Practical accounting policy choices within the meaning of this publication refer to scopes of action in the interpretation of open questions related to FER that have already been addressed in the specialized literature and/or at public events organized by a Big 4 company. Consequently, these are not options that can be derived directly from FER in the stricter or in the broader sense.

2. Focus of this publication

This publication focuses on accounting policy choices and scopes of action that are relevant for medium-sized and large FER preparers. It does not claim to present all accounting policy choices and scopes of action in a comprehensive manner. Its contents correspond to what KPMG AAS has frequently observed in the practical implementation of conversion projects as well as other advisory and audit engagements and thus what it considers relevant.

3. Applicable standard

The explanations in this publication concern Swiss GAAP FER as of January 1, 2023. The publication thus reflects the provision of the revised FER 30 published in 2022, which has to be applied by entities with a financial year beginning on or after January 1, 2024.

4. Practical assessments

For the practical assessments, the FER financial statements as of December 31, 2021 of entities listed on the Swiss stock exchange SIX (SIX Swiss Exchange AG) have been analyzed. Since DroneStar AG is an industrial entity, listed real estate entities, investment entities, insurance entities and financial institutions have deliberately been excluded from the sample. Under the abovementioned criteria, the number of analyzed financial statements is 60.

5. Disclaimer

The entities, persons and storyline mentioned in this publication are entirely fictitious. Any similarities with actual circumstances, entities and persons are purely coincidental.

Winds of change in financial reporting

Chapter 01

The classic case of a dynamic entity that takes on additional investors to ensure growth is used as an illustrative example. DroneStar AG is a production and sales entity active in the drone industry with a strong presence on the Swiss market. Founded over 20 years ago by Mr. Schwarz, the micro-business is now a well-established sole proprietorship with approximately 150 employees. Mr. Schwarz has been the sole owner of DroneStar AG since the Company began its operations. The next stage involves greater financial reporting requirements.

1. Background

Over the years, the Company has established a solid client base in Switzerland thanks to its quality product offering and has also started to form business relationships abroad. In order to develop business further, Mr. Schwarz is now considering a systematic expansion outside of Switzerland. With the support of KPMG AG ("KPMG") as advisor, Mr. Schwarz has developed an expansion strategy that addresses not only highly promising investment opportunities in new products and markets, but also the financing of the Company. As part of the recommended strategy, Mr. Schwarz has decided to bring on board Ms. Weissritter, who has a strong network of contacts in one of the target markets, as an additional equity provider and expansion partner.

As founder and head of the Company, Mr. Schwarz knows DroneStar AG like the back of his hand and until now, merely having a cash view of his entity was enough for him for financial purposes. Consequently, he did not need to base his management decisions on detailed financial figures and management reports. Since the Company began operations, it has prepared its financial statements in accordance with the provisions of the Swiss Code of Obligations ("CO"). These contain hidden reserves in accordance with the prudence principle established in the law.

Ms. Weissritter has accepted the offer on the condition that more transparent information about the Company's financial and business situation will be provided in future years. In order to meet this request, Mr. Schwarz and Ms. Weissritter have engaged KPMG's Accounting Advisory Services Team to support them in the choice of a true and fair view accounting standard that is widely accepted among equity providers in Switzerland.

The following table shows the balance sheet and income statement of the stand-alone financial statements of DroneStar AG as of December 31, 2022 prepared in accordance with CO.

In CHF thousands	December 31, 2022	December 31, 2021
Cash and cash equivalents	17,034	12,236
Securities	126	235
Trade receivables	8,443	7,498
Other current receivables	1,425	1,226
Inventories and non-invoiced services	7,467	6,067
Accrued income and prepaid expenses	1,469	1,253
Total current assets	**35,964**	**28,515**
Financial assets	550	550
Tangible fixed assets	7,411	6,455
Intangible fixed assets	276	208
Total non-current assets	**8,237**	**7,213**
Total assets	**44,201**	**35,728**
Trade creditors	6,296	5,680
Current interest-bearing liabilities	2,650	2,650
Other current liabilities	2,670	2,130
Provisions	775	720
Deferred income and accrued expenses	4,927	4,147
Total current borrowed capital	**17,318**	**15,327**
Long-term interest-bearing liabilities	5,670	5,130
Provisions	2,823	2,850
Total long-term borrowed capital	**8,493**	**7,980**
Share capital	6,000	5,000
Statutory retained earnings	1,200	1,000
Voluntary retained earnings	11,330	6,541
Own capital shares	–140	–120
Total shareholders’ equity	**18,390**	**12,421**
Total borrowed capital and shareholders’ equity	**44,201**	**35,728**

In CHF thousands	2022	2021
Net proceeds from the sale of goods and services	64,900	63,500
Changes in inventories of unfinished and finished goods	3,300	–2,200
Other operational income and own work capitalized	1,005	1,121
Total operating income	**69,205**	**62,421**
Cost of materials	–34,500	–31,200
Staff costs	–12,500	–11,200
Other operational costs	–11,700	–17,000
Depreciation on fixed asset items	–4,100	–3,600
Amortization of intangible asset items	–632	–572
Operating result before financial result and taxes	**5,773**	**–1,151**
Financial income	400	496
Financial costs	–200	–400
Profit/(Loss) for the year before taxes	**5,973**	**–1,055**
Direct taxes	–984	0
Profit/(Loss) for the year	**4,989**	**–1,055**

2. Possible true and fair view accounting standards

At the global level, there are several true and fair view accounting standards, with the following four standards mainly used in Switzerland:

- International Financial Reporting Standards ("IFRS")
- International Financial Reporting Standard for Small and Medium-sized Entities ("IFRS for SMEs")
- Swiss GAAP FER ("FER")
- United States Generally Accepted Accounting Principles ("US GAAP")

The true and fair view standards aim to provide the readers of financial statements with a true and fair view of the entity's financial position, cash flows and results of operations. The following table shows the similarities and differences between the various accounting standards in selected areas.

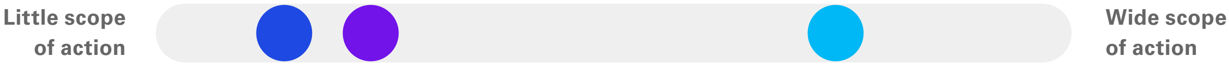
Accounting framework	Character	Target audience	Recognition by SIX Swiss Exchange	Dissemination	Scope
IFRS	Principle-oriented, detailed	Public entities, international financial markets	International Standard	Worldwide acceptance (mainly Europe, Asia, South America, for so-called Foreign Private Issues also in the US)	Approx. 5,500 pages (Parts A, B and C)
IFRS for SMEs	Principle-oriented, concise	Small and medium-sized entities	Not recognized	Worldwide acceptance (mainly Europe, Asia, South America)	Approx. 250 pages
FER	Principle-oriented, concise	Swiss small and medium-sized entities, incl. public entities	Swiss Reporting Standard	Switzerland	Approx. 200 pages
US GAAP	Case-by-case-oriented, high regulatory density	Public entities listed in the US, international financial markets	International Standard	Required for US public entities	Estimated more than 25,000 pages

As the above chart shows, the focus and details of the standards vary widely. The choice of accounting standard should therefore be considered carefully. For this reason, KPMG AAS assessed the most important aspects for the decision to be made by DroneStar AG in the following table.

A comparison is made between CO, FER and international true and fair view accounting standards. As regards international true and fair view standards, the focus is on IFRS and US GAAP since these are the most relevant in Swiss accounting practice.

CO FER International true and fair view standards (IFRS and US GAAP)

Influence on or smoothing of the result

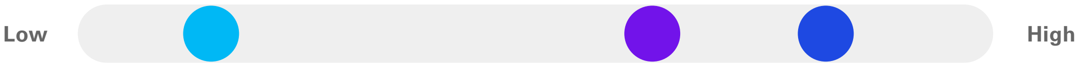


International true and fair view standards generally have a high regulatory density and thus offer little scope of action. Consequently, there are limited options for influencing the result.

FER follow the true and fair view principle and contain limited possibilities to smooth the result. However, due to the accounting policy choices and scopes of action, certain possibilities exist to influence the result.

CO offers the option of forming hidden reserves. Consequently, in good times a profit can be reduced by forming hidden reserves, whereas in bad times a loss can be decreased by releasing them. The result can thus be smoothed over the years.

Comparability of the financial statements with prior periods and peers

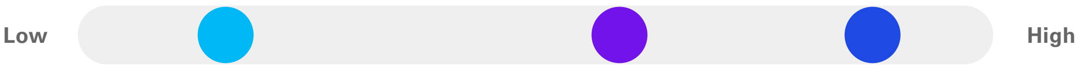


The formation and release of hidden reserves as well as the principles of prudence and imparity established in CO mean that the comparison of the financial statements with peers as well as with prior periods is rarely meaningful.

With the true and fair view principle, FER limits the options for controlling results and thus form a basis for a meaningful comparison with prior periods. However, the peer comparison is to a certain extent compromised by the high number of options and scopes of action.

The high regulatory density and the limited number of options in the international true and fair view standards, but also their global dissemination mean that the year-on-year comparability of the financial statements as well as their comparability with the financial statements of peers is high.

Popularity and recognition



CO forms the basis under commercial law for the preparation of the financial statements of Swiss entities and serves as a tax basis, which is why this standard is generally used in Switzerland. However, CO is not recognized by any stock exchange and is not relevant at the international level.

In Swiss accounting practice, FER have become more and more popular in recent years and are a recognized standard of the Swiss Reporting Standard of the Swiss stock exchange SIX Swiss Exchange. However, the international relevance of FER is limited.

International true and fair view standards are widely known in international accounting practice. Most stock exchanges recognize, for example, IFRS and/or US GAAP as applicable accounting standards.

CO FER International true and fair view standards (IFRS and US GAAP)

Cost of preparing the financial statements

CO financial statements can be prepared with relatively lean processes and CO is thus the most attractive standard from a mere cost perspective. The low regulatory density and the limited disclosure requirements contribute to maintaining the cost of preparing the financial statements at a low level.

The accounting and disclosure requirements of FER entail higher costs compared to CO financial statements. However, the cost of preparing FER financial statements is significantly reduced compared to international standards due to the lower regulatory density and the rare adjustments made to the standard.

The generally high regulatory density, complexity and detailed disclosure requirements as well as the changes that are regularly made to the standards mean that the preparation of the financial statements in accordance with an international true and fair view accounting standard often entails higher administrative costs.

Complexity in preparing financial statements

CO has a relatively low degree of complexity. The principles of the framework as well as the low regulatory density give great freedom of action to the preparer of the financial statements and rarely require the involvement of specialists.

The application of FER implies a certain degree of complexity and sometimes requires the involvement of a specialist. However, FER financial statements that do not present complex transactions can often be prepared without outside support.

The preparation of financial statements in accordance with an international true and fair view standard implies a high degree of complexity. External specialists, e.g. an actuary, are generally involved. Furthermore, the implementation of several new standards that have been introduced in recent years has often led to extensive projects and the Involvement of experts.

DroneStar AG is based in Switzerland and wants to prepare true and fair view financial statements while keeping the corresponding costs at an acceptable level. The pragmatically structured FER fully meet these requirements. FER financial statements form a solid evaluation basis for equity providers and lenders. Furthermore, FER are recognized by the Swiss stock exchange SIX Swiss Exchange. The FER financial statements of DroneStar AG could therefore also be used for a potential future listing – with a reasonable additional effort for adjustments due to FER 31, which is mandatory for listed entities.

Based on the comparisons and discussions with KPMG AAS, both owners conclude that the preparation of stand-alone financial statements in accordance with FER is an option worth exploring for them.

3. Swiss GAAP FER basics and structure

The target group of FER users is composed of small and medium-sized entities as well as groups of entities with a national reach in Switzerland. Other FER users include non-profit organizations, pension funds, insurance entities, real estate entities and health insurers.

The key principle of FER is the presentation of a true and fair view of the financial position, cash flows and results of operations (true and fair view principle). Users thus have a suitable basis for meaningful accounting. Communication with investors, banks and other interested parties is also improved and the comparability of financial statements between entities made easier.

Structure of Swiss GAAP FER

FER take into account the various types of financial statement preparers by applying the following modular approach:

Small entities may choose to apply only the framework and selected key recommendations ("core FER"). According to the provisions of FER, small entities are those that do not exceed two of the following criteria in two consecutive years:

- balance sheet total of CHF 10 million
- annual net sales from goods and services of CHF 20 million
- 50 full-time employees on average per year

Entities that do not meet the definition of a small entity must apply the core FER and the other FER. Groups of entities must also apply FER 30 *Consolidated financial statements*. Entities whose equity and/or debt instruments are listed, or which have filed an application for a listing and therefore are creating a listing prospectus are also required to comply with the provisions of FER 31 *Complementary Recommendation for listed entities*.

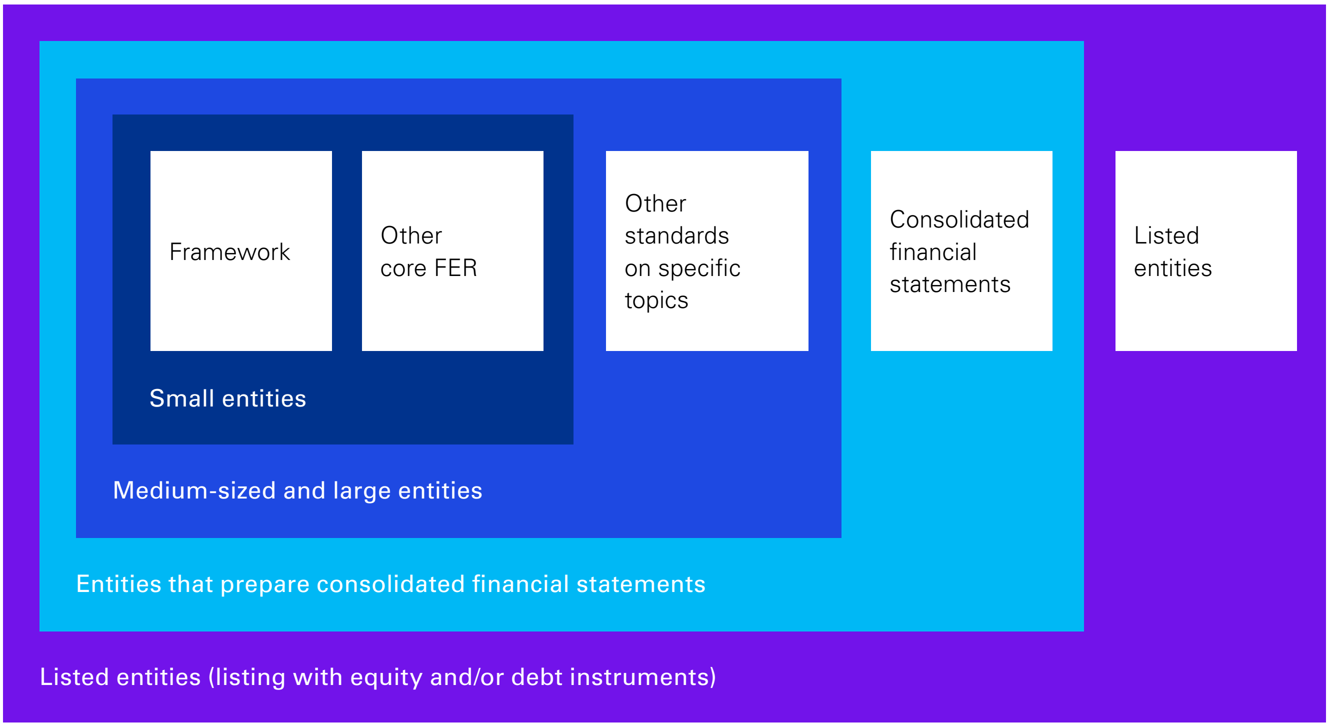


Illustration based on Meyer, 2014, p. 50

Overview of Swiss GAAP FER standards

Core FER
Swiss GAAP FER Framework
Swiss GAAP FER 1 Basics ("FER 1")
Swiss GAAP FER 2 Valuation ("FER 2")
Swiss GAAP FER 3 Presentation and format ("FER 3")
Swiss GAAP FER 4 Cash flow statement ("FER 4")
Swiss GAAP FER 5 Off-balance sheet transactions ("FER 5")
Swiss GAAP FER 6 Notes

Other standards on specific topics
Swiss GAAP FER 10 Intangible assets ("FER 10")
Swiss GAAP FER 11 Income taxes ("FER 11")
Swiss GAAP FER 13 Leases ("FER 13")
Swiss GAAP FER 15 Related party transactions
Swiss GAAP FER 16 Pension benefit obligations ("FER 16")
Swiss GAAP FER 17 Inventories ("FER 17")
Swiss GAAP FER 18 Tangible fixed assets ("FER 18")
Swiss GAAP FER 20 Impairment
Swiss GAAP FER 22 Long-term contracts ("FER 22")
Swiss GAAP FER 23 Provisions ("FER 23")
Swiss GAAP FER 24 Equity and transactions with shareholders ("FER 24")
Swiss GAAP FER 27 Derivative financial instruments ("FER 27")
Swiss GAAP FER 28 Government grants

Consolidated financial statements
Swiss GAAP FER 30 Consolidated financial statements ("FER 30")

Listed entities
Swiss GAAP FER 31 Complementary Recommendation for listed entities ("FER 31")

Specific sectors
Swiss GAAP FER 21 Accounting for charitable non-profit organizations
Swiss GAAP FER 26 Accounting of pension plans ("FER 26")
Swiss GAAP FER 40 Consolidated financial statements of insurance entities
Swiss GAAP FER 41 Accounting for real estate insurers and for health insurers

Side note on outstanding issues in relation to FER accounting

FER are principle-oriented recommendations. Compared to other true and fair view standards, FER are presented concisely (approximately 200 pages). Due to their relatively low regulatory density, it is possible that a specific issue may not be addressed directly. According to FER 1/4, open questions relating to financial accounting must be solved in line with the framework. The framework objectives "decision-making relevance" and "true and fair view" serve as a basis when searching for a solution. Very often, there are several answers to a specific issue. In order for the readers of financial statements to understand the solution that has been chosen, it is important to explain the selected approach and to apply it consistently.

Referring to other true and fair view accounting standards containing specific issue-related provisions is often helpful when searching for a solution to a concrete issue. It is a recognized practice of FER that previous rules of the accounting standard in question may also be considered in addition to the currently applicable provisions. Due to the widespread dissemination and high degree of detail of IFRS (or IFRS for SMEs), this accounting framework is often referred to (see Loser/Eberle, 2016, p. 126).

The chosen solution must always be assessed to make sure it is not in contradiction with the framework or other FER standards.

4. Decision to convert to Swiss GAAP FER

The numerous advantages and opportunities as well as the broad acceptance of FER accounting have convinced the two owners, Ms. Weissritter and Mr. Schwarz. During the initial discussions with KPMG AAS, Mr. Schwarz has learned that FER offer several accounting policy choices to users. Furthermore, due to the low regulatory density of FER, there are certain scopes of action in the interpretation of FER provisions. In order to make the necessary decisions, the two owners need to analyze the accounting policy choices and scopes of action that are available to DroneStar AG. Since the Company's finance department does not currently have the necessary knowledge, experience and resources to perform such an analysis, Mr. Schwarz also engages KPMG AAS as an advisor and sparring partner in the context of the FER conversion.

Decision regarding the conversion date

First, KPMG AAS and the owners discuss the conversion date for the financial statements of DroneStar AG. The Company wants to prepare its first FER stand-alone financial statements for the year ended as of December 31, 2023.

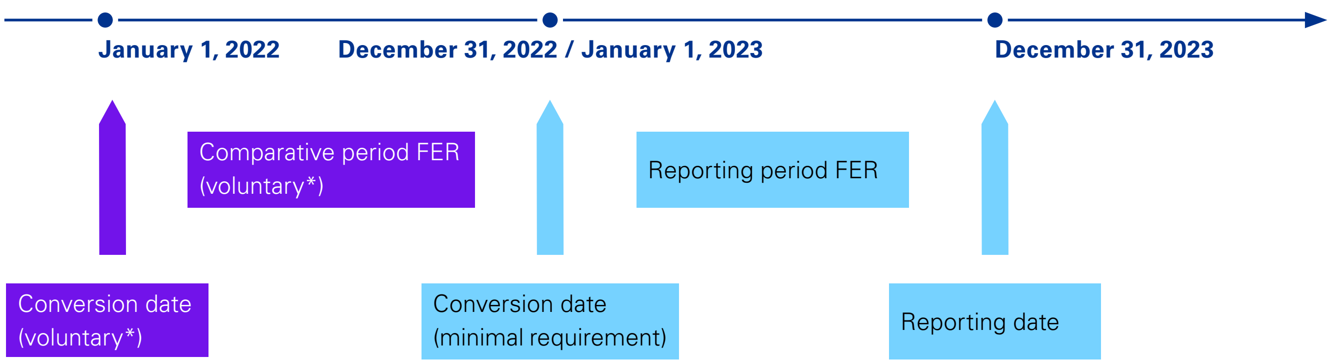
The FER framework states that an entity that adopts FER for the first time for its financial reporting is required to present the prior-year balance sheet in compliance with the new regulations. As a minimum requirement, therefore, DroneStar AG must present an opening balance sheet and a closing balance sheet as of January 1, 2023 or December 31, 2023. Consequently, the income statement, cash flow statement and statement of changes in equity are presented in the first FER financial statements only for the reporting year, i.e. 2023. For these elements of the financial statements, the 2022 comparative information is not presented since there are no FER-compliant figures for the latter. The same applies to the corresponding information disclosed in the notes, for which a prior-year comparison is required only as regards the balance sheet.

Entities with listed equity and/or debt instruments for which it is mandatory to apply FER 31 are required to present not only the figures for the reporting period, but also the figures for the prior year in accordance with FER ("restatement"). Consequently, the conversion date is the first day of the prior period. This approach may also be applied as an option for non-listed entities such as DroneStar AG.

The Company's two owners decide to present the figures for the reporting period and for the prior year in the financial statements as of December 31, 2023 in accordance with FER. Consequently, the conversion date is January 1, 2022. The key decision criterion was the fact that the financial position, cash flows and results of operations as well as the course of the business in the reporting year can be better assessed due to the comparability with the prior period. For the decision-makers at DroneStar AG, this advantage outweighs the higher costs resulting from the application of this approach. The illustration below summarizes the possibilities available to DroneStar AG as regards the conversion date.

Assessment of the size criteria for DroneStar AG

In 2022 and presumably in 2023, the Company exceeds the threshold values presented in Chapter 01 – 3. Swiss GAAP FER basics and structure regarding the balance sheet total, annual net sales from goods and services and full-time employees and thus does not qualify as a "small entity" according to FER. Consequently, in addition to the framework and the core FER, the other FER must also be applied by DroneStar AG when the accounting standards are changed.



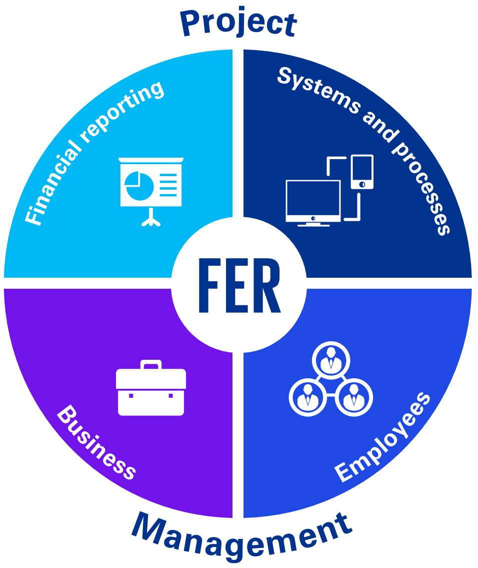
* Respectively mandatory for FER 31 users

5. The conversion project

The conversion of financial reporting to a new accounting standard is a project that will be more or less costly, depending on the size and complexity of the business concerned. The following illustration shows the critical issues that an entity should address when converting to FER.

Question 1
What are the main differences between CO and FER?

Question 2
How do investors (shareholders, banks) assess the financial consequences resulting from the exercise of accounting policy choices and scopes of action?



Question 3
Which changes must be made to the processes, systems and the internal control system – “quick fix” or complete overhaul?

Question 4
Who is affected by the conversion and what are the needs (training)?

Question 5
Is there a project plan for the conversion and have the corresponding resources been made available?

