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Evaluation of the Application of IFRS in the 2006 Financial Statements of EU Companies

Report to the European Commission

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Ineum Consulting, a French consultancy company, has prepared this Report "Evaluation of the Application of IFRS in the 2006 Financial Statements of EU Companies" at the request of, and with funding from, the Directorate General for Internal Market and Services of the Commission of the European Communities (the “Commission”). This Report comprises two separate documents - an Executive Summary and a Detailed Report – which together represent the Report as a whole. Readers are advised to refer to the Report as a whole in order to obtain a complete understanding of the contents included and the methodology used.
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Currency Convention:

In order to facilitate comparability between the companies in our sample, all figures presented in tables and in the text of the Report are expressed in Euros, except figures taken as a direct extract of the financial statements and included in the Report as an image or those figures for which a specific reported currency is mentioned. Closing Balance Sheet items have been translated using the closing rate and Profit & Loss Account items have been translated using the average rate.

Table of Contents

1. OVERALL CONCLUSIONS ... 9

1.1. Work performed ... 9

1.2. Overall progress from 2005 to 2006 ... 9

1.3. Accounting policies ... 9

1.4. Consistency and comparability ... 10

1.5. Overall level of compliance, regulation and audit ... 12

1.6. Small and medium-sized companies ... 15

2. REGULATORS AND PROFESSIONAL BODIES POINT-OF-VIEW ... 17

2.1. Reporting on enforcement activities ... 17

2.2. Issues regarding incomplete disclosures and accounting issues ... 20

2.3. Issues regarding consistency and comparability ... 26

2.4. Appetite for Wider Application of IFRS ... 27

2.5. Issues regarding cultural changes ... 29

3. PREPARERS VIEW ... 33

4. FAIR PRESENTATION AND ACCOUNTING POLICIES ... 41

4.1. Accounting policies in accordance with IFRS applicable in the EU ... 42

4.2. Fair presentation override ... 44

4.3. Changes in accounting policies ... 44

4.4. Restatements of the comparative period ... 50

4.5. Audit Opinion ... 55

4.6. Early adoption of IFRS ... 56

4.7. Comments on future standards ... 61

4.8. Disclosure of judgements and estimates ... 62

5. PRESENTATION OF FINANCIAL STATEMENTS ... 65

5.1. Ease of comparisons ... 66

5.2. Length of Financial statements ... 67

5.3. Income Statement Presentation (by Function, by Nature): ... 70

5.4. Type of captions used for the Income Statement ... 73

5.5. Performance indicators disclosed in Management Reports: ... 74

6. SEGMENT REPORTING ... 77

6.1. Disclosure of segment reporting ... 78

6.2. Disclosures for primary and secondary reporting ... 82

6.3. Disclosures for segment result ... 85

6.4. Disclosure for segment revenue ... 85

6.5. Analysis of geographical and business segmentation ... 86

7. CONSOLIDATION ... 93

7.1. De facto control ... 93

7.2. Thresholds and methods of consolidation 95
7.3. Interests in Joint ventures 95
8. GOODWILL, INTANGIBLE ASSETS AND IMPAIRMENT 99
8.1. Overview of Goodwill and other intangibles in the European companies 100
8.2. Detailed disclosures on Intangible Assets 103
8.3. Finite-lived Intangible Assets 106
8.4. Split between acquired R&D and internally generated Development Costs 107
8.5. Impairment on Goodwill and Intangible assets 108
9. PPE & INVESTMENT PROPERTY 113
9.1. Overview of Tangible Assets in the 250 EU companies 113
9.2. Detailed disclosures on Property, plant and Equipment 114
9.3. Investment property 118
10. FINANCIAL INSTRUMENTS – NON FINANCIAL ACTIVITIES 121
10.1. Presentation of the sample for the detailed analysis 122
10.2. Classification and presentation of non-consolidated financial investments 124
10.3. Impairment of non-consolidated financial investments 126
10.4. Issues related to debt/equity classification 127
10.5. Use of the Fair Value Option 129
10.6. Embedded derivatives 130
10.7. Use of derivative instruments and of hedge accounting 133
10.8. Use of hedge accounting 133
10.9. Debt disclosures 138
10.10. Disclosures on financial risks and financial risk management 141
10.11. Clarity of the presentation of financial risks 148
11. BORROWING COSTS 153
11.1. Accounting scheme 153
11.2. Information disclosed 156
12. SHARE BASED PAYMENT 161
12.1. Weight of share-based payments 161
12.2. Type of share-based transactions disclosed 164
12.3. Valuation of share-based transactions 167
12.4. Effect of share-based payment transactions on the profit or loss 170
13. POST-EMPLOYMENT BENEFITS 173
13.1. Significance of Defined Benefit Obligations 174
13.2. Detailed analysis 177
13.3. Reconciliation between financial statement disclosures and disclosures in accompanying notes regarding post-employment obligations 178
13.4. Analysis of Defined Benefit Obligations (DBO) and Plan Assets (PA): 179
13.5. Actuarial assumptions regarding defined benefit plans 184
13.6. Accounting treatment of actuarial gains and losses 187