For most entities, the transformation process is similar and can generally be divided into three phases by applying a structured approach. The typical project contents as regards financial reporting and, consequently, accounting are the following:

1. Initialization

1. First discussion with consultants/statutory auditors
2. Prepare project management:
   - Establish project request/specifications
   - Determine project organization/role distribution
   - Determine project planning
3. Perform kick-off

2. Gap analysis

1. Perform analysis of significant information and structures (effective situation)
2. Interviews/workshops to validate the effective situation
3. Compare the effective situation with the target situation (FER) (gap analysis)
4. Assess and document results (incl. impact on work processes)
5. Establish decision criteria

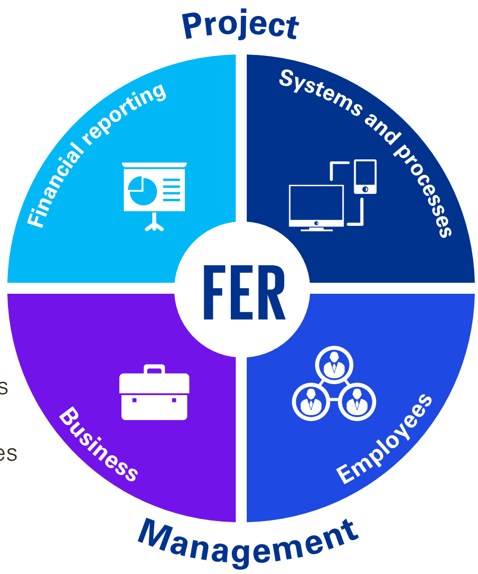
3. Implementation

1. Develop implementation concept, in particular for:
   - Chart of accounts
   - Accounting Manual
   - Training
   - Financial statements/annual report
   - Restatement
2. Realize task distribution and timetable for the implementation
3. Implementation of technical concept

The conversion represents more than the mere implementation of new accounting standards. It generally impacts the whole entity. In addition to the implications for financial reporting, other functions (IT, internal control system, HR/compensation system, etc.) are also affected. The following illustration shows the difficulties that arise when converting to FER.

Challenges related to question 1

- Inconsistent treatment of FER issues
- Timetable not complied with
- Insufficient data quality



Challenges related to question 2

- Financial consequences identified too late; too little time for alternatives
- Stakeholders (shareholders, banks) have diverging interests, which makes it more difficult to make decisions

Challenges related to question 3

- No time for tests
- The current reporting infrastructure cannot cover several standards
- Due to lack of time, no comprehensive integration in systems
- Delays in adapting the internal control system to the new processes

Challenges related to question 4

- Lack of resources (in particular at subsidiaries)
- Lack of awareness at the managerial level
- Lack of FER knowledge
- Challenge of handling a special project besides the ordinary business activity

Challenges related to question 5

- Budget overruns
- Delays
- Project tasks and responsibilities not clearly defined
- Lack of resources (in particular at subsidiaries)

Comprehensive project management is essential to ensure the smooth progress of the project and seamless collaboration among all functions. Furthermore, decision-makers and other stakeholders should be brought on board at an early stage and informed regularly about the main developments.

2023 financial statements: conversion of stand-alone financial statements to Swiss GAAP FER

Chapter 02

DroneStar AG is supported by KPMG AAS in the systematic analysis of the effects of the conversion from CO to FER. To this end, the income statement, balance sheet, cash flow statement and statement of changes in equity are examined as a first step. Next, the individual items of the financial statements are analyzed. In this regard, the accounting policy choices and scopes of action as well as the impact on the presentation and disclosures are presented.

1. Income statement, balance sheet, cash flow statement and statement of changes in equity

The income statement, balance sheet, cash flow statement and statement of changes in equity are the four core elements of the financial statements. They are highly relevant since they provide an overview of the financial situation and the results of operations. They are the first elements of the financial statements that are read and, together with the disclosures in the notes to the financial statements, form the basis on which decisions are made by investors, banks, regulators and an entity's other key stakeholders.

Entities have a strong interest in presenting these elements of the financial statements to show their financial situation in the best light possible. Auditors also attach a great importance to these four elements of the financial statements in the context of their audit activities. The presentation of financial transactions and events in the balance sheet, income statement, cash flow statement and statement of changes in equity often triggers discussions between the entity and its statutory auditor.

DroneStar AG also wants to understand how the conversion to FER impacts these central elements of the financial statements and has therefore asked KPMG AAS to compare their structure in accordance with CO and FER.

Income statement

The income statement is used to assess an entity's performance. Many readers of financial statements first look at the income statement in order to assess whether and how the entity generates profits. This is also the main reason why 40 of the 60 (67 %) analyzed FER preparers listed on the Swiss stock exchange SIX Swiss Exchange presented the income statement at the beginning of their financial statements as of December 31, 2021. The income statement contains historical information on the evolution of the results as "top line" as well as the net profit or loss as "bottom line." It also includes information about the composition of the costs that are necessary to achieve performance. This can provide an indication of current efficiency and the future focus.

The income statement can be presented by nature of expense or by function of expense under both CO and FER. Combining the two approaches is not permitted.

While the income statement by function of expense adopts a sales-related perspective, the income statement by nature of expense follows a production-oriented approach. Neither of the two accounting standards contain further provisions concerning the choice of approach. It is normally expected that an entity will choose the method that best reflects its business model. Many entities also align themselves with their competitors in order to ensure better comparability. In financial year 2021, 27 % of the 60 analyzed FER preparers listed on the Swiss stock exchange SIX Swiss Exchange applied the function of expense method and 73 % applied the nature of expense method.

The table on the next page compares both methods using the minimum structure required by FER 3. These differ only up to the intermediate total "Operating result." CO users are required to follow the sequence of positions specified in Art. 959b CO. The latter differs slightly from the FER 3 sequence presented in the table on the next page. FER financial statements offer more freedom as regards the sequence of positions.

Furthermore, FER users that have opted for the function of expense method must present personnel expenses, depreciation of tangible fixed assets and amortization of intangible assets separately in the notes. In the income statement, these cost blocks are attributed to the functions according to the "user pays" principle. CO users are also required to make these additional disclosures in the notes, with the difference that they are not required to present depreciation of tangible fixed assets and amortization of intangible assets separately.

For the items and intermediate totals highlighted in gray, there are further differences between CO and FER. For example, certain positions in the CO minimum structure are presented in an aggregated manner (administrative and selling expense in the income statement by function of expense, depreciation of tangible fixed assets and amortization of intangible assets in the income statement by nature of expense). Furthermore, the "other operating income and expense" as well as the intermediate totals highlighted in gray are not included in the minimum structure in accordance with CO.

Income statement by function of expense	Income statement by nature of expense
Net sales from goods and services	Net sales from goods and services
Cost of goods or services sold	Other operating income
Administrative expense	Change in inventory of finished and unfinished goods as well as unbilled goods and services
Selling expense	Material expense
Other operating income	Personnel expense
Other operating expense	Depreciation on tangible fixed assets
	Amortization on intangible assets
	Other operating expense

=	**Operating result**
	Financial result
=	**Ordinary result**
	Non-operating result
	Extraordinary result
=	**Profit/loss before income taxes**
	Income taxes
=	**Profit/loss**

A FER income statement can contain extraordinary results. CO includes the item “extraordinary, non-recurring or prior-period costs and income”. In deviation from CO financial statements, non-recurring or prior-period costs and income in FER financial statements are attributed to the functions or cost items in the operating result. A significant difference between the two standards is the evaluation of the events that can be presented in the “extraordinary” position. Under FER this evaluation must be carried out following stricter criteria, whereas there are no specific requirements under CO. FER 3 states that only expense and income that occur extremely rarely in the context of ordinary operations and that are not predictable are considered extraordinary.

In this regard, SIX Swiss Exchange has the following point of view, which shows that the contents of such positions are scrutinized closely and have already given rise to sanctions and fines issued by SIX for FER users:
“For the criterion ‘extremely rare’, the period since the last comparable event can be assessed as an indication of fulfilment of the criterion. The criterion ‘not predictable’ refers factually to the triggering event and not to the time of the booking entry. A low probability of occurrence of the triggering event (e.g. less than 50 %) or the fact that an event was not budgeted does not necessarily mean that the event was ‘not predictable’. Furthermore, a decision taken by the entity can qualify as ‘not predictable’ only in rare circumstances, where a recognizable causality between a non-predictable external event and the decision, that causes the extraordinary recognition of expenses/income, exists. It is important that the period between the external event and the decision is not unreasonably long in relation to the nature of the event.” (see SIX Exchange Regulation AG, 2022, p. 15)

Balance sheet

The balance sheet compares the assets, liabilities and capital of an entity’s owners at the reporting date. While the balance sheet is not usually the first element examined by the readers of financial statements, it is nevertheless an important component of the latter. It provides information about the investments that were necessary to achieve revenues and profits and shows the financing structure as well as the assets of an entity.

The comparison of the minimum requirements regarding the balance sheet’s structure under CO and FER shows that there are no major differences. Most differences between the two standards concern the equity-related positions. Under CO, reserves must be broken down further, not least because of the significance of CO financial statements under company law. Another example involves equity amounts not paid in, which are presented as assets in the non-current assets under CO and as negative amounts in equity under FER.

Another difference lies in the arrangement of the balance sheet. CO prescribes the order of the balance sheet items. In this regard, FER preparers have more freedom since they do not have to comply with a mandatory arrangement of positions. Similar to international accounting and reporting standards, it would be conceivable, for example, to record non-current assets before current assets under assets. Furthermore, the two standards use different designations for certain positions, which, however, should have no impact on the information provided by the balance sheet.

CO	FER
Under CO, at least the following positions must be presented separately under assets according to their degree of liquidity and under liabilities according to their maturity date in the given sequence. Other positions must be presented separately in the balance sheet or in the notes if this is essential for the evaluation of the assets or financial situation by third parties, or if this is a usual practice due to the entity's business operations.	FER 3 specifies, in particular, the minimum structure of the balance sheet. According to the provisions of this recommendation, the following positions must be disclosed separately in the balance sheet. Beyond, FER 3 contains further disclosure obligations for certain positions. This information can be presented either in the balance sheet or in the notes to the financial statements. Since in practice this additional information is frequently disclosed in the notes to the financial statements, it is not addressed in this section.

Current assets	
Cash and cash equivalents and current assets with a stock exchange price	Cash and cash equivalents
Trade receivables	Securities
Other current receivables	Receivables from goods and services
Inventories and non-invoiced services	Other short-term receivables
Accrued income and prepaid expenses	Inventories
	Prepaid expenses and accrued income

Non-current assets	
Financial assets	Tangible fixed assets
Shareholdings	Financial assets
Tangible fixed assets	Intangible assets
Intangible fixed assets	
Non-paid-up basic, shareholder or foundation capital	

Current borrowed capital (CO)	**Current liabilities (FER)**
Trade creditors	Short-term financial liabilities
Current interest-bearing liabilities	Payables for goods and services
Other current liabilities	Other short-term liabilities
Deferred income and accrued expenses	Short-term provisions
	Accrued expenses and deferred income

Long-term borrowed capital (CO)	**Non-current liabilities (FER)**
Long-term interest-bearing liabilities	Long-term financial liabilities
Other long-term liabilities	Other long-term liabilities
Provisions and similar items required by law	Long-term provisions

Shareholders' equity	
Basic, shareholder or foundation capital, if applicable, separately according to participation classes	Capital of the entity
Statutory capital reserves	Capital of the entity not paid in (negative amount)
Statutory retained earnings	Capital reserves
Voluntary retained earnings	Own shares/own units of the capital of the entity (negative amount)
Own capital shares as negative items	Retained earnings (profits) or accumulated losses
Profit carried forward or loss carried forward as negative items	
Annual profit or annual loss as negative items	

Cash flow statement

Unlike the income statement and the balance sheet, which follow the principle of period-specific accruing of expenses and income, the cash flow statement shows the effective cash inflows and outflows for the period. It provides relevant additional information about the entity's ability to settle short-term liabilities and to achieve sustainable cash flows from operating activities. A cash flow statement is indispensable for managing liquidity as well as maintaining solvency and, consequently, for ensuring the entity's going concern. Furthermore, the cash flow statement is an important instrument for investors that generally measure an entity's value based on the expected future cash flows.

Following the CO provisions, DroneStar AG was already under the obligation to prepare a cash flow statement. The CO legislative text states only that the cash flow statement must present the changes in cash and cash equivalents separately from operating activities, investment activities and financing activities. In the absence of further provisions, many entities follow recognized accounting standards such as FER or IFRS for the preparation of the CO cash flow statement.

The principle stated in CO for the presentation of the cash flows also applies under FER. However, further provisions regarding the structure apply. These are presented on the following page.

Accounting policy choices and scopes of action under FER

FER 4 grants the *direct* accounting policy choice according to which the cash flow from operating activities can be presented in accordance with the direct or indirect method. Since the direct method is used extremely rarely in practice, the focus is on cash flow from operating activities determined in accordance with the indirect method.

Both FER 4 and the entities' established practice give rise to certain accounting policy choices and scopes of action for the presentation of the cash flow statement.

There is an additional *direct* accounting policy choice regarding the definition of the funds for which a reconciliation must be presented. According to FER 4, the following two options are allowed:

Use of the "Cash" fund

or

Use of the "Net cash" fund

The "Cash" fund comprises cash on hand and demand deposits with banks and other financial institutions. Cash also comprises cash equivalents kept as a cash reserve. These are highly liquid investments that are convertible to cash at any time and that are subject to an insignificant risk of changes in value. Cash equivalents have a residual term to maturity of 90 days from the balance sheet date at most. Examples of cash equivalents include time deposits or money market instruments if they meet the predefined criteria. Shares are not considered to be cash equivalents since they are generally subject to changes in value. Cash whose use is restricted or financial investments with a residual term to maturity of over 90 days are not considered to be cash equivalents.

The "Net cash" fund corresponds to the "Cash" fund less the short-term bank overdrafts repayable at any time on demand (current accounts). Only bank overdrafts that that meet the definition of cash and cash equivalents may be deducted. The composition of the fund must be disclosed. In practice, this is particularly relevant for use of the "Net cash" fund since the fund cannot be reconciled directly with the cash and cash equivalents presented in the balance sheet.

An analysis of financial statements shows that approximately 92 % of preparers opt to present the "Cash" fund, which can be reconciled with the cash and cash equivalents disclosed in the balance sheet. At approximately 8 %, only a small portion of FER preparers choose to use the "Net cash" fund.

As a rule, the cash flows must be presented where they are most related to the nature of the underlying transactions. The presentation of certain types of cash flows is not addressed specifically in FER, which is why the established practice has resulted in different possible approaches. The differing interpretations made by FER preparers result in several *practical* accounting policy choices which have been examined in the context of the conversion to FER chosen by DroneStar AG.

It is recommended to disclose the cash flows whose presentation is not clearly specified so that they best reflect the entity's business model. For example, in the case of a financial institution, it seems appropriate to disclose the interest received in the operating cash flow, whereas in the case of an industrial entity a presentation in the cash flow from investing activities may be more appropriate.

Cash flows	Structure and cash inflows/outflows
Cash inflow/outflow from operating activities (operating cash flow) The cash flow from operating activities can be determined by applying the indirect method. This method starts with the result for the period and corrects it for expense and income not affecting cash.	Profit/loss **+/–** depreciation/amortization/revaluations resulting in profit of tangible and intangible fixed assets **+/–** loss from impairment/(partial or full) reversal of impairment **+/–** increase/decrease of provisions (including deferred income taxes) that do not affect the fund **+/–** other expense/income that do not affect the fund **+/–** loss/profit from the disposal of tangible and intangible fixed assets **+/–** decrease/increase of receivables from goods and services **+/–** decrease/increase of inventories **+/–** decrease/increase of other receivables and prepaid expenses and accrued income **+/–** increase/decrease of payables from goods and services **+/–** increase/decrease of other short-term liabilities and accrued expenses and deferred income
Cash inflow/outflow from investing activities The investing activities comprise additions to and disposals of tangible fixed assets and financial assets, acquisitions and disposals of entities as well as intangible assets.	**–** outflows for investment (purchase) of tangible fixed assets **+** inflows from disposal (selling) of tangible fixed assets **–** outflows for investment (purchase) of financial assets (including loans, investments, securities etc.) **+** inflows from disposal (selling) of financial assets (including loans, investments, securities etc.) **–** outflows for investment (purchase) of intangible assets **+** inflows from disposal (selling) of intangible assets
Cash inflow/outflow from financing activities The financing activities comprise changes of financial liabilities and of the equity paid in as well as profit distribution.	**+** inflows from capital increase (including agio) **–** outflows for capital reductions with release of resources **–** distribution of profits to holders of units of the capital **–/+** purchase/disposal of own shares/own units of the capital of the entity **+** inflows from a bond issuance **–** outflows for bond repayments **+/–** issuance/repayment of short-term financial liabilities **+/–** issuance/repayment of long-term financial liabilities

Practical accounting policy choice

Implementation in practice

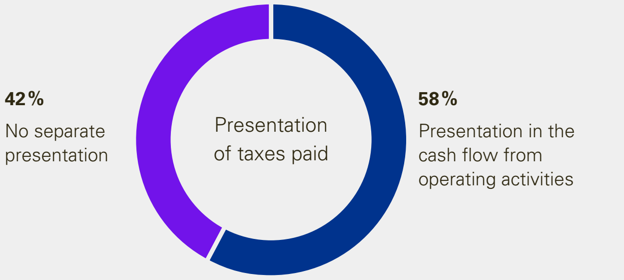
Presentation of taxes paid

Presentation of taxes paid in the cash flow from operating activities

or

*No separate presentation of taxes paid in the cash flow statement**

* Consequently: no cash outflows from taxes or cash outflows are part of the cash flow from operating activities determined according to the indirect method



A little more than half of the analyzed FER preparers presented the cash outflows from taxes in a transparent manner in the cash flow from operating activities.

Presentation of interest paid

Presentation of interest paid in the cash flow from operating activities

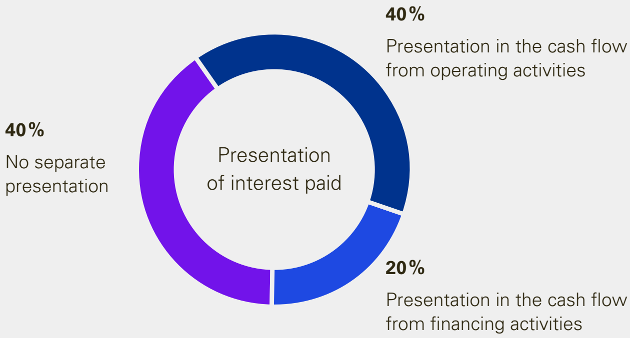
or

Presentation of interest paid in the cash flow from financing activities

or

*No separate presentation of interest paid in the cash flow statement**

* Consequently: no cash outflows or cash outflows from interests are part of the cash flow from operating activities determined according to the indirect method



For 80 % of the analyzed entities, interest paid was presented either as a separate item or, if any, indirectly in the cash flow from operating activities. Only 20 % decided to present interest paid in the cash flow from financing activities.

Presentation of interest received

Separate presentation of interest received in the cash flow from operating activities

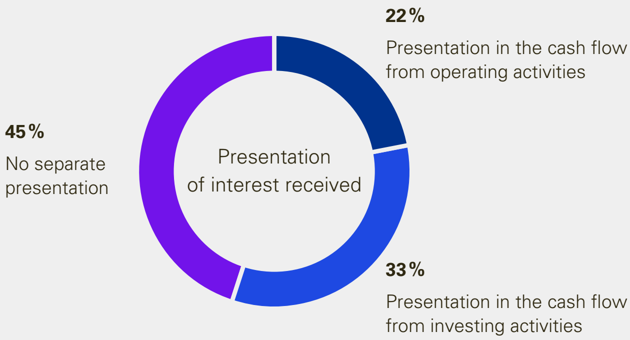
or

Separate presentation of interest received in the cash flow from investing activities

or

*No separate presentation of interest received in the cash flow statement**

* Consequently: no cash inflows or cash inflows from interests are part of the cash flow from operating activities determined according to the indirect method



It appears that nearly half of the analyzed entities have not opted for separate presentation. Consequently, approximately 67 % of the entities included in the sample consider interest received to have an operating character or have no corresponding cash inflows. For 33 % of the examined entities, the cash inflows are associated with the investing activities.

Practical accounting policy choice

Presentation of dividends received

Separate presentation of dividends received in the cash flow from operating activities

or

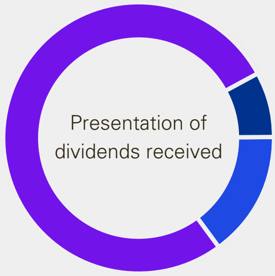
Separate presentation of dividends received in the cash flow from investing activities

or

*No separate presentation of dividends received in the cash flow statement**

* Consequently: no cash inflows or cash inflows from dividends are part of the cash flow from operating activities determined according to the indirect method

Implementation in practice



At 77 %, the majority of the entities do not present any cash inflows from dividends in the cash flow statement. This may mean that there are no corresponding transactions or that the dividends received are allocated to the operating activities without being presented separately. For 15 % of entities, these cash flows are directly connected to investing activities.

Statement of changes in equity

In its first FER financial statements, DroneStar AG must prepare a statement of changes in equity for the first time. According to FER, the statement of changes in equity must be presented as a separate component of the financial statements. It shows the opening and closing balances as well as the main changes for the most significant items of equity for the periods presented and must be presented in a table format. Each significant change in equity that is relevant for the evaluation of the financial statements must be disclosed separately in the reconciliation.

The statement of changes in equity of DroneStar AG for 2022 is presented as follows in the first financial statements prepared in accordance with FER. In addition, the 2023 FER financial statements include the reconciliation of total equity positions for financial year of 2023.

The effects of the conversion from CO to FER are presented as of the conversion date. This reconciliation as well as all corresponding additional disclosures will not be presented in future financial statements in which the conversion date is relevant, neither in the current period nor in the comparative period.

In CHF thousands	Share capital	Retained earnings	Own shares	Total
Equity as of December 31, 2021 according to CO	**5,000**	**7,541**[1]	**–120**	**12,421**
Effect of the conversion to Swiss GAAP FER	–	6,683	–	6,683
Equity as of January 1, 2022 according to Swiss GAAP FER	**5,000**	**14,224**	**–120**	**19,104**
Profit for the year	–	5,766	–	5,766
Capital increase	1,000	–	–	1,000
Acquisition of own shares	–	–	–20	–20
Equity as of December 31, 2022	**6,000**	**19,990**	**–140**	**25,850**

[1] The amount also includes the statutory retained earnings according to CO in the amount of CHF 1,000 thousand.

2. Presentation of the reconciliation from CO to FER

FER 31 contains provisions regarding the disclosure of the effects of the conversion from CO to FER. However, the application of FER 31 is not compulsory for DroneStar AG since is does not have listed equity/debt instruments and it has not filed an application for a listing. Consequently, the question arises as to which disclosures must be made in financial statements prepared for the first time in accordance with FER.

In this regard, FER 31 contains the following provision: *"A reconciliation to Swiss GAAP FER of the equity as per opening and end of the prior period as well as of the profit/loss for the prior period according to the accounting standard previously used has to be presented and explained."*

Such a reconciliation can for example be presented as follows:

In CHF thousands	January 1, 2022	December 31, 2022
Equity according to CO	**12,421**	**18,390**
Adjustment of trade receivables	330	371
Adjustment of inventories	2,724	3,274
Adjustment of financial assets	103	165
Adjustment of tangible fixed assets (excl. leases)	1,614	1,853
Adjustment of intangible fixed assets	1,255	1,312
Adjustment of accrued expenses and deferred income	50	80
Adjustment of provisions	2,023	2,282
Adjustment of leases	–9	–12
Deferred tax effect on adjustments	–1,407	–1,865
Equity according to Swiss GAAP FER	**19,104**	**25,850**

In CHF thousands	Result 2022
Result according to CO	**4,989**
Adjustment of trade receivables	41
Adjustment of inventories	550
Adjustment of financial assets	62
Adjustment of tangible fixed assets (excl. leases)	239
Adjustment of intangible fixed assets	57
Adjustment of accrued expenses and deferred income	30
Adjustment of provisions	259
Adjustment of leases	–3
Deferred tax effect on adjustments	–458
Result according to Swiss GAAP FER	**5,766**

FER 31 users are also required to explain the conversion effects.

The applicable FER for DroneStar AG do not give rise to an explicit disclosure requirement. Considering the principles defined in the FER framework, FER users must decide which disclosures are necessary. In this regard, they will find indications in paragraph 30 of the FER framework, which contains the guiding principles regarding consistency in the valuation, presentation and disclosure and, consequently, states that explanatory disclosures must be made in the event of changes to the previously chosen accounting principles. Furthermore, paragraph 31 of the FER framework states that it must be possible for users of financial statements to compare the financial statements over an extended period of time.

If the conversion results in significant effects, it is highly recommended – if not explicitly compulsory – to include disclosures that go beyond the reconciliation line presented in the statement of changes in equity. Since there is no explicit regulation, DroneStar AG has more freedom regarding the disclosures and, contrary to FER 31 users, can, for example, forgo the presentation of additional explanations.

3. Receivables from goods and services

The balance sheet position "Receivables from goods and services" shows all the receivables resulting from the entity's ordinary business activities that have been invoiced.

Accounting policy choices and scopes of action under FER

According to FER 2, receivables are measured at nominal value less impairment, if any. For the remaining insignificant receivables, FER grants the following *indirect* accounting policy choice:

Performance of a strict individual valuation of all receivables from goods and services

or

Application of a flat-rate allowance on the remaining insignificant receivables (based on empirical values)

The Company has many homogeneous small receivables resulting from its business operations. A strict individual valuation of the receivables would involve unduly high efforts. Consequently, the Board of Directors decides to measure the valuation allowance on insignificant receivables using a flat-rate allowance based on empirical values. If there are indications that certain receivables from the pool of insignificant receivables may be impaired, these will also be subject to an individual valuation, if necessary.

Effect of the conversion on DroneStar AG

Compared to the CO accounting applied previously, the impairment is reduced or the carrying amount of the receivables from goods and services increases by CHF 330 thousand as of January 1, 2022. The effect results from the different method of determination of the flat-rate allowance. Whereas under CO hidden reserves were built up following the principle of prudence as well as for tax purposes, under FER the flat rate-allowance must be based on an entity's actual empirical values.

The assessment of the existing population of insignificant receivables of DroneStar AG shows that a breakdown into Swiss and foreign receivables, as is the case under CO, does not constitute an appropriate basis for the determination of the flat-rate allowance under FER. According to the analyses carried out by DroneStar AG, a valuation based on the categorization of the receivables according to their maturity pattern results in a realistic value. As a basis for the calculation of the flat-rate allowance, the actual impairment allowance rates in prior periods have been determined for the defined maturity categories. In a second step, these have been adjusted for the expected future change in credit losses.

At the conversion date, the following differences result for DroneStar AG:

Previous accounting applied by DroneStar AG under CO	New accounting applied by DroneStar AG under FER
Initial recognition of receivables from goods and services	
Recognition at nominal value less impairment, if any	
Subsequent accounting	
• Individual valuation of significant receivables • Flat-rate allowance on the remaining receivables with hidden reserves (5 % of the nominal value for Swiss receivables and 10 % of the nominal value for foreign receivables)	• Individual valuation of significant receivables • Flat-rate allowance on the remaining receivables based on the Company's empirical values and taking into account expected future changes (using the receivables' maturity pattern)
Carrying amount of receivables from goods and services as of January 1, 2022	
CHF 7,498 thousand	CHF 7,828 thousand

Presentation and disclosures

Similar to the CO provisions, receivables from goods and services must be presented as a separate position in the FER balance sheet. For the presentation in the balance sheet, impairment allowances are generally deducted directly from the receivables under both standards.

Compared to CO, FER contains additional disclosure obligations and explicitly requires the presentation of the impairment allowances amount as well as of the assumptions in relation to the calculation of the flat-rate allowance. These disclosures are usually made in the notes to the financial statements.

4. Inventories

Inventories represent goods held for sale or consumed in the normal course of business as well as services delivered but not yet billed.

Accounting policy choices and scopes of action under FER

As regards the accounting of inventories, the provisions of FER 17 include several accounting policy choices.

Upon initial recognition, the general principle is that inventories are recognized at acquisition or production cost. This comprises all direct and indirect expenses required for making the inventories available at their present location and in their current condition. This also includes incidental charges (e.g. for transportation, freight, unloading, duties, provisions, etc.) less purchase price reductions (e.g. rebates, refunds, etc.).

A *direct* accounting policy choice exists for the determination of the acquisition cost.

Recognition of inventories at the actual cost incurred
or
Recognition of inventories at the acquisition cost determined using a simplified valuation method

The decision regarding this accounting policy choice is generally automatic. An entity that, for example, buys finished goods in order to resell them usually recognizes this transaction at the actual cost incurred that can be determined individually for each item. A production business that sells its own goods usually applies a simplified method in order to determine the production cost. The application of a simplified valuation method is allowed if it results in a justifiable approximation to the actual acquisition or production cost. A conceivable method is, for example, the standard cost or planned cost method or the retail method, which are mentioned in FER 17 in the sense of a *direct* accounting policy choice.

Regarding the recognition of settlement discounts, which can be claimed in the sense of a deduction for a quick payment upon the purchase of inventories or components thereof, there is a *direct* accounting policy choice:

Recognition of settlement discounts as purchase price reductions
or
Recognition of settlement discounts as financial income

After the initial recognition at acquisition or production cost, the question of the subsequent valuation of inventories arises. Here, too, FER contains a *direct* accounting policy choice:

Strict individual valuation of items of inventories
or
Group valuation for similar items of inventories

However, this accounting policy choice does not apply to work in progress and finished goods specifically produced at client requests. Furthermore, applying a group valuation method is not allowed if parts of the relevant group of inventories are no longer marketable.

In the context of the group valuation of inventories at the balance sheet date, the following valuation methods are possible in the sense of a *direct* accounting policy choice:

Valuation of the consumption of inventories using a cost formula
or
Valuation of the consumption of inventories using a consumption formula

The weighted average method is one of the possible cost formulas mentioned by FER. Under this formula, the average is calculated permanently (per addition) or periodically (e.g. monthly) (*direct* accounting policy choice). Regarding the consumption formula, the first-in-first-out formula (FIFO) is mentioned as an example. The last-in-first-out formula (LIFO) is not permitted since it does not allow for a valuation that is close to the market.

Effect of the conversion on DroneStar AG

Regarding the initial recognition and the application of cost and consumption formulas, CO and FER contain very similar provisions, which is why DroneStar AG does not need to make any adjustments in this respect.

Purchased raw and commercial materials are recognized at acquisition cost, which can be determined directly, whereas a planned cost method is applied for the determination of production cost for own productions.

Concerning the derecognition of inventories, CO grants more freedom of action. For example, the LIFO formula can also be applied. In its financial statements prepared in accordance with CO, DroneStar AG has already applied the rolling average method, which must not be adjusted in the context of the conversion to FER, for raw and commercial materials. Own productions are derecognized at planned costs both under CO and FER.

A major difference between the two standards is that, due to the principle of prudence, CO allows the recognition of an additional flat-rate allowance. In addition to the impairment actually necessary, inventories are thus reduced by a flat-rate allowance in the amount of one-third of the value of the goods. In financial statements prepared in accordance with CO, this one-third allowance represents hidden reserves and is generally accepted from a tax perspective. However, it does not correspond to the true and fair view principle under FER, which is why the hidden reserves must be released when converting from one accounting standard to another. The detailed provisions of FER could result in the need for FER preparers to spend more time than CO preparers on the valuation of inventories and in particular on the determination of the fair value less cost to sell. Under certain circumstances, this may also mean it is necessary to improve the understanding of some inventory items.

At the conversion date, the following differences result for DroneStar AG:

<table>
<tr><th>Previous accounting applied by DroneStar AG under CO</th><th>New accounting applied by DroneStar AG under FER</th></tr>
<tr><td colspan="2">Initial recognition of inventories</td></tr>
<tr><td colspan="2">• Raw and commercial materials: recognition at acquisition cost (actual cost)
• Own productions: recognition at production cost (planned cost method)</td></tr>
<tr><td colspan="2">Subsequent accounting</td></tr>
<tr><td>• Impairment of individual items of inventories
• Additional one-third flat-rate allowance</td><td>• Impairment of individual inventory items to the lower fair value less cost to sell (if necessary)</td></tr>
<tr><td colspan="2">Derecognition of inventories</td></tr>
<tr><td colspan="2">• Raw and commercial materials: derecognition at the rolling average price
• Own productions: derecognition at the recorded planned cost or the fair value less cost to sell for products that were impaired previously</td></tr>
<tr><td colspan="2">Carrying amount of inventories as of January 1, 2022</td></tr>
<tr><td>CHF 6,067 thousand</td><td>CHF 8,791 thousand</td></tr>
</table>

Presentation and disclosures

Due to the various accounting policy choices, it is generally important for the chosen principles to be presented in the notes to the financial statements. These disclosures should be more detailed than the rather general accounting policies presented in CO financial statements.

Regarding prepayments received from clients with no right of clawback, FER allows three forms of presentation in the sense of an *indirect* accounting policy choice:

Reduction of inventories by client prepayments with no right of clawback (net presentation)

or

Presentation of client prepayments with no right of clawback as a separate position in the current assets with a negative prefix (gross presentation under assets)

or

Presentation of client prepayments with no right of clawback under liabilities (gross presentation)

A net presentation of the prepayments received from customers and inventories is a substance-over-form approach since an entity no longer presents as own inventories the goods that are viewed as sold. As long as the client has a right of clawback, a net presentation is not allowed. The netted amount must be disclosed in the financial statements.

Regarding the presentation of prepayments to suppliers, FER contains a *direct* accounting policy choice:

Presentation of prepayments to suppliers under inventories

or

Presentation of prepayments to suppliers as a separate position under current assets

FER preparers are required to break down inventories, either directly in the balance sheet or in the notes to the financial statements, into additional categories that are appropriate for their business activities. In this context, prepayments to suppliers are either allocated to the different categories of inventories or should be disclosed as a single line item (*direct* accounting policy choice). The disclosure of this additional information is not compulsory in CO financial statements.

5. Tangible fixed assets

Tangible fixed assets (tangible long-lived assets, property, plant and equipment) are tangible and are used for the production of goods, rendering of services or investment purposes. They can be acquired or self-produced.

Accounting policy choices and scopes of action under FER

An analysis of FER 18 has revealed that there are no relevant accounting policy choices for DroneStar AG.

However, FER 18 contains options regarding the valuation of tangible fixed assets that are kept for investment purposes. Among these, the most interesting *direct* accounting policy choice is the subsequent valuation of investment properties:

Subsequent valuation at fair value

or

Subsequent valuation at acquisition or production cost less accumulated depreciation and impairment

For entities that have recognized tangible fixed assets under construction, FER 18 provides an *indirect* accounting policy choice regarding borrowing cost during the construction phase:

Recognition of the borrowing cost during the construction phase as part of the acquisition and production cost (if the conditions are met)

or

Recognition of the borrowing cost during the construction phase in the income statement in the period in which it is incurred

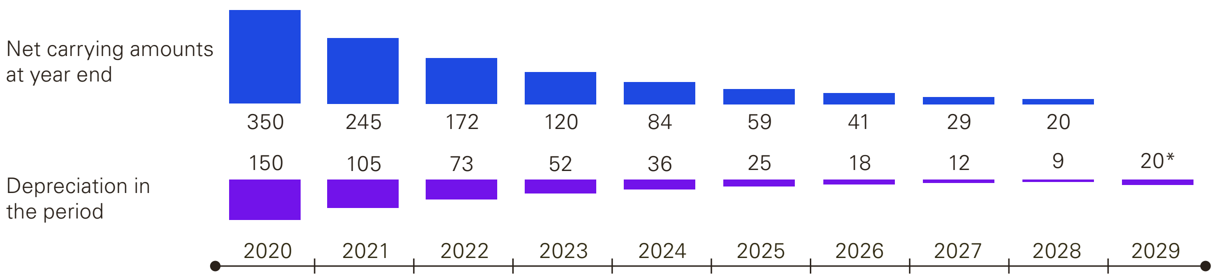
On the advice of KPMG AAS, DroneStar AG will make its decision about these accounting policies only when the underlying circumstances occur for the first time in the future.

Effect of the conversion on DroneStar AG

DroneStar AG has various assets that have been capitalized under tangible fixed assets in its CO financial statements. The tangible fixed assets items in the CO financial statements frequently include hidden reserves since depreciation is often accelerated due to the principle of prudence or tax considerations or even occurs immediately after the initial recognition as full one-time depreciation. The formation of hidden reserves by applying economically unjustified depreciation methods or by applying depreciation over a reduced useful life is not allowed in FER financial statements since this approach would violate the true and fair view principle established in the framework. The depreciation method applied in the FER financial statements (straight-line, degressive or performance-based) must reflect actual consumption. Furthermore, the underlying depreciation period must correspond to the best estimate of the economic useful life.

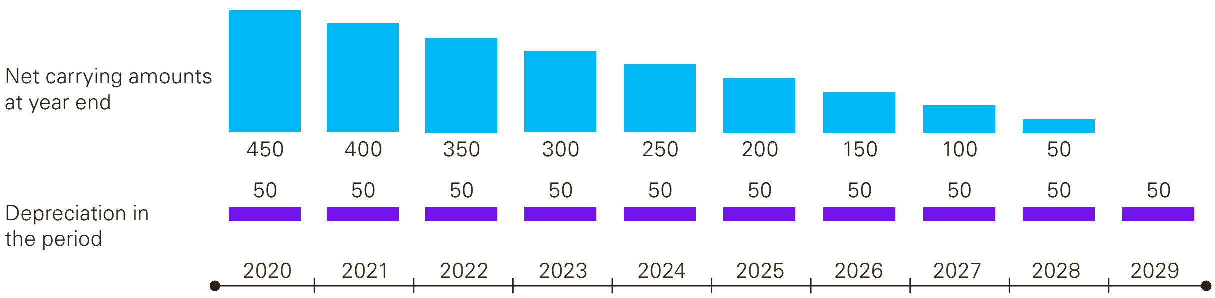
The difference of treatment is illustrated with an example. On January 1, 2020, DroneStar AG acquired a production machine that was recognized at acquisition cost in the CO balance sheet in the amount of CHF 500 thousand. For tax reasons, the machine was depreciated degressively at 30 % in the financial statements prepared in accordance with CO and had a carrying amount of CHF 245 thousand as of January 1, 2022. However, according to management's estimate, the fair value consumption is evenly distributed over the expected economic useful life of 10 years, which is why under FER straight-line depreciation is applied over this period. The FER net carrying amount at the conversion date thus amounts to CHF 400 thousand, whereby hidden reserves of CHF 155 thousand from the production machine are released in the context of the FER conversion.

Accounting of the production machine under CO



* After 10 years, the production machine is fully depreciated.

Accounting of the production machine under FER



The hidden reserves of the tangible fixed assets item resulting from different depreciation methods and periods must be fully released. At the conversion date, the following differences result for DroneStar AG:

Previous accounting applied by DroneStar AG under CO	**New accounting applied by DroneStar AG under FER**
Initial recognition of tangible fixed assets	
Recognition at acquisition or production cost	
Subsequent accounting	
• Systematic depreciation in accordance with economic criteria or with a more cautious method or over a reduced period (hidden reserves) • Recognition of unplanned impairment (if necessary)	• Systematic depreciation in accordance with economic criteria • Recognition of unplanned impairment (if necessary)
Carrying amount of tangible fixed assets (excl. leases*) as of January 1, 2022	
CHF 6,455 thousand	CHF 8,069 thousand*

* The carrying amount of tangible fixed assets in the FER balance sheet also comprises assets from leases Chapter 02 – 11. Leasing as lessee.

Presentation and disclosures

Tangible fixed assets must be presented as a separate position in the FER balance sheet, similar to CO. Under both accounting standards, this position can be broken down either directly in the balance sheet or in the notes (*direct* accounting policy choice), whereby the subcategories under FER must be disclosed.

The notes to the financial statements under FER must include the valuation principles for each category of tangible fixed assets as well as the depreciation methods and expected useful lives. These disclosures are more detailed than in average CO financial statements.

Furthermore, a statement of changes in tangible fixed assets must be presented in a table format in the notes to the FER financial statements. This must provide information about the opening and closing acquisition cost as well as about accumulated depreciation and impairment and significant changes to them.

The Appendix to FER 18 contains the following statement of changes in tangible fixed assets as an example for the practical implementation of the disclosure requirements:

In CHF million	Undeveloped property	Land and buildings	Equipment and facilities	Prepayments and fixed assets under construction	Other tangible fixed assets	Total
Net carrying amounts 1.1.20x1	**50**	**172**	**40**	**130**	**117**	**509**
Acquisition/production cost or gross values of cost						
Beginning of the period 1.1.20x1	50	422	60	130	253	915
Additions			12	24		36
Changes in the fair values		10				10
Disposal		–36				–36
Reclassifications		36		–36		0
End of the period 31.12.20x1	50	432	72	118	253	925
Accumulated depreciation						
Beginning of the period 1.1.20x1	0	–250	–20		–136	–406
Systematic depreciation		–10	–12		–53	–75
Impairment		–20				–20
Disposals		23				23
Reclassifications						0
End of the period 31.12.20x1	0	–257	–32	0	–189	–478
Net carrying amounts 31.12.20x1	**50**	**175**	**40**	**118**	**64**	**447**
Total revaluation of fair values at the balance sheet date compared to acquisition or production cost		**52**				**52**

Illustration from Appendix of FER 18

6. Intangible assets

Intangible assets are of non-monetary nature and have no physical substance. Examples of intangible assets include licenses, patents, software, development costs etc.

Accounting policy choices and scopes of action under FER

FER 10 addresses the treatment of intangible assets. These can be acquired or generated internally.

Acquired intangible assets must be recognized if they yield measurable economic benefits for the entity over several years. Consequently, the only scope of estimation is the assessment of whether the capitalization criteria are met.

For intangible assets generated internally, FER 10 states that they can only be recognized as an asset if they meet all of the following conditions:

- the intangible assets generated internally are identifiable and are controlled by DroneStar AG;
- the intangible assets generated internally will yield a measurable benefit for the entity over several years;
- the expenses that arise from the creation of the intangible assets generated internally can be recognized and measured separately; and
- it is likely that the resources needed to complete and sell or use the intangible assets for the Company's own purposes are available or will be made available.

The formulation in the standard results in the following *indirect* accounting policy choice:

Capitalization of intangible assets generated internally (if all of the above-mentioned criteria are met)

or

Forgoing of the capitalization of intangible assets generated internally (even though all of the above-mentioned criteria are met)

Effect of the conversion on DroneStar AG

DroneStar AG conducts research and development activities in order to produce its own drones and assumes that part of the costs resulting from such activities can be capitalized under FER.

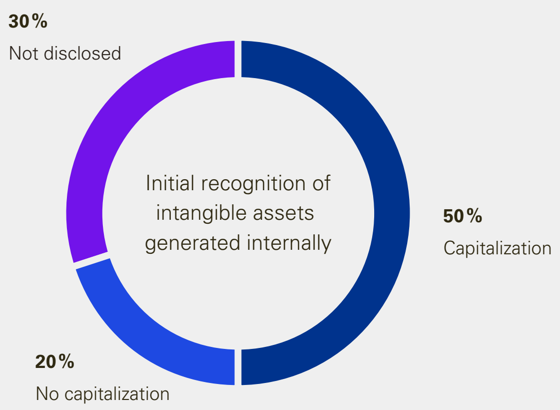
The Board of Directors of DroneStar AG decides that intangible assets generated internally are recognized as assets. The advantage of doing so is that the non-current assets that are relevant for the Company's business activities will be shown in a transparent manner in the balance sheet. Furthermore, the expenses are distributed over the actual useful life instead of being recognized as expenses directly in the period in which they are incurred. The advantage of matching the benefits in the form of revenues with the corresponding costs for the period (matching principle) prevails. The Company accepts that capitalization of the intangible assets is the less cautious option, which may be associated with potential future impairment losses on assets. Furthermore, verification of the capitalization potential of the costs as well as a possible future impairment test involve higher administrative costs.

There is no difference between the asset capitalization criteria under CO and FER. However, in its CO stand-alone financial statements, DroneStar AG immediately and fully impaired all intangible assets generated internally that could be capitalized and thus formed hidden reserves. Since under FER amortization over the actual useful life of five years is applied in the case at hand, intangible assets increase by CHF 1,255 thousand in the context of the conversion.

According to FER 10, the useful life applied for amortization must be carefully estimated. Careful within the meaning of FER does not mean that it is allowed to form hidden reserves in this context. Amortization is applied systematically – normally, on a straight-line basis. If the useful life cannot be clearly determined, an amortization period of five years is applied or, in justified cases, twenty years at most.

Previous accounting applied by DroneStar AG under CO	New accounting applied by DroneStar AG under FER
Initial recognition of intangible assets	
Recognition at acquisition or production cost	
Subsequent accounting	
Acquired intangible assets: • Amortization over the useful life (five years for acquired intangible assets) • Recognition of unplanned impairment losses (if necessary) *Intangible assets generated internally:* • Immediate amortization of costs that can be capitalized	• Amortization over the useful life (five years for acquired and internally generated intangible assets) • Recognition of unplanned impairment losses (if necessary)
Carrying amount of intangible assets as of January 1, 2022	
Acquired intangible assets: CHF 208 thousand	*Acquired intangible assets:* CHF 208 thousand *Intangible assets generated internally:* CHF 1,255 thousand

Implementation in practice



Half of analyzed FER preparers capitalize intangible assets generated internally and amortize them over their useful life.

One fifth of the entities have opted for the less burdensome option of the direct recognition of costs as expenses.

30 % of the population have decided not to disclose the accounting principles, which indicates that internally generated intangible assets are either not relevant or not significant enough.

Presentation and disclosures

Similar to CO provisions, under FER intangible assets must also be presented separately in the balance sheet. Additionally, FER 10 requires the disclosure of a statement of changes in intangible assets in a table format in the notes to the financial statements. Similar to the statement of changes in tangible fixed assets Chapter 02 – 5. Tangible fixed assets, it must present the acquisition cost, accumulated amortization and net carrying amount for each category.

Again, it is to be expected that the chosen accounting policies, including the amortization methods and periods, will be described in more detail than is the case in CO financial statements.

7. Securities

Securities in the context of accounting include, among other things, shares, bonds, participation certificates and derivatives.

Accounting policy choices and scopes of action under FER

According to FER 2, securities that are part of current assets must be measured at fair values. They may be valued at acquisition cost less impairment only if there is no fair value at hand. As such, no accounting policy choice exists.

If the securities are assets held over the long term, they must be presented under the non-current assets in accordance with the framework. FER 2 must be applied for the valuation of securities to be recognized under financial assets, which results in the following *direct* accounting policy choice:

Securities presented under financial assets are valued at acquisition cost less impairment, if any

or

Securities presented under financial assets are valued at fair values

For securities, a current value is usually used as the fair value. According to the framework, the net selling price, the value in use or the liquidation value can generally also be considered as the fair value, although these play a minor role in determining the fair value of securities.

Effect of the conversion on DroneStar AG

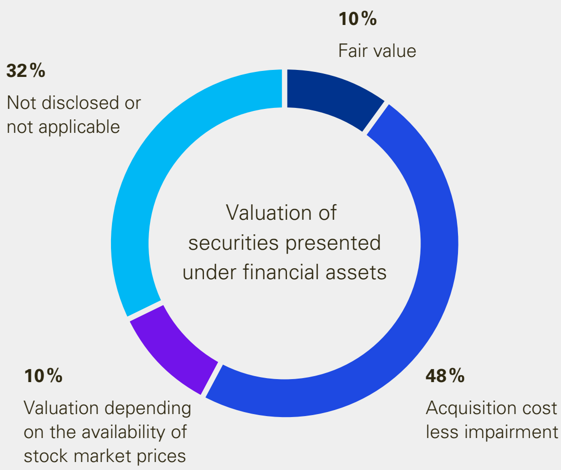
DroneStar AG has a 5 % investment in a small entity listed on the BX Swiss stock exchange (Bern stock exchange) that is held for long-term investment purposes. In the CO financial statements, the securities had until now been valued at acquisition cost less impairment, if any.

In accordance with the decision of the Company's Board of Directors, the securities presented under the financial assets in the FER financial statements are measured at the fair value applicable at the reporting date – in this case, at the current stock market price.

The valuation of the securities at fair values results in an additional conversion effect. For the first FER financial statements, the securities are valued at the stock market price and the existing compulsory reserves resulting from the accounting principles in the CO financial statements are released.

Previous accounting applied by DroneStar AG under CO	**New accounting applied by DroneStar AG under FER**
Initial recognition of securities	
Recognition at acquisition cost	
Subsequent accounting	
Lowest value principle; write-down to the lower market value if the stock market price is lower than the historical cost of acquisition	Valuation at fair value (stock exchange price); changes in value must be recognized in the income statement
Carrying amount of securities as of January 1, 2022	
CHF 550 thousand	CHF 653 thousand

Implementation in practice



The examination of the financial statements has yielded mixed results. Almost half of all FER preparers have opted for a valuation at acquisition cost less impairment, if any. 10 % of the population value the securities presented under non-current assets at fair values if a stock market price is available. Otherwise, a valuation at acquisition cost is chosen. Consequently, these entities seem to consider only stock market prices as sufficiently reliable fair values.

An additional 10 % in the analyzed sample indicated that the securities presented under the financial assets are valued at fair values.