13.7. Other disclosures 192
14. GOVERNMENT GRANTS 197
14.1. Accounting and disclosure of government grants related to assets 198
15. ENVIRONMENT 201
15.1. Definition of the sample under review 201
15.2. Environmental issues or related subjects disclosures 202
15.3. Detailed disclosures 203
16. CONCESSION SERVICES 209
16.1. Definition of the sample under review 209
16.2. Accounting treatment of concession services 210
16.3. Early application of IFRIC 12 211
17. EXTRACTIVE INDUSTRY 215
17.1. Definition of the sample under review 215
17.2. Accounting methods and classification of exploration and evaluation costs 216
17.3. Existence of disclosures required by IFRS 6 217
18. INSURANCE CONTRACTS 219
18.1. Definition of the sample under review 220
18.2. Disclosure of the definition of an insurance contract and related classification 221
18.3. Fair Value option 222
18.4. Election of presentation options 224
18.5. Insurance liabilities 226
18.6. Impairment of reinsurance assets 229
18.7. Segment reporting 230
18.8. Classification and presentation of non-consolidated financial investments 231
18.9. Impairment of non-consolidated financial investments 233
18.10. Issues related to debt/equity classification 234
18.11. Use of derivative instruments and of hedge accounting 235
18.12. Use of hedge accounting 235
18.13. Debt disclosures 237
18.14. Disclosures on financial risks and financial risk management 238
18.15. Disclosures on risks and risk management 239
19. INVESTMENT ENTITIES 247
19.1. Definition of the sample under review 247
19.2. Classification and valuation of investments held by investment entities 248
19.3. Issues related to debt/equity classification 252
19.4. Embedded derivatives 253
19.5. Use of derivative instruments 254
19.6. Use of hedge accounting 254
19.7. Debt disclosures 256
19.8. Disclosures on financial risks and financial risk management 258

20. BANKS **261**
20.1. PRESENTATION OF THE SAMPLE 263
20.2. PRESENTATION OF THE INCOME STATEMENT 264
20.3. SEGMENT REPORTING 269
20.4. FAIR VALUE OPTION 271
20.5. MACRO HEDGES AND THE EUROPEAN CARVE-OUT 275
20.6. LOANS AND ADVANCES 278
20.7. NON-CONSOLIDATED FINANCIAL INVESTMENTS 282
20.8. MATTERS RELATED TO DEBT/EQUITY CLASSIFICATION AND CAPITAL 285
20.9. DAY ONE PROFIT 290
20.10. HEDGING AND HEDGE ACCOUNTING 291
20.11. LOAN COMMITMENTS 294
20.12. DISCLOSURES RELATED TO RISK MANAGEMENT AND RISK EXPOSURES 295
20.13. CLARITY AND RELEVANCE OF THE PRESENTATION OF RISKS 306
21. OVERALL EVOLUTION FROM 2005 TO 2006 ..... **311**
22. SAMPLING METHODS FOR 2006 FINANCIAL STATEMENTS SELECTION **317**