Presentation and disclosures

Due to the existence of the accounting policy choice, the chosen accounting principle must be disclosed in the notes to the financial statements.

The securities presented under the financial assets must also be disclosed as a separate position in the FER financial statements, either in the balance sheet or in the notes to the financial statements (*direct* accounting policy choice). For an entity that measures securities held over the long term at fair values only if a stock market price is available, it is recommended, if the amounts are significant, that the carrying amount capitalized in this financial statements caption be broken down into at least the two valuation categories.

8. Derivative financial instruments

A derivative is a financial instrument whose value is primarily impacted by the price of one or several underlying basic values. Compared with a direct purchase, it only requires a minor initial investment and is only settled in the future.

Accounting policy choices and scopes of action under FER

FER 27 states that a derivative must be recognized in the balance sheet as soon as it meets the definition of an asset or liability. Derivatives without hedging purpose must generally be valued at fair values.

For the recognition of derivatives that are used to hedge future cash flows (cash flow hedges), the following *direct* accounting policy choice exists:

Capitalization of the derivatives used to hedge future cash flows and recognition of their changes in value in equity (until the occurrence of the underlying transaction)

or

Mere disclosure of the derivatives used to hedge future cash flows in the notes to the financial statements (no recognition of the derivative until the occurrence of the underlying transaction)

In order for the accounting policy choice to be exercised, the occurrence of the future cash flow must be considered highly probable. If this cannot be proved and thus documented, the derivative is capitalized at fair value and changes in value are recognized in the result for the period. Even if FER do not contain any explicit requirements regarding the documentation of the hedging relationship, it is nevertheless expected in practice that such documentation will be established. As a minimum, this should contain descriptions of the hedging purpose and the future hedging effect in relation to the concrete underlying transaction and the concrete hedging instrument.

Effect of the conversion on DroneStar AG

DroneStar AG mainly uses derivative financial instruments to hedge future purchases. At the conversion date, a purchase agreement for a significant quantity of raw materials was concluded with a German entity. The corresponding future cash outflows amount to approximately EUR 1,000 thousand. In order to reduce the currency risk in relation to this purchase of goods, the transaction was hedged using a forward contract.

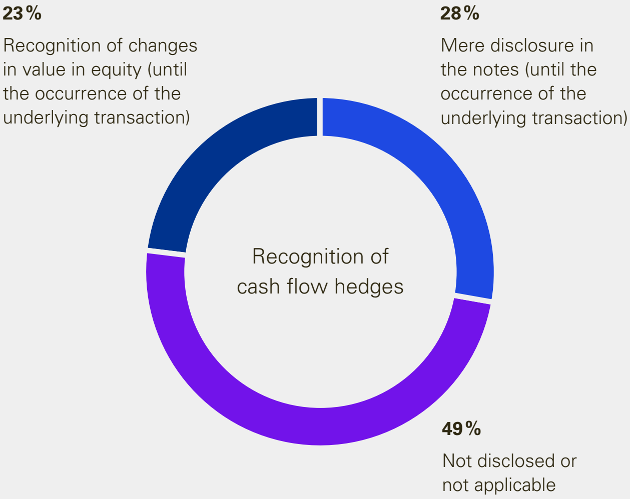
Under CO, the capitalization of the derivative financial instruments of DroneStar AG follows the lowest value principle. Consequently, if a derivative has a negative replacement cost at the balance sheet date, a corresponding short-term liability is recorded in the income statement. If the replacement cost is positive, the corresponding asset and the profit resulting from recognition cannot be recognized since it has not yet been realized (imparity principle). It is only presented in the notes to the financial statements. In the CO financial statements of DroneStar AG, no hedge accounting is applied.

Following an in-depth assessment of the accounting policy choice regarding derivatives used to hedge future cash flows, the Company's Board of Directors opts for a mere disclosure in the notes and thus forgoes the recognition of this kind of hedging transactions in the balance sheet. This decision is based, in particular, on the fact that, from the owners' point of view, the recognition of such derivatives and the recording of their changes in value under equity would not increase the transparency of the financial statements. The replacement costs recognized under assets and liabilities resulting from the forward contract are presented in the notes to the financial statements.

This accounting policy choice can be exercised only if the conditions as well as certain increased qualitative requirements regarding the documentation of the hedge transaction are met.

Previous accounting applied by DroneStar AG under CO	New accounting applied by DroneStar AG under FER
Initial recognition/subsequent accounting of the derivative (cash flow hedge)	
Imparity principle: • Negative replacement values are recognized as liabilities • Positive replacement values are not capitalized Changes in value are recorded in the income statement	• No recognition in the balance sheet; mere disclosure in the notes
Carrying amount of derivative (in accrued expenses and deferred income) as of January 1, 2022	
CHF 50 thousand	–

Implementation in practice



Almost half of all analyzed entities have no cash flow hedges or have not included corresponding disclosures in their financial statements. This shows that at many entities there is no hedge accounting for future cash flows or it is only done to an insignificant extent.

Approximately one quarter of entities have opted for a mere disclosure of cash flow hedges resp. for a capitalization in the balance sheet and a recognition of the changes in value in equity.

Presentation and disclosures

The applied accounting policy choice must be disclosed in the notes to the financial statements.

Additionally, FER require the disclosure of the gross values of the replacement values as well as the purpose of holding derivatives. The presentation must be broken down using the basic values. FER 27 mentions the following categories of basic values: “interest rates,” “foreign exchange,” “equity instruments and respective indices” and “other underlying basic values.”

The total fair values from derivatives disclosed in the notes must be reconciled with the carrying amounts of the corresponding assets and liabilities as of the balance sheet date by specifying the impact of the netting. These disclosure obligations can be met, for example, with the following presentation

	December 31, 2022		January 1, 2022		
In CHF thousands	Asset	Liability	Asset	Liability	Purpose
Currencies	–	–80	–	–50	Hedging
Total derivatives	**–**	**–80**	**–**	**–50**	
Of which for hedging of future cash flows	–	80	–	50	
Total carrying amounts recognized in the balance sheet	**–**	**–**	**–**	**–**	

9. Provisions

A provision represents a probable obligation that is based on a past event and its amount and/or its due date is uncertain but can be estimated. The obligating event must have taken place prior to the balance sheet date and can be based on a legal or constructive obligation.

FER 23 states that existing provisions need to be revised at each balance sheet date. In this regard, the amount of provisions must equal the value of the expected future outflow of resources. Regarding the evaluation of the recognition criteria and the determination of the amount of the provision, there are no accounting policy choices or scopes of action that are worth mentioning. However, these estimates often involve significant judgment on the part of management.

Effect of the conversion on DroneStar AG

Even if there are no significant accounting policy choices or scopes of action regarding provisions, this balance sheet item must nevertheless be analyzed in the context of the FER conversion since it is frequently treated differently under CO and FER. The CO financial statements of DroneStar AG contain various provision items, including provisions from the past that are no longer needed but have never been released. This approach is allowed according to CO. Such provisions represent hidden reserves. Under FER, provisions that are no longer needed must be released, which is why they must be eliminated in the context of the FER conversion.

Furthermore, in the CO financial statements flat-rate guarantee provisions are built up within the ranges allowed from a tax point of view (i.e. 2 % of the net revenues for the financial year). The effective guarantee expenses of the last five years were determined in the context of the conversion project. In this regard, it appeared that the warranty claims to be made effectively had stabilized at around 0.5 % of annual net revenues. It is expected that this will also apply to future warranties. Consequently, the warranties subject to a flat-rate provision contain hidden reserves.

The Board of Directors concludes that the provisions must be reduced by CHF 2,023 thousand in the context of the FER conversion since this amount represents a hidden reserve.

Presentation and disclosures

Whereas no disclosure requirements can be derived from CO up to the separate presentation of the provisions in the balance sheet, detailed information must be provided in the notes to the FER financial statements. A statement of changes in provisions showing the changes in the position in the reporting and prior period must be provided. In this respect, information on provisions for taxes, provisions for pension benefit obligations, restructuring provisions and other significant provisions must be provided in accordance with FER 23. In the case of DroneStar AG, warranty obligations, for example, are presented separately.

According to FER 23, the statement of changes in provisions must contain at least the following information:

- carrying amount at the beginning of the period
- creation of provisions
- utilization of provisions
- release of provisions recognized in the income statement
- carrying amount at the end of the period.

The amount of the short-term provisions for each category must be disclosed in the notes and is usually presented under the reconciliation in the statement of changes in provisions. These figures must also include an explanation for significant provisions that discloses the nature of the liability as well as its degree of uncertainty. FER 23 also requires the disclosure of the discount rate if a provision is discounted.

Previous accounting applied by DroneStar AG under CO	New accounting applied by DroneStar AG under FER
Initial recognition of provisions	
• Recognition of the provisions in the amount of the expected future outflows of resources; the outflows of resources can be estimated cautiously (hidden reserves)	• Recognition of the provision in the amount of the expected future outflows of resources • Discounting of provisions for which the time factor has a significant influence
Subsequent accounting	
• Remeasurement of the provision amount at each balance sheet date with recognition of changes in value in the income statement • Provisions that are no longer needed must not be released (hidden reserves)	• Remeasurement of the provision amount at each balance sheet date with recognition of changes in value in the income statement (consumption and changes in estimates in the sense of the release or formation of provisions)
Carrying amount of provisions (without deferred tax liabilities*) as of January 1, 2022	
CHF 3,570 thousand	CHF 1,547 thousand

* The carrying amount of the provisions in the FER balance sheet also includes deferred tax liabilities: Chapter 02 – 12. Income taxes.

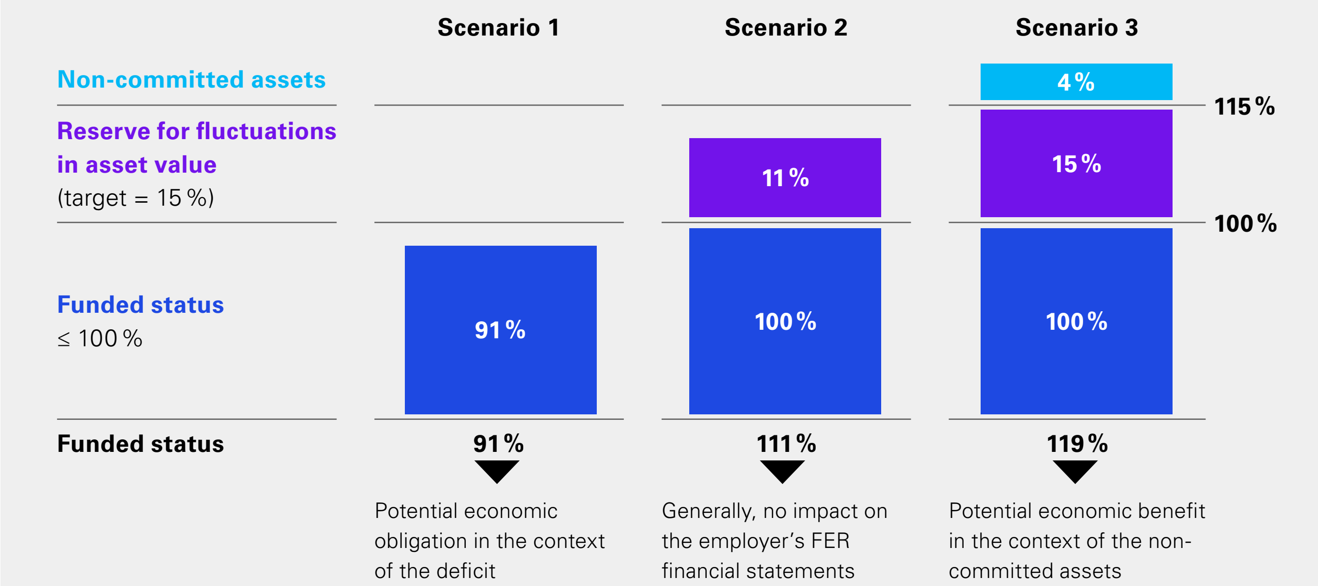
10. Economic benefit/obligation from pension institutions

FER aims to present the economic impact of pension benefit obligations on an entity's financial statements. Pension institutions within the meaning of FER are all pension plans and institutions that provide employees with benefits for retirement, death and disability.

Accounting policy choices and scopes of action under FER

For an entity, pension benefit obligations can give rise to an economic benefit or an economic obligation. Each year, it must be determined whether there is an economic benefit or an economic obligation that requires the recognition of an asset or a liability. In this respect, contractual, regulatory and legal bases must be taken into account. An economic benefit can arise if there is a possibility that a surplus at a pension institution will have a positive impact on the entity's future cash flows (e.g. reduction in contributions). If it is possible that a deficit at a pension institution will have a negative impact on the future cash flows (e.g. contributions for financial restructurings), this can result in the requirement for an entity to recognize an economic obligation in its FER financial statements. Changes economic benefits or economic obligations compared with the corresponding amounts in the previous period are recognized in the income statement under personnel expenses.

The following table shows the potential impact of the financial situation of a Swiss pension institution on an entity's financial statements using three different scenarios. In this example, the pension institution's financial statements prepared in accordance with FER 26 serve as a basis for the determination of the financial situation.



Target = target value defined by the pension institution for the reserve for fluctuations in asset value
The funded status is determined using the pension fund's financial statements prepared in accordance with FER 26.

In **Scenario 1** the pension institution's obligations to the entity's affiliated employees are covered at only 91 % at the balance sheet date. Because of the deficit at the pension institution, the FER user must determine whether an economic obligation must be recognized in its financial statements. This is the case if the criteria for the recognition of a provision in accordance with FER 23 Chapter 02 – 9. Provisions are met.

In **Scenario 2** the pension institution discloses in its financial statements a coverage rate of 111 % and thus reserves for fluctuations in asset value of 11 %. All pension institutions must form reserves for fluctuations in asset value in order to compensate for fluctuations on capital markets. If the target value defined by the pension institution for the reserve for fluctuations in asset value is exceeded, this results in so-called "non-committed assets." These can then, as a surplus remaining at the institution, be distributed to insured persons in the form of a benefit increase or used to reduce contributions in accordance with pension benefit and regulatory requirements.

In Scenario 2, the target value for the reserve for fluctuations in asset value of 15 % has not yet been reached. In such situations, because the resources cannot be used, there is generally no economic benefit for the entity. Furthermore, a direct economic obligation cannot be derived.

With a funded status of 119 %, the pension institution in **Scenario 3** is in the fortunate position of having reached the target value for the reserve for fluctuations in asset value of 15 % and having additional non-committed assets. Because of the surplus, it must be determined whether there is an economic benefit for the entity. According to FER, this is the case if the surplus may and will be used to reduce employer contributions, to reimburse the employer based on local law or outside of the regulatory benefits for the purpose of another economic benefit for the employer.

For Swiss pension plans, the financial situation must be determined using the pension institution's financial statements prepared in accordance with FER 26. On what basis is the financial situation determined for foreign pension plans that do not prepare FER 26 financial statements? FER 16 states that the financial situation of a pension institution must be determined according to a recognized method that is appropriate for the pension institution in question. This results in the following *direct* accounting policy choice for foreign pension plans:

Determination of a pension institution's financial situation according to a recognized country-specific (static) method

or

Determination of a pension institution's financial situation according to a (dynamic) method as applied in international accounting standards (e.g. projected unit credit method)

Effect of the conversion on DroneStar AG

All employees of DroneStar AG are affiliated with the same pension plan with a Swiss collective pension institution. Consequently, DroneStar AG will determine the financial situation of the pension plan for its employees based on the pension institution's financial statements prepared in accordance with FER 26.

In a group environment with international subsidiaries, it may be advisable to determine the financial situation of the corresponding pension institutions by using a dynamic method if there are no appropriate alternative methods. It is possible to assess the economic obligations from Swiss pension institutions based on the FER 26 financial statements, while using a dynamic model for the assessment of foreign pension institutions. However, the determination of the financial situation of pension institutions with similar plans in comparable legal and economic environments should not be performed using different methods. Consequently, for consolidated financial statements with several German plans, using a static model for one German plan and a dynamic model for another German plan would not be in line with FER.

As of January 1, 2022, the DroneStar AG pension plan has a funded status of 100 %, but the target value for the reserves for fluctuations in asset value has not yet been reached. DroneStar AG concludes that, concerning the pension institution, no additional future cash inflows and outflows such as financial restructuring payments are probable. Consequently, there is neither an economic benefit or an economic obligation for DroneStar AG and thus no conversion effects from the application of FER 16.

Presentation and disclosures

In CO financial statements, liabilities to pension institutions must be presented separately. There are no other disclosure requirements regarding the links between an entity and its pension institution.

FER 16 contains additional disclosure requirements for economic benefits and obligations, which must be presented in a table format. FER 16 includes the following illustrative presentation of the disclosure requirements:

Economical benefit/ economical obligation and pension benefit expense In CHF thousands	Surplus/ deficit	Economic share of the entity		Change to prior year period or recognized in the current result of the period, respectively	Contributions concerning the current period	Pension benefit expenses within personnel expenses	
	31.12.20x2	31.12.20x2	31.12.20x1			20x2	20x1
Patronage funds/patronage pension institutions	100	0	0	0	0	1,589	0
Pension institutions without surplus/deficit					638	638	674
Pension institutions with surplus	17,286	1,735	1,321	–414	1,010	596	1,216
Pension institutions with deficit	–2,644	–620	–918	–298	926	628	991
Pension institutions without own assets		–500	–480	20	32	52	48
Total	**14,742**	**615**	**–77**	**–692**	**2,606**	**3,503**	**2,929**

Illustration from FER 16

If, in connection with the affiliation with a Swiss collective foundation, the information to be disclosed cannot be determined on the basis of the individual affiliation contract, this must be disclosed in the notes together with the funded status of the collective plan as a whole. Furthermore, the inclusion of an economic benefit or an economic obligation in the balance sheet must be explained in the notes to the financial statements.

Any economic benefit is recognized as an "asset from pension institutions" under long-term financial assets. Any economic obligation is recognized as a "pension obligation" under long-term liabilities.

11. Leasing as lessee

FER 13 addresses lessee lease accounting. A lease within the scope of FER 13 is a contract whereby the lessor conveys to the lessee the right to use an asset for an agreed period of time in return for a periodic payment.

A lease agreement can either be a finance lease or an operating lease. The differentiation is based on economic criteria. The economic approach puts economic substance over the legal form of the contract ("substance over form"). If the lease agreement is based on a finance lease, the leased object is recognized as an asset and the financing in the form of the present value of the future lease payments is recognized as a liability in the lessee's balance sheet. If the lease agreement is an operating lease, the lessee recognizes only the periodic lease payments as expenses.

At the beginning of the lease agreement, an entity determines whether the latter is a finance lease or an operating lease. According to FER 13, a finance lease generally exists if:

- at the signing date of the contract, the present value of the lease payments, including a possible final payment, is approximately equal to the acquisition cost or market value of the leased asset; or
- the expected lease term does not differ substantially from the economically useful life of the leased asset; or
- the leased asset will become the property of the lessee at the end of the lease term; or
- a possible final payment at the end of the lease term is substantially below its current market value.

All lease contracts that do not qualify as finance leases are considered operating leases.

Effect of the conversion on DroneStar AG

DroneStar AG has concluded two significant lease contracts that are analyzed in the context of the conversion project. Both contracts are assessed using the above-mentioned criteria.

Contract 1

Contract for the lease of DroneStar AG office and commercial spaces

For its office and commercial spaces, DroneStar AG has concluded a lease contract with the following conditions:

- Beginning of useful life: January 1, 2020
- End of useful life: December 31, 2029
- Monthly payment: CHF 15 thousand

The premises are part of a building complex that was leased for the first time as of January 1, 2020.

Contract 2

Contract for the lease of the production machine for drone components

For the production of a new type of drone, DroneStar AG has concluded a lease contract with the following conditions:

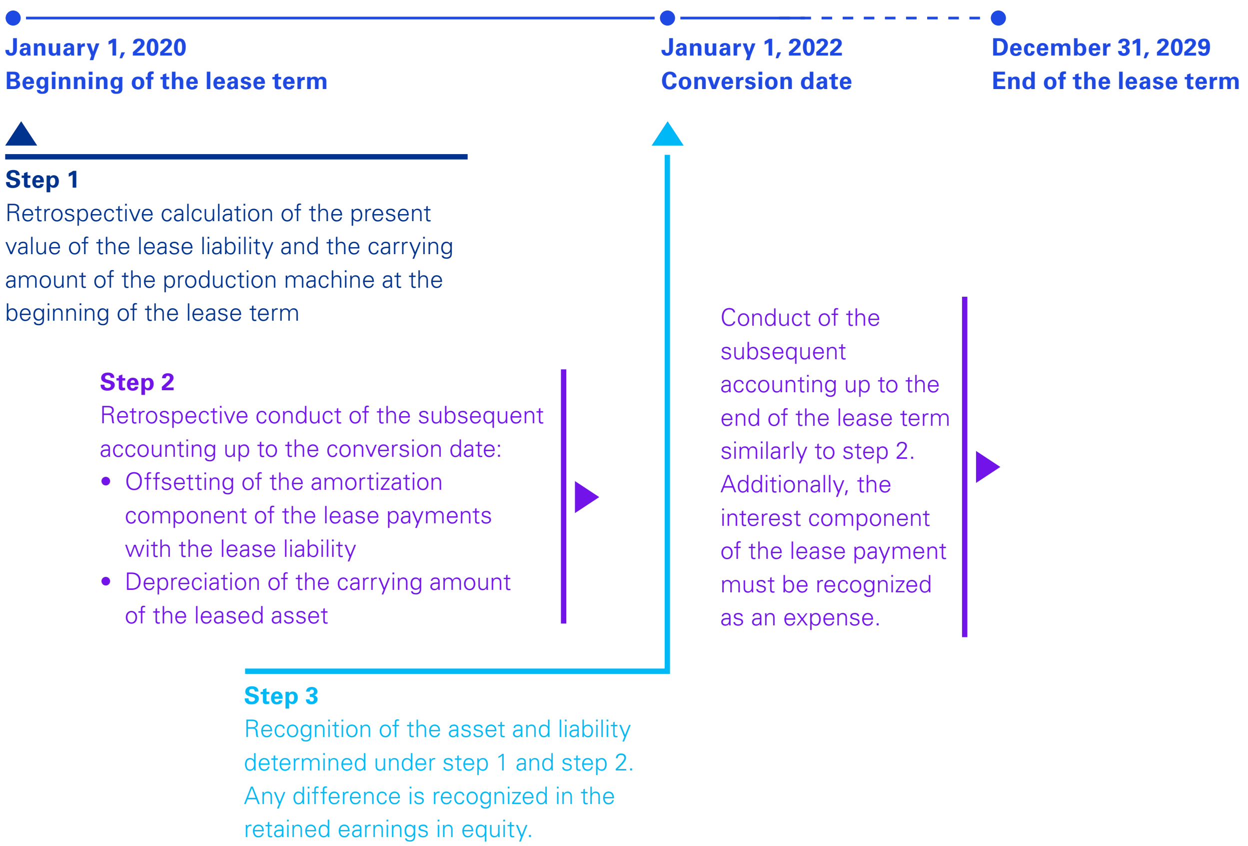
- Beginning of useful life: January 1, 2020
- End of useful life: December 31, 2029
- Monthly payment: CHF 10 thousand

At the end of the lease term, DroneStar AG has a call option with an exercise price of CHF 1.

Amounts in CHF thousands	**Contract 1** **Office and commercial spaces**	**Contract 2** **Production machine for drone components**
Comparison of the present value of all contractually defined payments for the lease of the leased asset with the acquisition cost or market value of the leased asset	Present value of lease payments: CHF 1,712 thousand Acquisition cost/market value: CHF 8,000 thousand (management estimate) The present value of lease payments and the acquisition cost or market value of the premises are far apart. **→ Criterion not met**	Present value of lease payments: CHF 1,142 thousand Acquisition cost/market value: CHF 1,100 thousand (management estimate) The present value of the lease payments is approximately equal to the net acquisition cost or market value of the leased asset. **→ Criterion met**
Comparison of the expected lease term with the economic useful life of the leased asset	The lease term at the beginning of the contract is 10 years. In particular, because the building complex is new, it can be assumed that the economic useful life of the premises is significantly longer. **→ Criterion not met**	The economic useful life of the production machine is estimated to be approximately 10 to 12 years. This is equal to the term of the lease contract. According to the estimates of DroneStar AG, this does not constitute a significant deviation from the term of the lease contract. **→ Criterion met**
Transfer of ownership of the leased asset at the end of the lease term	No transfer of ownership at the end of the lease term. **→ Criterion not met**	No transfer of ownership at the end of the lease term. **→ Criterion not met** However, there is the option to acquire ownership at a low price (see below).
Comparison of the final payment at the end of the lease term with the market value at that date	No final payment at the end of the lease term. **→ Criterion not met**	The exercise price of CHF 1 is, according to the estimates of DroneStar AG, below the machine's market value at the end of the term. **→ Criterion met**
Conclusion	None of the criteria mentioned in FER 13 are met. Consequently, the present contract is not a finance lease. The contract is thus classified as an operating lease.	Three of the four criteria are met. DroneStar AG pays about the full new value of the machine over the lease term. Furthermore, it can use the machine until about the end of its economic useful life. According to the assessment of DroneStar AG, the contract is a finance lease.

In its CO financial statements, DroneStar AG recognized the lease payments as expenses in the period concerned. Since the lease contract for the office and commercial spaces qualifies as an operating lease, this accounting practice continues to be applied under FER with no changes for this contract.

The accounting for the finance lease in relation to the production machine must be converted as of January 1, 2022. The determination of the values to be recognized at the conversion date must be performed as in the following illustration, as if the method for finance leases had always been applied (i.e. retrospectively).



When recognizing a finance lease, the lease liability and the asset for the use of the leased asset must be recognized at the beginning of the lease term. The lease liability corresponds to the present value of all lease payments during and at the end of the lease term. For discounting, the interest rate upon which the lease contract is based must be chosen. The asset for the leased object must be recognized at the lower of the market value, which corresponds in principle to the acquisition cost, and the present value of the lease payments.

In the subsequent accounting, the asset is depreciated according to economic criteria. The lease payments are broken down into an interest component and an amortization component. The interest component is recognized as an expense. The amortization component is charged to the lease liability and thus reduces the latter progressively over the course of the contract.

Due to the conversion from CO to FER, the following accounting changes result from the lease for the drone production machine:

Previous accounting applied by DroneStar AG under CO	New accounting applied by DroneStar AG under FER
Initial recognition	
• No capitalization; recognition of the costs from the lease contract for the production machine as expenses in the period in which they are incurred	• Recognition of a lease liability • Recognition of an asset (leased object) for the production machine
Subsequent accounting	
Not applicable	• Recognition of the interest component of the lease payment as expenses • Charging of the amortization component of the lease payment to the lease liability • Depreciation of the leased asset over 10 years
Carrying amount as of January 1, 2022	
–	Lease liability: CHF 922 thousand Leased asset: CHF 913 thousand

Presentation and disclosures

Finance leases must be presented separately. Regarding the presentation of the positions resulting from finance leases, FER 13 contains the following *direct* accounting policy choice:

Presentation of the carrying amount of the capitalized leased assets from finance leases as well as of the corresponding liabilities in the balance sheet

or

Presentation of the carrying amount of the capitalized leased assets from finance leases as well as of the corresponding liabilities in the notes

Finance leases are not a significant part of the business activities of DroneStar AG. Furthermore, the values of the asset and liability from the finance lease are not sufficiently significant from a quantitative point of view for a separate presentation in the balance sheet. Consequently, the Board of Directors of DroneStar AG decides to disclose the amounts in the notes to the financial statements.

Similar to the CO provisions, under FER future operating lease obligations that cannot be canceled within one year must be presented in the notes to the financial statements. FER 13 also requires a lessee to disclose the maturity pattern of all future operating lease payments.

12. Income taxes

FER 11 makes a distinction between current and deferred income taxes. Income taxes generally include taxes on profits – i.e. a net figure. Public duties, charges and taxes, such as the capital tax or the value added tax, are not income taxes and thus do not fall within the scope of FER 11.

Current income taxes are, in general, annually recurring taxes on profits and are measured based on the result of the period in the tax-relevant financial statements.

The assets and liabilities recognized in the FER financial statements correspond to the true and fair view principle. Since a different basic principle is applied in the tax-relevant financial statements, valuation differences in the balance sheet are possible between the FER financial statements and the tax-relevant financial statements. These differences are generally temporary. FER 11 states that deferred taxes must be recognized on temporary differences.

In Switzerland, the authoritative principle, whereby the CO financial statements are generally the tax-relevant financial statements, applies. Consequently, DroneStar AG uses the carrying amounts from the CO financial statements as the tax basis for calculating deferred taxes.

Accounting policy choices and scopes of action under FER

The deferred income taxes are determined based on a balance sheet-oriented concept. At each balance sheet date, the values of the individual balance sheet items under FER and CO are compared. This comparison can result in differences that will generally balance out in the future. These temporary differences form the basis for the determination of the deferred income tax positions.

The emergence of a temporary difference and the resulting effect on the deferred income tax positions is illustrated hereafter with the example of the receivables from goods and services of DroneStar AG as of January 1, 2022. DroneStar AG expects that a tax rate of 20 % will be applicable at the time of the reversal of the temporary difference.

The following example shows a situation that occurs frequently in practice in Switzerland, which results in a taxable temporary difference. Taxable temporary differences arise when an asset item in the FER balance sheet is valued higher than in the CO balance sheet (= tax basis), or when a liability item in the FER balance sheet is valued lower than in the CO balance sheet. The taxable temporary difference results in the recognition of deferred income tax liabilities. The liability item reflects the existing obligation, based on the values recognized in the FER financial statements, to pay taxes in future. By recognizing deferred taxes, the effective income tax expenses presented in the FER income statement will be equal or close to an expected tax expense in relation to the result calculated in accordance with FER. In the CO financial statements, the obligation and the corresponding tax expense arise only at the time of the reversal of the temporary difference, for example, when the receivables are paid.

Besides the taxable temporary differences, tax-deductible temporary differences can also arise. Tax-deductible temporary differences may lead to the recognition of deferred tax assets.

CO balance sheet

CHF **7,498** thousand

In the CO financial statements, individually insignificant receivables are impaired at a 5 % rate for Swiss receivables and at a 10 % rate for foreign receivables. Due to the principle of prudence and tax considerations, the impairment rates are higher than the expected losses.

FER balance sheet

CHF **7,828** thousand

In the FER financial statements, individually insignificant receivables are valued based on the expected losses. The impairment rates are determined based on the maturity pattern.

Temporary difference

CHF **330** thousand

The valuation differences give rise to differences that will balance out in the future (e.g. when the receivable is paid by the client). This results in a taxable temporary difference since the FER carrying amount is higher than the CO carrying amount.

Recognition of deferred income tax liabilities

CHF **66** thousand

The taxable temporary difference results in the recognition of deferred income tax liabilities by a multiplication of the temporary difference with the expected tax rate.

Temporary differences between the FER and CO carrying amounts

Assets FER balance sheet carrying amount > tax value **Liabilities** FER balance sheet carrying amount < tax value	**Assets** FER balance sheet carrying amount < tax value **Liabilities** FER balance carrying amount amount > tax value
Taxable difference	**Tax-deductible difference**
Recognition of deferred income tax liabilities	**Potential recognition of deferred income tax assets**

Deferred income tax assets can also arise if an entity has tax losses carried forward not yet used.

FER 11 states that deferred income tax assets on tax losses carried forward may only be capitalized if it is probable that they can be realized in the future through sufficient taxable profits. These elements of the standard give rise to the following *indirect* accounting policy choice:

Deferred income tax assets on tax losses carried forward with a sufficiently high probability of future tax profit realizations are capitalized.

or

Deferred income tax assets on tax losses carried forward with a sufficiently high probability of future tax profit realizations are not capitalized.

In 2021, restructurings within the organization resulted in a loss in the CO financial statements of DroneStar AG and, consequently, to losses carried forward, which can be netted against profits for tax purposes over the course of the next seven years. On the conversion date of January 1, 2022, DroneStar AG assumes that the losses carried forward not yet used can be netted against future profits. Since the recognition criteria for deferred income tax assets from losses carried forward not yet used are met, DroneStar AG may exercise the accounting policy choice and recognize deferred income tax assets.

The Board of Directors of DroneStar AG decides to recognize deferred tax assets for losses carried forward not yet used. The advantage of this decision is that the income tax expense is adjusted through the recognition and future release of deferred tax assets to the result in the FER financial statements. Consequently, the tax effect can be better put in relation with the result in the corresponding period both in the year of origination and in the year of use.

The deferred income tax positions are calculated using the tax rates expected to be in effect at the time of the settlement of the temporary difference for each tax subject.

Effect of the conversion on DroneStar AG

In the context of the conversion of the financial statements of DroneStar AG as of January 1, 2022, several differences between the CO and FER balance sheet carrying amounts were identified. All these identified differences are temporary differences that result in the recognition of deferred taxes. The following comparison shows the calculation of the deferred income taxes of DroneStar AG.

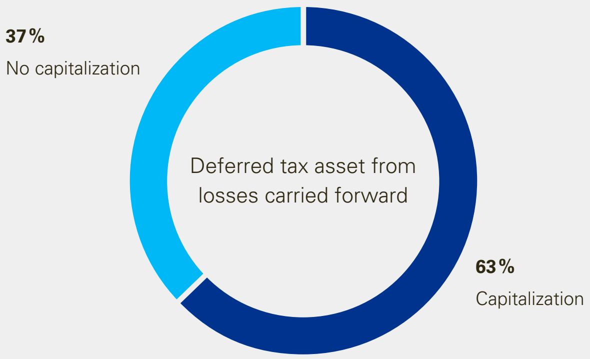
The deferred tax assets and liabilities can be netted since they relate to the same tax subject, i.e. DroneStar AG, and since management expects that the differences will reverse simultaneously. On the whole, net deferred tax liabilities of CHF 1,407 thousand are recognized at the conversion date. They are presented in retained earnings and create a reconciling item in the conversion from CO to FER.

Deferred income taxes resulting from temporary differences and losses carried forward not yet used as of January 1, 2022

In CHF thousands	**CO carrying amount**	**FER carrying amount**	**Temporary differences** deductible/ (taxable)	**Expected tax rate**	**Deferred tax assets**	**(Deferred tax liabilities)**
Receivables from goods and services	7,498	7,828	–330	20 %	–	–66
Inventories	6,067	8,791	–2,724	20 %	–	–545
Financial assets	550	653	–103	20 %	–	–21
Tangible fixed assets (excl. leases)	6,455	8,069	–1,614	20 %	–	–323
Intangible assets	208	1,463	–1,255	20 %	–	–251
Accrued expenses and deferred income	–4,147	–4,097	–50	20 %	–	–10
Provisions	– 3,570	–1,547	–2,023	20 %	–	–404
Leases	–	–9	9	20 %	2	–
Total deferred tax assets/(liabilities) from temporary differences					**2**	**–1,620**

In CHF thousands	**Value**	**Expected tax rate**	**Deferred tax assets**	**(Deferred tax liabilities)**
Losses carried forward not yet used of DroneStar AG	1,055	20 %	211	–
Total deferred tax assets from losses carried forward			**211**	**–**
Total deferred tax assets/(liabilities), gross			213	–1,620
Netting of deferred tax assets and liabilities			–213	213
Total deferred tax liabilities, net			**–**	**–1,407**

Implementation in practice



Of the 60 analyzed FER preparers listed on the SIX Swiss Exchange, almost two-thirds made the same decision as DroneStar AG and capitalize deferred tax assets on losses carried forward.

Just over one-third of the entities decided not to capitalize. Consequently, the risk of future impairments on deferred tax assets is avoided.

Presentation and disclosures

In the CO financial statements, due to the minimum structure requirements, the current taxes must be presented in the income statement. In the FER financial statements, the income taxes must also be presented separately in the income statement. Current and deferred income taxes are typically grouped under one item in the income statement, which is broken down into the two components in the notes to the FER financial statements.

Regarding the presentation of the current income tax liabilities, FER 11 contains the following *direct* accounting policy choice:

Presentation of current income tax liabilities under accrued expenses and deferred income

or

Presentation of current income tax liabilities under other short-term liabilities

The accounting policy choice can be applied similar to any receivables from current income taxes. These are presented either under prepaid expenses and accrued income or under other short-term receivables.

According to the provisions of FER 11, deferred income tax liabilities must be presented under tax provisions. Deferred income tax assets must be presented under financial assets.

According to FER, the entitlements for deferred income taxes on tax losses carried forward not yet used must also be disclosed in the notes.

13. Revenue recognition

According to FER 3, net sales from goods and services are deemed to be revenues that result from ordinary business activities. The income statement position comprises the value of the work performed less sales reductions, such as trade discounts and rebates.

Accounting policy choices and scopes of action under FER

FER 22 contains specific guidelines regarding the presentation of long-term contracts from the service provider's point of view. A long-term contract is defined as establishing a specific product or performing a specific service for a third party, if the production or service is rendered over an extended period of several months and if the project is significant for the entity. Long-term contracts are recognized according to the percentage-of-completion method ("POCM") if the following preconditions are all met:

- There is a contractual basis
- There is a high probability that the contractually agreed performance can be delivered by the contractor as well as the client
- There is a suitable project organization to run the project
- There is a reliable determination of all financial aspects of the project, such as revenue, expense, and degree of completion

When applying the POCM, the degree of completion is determined for each project at the balance sheet date. The method applied should be the one that most reliably reflects the degree of completion. Examples include the cost-to-cost method and the use of expert evidence. The income statement contains revenue from the performance for the period reflecting the degree of completion. Project expenses are charged to the income statement for that period in which the corresponding performance was rendered.

If the abovementioned criteria for the application of the POCM are not met, FER 22 contains a *direct* accounting policy choice for the recognition of long-term contracts:

Capitalization according to the completed contract method ("CCM")

or

Presentation of revenue to the extent of recoverable expenses ("modified POC method")

Under the CCM, the profit is only recognized in the income statement after passing the delivery and performance risks from the contractor to the client. Consequently, the long-term contract is presented in the income statement only when it is finalized. Recoverable costs until that date are capitalized in the balance sheet.

The modified POC method allows FER users to recognize revenue to the extent of recoverable expenses. Consequently, expenses and revenues with a zero margin are recognized in the income statement in the period of the performance during the term of the long-term contract.

As an example to illustrate the differences for the income statement, the following data are available for a long-term contract concluded by DroneStar AG that does not meet the conditions for applying the POCM since there is no appropriate project controlling:

- Contract term: 3 years (2022–2024)
- Contract volume (fixed revenue agreed upon): CHF 10,000 thousand
- Incurred and recoverable expenses of DroneStar AG:
  - in 2022: CHF 2,500 thousand
  - in 2023: CHF 1,500 thousand
  - in 2024: CHF 1,000 thousand

Contract data (in CHF thousands)	2022	2023	2024
CCM			
Revenue according to CCM	0	0	10,000
Expenses in the income statement according to CCM	0	0	5,000
Profit in the income statement according to CCM	**0**	**0**	**5,000**
Modified POC method			
Revenue according the modified POC method	2,500	1,500	6,000
Expenses in the income statement according to the modified POC method	2,500	1,500	1,000
Profit in the income statement according to the modified POC method	**0**	**0**	**5,000**

Effect of the conversion on DroneStar AG

In the year of the conversion, DroneStar AG sold standardized drones. For this, there are no conversion effects resulting from the application of FER compared to the previously applied CO provisions. The corresponding revenue continues to be recognized at the time of the transfer of the drones' ownership to the client since the main risks and benefits are passed to the client at that date.

Furthermore, at the beginning of 2022 DroneStar AG concluded a profitable long-term contract with a client for the development and sale of 500 tailormade special drones over a period of three years. DroneStar AG does not meet the criteria for applying the POCM since it does not have an appropriate project organization due to the lack of project controlling. The Company decides to apply the modified POC method for its long-term contract, and not the CCM. For 2022, it thus recognizes the recoverable expenses and revenues in the same amount in its income statement. This represents a difference compared to the Company's statutory financial statements since it does not present any revenues and expenses in the latter, but only accruals/deferrals that are typical in the context of the CCM.

Presentation and disclosures

In its FER financial statements, DroneStar AG discloses the following information for long-term contracts:

- Application of the modified POC method for the capitalization of long-term contracts since the POCM conditions are not fully met;
- Specific balance sheet items related to long-term contracts (the resulting receivables); and
- Prepayments received for long-term contracts.

14. Income statement and balance sheet after the FER conversion

The opening and closing balance sheet as well as the income statement for 2022 result from the conversion of the accounting and financial reporting.

In its 2023 FER financial statements, DroneStar AG will present the following values for the comparative period.

In CHF thousands	December 31, 2022	January 1, 2022
Cash	17,034	12,236
Securities	126	235
Receivables from goods and services	8,814	7,828
Other short-term receivables	1,425	1,226
Inventories	10,741	8,791
Prepaid expenses and accrued income	1,469	1,253
Total current assets	**39,609**	**31,569**
Financial assets	715	653
Tangible fixed assets	10,063	8,982
Intangible assets	1,588	1,463
Total non-current assets	**12,366**	**11,098**
Total assets	**51,975**	**42,667**
Payables for goods and services	6,296	5,680
Short-term financial liabilities	2,762	2,761
Other short-term liabilities	2,670	2,130
Short-term provisions	230	250
Accrued expenses and deferred income	4,847	4,097
Total current liabilities	**16,805**	**14,918**
Long-term financial liabilities	6,369	5,941
Long-term provisions	2,951	2,704
Total non-current liabilities	**9,320**	**8,645**
Share capital	6,000	5,000
Retained earnings	19,990	14,224
Own shares	–140	–120
Total equity	**25,850**	**19,104**
Total liabilities and equity	**51,975**	**42,667**

In CHF thousands	2022
Net sales from goods and services	67,400
Change in inventory of finished and unfinished goods	3,300
Other operating income and own work capitalized	1,005
Total operating income	**71,705**
Material expense	–36,450
Personnel expense	–12,500
Other operating expense	–11,280
Depreciation on tangible fixed assets	–3,975
Amortization on intangible assets	–575
Operating result	**6,925**
Financial income	462
Financial expense	–179
Profit before income taxes	**7,208**
Income taxes	–1,442
Profit	**5,766**

The balance sheet carrying amounts as of December 31, 2022 represent the opening values for the 2023 financial statements that are prepared in the context of the financial statements' preparation process.

2024 financial statements: preparation of consolidated financial statements in accordance with Swiss GAAP FER

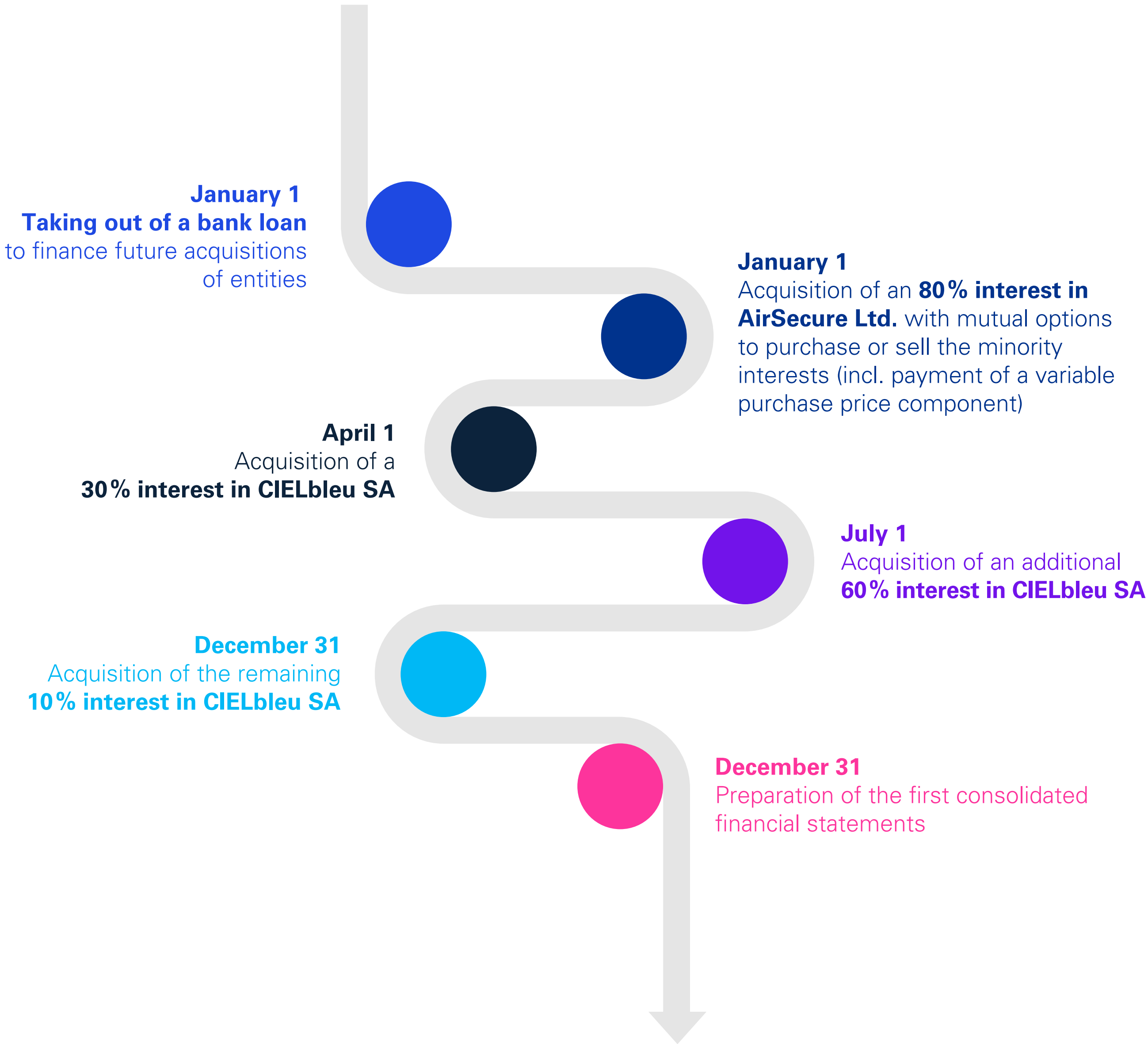
Chapter 03

Following the successful conversion to FER, DroneStar AG is ready for the 2024 financial year. The new financial reporting provides a true and fair view of the Company's actual financial position and results of operations and thus establishes an optimal foundation for the implementation of further expansion plans at DroneStar AG.
Once again, the Company is being supported by KPMG AAS in its decisions relating to accounting policy choices and scopes of action during the transformation from stand-alone financial statements to consolidated financial statements. In this context, provisions that are contained in FER 30, which was revised in 2022 and is to be applied for the first time in consolidated financial statements for financial years beginning on or after January 1, 2024, are to be implemented.

The year 2024 is an eventful year. For the planned acquisition of shares in two entities, DroneStar AG takes out a bank loan.

The acquisitions shown below will lead to a situation in which DroneStar AG will control two other entities, and will therefore, in accordance with Art. 963 CO, be required to prepare consolidated financial statements.

Beginning of the 2024 financial year



AirSecure Ltd.

DroneStar AG negotiated a fixed purchase price of CHF 4,500 thousand for the acquisition of an 80 % interest in AirSecure Ltd. on January 1, 2024. This amount will be paid by bank transfer within the first month after the acquisition is completed. The acquisition agreement also includes a performance-based purchase price component that has an estimated fair value of CHF 500 thousand at the time of the transaction.

Chapter 03 – 4. Acquisition of subsidiaries

The share purchase agreement covering the acquisition of an 80 % interest in AirSecure Ltd. also contains the following options, both of which may be exercised on January 1, 2027:

- Option for DroneStar AG to acquire the remaining 20 % of the shares of AirSecure Ltd. at a price of CHF 1,200 thousand (call option)
- Option for the former majority shareholder of AirSecure Ltd. to sell the remaining 20 % of the shares of AirSecure Ltd. to DroneStar AG at a price of CHF 1,200 thousand (put option)

Chapter 03 – 4. Acquisition of subsidiaries

AirSecure Ltd. has its registered office in the U.S. The functional currency of AirSecure Ltd. is the U.S. dollar (USD).

CIELbleu SA

DroneStar AG purchases the shares of CIELbleu SA in three independent transactions, as the shares are divided between three ownership parties.

- With effect on April 1, 2024, DroneStar AG acquires a 30 % interest in CIELbleu SA for CHF 3,400 thousand. Once the transaction has been completed, DroneStar AG can exercise significant influence on CIELbleu SA, which is why, pursuant to FER 30, the target entity is to be classified as an associated entity and recognized using the equity method.

  Chapter 03 – 5. Investments – Equity-accounted investments

- A further 60 % of the shares of CIELbleu SA are purchased on July 1, 2024. The transaction price of CHF 9,000 thousand is paid by bank transfer at the date of the acquisition. Through the acquisition of this second tranche, DroneStar AG obtains control of the entity and will be required to incorporate it as a subsidiary in the scope of consolidation as of the acquisition date. The assumption of control will be completed via two transactions, whereby this procedure is referred to in accounting as a step acquisition.