APPENDIX 1: SAMPLED COMPANIES **321**
LISTED COMPANIES 321
NON-LISTED COMPANIES 328

APPENDIX 2: ON-LINE SURVEY RESULTS **329**

INDEXES **337**
STANDARDS & INTERPRETATIONS 337
COMPANIES 339

1. Overall conclusions

1.1. Work performed

The study of the 2006 IFRS Financial Statements has led us to:

- examine 270 sets of Financial Statements, of which some were for the same Group's as those selected for study in the previous 2005 ICAEW analysis and report,
- study reports issued by regulators on points resulting from their reviews of the 2006 Financial Statements,
- hold meetings with certain regulators and members of the Accounting Profession,
- obtain the viewpoint of the preparers of the financial statements included in our selection, both from their own view point and from those of users with whom they relate (particularly analysts),
- Study other reports and documents available including certain studies performed by some of the international accounting firms.

Based on this work, we have formed an overall conclusion concerning the IFRS application in the 2006 Financial Statements of EU companies.

Our sampling method was selected to give the widest and most representative sample of Financial Statements possible within the overall sample size defined, and we have examined all other documentation that we have been able to identify. The regulators reports that we have studied were also based on a finite number of companies studied in each of their countries.

Therefore, having only studied a sample of companies, our conclusions can only purport to the sample that we have studied, and to the samples of companies studied by the regulators. Although we have also sought more generally the opinions of regulators, preparers of the Financial Statements and members of the accounting profession to provide further insight, the overall opinion that we have formed cannot be construed as being as "all encompassing" as if a wider detailed study had been performed.

1.2. Overall progress from 2005 to 2006

Stated compliance specifically with IFRS-EU by the preparers in the 2006 sample of Financial Statements selected was up from 87% in 2005 to 99% in 2006.

Other than this, and apart from the amendments and early adoptions, relatively little changes have taken place between 2005 and 2006 in the overall presentation and content of the Financial Statements, and the results in terms of choices of options from the respective samples of companies studied from 2005 to 2006 are similar in most respects. Early adoption of future IFRS standards and IFRIC interpretations was at approximately at the same level if one does not consider the large early application of the amendments to IAS 19 & 39 in 2005.

A difference in the method for the recognition of actuarial gains and losses on post-employment benefit plans from the corridor approach in 2005 to immediate recognition in the balance sheet and equity approach in 2006 was observed.

1.3. Accounting policies

In the ICAEW report on the 2005 Financial Statements, comments were made concerning a tendency for Group's to apply standard texts, or "boilerplating" for the notes on accounting policies, or presenting accounting policies for activities or operations for which there was no subsequent disclosure of transactions or balances in the Financial Statements.

Progress has been made in this area in 2006 although a number of cases still occur, and certain regulatory authorities have referred to this in their communications to companies. This seems proportionately to occur more frequently in small and medium sized companies. An example of this "boilerplating" approach is the IAS 36 requirement on Impairment of Assets for which a large part of the companies in our sample used simply the wording stated in IAS 36 without any further explanations relating to the specific nature and circumstances of the group or the methodology used to calculate the recoverable value.

Continuing vigilance, and some form of information to companies, needs to be applied in this area to ensure that the accounting policies notes are the most informative and relevant to each company's business model, operations and circumstances.

Concerning the requirements for disclosure on judgments and estimates, 19% of companies sampled did not disclose this required information in the accounting policies notes. Again, some form of communication is needed on this topic.

1.4. Consistency and comparability

The subject of consistency and comparability is a complex one to measure:

- each of the 25 countries has specific economic conditions and commercial and fiscal legislation
- each industry has its own business model and specific constraints
- each country is evolving from its own specific financial reporting background towards a common European goal

Evaluating this subject therefore requires an appreciation of the underlying constraints and specific nature of each company examined in assessing the way that IFRS addresses and provokes reporting of these specific points and enables each company to present its results and financial situation on a common basis.