  Chapter 03 – 4. Acquisition of subsidiaries
  Chapter 03 – 6. Step acquisition

- The remaining 10 % of the entity's shares will be purchased for CHF 2,000 thousand on December 31, 2024. This transaction constitutes an acquisition of minority interests.

  Chapter 03 – 7. Acquisition of minority interests

CIELbleu SA has its registered office in Switzerland
The functional currency of CIELbleu SA is CHF.

With the acquisition of an 80 % interest in AirSecure Ltd. on January 1, 2024, DroneStar AG obtains control of an entity, and from that point on it is required to prepare consolidated financial statements. Art. 963 CO stipulates that any entity that is subject to a legal obligation to file financial reports, and which controls one or more entities that are subject to the same legal obligation, is required to prepare consolidated financial statements. Certain entities are exempt from this requirement, but DroneStar AG is not one of them. The consolidated financial statements can be prepared in accordance with the provisions of CO or in accordance with a so-called "recognized standard". Pursuant to Art. 1, para 1 VASR (Ordinance on the Recognized Accounting Standards), FER is a recognized standard.

FER 30, which defines additional requirements for consolidated financial statements, must be applied by groups of entities. Consolidated financial statements are the financial statements of a group of entities and therefore contain the financial statements of the parent entity and its subsidiaries, including joint ventures and associated entities. Chapter 03 – 2. Scope of consolidation under FER 30

Along with rules relating to consolidation procedures, FER 30 also includes provisions regarding valuation of assets and liabilities, presentation and disclosures.

Because preparing consolidated financial statements for the first time involves a new challenge, and due to the fact that share purchase agreements contain elements that are somewhat complex, DroneStar AG has engaged KPMG AAS to provide support and assistance with the new issues that will arise.

1. Revised FER 30

FER 30 Consolidated financial statements contains all additional requirements relating to consolidated financial statements. Along with these requirements, all provisions relating to stand-alone financial statements must also be complied with when consolidated financial statements are prepared. In 2017, a decision was made to subject FER 30 to a review process. The objective was to review the standard for actuality, completeness and relevance, as well as to analyze the comprehensibility of the regulations and their potential for abuse. Various interest groups, such as users of the standard, addressees of financial reporting, and auditors, were involved in this process. Ultimately, in May 2022, the Commission of Experts approved the revised FER 30, which is mandatory for consolidated financial statements for financial years beginning on or after January 1, 2024. However, earlier application of the revised FER 30 is permitted.

The following comparison contains an overview of what in our view are the most significant changes (this list is not exhaustive).

Topic	Guidance in the revised FER 30 (2022)	Guidance in the previous FER 30 (2012)
Recognition of intangible assets in a business combination	Entities that offset goodwill against equity must, at the date when control is obtained, identify and recognize intangible assets that were relevant to the decision to obtain control, including those intangible assets that were previously not recognized by the acquiree. These assets must be measured at their acquisition-date fair value. As a result, the acquiring entities must analyze, in the sense of a "management approach", which intangible assets at the acquiree are relevant and consequently must be recognized at the acquisition date. This requirement does not apply to entities that capitalize goodwill and amortize it over its useful life. Chapter 03 – 4. Acquisition of subsidiaries – Recognition and revaluation of net assets	*The previous FER 30 contained a provision stipulating that acquired assets are recognized at their acquisition-date fair value. This type of open formulation led to a practical accounting policy choice to which entities recognized either only previously recognized intangible assets or alternatively also newly identified intangible assets.*
Contingent purchase price payments (earn-out) when acquiring shares	Purchase price components that are contingent on future events are considered part of the purchase price at the acquisition date if an outflow of funds is likely. Changes stemming from the subsequent measurement of the resulting liability on future balance sheet dates will lead to an adjustment of the goodwill recognized on the balance sheet, or the offset (negative) goodwill. Chapter 03 – 4. Acquisition of subsidiaries – Variable purchase price components	*The previous FER 30 did not contain any provisions. This led to a practical accounting policy choice for entities to recognize the changes from the subsequent measurement of the liabilities from contingent purchase price components on the balance sheet date either through profit or loss or as an adjustment of (negative) goodwill.*

Topic	Guidance in the revised FER 30 (2022)	Guidance in the previous FER 30 (2012)
Achieving significant influence and the equity method	At the time significant influence is achieved, the acquired net assets of the associated entity must be revalued. Such a revaluation is only required for those items whose fair value deviates significantly from the value that would result if FER had always been applied. Goodwill is treated in exactly the same way as goodwill from the acquisition of subsidiaries. Entities that recognize goodwill as an asset must disclose it as part of the carrying amount of the equity-accounted investment and present its amortization in the same line as the share of profit or loss from equity-accounted investments. When using the equity method, equity and net result for the reporting period in question must be recognized pro rata. The basis for this are the FER financial statements of the associated entity. If no such financial statements have been prepared, at least the items considered material from a group perspective must comply with the group accounting policies in accordance with FER. The share of profit or loss from associated entities is to be disclosed in the income statement as a separate item. Chapter 03 – 5. Investments – Equity-accounted investments	*The previous FER 30 also stipulated that net assets were to be revalued at the time a significant influence is achieved, and that any goodwill resulting thereof was to be treated in accordance with the generally selected accounting policy. However, the previous standard did not contain any specific provisions regarding applicable accounting requirements and the disclosure of goodwill. Entities that recognize goodwill as an asset had an indirect accounting policy choice with regards of disclosing goodwill. Goodwill from the purchase of equity-accounted investments could be disclosed either as part of the carrying amount of the equity-accounted investment, as an individual item, or as part of intangible assets.* *The previous FER 30 did in fact stipulate that equity and net result for the reporting period in question were to be recognized pro rata when the equity method is used, and that share of profit or loss from associated entities was to be disclosed in the income statement as a separate item. However, the provisions relating to the treatment of associated entities were less extensive in nature, and there were no practical exemptions.*
Step acquisition	If control was obtained in stages, the acquired net assets are to be recognized on the balance sheet at their fair value when control is obtained. Goodwill is to be determined as the difference between purchase price and the pro rata net assets and is calculated separately for each acquisition step. This generally results in valuation differences between the fair values and the carrying amounts on previously held equity interests, which are recognized in equity. If a minority interest is acquired, goodwill is the difference between purchase price and the proportional carrying amount of the minority interest. Goodwill is treated in exactly the same way as goodwill resulting from the acquisition of subsidiaries. Chapter 03 – 6. Step acquisition Chapter 03 – 7. Acquisition of minority interests	*The previous FER 30 did not contain any provisions regarding step acquisitions.* *This led to a practical accounting policy choice with regard to the acquisition of a controlling interest in stages, whereby entities either separately calculated goodwill for each acquisition step, or else calculated goodwill for all shares at the time of obtaining control. In the latter case, a "sales fiction" for the shares previously held was assumed when obtaining control, which led to a revaluation (through profit or loss) of the shares in question.* *In the case of the acquisition of a minority interest as well, there was no guidance regarding the treatment of the difference between purchase price and the proportional carrying amount of the minority interest. As a result, a practical accounting policy choice was established whereby this difference was recognized either in equity or as part of goodwill.*

Topic	Guidance in the revised FER 30 (2022)	Guidance in the previous FER 30 (2012)
Recognition of negative goodwill (badwill)	Badwill results when the value of the acquired and revalued net assets is higher than the purchase price. The way badwill is treated depends on the accounting policy applied for goodwill: • Entities that recognize goodwill as an asset and amortize it over its useful life must recognize badwill as a liability and released to the income statement within a maximum of five years. • Entities that offset goodwill against equity must also offset badwill against equity Chapter 03 – 4. Acquisition of subsidiaries – Treatment of goodwill	*The previous FER 30 contained no explicit requirements regarding the treatment of badwill. This led to a practical accounting policy choice for entities that recognize goodwill as an asset and amortize it over its useful life. Badwill was either recognized as a liability and released to the income statement over a self-defined period of time, or recognized directly as income in the income statement upon acquisition. Entities that offset goodwill against equity also used this method for badwill.*
Gradual sale of shares	Profits or losses that result from the sale of shares are recognized in the income statement in net result for the reporting period in question. If a sale of shares leads to a loss of control, or a loss of significant influence, the remaining interest is valuated as part of pro rata net assets under consideration of the pro rata (negative) goodwill.	*The previous FER 30 did not contain any provisions.*
Treatment of accumulated foreign currency translation differences when shares are sold	The loss of control of a subsidiary whose financial statements are in a foreign currency leads to a recycling of previously recognized accumulated foreign currency translation differences in equity to profit or loss. If a divestment does not lead to a loss of control, the accumulated foreign currency translation differences must be allocated pro rata to minority interests. Other step-by-step disposals of shares result in pro rata recognition in profit or loss. This also applies to divestments that result in a loss of a significant influence over an associated entity. Chapter 03 – 8. Foreign currency translation in consolidated financial statements	*The previous FER 30 did not contain any provisions. This led to a practical accounting policy choice for entities to either recognize accumulated foreign currency translation differences through profit or loss or else reclassify them within consolidated equity without an impact on profit or loss.*

Along with the changes relating to the accounting as presented in the chart, the revised FER 30 also introduces modified presentation and disclosure requirements. For example, it explicitly stipulates that goodwill that was offset with equity and the accumulated foreign currency translation differences are to be presented as separate components (in separate columns) in the statement of changes in equity.

The overview of the most important changes shows that the revised FER 30 contains clear guidance for certain issues and topics about which the previous standard was silent. Several previous practical accounting policy choices were eliminated, and it can generally be expected that the comparability of consolidated financial statements will be increased.

In order to ensure that the implementation of the revised standard does not require an inordinate amount of additional time and expense and/or to ensure that significant restatements can be avoided, the revised FER 30 contains transitional provisions that will make the initial application easier for preparers. For example, there is no requirement to retrospectively apply certain provisions relating to goodwill (including recognition of intangible assets at the acquisition date) and provisions regarding derecognition of accumulated foreign currency translation differences. In addition, the revised FER 30 contains relief provisions for entities at which an allocation of accumulated foreign currency translation differences at the time of the initial application is impracticable.

Very few significant changes of relevance for most preparers were made to the FER over the last few years. However, it is expected that the revision of FER 30 will have an effect on many entities. It is therefore advisable that the potential effects the initial application may have on the 2024 consolidated financial statements be analyzed in a timely manner and that implementation be effectively managed.

The revised FER 30 is applicable in the first consolidated financial statements for DroneStar AG. The requirements, accounting policy choices, and other descriptions presented below therefore relate to the FER 30 that was revised in 2022.

2. Scope of consolidation under FER 30

The scope of consolidation includes subsidiaries, joint ventures, and associated entities, whereby different consolidation methods must be used in accordance with the given situation.

Scope of consolidation

Control Subsidiary	Control is assumed if an entity holds more than 50 % of voting rights either directly or indirectly. Control may also exist if an entity holds less than 50 % of voting rights but can nevertheless exert control over relevant decisions using other instruments at its disposal. For example, control can be achieved via a shareholders' agreement, through a majority on a supervisory board or other governing body, or by exercising certain option rights. It is of no relevance whether control is effectively exercised.	**Full consolidation**	**> 50 %**
Joint control Joint venture	A joint venture is a contractual agreement under which two or more parties conduct business activities that are managed under joint control (e.g. two parties, each of which owns 50 % of the entity, or three parties, each with an interest of 33 ⅓ %). None of the parties is able to exercise control over the joint organization.	*Direct* accounting policy choice: **Proportional consolidation** or **Equity method**	**20 %–50 %**
Significant influence Associated entity	A significant influence is defined as a situation in which an entity can influence the financial and business decisions of another entity but cannot assume control or joint control. One can assume that a significant influence exists if an entity holds at least 20 % of voting rights either directly or indirectly. In some cases, significant influence can also be exercised in connection with a share of less than 20 %, and it is also possible that no significant influence exists even if an entity holds 20 % or more of voting rights. Such situations require further analysis	**Equity method**	**< 20 %**

Special purpose entities are to be consolidated. A special purpose entity is an entity that is not controlled in a legal sense, but whose economic contribution directly benefits the group. A common example of a special purpose entity is a foundation that is used to organize and issue share-based remuneration components of an entity.

Ownership interests in an entity with voting rights of less than 20 % are generally not considered part of the scope of consolidation. However, additional clarifications need to be made if there are indications that a significant influence can be exercised. A significant influence can also exist, for example if:

- a representative on the entity's Board of Directors;
- involvement in the entity's business policy;
- key business relationships exist between both entities; and/or
- provision of significant technical know-how from the investment.

Subsidiaries can be excluded from the scope of consolidation, provided their overall size and their activities are insignificant. Nevertheless, a reporting entity must provide evidence on every balance sheet date that the non-inclusion of an entity in the scope of consolidation does not in fact lead to any significant effects. Once this is no longer the case, the entity in question must be included in the scope of consolidation. In practice, the question often arises here as to how such subsequent inclusion should proceed, especially given the fact that the entity often has a significant impact on the financial statements in the year of its initial inclusion in the scope of consolidation.

Entities that are part of the scope of consolidation must prepare stand-alone financial statements or a reporting package in accordance with FER that form the basis for the consolidation. The reporting packages for the parent entity, subsidiaries, and joint ventures that are included in the consolidation must be in conformance with uniform group accounting policies, which in turn must comply with FER. The balance sheet date for the reporting packages for the included entities and the reporting date for the consolidated financial statements may not be more than three months apart. Subsidiaries are fully consolidated, whereby all items in the reporting packages for subsidiaries are incorporated into the consolidated financial statements.

Any minority interest in the net result and equity is to be disclosed in the consolidated financial statements separately. With regard to the allocation of negative shares of equity contributed by over-indebted subsidiaries to majority and minority shareholders, the following *practical* accounting policy choice has established itself:

Allocation of pro rata negative equity contributed by over-indebted subsidiaries to minority shareholders

or

Full allocation of negative equity contributed by over-indebted subsidiaries to shareholders of the consolidating entity

(see Loser/Eberle, 2018b, p. 41 ff.)

The full allocation of negative shares of equity to majority shareholders is only permissible if minority shareholders have no binding obligation to make additional payments (reserve liability).

In the case of DroneStar AG, DroneStar AG and AirSecure Ltd. are to be reported from January 1, 2024, onwards as if they were a single entity whose joint annual financial statements only disclose relationships to third parties. All intragroup transactions and intragroup profits are to be eliminated in the context of the consolidation procedure. Intragroup transactions can involve income and expenses in connection with other group entities, as well as intragroup receivables or payables and internal dividend payouts. Another step in the consolidation procedure involves offsetting the carrying amount of the investment as disclosed in the stand-alone financial statements of the parent entity with the (pro rata) equity of the subsidiary, whereby this is referred to as capital consolidation.

3. Financial liabilities

In order to implement its future strategy, DroneStar AG requires additional funds and has therefore decided to take out a bank loan in the amount of CHF 12,000 thousand on January 1, 2024.

FER 2 generally requires the use of the nominal value for the initial recognition of liabilities. The formulation in FER 2 and other components of the standard result in the following *practical* accounting policy choice.

Recognition of financial liabilities at nominal value
or
Recognition of financial liabilities according to the effective interest method

Financial liabilities are generally initially recognized at their nominal value, which in the case of DroneStar AG amounts to CHF 12,000 thousand – i.e. the cash inflow resulting from the loan agreement with the bank.

The accounting policy choice presented above has an effect on the way directly attributable transaction costs incurred in connection with taking out the loan.

On the one hand, those who apply FER have the possibility to recognize financial liabilities at their nominal value. In this case, the directly attributable transaction costs that are incurred are capitalized under prepaid expenses and accrued income, which are subsequently released to the income statement over the term of the loan, generally on a straight-line basis. On the other hand, transaction costs can be shown as deductions of the nominal value of the loan at initial recognition when the effective interest method is used. The difference between the carrying amount of the financial liability at initial recognition and the nominal value that will have to be paid out at the end of the term is spread out over the term of the financial instrument when the effective interest method is used. Liabilities treated in this manner are measured at amortized costs.

The recognition and subsequent measurement of financial liabilities, including directly attributable transaction costs, is presented using the example of the loan to be taken out by DroneStar AG. The conditions are as follows:
- Nominal value of CHF 12,000 thousand
- Interest rate of 2.5 % per year (CHF 300 thousand annually)
- Term from January 1, 2024, to December 31, 2026 (3 years)
- Transaction costs of CHF 100 thousand

In CHF thousands	Recognition of the financial liability at nominal value		Recognition of the financial liability using the effective interest method	
2024	Cash / Financial liability	12,000	Cash / Financial liability	11,900
	Prepaid expenses and accrued income / Cash	100	Interest expenses / Cash	300
	Interest expenses / Cash	300	Interest expenses / Financial liability	32.4
	Financial expenses / Prepaid expenses and accrued income	33.3		
2025	Interest expenses / Cash	300	Interest expenses / Cash	300
	Financial expenses/ Prepaid expenses and accrued income	33.3	Interest expenses / Financial liability	33.3
2026	Interest expenses / Cash	300	Interest expenses / Cash	300
	Financial expenses/ Prepaid expenses and accrued income	33.4	Interest expenses / Financial liability	34.3
	Financial liability / Cash	12,000	Financial liability / Cash	12,000

DroneStar AG decided to initially recognize the financial liability at nominal value. The calculations and activities associated with this method are easier to perform than using the effective interest method. Both methods result in a distribution of transaction costs over the term of the loan.

In addition, DroneStar AG believes presenting financial liabilities at their nominal value is a more transparent approach, as this causes the balance sheet to reflect the effective cash outflow at maturity throughout the term of the loan.

4. Acquisition of subsidiaries

The acquisition date for the purchase of a majority interest in AirSecure Ltd. is January 1, 2024, which will also be the date on which DroneStar AG will be required to begin preparing consolidated financial statements.

A so-called purchase price allocation ("PPA") is performed when a subsidiary is acquired. At the time control is obtained, the acquired assets and liabilities are incorporated into the consolidated financial statements of the acquirer and compared with the purchase price. The consolidation is based on the purchase method, which means the initial consolidation at the acquisition date involves a revaluation of the acquired net assets to reflect their acquisition-date fair value. The purchase price can consist of both fixed and variable components. Chapter 03 – 4. Acquisition of subsidiaries – Variable purchase price components

A purchase price can include cash payments as well as other components such as an assumption of liabilities or a transfer of equity instruments, whereby the latter are generally recognized at their fair value. If the purchase price relevant for the PPA exceeds the value of the revalued net assets, goodwill will be generated.
Chapter 03 – 4. Acquisition of subsidiaries – Treatment of goodwill

Negative goodwill ("badwill") results if the value of acquired net assets exceeds the purchase price. Such a situation rarely occurs, and the given circumstances should therefore be analyzed closely and critically before a transaction is posted. In this context, it is important to determine whether obligations that were previously not reflected led to the badwill, and if provisions of the same amount must be recognized, or whether it is in fact a "lucky buy".

Unlike the previous version, the revised FER 30 from 2022 contains more detailed provisions relating to the preparation of consolidated financial statements and also addresses significantly more issues than the previous version. Certain details are also not addressed in the revised FER 30, which is why there is still scope of action with regard to resolving specific issues that affect groups of entities.

As is the case with other FER, the accounting policy choices selected and the scope of action decided upon must be used consistently over time. The notes to consolidated financial statements must disclose the accounting policies used.

Treatment of goodwill

With regard to the treatment of goodwill, FER 30 contains a *direct* accounting policy choice:

Capitalization of goodwill with corresponding amortization over the useful life

or

Capitalization and direct offsetting of goodwill against equity at the acquisition date

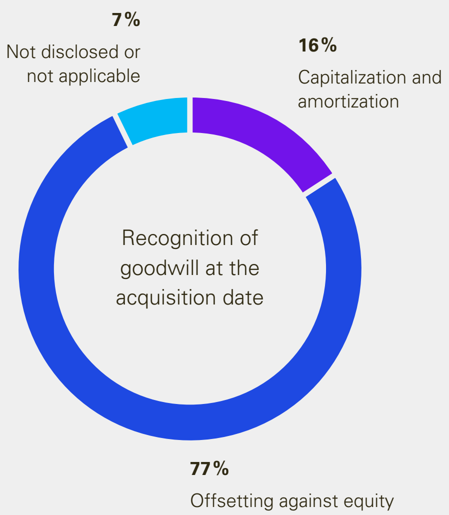
One way to treat goodwill is to recognize it under intangible assets at the acquisition date and then amortize it over its estimated useful life. FER 30 stipulates that amortization is to be performed using a schedule (and in general straight-line) over the estimated useful life. The latter may not exceed twenty years. If the useful life cannot be reliably estimated, it should be set at five years. Twenty years is, generally speaking, a long period of useful life, but it may be suitable for goodwill, which, for example, includes a very well-known brand that is not separately recognized as an asset and made a major contribution to the success of the acquiree in the past.

Goodwill can also be offset against the consolidated equity at the acquisition date. The offset goodwill items are to be presented in a separate column in the statement of changes in equity. In addition, the notes to the consolidated financial statements must disclose a shadow accounting statement that shows all the effects that a theoretical capitalization and scheduled amortization (or impairment) would have on the consolidated balance sheet and income statement for the reporting and comparative period.
The items to be disclosed are acquisition cost, additions and disposals, (cumulative) amortization and impairments, foreign currency translation differences, and carrying amounts.

Care should be taken to ensure that in the future, if (part of) a business is sold, any goodwill offset against consolidated equity at the acquisition date will be charged to the consolidated income statement ("recycling") in order to calculate the profit or loss resulting from the sale. The closure or liquidation of (part of) a business is to be treated in the same manner as a sale. This provision ensures that regardless of which method is used, the same amount will be charged to the consolidated income statement, although in different periods. If goodwill is amortized over its useful life, it systematically appears in the consolidated income statement throughout the amortization period. In the case of entities that offset goodwill against equity at the acquisition date, such entries will be delayed – namely until the point in time of the sale, closure, or liquidation – and will therefore impact the profit or loss resulting from the sale. Under certain circumstances, this can also result in unwanted effects at the time of a sale, since recycling can lead to a sales gain suddenly being transformed into a loss.

The goodwill resulting from the acquisition of AirSecure Ltd. is recognized in the DroneStar AG consolidated balance sheet and amortized on a straight-line basis over its estimated useful life of five years. DroneStar AG uses this approach in order to ensure the transparent disclosure of goodwill in the consolidated balance sheet. According to an analysis conducted by DroneStar AG, the amortization expense to be recognized from the acquisition date to the end of useful life will reflect the actual utilization of the synergies generated by the acquisition. Amortization will thus be recognized in the period in which an economic benefit results from the synergies. In this manner, DroneStar AG is also seeking to avoid a situation in which goodwill held as a part of equity might negatively affect the consolidated income statement if AirSecure Ltd. were to be sold off at some future point in time. This approach also offers another benefit in that no additional intangible assets have to be identified and recognized in the course of the PPA at the acquisition date. Chapter 03 – 4. Acquisition of subsidiaries – Recognition and revaluation of net assets

This decision is included in the accounting policies of DroneStar AG and must be applied in connection with other acquisitions as well. The accounting policy must also be applied for acquisitions of associated entities or minority interests. Chapter 03 – 5. Investments – Equity-accounted investments; Chapter 03 – 7. Acquisition of minority interests



The chart shows the result of an analysis of the consolidated financial statements of 60 listed entities that apply the previous FER 30. The chart shows that approximately 77 % of these entities disclosed direct offsetting of goodwill against equity as their accounting policy. One reason for this might be that the entities in question wished to avoid reporting on the balance sheet those assets that are not directly tangible. Another important consideration here could be to prevent a negative impact on the income statement over the course of useful life as a result of goodwill amortization or possible impairment. In addition, the requirements for annual indicator-based impairment tests are likely not followed as strictly as usual if the effect of a goodwill impairment during useful life is only reflected in a shadow accounting statement.

Side note on the recognition of badwill

Badwill results if the value of the revalued net assets acquired in a business combination exceeds the purchase price. Basically, badwill is rarely encountered in practice, but there are nevertheless situations in which the agreed purchase price is lower than the value of the acquired net assets. The way badwill is treated depends on the accounting policy applied for goodwill:

- Entities that capitalize and amortize goodwill recognize badwill as a liability and disclose it separately on the balance sheet or in the notes to the consolidated financial statements. Badwill recognized as a liability must be released to the income statement over a maximum period of five years.

- Entities that offset goodwill against equity at the acquisition date also offset badwill against equity. Analogous to the treatment of goodwill, badwill is to be charged to the income statement in the event of the sale, closure, or liquidation of a business or part of a business. Presentation and disclosure requirements for goodwill also apply to badwill in an analogous manner.

Recognition and revaluation of net assets

FER 30 contains a general provision stipulating that assets and liabilities acquired in a business combination are to be valued and recognized at their acquisition-date fair values when control is obtained.

In the case of acquired assets in particular, the question arises as to whether these may, or must, be recognized on the consolidated balance sheet in a PPA. The focus here is generally on intangible assets. These involve, for example, software, trademarks and brands, and customer relationships that were created by the acquired entity and not previously capitalized. Other true and fair view accounting standards require consistent recognition of identifiable intangible assets that are of value at the acquisition date. Previous practical experience with FER has shown that when performing a PPA, many entities intentionally choose not to identify, assess the value of, and recognize additional previously unrecognized intangible assets. There are several reasons for this. One involves the fact that many entities that apply FER seek to reduce the time, effort, and costs associated with the performance of a PPA.

The revised FER 30 distinguishes between entities that capitalize and amortize goodwill and those that offset goodwill against equity at the acquisition date. Chapter 03 – 4. Acquisition of subsidiaries – Treatment of goodwill

The formulation in the standard indicates that regardless of the way goodwill is treated, the application of the revised FER 30 will also allow for the possibility to recognize in a PPA all identifiable assets that meet the criteria for capitalization. It can therefore be assumed that the following *practical* accounting policy choice will be established when the revised FER 30 is applied:

Entities that capitalize and amortize goodwill

Recognition of net assets previously recognized by the acquired entity

or

Recognition of
- *net assets previously recognized by the acquired entity, and*
- *other newly identified assets*

Entities that offset goodwill against equity

Recognition of
- *net assets previously recognized by the acquired entity, and*
- *previously unrecognized intangible assets that are relevant to the decision to obtain control*

or

Recognition of
- *net assets previously recognized by the acquired entity, and*
- *previously unrecognized intangible assets that are relevant to the decision to obtain control, and*
- *other newly identified assets*

Regardless of which accounting policy is chosen, all acquired assets and liabilities are to be recognized at their acquisition-date fair values.

Entities that also recognize other newly identified assets can either make a full identification and thus recognize all identifiable assets, or only revalue and capitalize selected classes of identifiable assets. This latter selective approach for newly identified assets leads to a situation in which, for example, software that was created by the acquired entity and not previously capitalized is recognized, but no recognition is performed for customer relationships. Once a method has been chosen, it must be applied consistently for all acquisitions and be disclosed in the accounting policies in the notes to the consolidated financial statements.

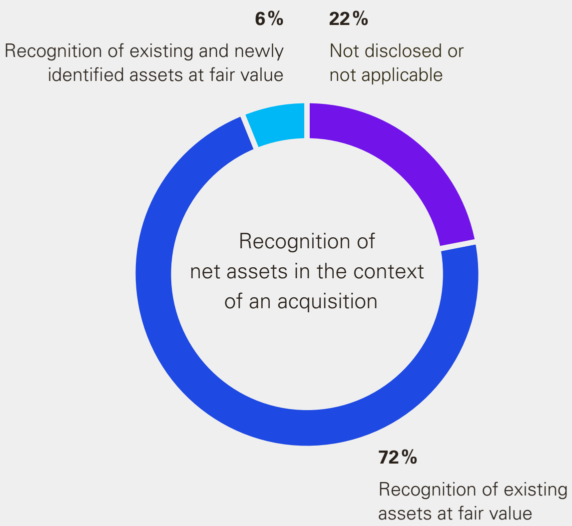
It should be noted, however, that entities which offset goodwill against equity generally must recognize at their acquisition-date fair values all intangible assets that are relevant to the decision to obtain control of the acquiree. These entities must, in accordance with a management approach, perform an analysis to determine which intangible assets are to be identified and recognized separately in the PPA. Any intangible assets held by the acquired entity that were not previously recognized on the balance sheet, but which are relevant to the decision to obtain control, must be recognized in the takeover balance sheet at their acquisition-date fair values.

This is not an accounting policy choice. As a minimum requirement of FER 30, intangible assets that are relevant to the decision to obtain control must, without exception, be recognized by entities that offset goodwill against equity. The type of assets recognized in the consolidated financial statements in a PPA can thus differ depending on the acquired entity. Whereas the purchase of one entity might require recognition of a trademark because it played a key role in the acquisition decision, the same consolidated financial statements might also dispense with recognition of a trademark from another acquisition because that trademark did not influence the acquisition decision.

The actual manner in which this provision is applied can involve a certain degree of judgement and thus may lead to discussions with the auditor. In addition, in some cases it may be necessary to involve a valuation specialist in the calculation of acquisition-date fair values.

Entities that capitalize and amortize goodwill can generally consistently refrain from the recognition of previously unrecognized assets.

DroneStar AG capitalizes and amortizes goodwill. On this basis, the basic decision has been made to only revalue and recognize in the consolidated financial statements those assets that were previously already recognized by the acquired entity. The advantage of this approach is that the effort required to account for and present the transaction is lower, thus saving time and money. It is not uncommon that detailed analyses and interviews have to be performed in connection with the identification of new assets. The subsequent valuation often requires the assistance of a valuation specialist. As a disadvantage, the value of the net assets to be recognized is correspondingly lower due to the fact that additional existing assets remain unrecognized, and therefore the goodwill resulting from the transaction is correspondingly higher. Even if the goodwill as a residual value from the PPA is not an intangible asset in terms of the scope of FER 10, its capitalization will make the acquired value visible on the consolidated balance sheet.



The chart shows the result of an analysis of accounting policies for the consolidated financial statements of 60 listed entities that apply the previous FER 30. This means that all the entities analyzed were able to decide whether they recognized previously unrecognized assets at their acquisition-date fair values or whether they completely forgo the recognition.

The disclosures of 72 % of the entities lead to the conclusion that when they acquire other entities, these entities only recognize previous assets at their acquisition-date fair values. Only 6 % of the entities examined recognize other additionally identified assets.

In accordance with the provisions from the revised FER 30 that will apply in the future, it is expected that the majority of entities will have to accept higher costs when they conduct PPA, as they offset goodwill against equity and therefore will also have to identify, to value, and to recognize all intangible assets that are relevant to the decision to obtain control.

Variable purchase price components

A variable purchase price component within the framework of the acquisition of a subsidiary generally involves an obligation by the buyer to transfer to the previous owners of the acquired entity additional assets or equity shares after future events occur or certain conditions have been met.

The incorporation of variable purchase price components (which are often performance-based) makes it possible to adequately take into account assessments of future prospects that tend to deviate from one another and the directly associated divergent attitudes regarding the purchase price. Financial performance indicators such as EBITDA or EBIT are generally used to evaluate an entity's development.

According to FER, purchase price components that are dependent upon future events are considered part of the purchase price at the acquisition date if an outflow of funds is likely. Liabilities arising from variable purchase price components are to be assigned to the "provisions" balance sheet item, as they involve obligations resulting from an event in the past, whereby the exact amount is unclear but can be estimated. The amount of the provision corresponds to the expected value of the future outflow of funds. DroneStar AG expects an outflow of funds of CHF 500 thousand three years after the acquisition date. Because the discounting effect is considered insignificant, it is not taken into account. The CHF 500 thousand is part of the transaction price, which is juxtaposed against the acquired net assets in order to calculate goodwill.

The provisions for variable purchase price components must be remeasured on every balance sheet date and adjusted if the estimate changes. FER 30 explicitly stipulates that changes to the estimate should always lead to an adjustment of capitalized goodwill or goodwill offset against equity, as the case may be. In a business combination that resulted in a badwill, an adjustment of a liability from variable purchase price components leads to an adjustment of the badwill liability, or else badwill offset in equity. Amortization of adjusted goodwill or badwill is performed prospectively over the remaining useful life.

Purchase price components that are recognized on the balance sheet, and purchase price components that are not recognized, are to be disclosed in the notes to the consolidated financial statements. In addition, entities that offset goodwill against equity need to adjust their shadow accounting statement in the notes.

Side note on purchase price components linked to future employment

It is not uncommon for entities that make acquisitions to seek to retain the previous owners of the acquiree for a certain period of time after the acquisition, as these individuals have extensive knowledge of the acquired entity and can be used to ensure effective knowledge transfer. As a result, share purchase agreements often contain clauses that guarantee previous owners continued payments if they remain with the acquired entity for a certain period of time after control has been transferred.

In the event that fixed or variable price components are linked to previous owners of the acquiree remaining in the entity, these components cannot be considered part of the purchase price that is relevant for the PPA, but must instead be considered compensation for future employment. As a result, payments made when these individuals perform work are generally recognized as personnel expenses in the period or periods in question.

This aspect will be of particular interest to entities that offset goodwill against equity, as such price components must be recognized in the income statement rather than as part of goodwill in equity. Entities that capitalize and amortize goodwill might view such clauses critically, as the associated expenses (especially in connection with a long useful life for goodwill amortization) will lead to an expense at an earlier stage than would otherwise be the case, and will also negatively impact key performance indicators such as EBITDA.

Transaction costs in the context of the acquisition of an entity

Generally, costs are incurred in connection with business combinations. Examples include consulting fees, brokerage commissions, and directly attributable administrative costs. The question arises as to how costs directly attributable to the transaction are to be recognized. The treatment of transaction costs incurred in the acquisition of the subsidiary is not regulated in FER. The following *practical* accounting policy choice has arisen from company practice, which is likely to continue due to the lack of specific rules in this regard in the revised FER:

Capitalization of transaction costs as part of the purchase price

or

Recognition of transaction costs in the income statement at the acquisition date

(see Loser/Eberle, 2018a, p. 367)

While the capitalization option is based on paragraph 26 of the FER framework and a previous version of IFRS, the option of direct recognition in profit or loss is derived from currently applicable guidance from IFRS 3, which addresses business combination accounting for IFRS preparers. DroneStar AG has opted to capitalize transaction costs, whereby the capitalized transaction costs increase the value of goodwill from the transaction and are therefore recognized in the income statement over its useful life as part of amortization expense.

Mutual call and put option of minority interests

The share purchase agreement covering the acquisition of an 80 % interest in AirSecure Ltd. also granted DroneStar AG a call option to purchase the remaining 20 % of the shares for CHF 1,200 thousand. This option can be exercised on January 1, 2027. The former majority shareholder has a put option with the same conditions. From an economic point of view, one of the two parties will exercise the option because one of the two parties will be able to gain an economic advantage through the transaction. This therefore amounts to a synthetic forward contract that will result in an irrevocable obligation for DroneStar AG to make a payment to the minority shareholder.

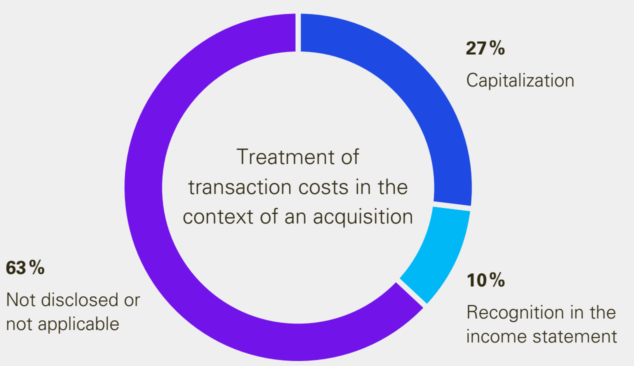
Since this is a derivative on equity instruments of the own organization, the provisions of FER 27 do not apply. Due to this, and the lack of an explicit provision regarding the accounting treatment (even under consideration of the provisions contained in the revised FER 30), the following *practical* accounting policy choice has arisen, which is also likely to prevail in the future:

Disclosure of the synthetic forward as an irrevocable payment obligation resulting from a non-recognizable commitment in the notes to the consolidated financial statements

or

Recognition of the irrevocable payment obligation resulting from the synthetic forward as a liability by derecognizing the minority interest in equity

(see Loser/Eberle, 2018a, p. 367)



The analysis of the consolidated financial statements of 60 listed entities shows that nearly two-thirds do not disclose their accounting policy. This may be due to the fact that these costs are not considered significant enough for disclosure or there were no significant costs in the past. 27 % of the entities capitalize transaction costs as part of the purchase price, while the remaining 10 % opted for direct recognition in the income statement.

The first approach, which pursues a pure disclosure in the notes without recognition of a liability on the consolidated balance sheet, is based on the provisions in FER 5 on irrevocable payment obligations resulting from non-recognizable commitments. The disclosure should include all information needed to understand the transaction in question. This includes the most important terms and conditions of the contract concluded by the two parties as well as the exercise conditions.

The second approach is based on IFRS. The IFRS provisions require the recognition of a financial liability in such situations, which is measured at the present value of the exercise price of the option at the date of initial recognition. “Insights into IFRS: KPMG’s practical guide to IFRS Accounting Standards” includes an accounting policy choice according to which the debit entry at initial recognition is to be made against the minority interest or against other consolidated equity (see The KPMG International Standards Group, 2022, p. 250). Recognition against the minority interest can be used in all constellations, while recognition against other consolidated equity requires further analysis and can only be applied in special cases. The latter is therefore not considered further. In line with KPMG’s IFRS guidance the recognition of subsequent value changes via consolidated equity or the consolidated income statement is conceivable.

DroneStar AG opts for the pure disclosure of the synthetic forward in the notes to the consolidated financial statements, as this allows it to dispense with a detailed valuation of the payment obligation and the recognition of future changes in value. In addition, this approach makes the share of AirSecure Ltd. equity held by minority shareholders transparent in the consolidated financial statements. DroneStar AG is of the opinion that detailed disclosures in the notes provide sufficient information to enable readers of the consolidated financial statements to gain a clear picture of future cash flows.

Presentation and disclosure

As DroneStar AG is now required to prepare consolidated financial statements, disclosures on the on the scope of consolidation, consolidation principles, valuation basis and principles, and other disclosures relevant to an understanding of the consolidated financial statements. The disclosure of the scope of consolidation includes the treatment of the entity (consolidation method applied), as well as key data on AirSecure Ltd. (e.g. name and domicile of its registered office) and information on the share of capital and voting rights acquired (if these differ). The disclosures on the consolidation principles include capital consolidation, foreign currency translation methods (including the treatment of foreign currency translation differences), and the treatment of intercompany profits and transactions among consolidated entities. If the scope of consolidation includes associated entities or joint ventures, the way these would be treated would also have to be disclosed.

FER 30 stipulates that all changes to the scope of consolidation, and the dates of such changes, must be disclosed in the notes. The most important balance sheet items at AirSecure Ltd. at the acquisition date must be disclosed. To enable readers of the consolidated financial statements to understand the effect of the acquisition, the impact of the initial consolidation on net sales must be disclosed. The disclosures include the net sales generated since the acquisition date and thus included in the consolidated income statement as well as the net sales from the start of the financial year until the acquisition date. If the net sales until the acquisition date cannot be determined, the net sales according to the last available financial statements are to be disclosed.

The change in the scope of consolidation has an impact on various disclosures. For example, property, plant, and equipment or intangible assets acquired through the transaction must be disclosed separately as changes in the scope of consolidation in the asset movement schedules in the notes. Any change in provisions resulting from changes in the scope of consolidation must also be disclosed separately in the provisions table. In addition, the cash outflow resulting from the purchase of the subsidiary, less the acquired cash and cash equivalents must be shown separately in the cash flow from investing activities.

The statement of changes in equity in the consolidated financial statements of DroneStar AG must be supplemented by a new column for the presentation of accumulated foreign currency translation differences. Entities that offset goodwill or badwill against equity at the date of acquisition must additionally present the offset amounts in a column in the statement of changes in equity. With the first-time application of FER 30, DroneStar AG will also have to comply with disclosure requirements regarding net sales from the supply of goods and services. These sales from goods and services shall be broken down by geographical markets and business lines. However, the segmentation into business divisions is only necessary if these differ significantly from each other. Entities that apply FER 31 generally already disclose segment reporting in which the sales per operating segment are presented and can therefore dispense with the disclosures according to FER 30. Entities that apply FER 40 are also exempt from the FER 30 requirement to disclose the breakdown of net sales from goods and services.

5. Investments

DroneStar AG acquired a 15 % interest in FirstInvestment AG in 2023. This investment is recognized in the FER stand-alone financial statements at acquisition cost, less any impairments.

In addition, on April 1, 2024, DroneStar AG will acquire 30 % of CIELbleu SA by means of a payment in the amount of CHF 3,400 thousand.

Investments with voting rights of less than 20 %

The investment in FirstInvestment AG will not be part of the scope of consolidation because DroneStar AG will hold less than 20 % of voting rights. With regard to the valuation of this investment in the consolidated financial statements, the application of FER 30 leads to the following *direct* accounting policy choice:

Valuation of entities with a proportion of voting rights of less than 20 % at acquisition cost less any impairment

or

Valuation of entities with a proportion of voting rights of less than 20 % at fair value

The DroneStar AG Board of Directors has chosen to continue to value the 15 % interest in FirstInvestment AG at acquisition cost less any impairments. The additional application of FER 30 therefore has no influence on the valuation of the investment.

Equity-accounted investments

Entities in which the group holds at least 20 % of the voting rights, but not control, or over which significant influence can be exercised in some other way, are classified as associated entities and are included in the scope of consolidation. Associated entities are accounted for using the equity method. This applies to the 30 % interest in CIELbleu SA.

When the equity method is applied for the first time, the net assets acquired at the time of acquisition are revalued, similar to the acquisition of subsidiaries. FER 30 stipulates that a revaluation is only necessary for assets and liabilities for which the current value deviates significantly from the value that would have resulted if FER had always been applied. The requirement to recognize previously unrecognized intangible assets applies to entities that offset goodwill against equity – analogously to the acquisition of subsidiaries.

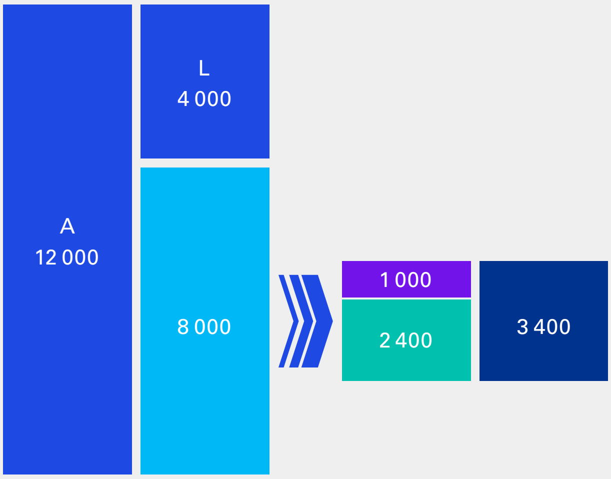
If the purchase price exceeds the value of the pro rata net assets acquired, goodwill will be generated. Goodwill thus represents the surplus resulting from the comparison of the carrying amount of the investment with the value of the pro rata net assets. Goodwill is to be treated in the same way as is the case with the acquisition of subsidiaries.
For DroneStar AG, this means that after any acquisition of an associated entity, goodwill is recognized as part of the carrying amount of the investment and then amortized over its useful life. Along with the annual increase or reduction of the carrying amount of the investment due to equity accounting, the scheduled goodwill amortization, in isolation, leads to a reduction of the carrying amount. An entity that chooses to apply the accounting policy of offsetting goodwill against equity must also apply this policy in connection with goodwill from associated entities. The same disclosure requirements apply here as for goodwill from the acquisition of subsidiaries, which is offset against consolidated equity.

With regard to the acquisition of subsidiaries, DroneStar AG has made the basic decision to only revalue and recognize those assets and liabilities that were previously already recognized by the acquired entity, which means that this approach also has to be employed when associated entities are acquired. The acquisition of a 30 % interest in CIELbleu SA will consequently lead to a revaluation of previous assets and liabilities – and the figures shown on the next page:

April 1, 2024

Balance sheet of CIELbleu SA after revaluation

1st acquisition step 30 %



= Assets (A) and liabilities (L) at the balance sheet date
= Net assets at the balance sheet date
= Pro rata net assets at CIELbleu SA (part of the carrying amount of the equity-accounted investment)
= Goodwill (part of the carrying amount of the equity-accounted investment)
= Transaction price

Amounts in CHF thousands

The revaluation reveals hidden and compulsory reserves. The effect of revaluation and the deferred taxes taken into consideration have led to an increase in net assets of CHF 1,000 thousand compared to the previous carrying amounts of the balance sheet items of CIELbleu SA. As at April 1, 2024, the revalued net assets at CIELbleu SA have a value of CHF 8,000 thousand.

DroneStar AG's corresponding share of 30 % of the CHF 8,000 thousand amounts to CHF 2,400 thousand, which is disclosed as part of the carrying amount of the equity-accounted investment. The comparison of the purchase price of CHF 3,400 thousand with the pro rata net assets upon acquisition results in goodwill of CHF 1,000 thousand, which also represents part of the carrying amount of the equity-accounted investment and is amortized on a straight-line basis over its expected useful life of five years.

Presentation and disclosure

The acquisition of the associated entity represents a change in the scope of consolidation that must be disclosed. Since CIELbleu SA becomes part of the scope of consolidation at the acquisition date, the corresponding scope of consolidation information must also be integrated into the notes to the consolidated financial statements. The key features of the equity method will have to be added to the consolidation policies. In addition, payables to and receivables from associated entities are to be disclosed separately on the consolidated balance sheet or in the notes.

If an entity has chosen the accounting policy whereby goodwill is offset against equity, any goodwill offset against equity after the acquisition of an associated entity must also be included in the shadow accounting statement in the notes to the consolidated financial statements.

Application of the equity method also impacts the presentation in the consolidated income statement. For example, net share of profit or loss of associated entities must be shown as a separate line item in the consolidated income statement.

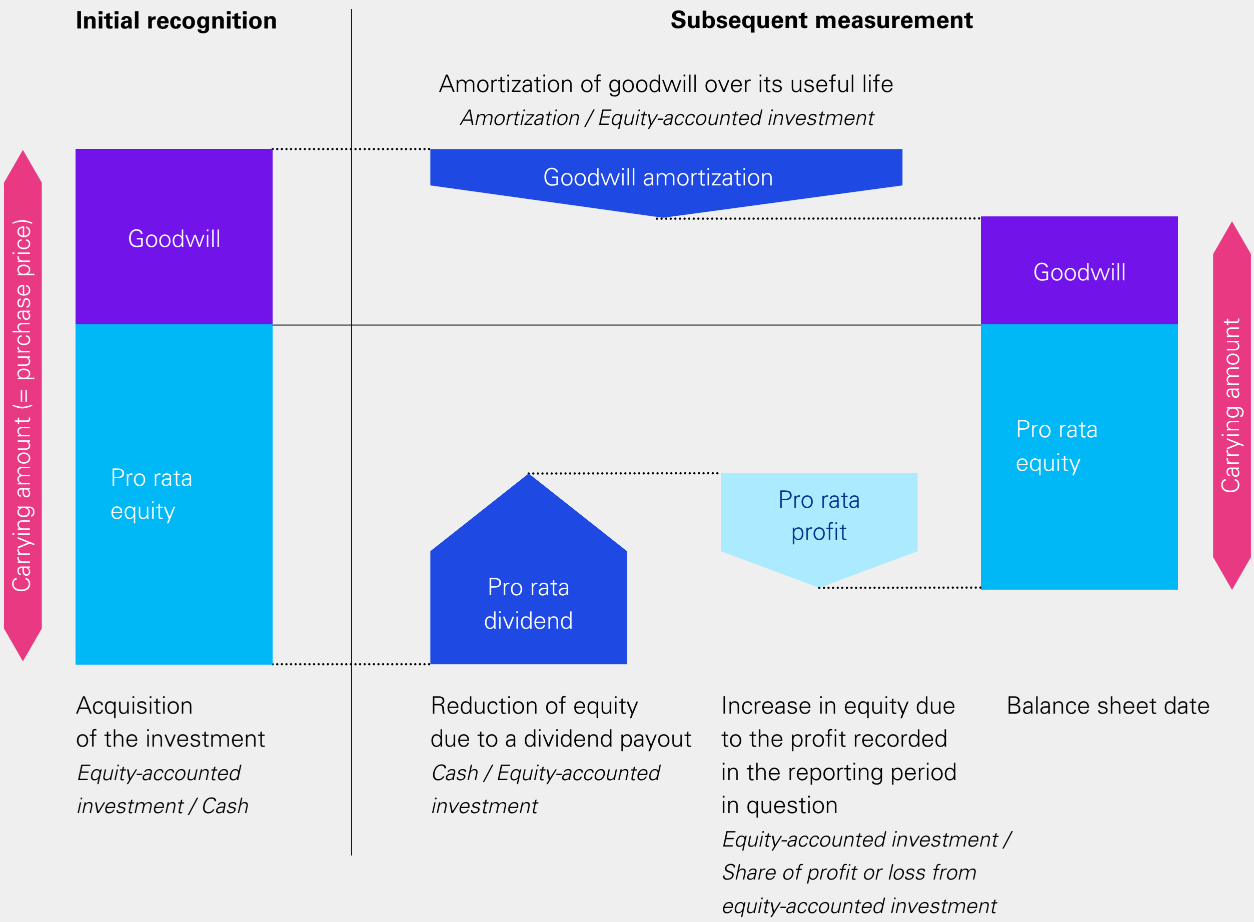
The cash outflow resulting from the acquisition of an associated entity is to be disclosed in the investing activities of the consolidated cash flow statement. The share of profit or loss of the associated entity does not have an effect on cash flows. Therefore, in the indirectly determined cash flow from operating activities, the starting point profit or loss is to be adjusted by the share of profit or loss of the associated entity.