Consistency and comparability by country

Our work on the sample of companies showed three noteworthy areas on the topic of comparability across countries:

- a preference in the choice of Profit and Loss Account format linked to previous local GAAP preferences (certain countries preferring the costs by function presentation and others the costs by nature/cost type presentation)
- a format of disclosure in the notes to Financial Statements which tended to reflect prior approaches for either text based disclosures or tabular based analysis of figures
- a large diversity in the disclosures relating to IAS 19 – Post Employment Benefits

Concerning IAS 19, the different structuring of pension mechanisms and obligations in each country means that the underlying economic basis concerning employees in each country is very diverse. Accordingly, the financial consequences to be reported are also diverse. In examining the Plan Asset/DBO ratios for employees in each country, it is interesting to note that for our sample of companies examined, whereas Defined Benefit Obligations for Dutch employees are provided for by Plan Assets representing more than 100% of DBO, and for the UK just under 100%, very little Plan Asset coverage is provided for example in France and Spain.

In this complex context, and in view of the amounts concerned, clear and consistent disclosure is therefore paramount. We have noted however in analysing the disclosures and underlying assumptions, that a fairly wide range of different values have been used across different companies for the same countries and market situations, for subjects such as life expectancy and underlying economic conditions.

While it is not possible, nor appropriate, to have total harmonisation of all these aspects, we believe that the level of disparity currently existing could create difficulties both in understanding and in comparability. We therefore recommend that the European Commission explores with the Actuarial Profession across Europe ways to better harmonise the underlying assumptions used in making the evaluations of Pension Obligations and related Plan Asset evaluations. In this context, adaptations to the standard might also be considered for certain cases of disclosure.

Other than these topics, we have not found comparability across countries to be an issue and this conclusion would seem to be borne out by the replies we received from the preparers' survey in which 62% responded that better comparability between countries has been achieved with IFRS.

Consistency and comparability across industry sectors and within industry sectors

Comparability across industry sectors is difficult and imperfect as each industry has a different underlying business model. A number of the IFRS requirements apply with a different level of significance depending on the specifics of each industry sector.

In the analysis of each topic in our report, we have highlighted wherever possible the areas in which particular industry sectors are more significantly impacted (goodwill and intangibles, PPE …). We have not however identified any specific areas in which IFRS is preventing comparability across industry sectors, bearing in mind the different underlying business models which prevent total comparability.

Comparison within an industry sector is mainly impacted by the points raised below in terms of overall consistency and comparability, particularly in the area of Profit and Loss Account format for banks.

In the survey of preparers, the industry sector comparison objectives were noted less favourably than last year. While 48% of preparers felt that IFRS made it easier to compare competitors within an industry sector, only 33% felt it was easier to compare across sectors. We believe that this is more a recognition that different industry sectors are difficult to compare, than an expression of need for improvements, except for the points mentioned immediately hereafter.

Overall consistency and comparability

Having analysed 270 sets of IFRS Financial Statements, and talked with certain regulators and professional bodies, two points have come to our attention concerning the overall consistency, comparability and ease of reading of IFRS Financial Statements:

The lack of a common structure of the Notes to Financial Statements

Disparities observed in the structure of the Notes to Financials Statements make access to detailed information sometimes challenging. A standardised detailed table of contents is a short term must for easy use of the financial statements. In addition, several factors must be considered as constraints to genuine comparability of the primary financial statements of EU listed companies:

- Differences in financial vocabulary used.
- Lack of standardisation for financial aggregates.
- Lack of harmonisation linked to the national legacy in terms of reporting requirements.

When these comments are put in the context of the overall size and volume of information provided by certain companies, particularly banks (verbatim quote - "*one set of financial statements per postman*"), additional study is needed on how to make the financial statements more accessible for ease of comparability.

In particular, ways and means should be examined to enable all the data provided by companies in disclosures to be processed by computer analysis on an interactive basis, using a common language for data definitions and retrieval methods to load the data into appropriate analysis tools. Failing this, all the detailed information provided will continue to be difficult for professional analysts to use, and will therefore lose a lot of its interest and relevance. Some form of "shortform analysis" for non professional users would also improve ease of use.