Side note on the equity method

As part of equity accounting, pro rata equity from an associated entity (or a joint venture) is incorporated into the consolidated financial statements. The entity's FER financial statements serve as the basis for this incorporation. If the entity does not prepare FER financial statements, at least the financial statement items considered material from a group perspective must comply with the FER compliant, uniform group accounting policies.

In the subsequent periods, the pro rata equity figure generally changes due to the pro rata net result of the associated entity, as well as the dividends it pays out.

In the case of equity-accounted investments that prepare their stand-alone financial statements in a foreign currency, foreign currency translation differences are also to be taken into account, whereby these are to be recognized in equity.



Based on Loser/Eberle, 2016, p. 129

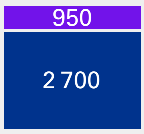
6. Step acquisition

With the acquisition of a further 60 % interest in CIELbleu SA as at July 1, 2024, DroneStar AG will acquire the majority of the share capital and voting rights in that entity and thus control it from that date. This means that CIELbleu SA, which was previously included in the consolidated financial statements as an associated entity, will be fully consolidated as at July 1, 2024. Control over the entity is obtained via two separate transactions, whereby this is referred to as a step acquisition.

This step acquisition in accordance with FER 30 is presented in the chart below.

June 30, 2024

Values in accordance with the equity method and after amortization of goodwill



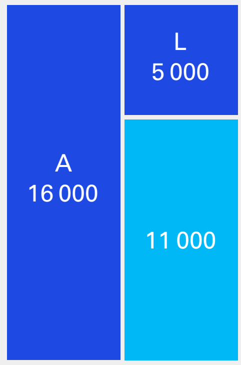
Goodwill amortization for 3 months: 50
Amortization / Equity-accounted investment

Pro rata profit: 300
Equity-accounted investment / Share of profit or loss of equity-accounted investment

DroneStar AG carries out equity accounting and regular goodwill amortization until June 30, 2024. This will change the carrying amount of the equity-accounted investment.

July 1, 2024

Balance sheet of CIELbleu SA after revaluation



Incorporation of CIELbleu SA assets and liabilities into the consolidated financial statements

Assets and liabilities at the time control of the entity is obtained (July 1, 2024) will be revalued once again and then used as the basis for the recognition of the acquisition. There was an increase in compulsory reserves of CHF 2,450 thousand after the revaluation on April 1, 2024. As part of the initial consolidation of CIELbleu SA, the revalued items, as well as the deferred taxes that are to be recognized in connection with the temporary differences, are transferred to the consolidated balance sheet.

The figures also serve as the basis for the calculation of goodwill.

= Assets (A) and liabilities (L) at the balance sheet date
= Net assets at the balance sheet date
= Pro rata net assets at CIELbleu SA (part of the carrying amount of the equity-accounted investment)
= Goodwill (part of the carrying amount of the equity-accounted investment)

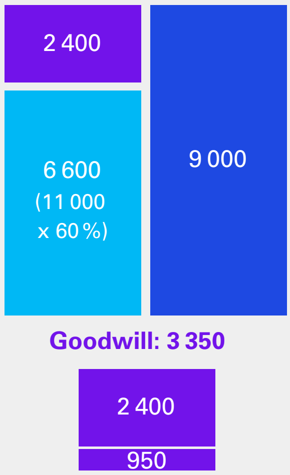
Amounts in CHF thousands

In a step acquisition, goodwill is calculated per acquisition step as the difference between the purchase price for the acquired tranche and the pro rata net assets for each acquisition step separately. Acquired net assets are to be recognized at their acquisition-date fair value at the time control of an entity is obtained. When this approach is used, any differences between the acquisition-date fair values and carrying amounts are only taken into account to the extent of newly acquired share tranche. The portion of the change in the difference attributable to the previously held share is recognized in the consolidated equity. This approach ensures that the acquired assets and liabilities are included in the consolidated financial statements at full fair value at the time of the acquisition of control.

The useful life of goodwill is determined separately for each acquisition step.

2nd acquisition step 60 %

2.1 Calculation of goodwill by juxtaposing the transaction price for the 60 % interest against the pro rata revalued net assets



The carrying amount of goodwill from the first transaction step is incorporated unchanged.

= Pro rata net assets at the balance sheet date (revalued)
= Goodwill
= Transaction price

Amounts in CHF thousands

2.2 Calculation of the revaluation reserve in equity by multiplying the sum of newly created compulsory reserves and the associated deferred tax effect with the previously held portion of shares (30 %)

In CHF thousands	
Change in the compulsory reserves at CIELbleu SA (April 1 to June 30, 2024)	2,450
Deferred tax effect from the change in the compulsory reserves at CIELbleu SA	–450
Difference between acquisition-date fair values and carrying amounts at CIELbleu SA	**2,000**
Previously held portion of shares	30 %
Revaluation reserve	**600**
	(2,000 × 30 %)

Posting the transaction

In CHF thousands	Debit	Credit
Various acquired revalued assets	16,000	
Goodwill (from the second acquisition step)	2,400	
Goodwill (carrying amount from the first acquisition step)	950	
Various acquired revalued liabilities		5,000
Equity-accounted investment		3,650
Cash and cash equivalents		9,000
Revaluation reserve in equity*		600
Minority interests in equity		1,100

* For illustrative purposes, the revaluation reserve is shown as a separate reserve. However, separate disclosure is not required and also not recommended (especially in view of questions that will inevitably arise in connection with updates made to this item).

Presentation and disclosure

Since the acquisition of a further 60 % interest in CIELbleu SA resulted in the acquisition of control over the entity, the disclosure requirements for the acquisition of subsidiaries apply. Besides that, FER 30 does not contain any explicit requirements on necessary disclosures in the notes for the effects of step acquisitions.

If the transaction is material, the FER framework requires disclosure of sufficient information to enable users of the consolidated financial statements to gain an understanding of the matter.

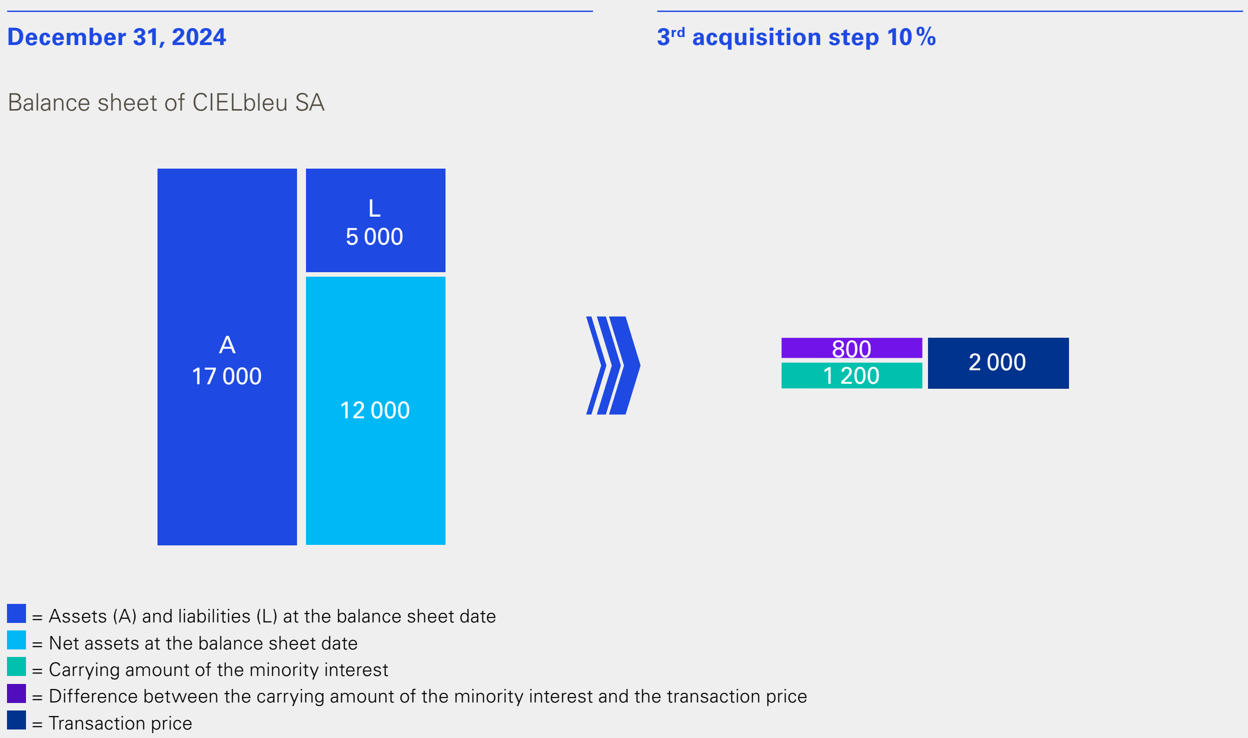
7. Acquisition of minority interests

Shortly before the end of 2024, the remaining minority shareholder of CIELbleu SA decides to sell their 10 % interest in the entity to DroneStar AG.

The parties agree on a purchase price of CHF 2,000 thousand. The acquisition date is set for December 31, 2024. CIELbleu SA has achieved a profit of CHF 1,000 thousand for the second half of 2024, which is why its net assets have increased from CHF 11,000 thousand to CHF 12,000 thousand.

Unlike the case with the acquisition of a controlling interest, the net assets obtained through the acquisition of a minority interest are not recognized at their acquisition-date fair value but instead at their carrying amount. This is done because the assets and liabilities are already included in the consolidated balance sheet and their revaluation was already performed at the time control of the entity was obtained. In the case of CIELbleu SA, control was obtained on July 1, 2024. Chapter 03 – 6. Step acquisition

The purchase price generally does not correspond to the pro rata book value of the minority interests recognized in equity. The comparison of the purchase price and the pro rata carrying amount for the third acquisition step results in a difference of CHF 800 thousand.



Amounts in CHF thousands

According to FER 30, the purchase of a minority interest is also considered a form of acquisition. This means that goodwill, or badwill, is the difference between the purchase price and the proportional carrying amount of the minority interest. This goodwill/badwill is to be treated analogously to goodwill or badwill from the acquisition of subsidiaries.
Chapter 03 – 4. Acquisition of subsidiaries – Treatment of goodwill

Entities that recognize goodwill as an asset/badwill as a liability must also recognize the difference between the purchase price and the proportional carrying amount of the minority interest as an asset or a liability. Entities that offset goodwill against equity must also apply this accounting policy when they acquire minority interests.

Because DroneStar AG uses the accounting policy of recognizing goodwill as an asset, the third acquisition step at the end of 2024 leads to the following entries.

In CHF thousand	Debit	Credit
Minority interests in equity	1 200	
Goodwill	800	
Cash and cash equivalents		2 000

Presentation and disclosure

The accounting policy must be disclosed in the notes if such disclosure is considered relevant for readers of the consolidated financial statements. Besides the disclosure requirements relating to the acquisition of subsidiaries, FER does not contain any explicit provisions on the necessary disclosures in the notes to the consolidated financial statements. If the transaction is material, sufficient information must be disclosed in accordance with the FER framework to ensure that those who read the consolidated financial statements will be able to gain an understanding of the facts. Entities that offset goodwill against equity must also disclose goodwill components from acquisitions of minority interests in the notes to the consolidated financial statements in the shadow account schedule.

8. Foreign currency translation in consolidated financial statements

Each entity prepares its reporting package using the local currency or the entity's functional currency, which are usually the same.

AirSecure Ltd. is a foreign subsidiary with functional currency USD. Thus, the functional currency at AirSecure Ltd. differs from the presentation currency of the consolidated financial statements. The reporting package prepared by AirSecure Ltd. must be converted into the presentation currency of the consolidated financial statements at each reporting date. This translation must be carried out at the closing rate method. All balance sheet items (excluding equity) are converted using the exchange rate at the balance sheet date. FER 30 contains the following *direct* accounting policy choice for foreign currency translation in income statement and cash flows statement.

Translation of individual transactions and items in the income statement / cash flow statement into the presentation currency at the average exchange rate for the period

or

Translation of individual transactions and items in the income statement / cash flow statement into the presentation currency at the current transaction rate

Equity is translated using historical exchange rates. The translation differences resulting from the conversion are to be recognized in equity without any impact on the income statement.

Along with foreign currency translation of reporting packages, the issue of long-term intra-group loans with equity character must be considered in connection with foreign subsidiaries. Such equity-like loans frequently involve credit granted by a parent entity to a subsidiary for which there is no repayment schedule, nor any likelihood that the loan will be repaid in the foreseeable future. Other constellations are also conceivable. Due to the lack of will to repay and the low probability of future return flow of funds, such loans in substance form part of the investment in the subsidiary – not a loan in a true sense.

One of the two group entities recognizes the equity-like loan in its reporting package in a foreign currency. The translation of the loan into its own functional currency results in foreign currency translation effects that are recognized in the reporting package in the income statement. However, in the case of equity-like loans these foreign currency translation effects must be reclassified during consolidation to consolidated equity, where they are presented as part of the foreign currency translation reserve resulting from the conversion of all other foreign currency figures from the various reporting packages with a functional currency different from the presentation currency. Therefore, they are recognized in the consolidated financial statements without affecting the income statement.

Even if repayment is not planned or unlikely at the time of initial classification as an equity-like loan, conditions may change in subsequent periods and the borrowed amount could in fact be paid back at some point in time. This raises the question of how to treat the foreign currency translation differences from the settled equity-like loan that were previously recognized in equity without affecting the income statement. FER 30 contains the following *direct* accounting policy choice:

Pro rata derecognition through the income statement of accumulated foreign currency translation differences resulting from equity-like loans

or

Retention of the cumulative foreign currency translation differences resulting from equity-like loans in equity

Once an accounting policy has been chosen, it must be applied consistently to all future transactions. The DroneStar Group has never granted any equity-like loans in the past, which means it will not make a decision on this accounting policy choice until such a decision becomes necessary. This has the advantage that the financial effects of both options can then be assessed using an actual example.

In the event of a loss of control of a subsidiary, or the loss of a significant influence over an associated entity, the accumulated foreign currency translation differences recognized in equity are derecognized to the income statement. This applies to the cumulative effects resulting from foreign currency translation for reporting packages into the presentation currency, as well as to the accumulated foreign currency translation differences resulting from equity-like loans. Gradual divestitures of subsidiaries that do not lead to a loss of control result in a pro rata reclassification of accumulated foreign currency translation differences to the equity attributable to minority interests, without any impact on the income statement. In the case of other gradual divestitures, the accumulated currency translation differences are to be recognized pro rata in the income statement.

Presentation and disclosure

The accounting policies applied for foreign currency translation in a group shall be disclosed in the notes to the consolidated financial statements if such disclosure is considered relevant for the reader of the financial statements. In addition, reserves from foreign currency translation are to be presented in a separate column in the statement of changes in equity. The effects resulting from foreign currency translation at the balance sheet date, as well as the effects of transactions in connection with the accumulated foreign currency translation differences recognized in equity must be disclosed as separate lines in the statement of changes in equity if they are material.

9. Deferred income taxes in consolidated financial statements

With the preparation of consolidated financial statements and the associated consolidation of the financial statements of individual subsidiaries, additional entries often arise at group level. Such entries can in turn result in temporary differences that lead to the recognition of deferred tax assets and deferred tax liabilities. Chapter 02 – 12. Income taxes

A classic example of such a situation involves the elimination of interim profits on inventories or property, plant, and equipment resulting from transactions between group entities. The elimination of such interim profits is necessary from a group perspective because profits may only be recognized if the corresponding services are provided to third parties, or if the corresponding goods are sold to third parties.

The elimination generally leads to an income that differs from taxable income, thereby leading to the recognition of deferred income taxes in accordance with FER 30.

FER 30 provides for a *direct* accounting policy choice with regard to the tax rate to be applied for calculating deferred tax implications for entries resulting from consolidation procedures:

Application of the effectively expected tax rate per tax subject

or

Application of an adequate and consistently used group average tax rate

or

Application of an average expected tax rate

DroneStar AG has chosen to use an average anticipated tax rate, as this simplifies the calculation of deferred taxes at the group level. Due to this simplification, the tax positions recognized as a result do not, in the opinion of the entity's Board of Directors, deviate significantly from reality.

Presentation and disclosure

The accounting policies on deferred income tax in the group are to be disclosed in the notes to the consolidated financial statements if such disclosure is considered relevant for readers of the financial statements. FER 30 does not contain any other specific disclosure requirements.

10. Impact of FER 30 on the elements of the financial statements

Consolidated income statement

With the exception of the addition of the share of profit or loss from equity-accounted investments, the structure and items in the consolidated income statement remain unchanged. All income and expenses of fully consolidated entities are fully included in the income statement from the date of acquisition of control until the end of the reporting period.

Income statement

In CHF thousands	2024
Net sales from goods and services	96,718
Change in inventory of finished and unfinished goods	4,735
Other operating income and own work capitalized	1,442
Total operating income	**102,895**
Material expense	–52,305
Personnel expense	–17,937
Other operating expense	–16,187
Depreciation on tangible fixed assets	–5,704
Amortization on goodwill and intangible assets	–1,365
Share of profit or loss from equity-accounted investments	300
Operating result	**9,697**
Financial income	663
Financial expense	–712
Profit before income taxes	**9,648**
Income taxes	–1,870
Profit	**7,778**
Of which attributable to:	
Shareholders of DroneStar AG	7,540
Minority shareholders	238

Due to the 30 % interest in CIELbleu SA, which was included in the scope of consolidation for three months as an associated entity using the equity method, the pro rata profit generated by CIELbleu SA during this period must be taken into account as a separate item in the income statement. FER does not contain any provisions on where this position is reported. The DroneStar Group has concluded that this investment is operational in nature and that pro rata profit is therefore recognized as part of the operating result. Other presentation approaches are also conceivable.

Since the acquisition of control over AirSecure Ltd., a minority shareholder has held 20 % of the shares of the entity. Furthermore, a third shareholder maintained a 10 % interest in CIELbleu SA between July 1 and December 31. The minority shareholders' share of the profit of the respective subsidiary generated in the periods with minority interests must be reported separately in the income statement.

Consolidated balance sheet

The assets and liabilities of subsidiaries, and the retained earnings accumulated since the acquisition date, are disclosed in the consolidated balance sheet at the balance sheet date. The individual balance sheet items are not changed significantly, as in the income statement. However, a new goodwill item will now be disclosed under assets and the foreign currency translation reserve will be disclosed in equity. In order to increase transparency, DroneStar AG made the decision to present these two items separately, despite the fact that FER does not require this type of disclosure.

If this voluntary separate presentation was not performed, goodwill would have to be presented in the intangible assets line item and the effects resulting from foreign currency translation for subsidiaries using a foreign currency would have to be presented under retained earnings. It should be noted, however, that the foreign currency translation reserve is to be presented as a separate column in the statement of changes in equity. Due to the voluntary presentation of this equity item in the balance sheet, the statement of changes in equity and the balance sheet can be reconciled without any additional calculation.

Analogous to the income statement, the share of minority interests in equity is to be presented separately.

As the equity investment in CIELbleu SA no longer exists on the balance sheet date of 31 December 2024 due to the acquisition of control, it can no longer be found in the balance sheet. Otherwise, this equity-accounted investment would have to be presented as a separate balance sheet item, if material.

Equity

In CHF thousands	2024
Share capital	6,000
Own shares	–160
Retained earnings	31,440
Foreign currency translation reserve	96
Total shareholders' equity, excl. minority interests	**37,376**
Minority interests	962
Total shareholders' equity, incl. minority interests	**38,338**

The foreign currency translation reserve results from the conversion of the USD reporting package of AirSecure Ltd. into the presentation currency in the consolidated financial statements (CHF). Such effects are recognized directly in equity, without any impact on the income statement. The foreign currency translation reserve is part of the retained earnings and can therefore be disclosed as a sub-item of retained earnings. For reasons of transparency, DroneStar AG presents it as a separate item in equity.

As of 31 December 2024, AirSecure Ltd. still has a minority shareholder. The share of the minority interests in equity is to be presented separately.

Consolidated cash flow statement

Cash flows that result from changes to the scope of consolidation or from transactions with minority shareholders, as well as effects resulting from the application of the equity method, must be presented separately in the cash flow statement of the consolidated financial statements. FER 30 contains additional provisions that supplement the provisions in FER 4. Cash flows at the DroneStar Group in 2024 are disclosed as shown below.

Excerpt from the cash flow statement

In CHF thousands	2024
Profit	**7,778**
Share of profit or loss from equity-accounted investments	–300
Other positions of the indirectly calculated cash flow from operating activities	[...]
Cash flow from operating activities	**[...]**
Various cash inflows and outflows from investing activities	[...]
Acquisition of subsidiaries, net of cash acquired	–13,000
Acquisition equity-accounted investments	–3,400
Acquisition of minority interests	–2,000
Cash flow from investing activities	**[...]**
Various cash inflows and outflows from financing activities	[...]
Cash flow from financing activities	**[...]**

The pro rata profit from CIELbleu SA recognized on the basis of the equity method is not cash-effective and is therefore corrected in the indirectly calculated cash flow from operating activities.

The net cash outflow resulting from the acquisition of a subsidiary is presented in the cash flow from investing activities. This line item contains the cash outflows resulting from the acquisition steps that led to obtaining control of AirSecure Ltd. and CIELbleu SA, less the cash and cash equivalents acquired via these transactions.

The cash outflow resulting from the purchase of the initial 30 % interest in CIELbleu SA, which was recognized as an equity-accounted investment over the first few months, is presented in the cash flow from investing activities.

The cash outflow resulting from the purchase of the 10 % minority interest in CIELbleu SA is presented in the cash flow from investing activities.

Consolidated statement of changes in equity

FER 30 requires separate presentation, in separate columns, of the foreign currency translation reserve and goodwill or badwill offset against equity. Similar to the consolidated income statement, minority interests are also presented separately in the consolidated statement of changes in equity.

The transactions and foreign currency translation lead to additional reconciling items that are disclosed in the statement of changes in equity.

In CHF thousands	Share capital	Own shares	Retained earnings	Foreign currency translation reserve	Total excl. minority interests	Minority interests	Total incl. minority interests
Balance as of January 1, 2024	**6,000**	**–140**	**25,900**	–	**31,760**	–	**31,760**
Profit	–	–	7,540	–	**7,540**	238	**7,778**
Acquisition of subsidiaries with minority shareholders	–	–	–	–	**–**	1,900	**1,900**
Foreign exchange differences	–	–	–	96	**96**	24	**120**
Dividend distributions	–	–	–2,000	–	**–2,000**	–	**–2,000**
Acquisition of own shares	–	–20	–	–	**–20**	–	**–20**
Acquisition of minority interests	–	–	–	–	–	–1,200	**–2,000**
Balance as of December 31, 2024	**6,000**	**–160**	**31,440**	**96**	**37,376**	**962**	**38,338**

Notes to the consolidated financial statements

FER 30 contains additional disclosure requirements for consolidated financial statements, some of which have been developed in response to the new circumstances. For example, information must be provided on the scope of consolidation, the acquisition and sale of subsidiaries, and goodwill. Groups with subsidiaries that operate with foreign functional currencies must explain the way they treat foreign currency translation differences. Additions also need to be made to asset movement schedules and change schedules (e.g. asset movement schedule for property, plant, and equipment / intangible assets; the table of provisions) – i.e. addition of reconciling items relating to the effects of changes to the scope of consolidation and the impact of foreign currency translation.

Any new and relevant accounting policies being applied also need to be explained. Given the fact that there is still a certain amount of accounting policy choices and of scope of action available when consolidated financial statements are prepared, the disclosure of the principles is central to the understanding of the consolidated financial statements.

Further FER 30 requirements stipulate the provision of information that enables readers of the consolidated financial statements to gain a better understanding of the group in question. This includes the disclosure of net sales from the supply of goods and services for each geographic market and each business area.

FER has less extensive and comprehensive disclosure requirements than international accounting standards. Again, the general principle applies that even in the absence of detailed requirements, entities that apply FER must disclose sufficient information to enable the readers of the consolidated financial statements to gain a better understanding of the group's asset, financial, and income situation.

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