The different forms of Profit and Loss Account presentation

The fact that companies can choose between a presentation of costs by function or cost by nature/cost type introduces an immediate difficulty in comparability of costs across companies, irrespective of country or industry sector. Full comparability can only be achieved by opting for one format of presentation, or requesting both formats to be presented, which does not enhance simplicity, or opting for one format of presentation with an option to provide also the other format if the company so wishes.

In addition, the point was raised in discussions with certain regulators and professional bodies that further work is required in standardising the main profit and loss account indicators to be presented and improving the profit and loss account presentation to enable both a comparable presentation and also more informative information based on each company's underlying business model.

Our detailed analysis of 28 banks within our sample of 270 companies has also showed widely differing forms of Profit and Loss Account presentation between banks which renders difficult or impossible real comparability across the banking sector.

Finally we have observed a number of cases in which comments elsewhere in the Financial Statements, for example in the Management Report have been made on other figures and aggregates than those reported in the Profit and Loss Account, sometimes without adequate reconciliation. Although we believe that additional indicators can be relevant to understanding fully the results of a company, as long as they meet the relevancy and permanency requirements, proper reconciliation to the figures reported in the Profit and Loss Account should always be made.

We therefore believe that further work is necessary on these two aspects to improve the overall consistency, comparability and ease of reading of the financial statements. We believe that the result of the preparers' survey of only 24% that consider IFRS to be more relevant through enhanced quality of disclosures supports this viewpoint.

1.5. Overall level of compliance, regulation and audit

A number of problems with compliance are highlighted above and additional ones are stated in the point 1.6 below. In addition to these points, non compliance in other areas of IFRS has also been observed during the study, for example:

- Borrowing Costs – IAS 23
- Environmental issues – IAS 37 and related IFRIC

Summing in total all these compliance issues identified, for a sample of only 270 companies, leads us to the conclusion that although many companies have made extreme efforts, and in most cases successful efforts, to be totally compliant with IFRS, there exists an underlying issue of non compliance that needs to be addressed.

In those countries in which regulators have reviewed Financial Statements for IFRS compliance, based on a sample of companies or particular issues addressed to them, they have drawn non compliant companies' attention to issues to be solved. The regulators however cannot cover the complete population of companies. For a significant number of countries, we have not been able to find documentation providing results from the regulators in those countries resulting from formal reviews of a sample of quoted companies Financial Statements for IFRS compliance in their respective countries.

Within our sample, auditors' reports have generally not mentioned non compliance with IFRS disclosures. Except for the 6 cases identified in our report, despite there being a substantial volume of non compliance points and in certain limited cases, significant points of non compliance, no reference to this has been made in audit reports.

We therefore believe that thought needs to be given on how a better level of compliance can be achieved, and on the roles of various parties, particularly the auditing firms, in encouraging companies towards full compliance with IFRS.

Points relating to specific areas

Segment reporting – IAS 14

While 100% of companies reported the revenue by segment, only 85% reported capital expenditure for the primary segment and only 79% capital expenditure for the secondary segment. Overall, only 71% of our sample met the fully IFRS segment disclosure requirements. However, over half the companies already commented in some form on IFRS 8, although only 2 in our sample were early adopters. Continuing vigilance is needed to ensure that when IFRS 8 will have been implemented, full disclosure is provided by all companies.

Estimated useful lives – IAS 16 and 38

The ranges of estimated useful lives for PPE disclosed by companies, and also to a certain extent those for intangible assets, pose certain problems in terms of comparability. For example, the most frequent ranges have been identified in our sample as follows:

- Buildings – between 1 and 50 years or more
- Fixtures - between 3 and 10 years
- Equipment and furniture – between 2 and more than 45 years
- Computer equipment – between 1 and 17 years

While many different situations will arise in companies, and the extension of the useful life of assets is a major performance improvement driver, the size of the current range spread would seem to create potential issues of comparability.

This point would seem to need at least reviewing to examine whether or not some form of more precise approach could be found:

- Either, through providing information on the weighted average number of years estimated useful life used by asset category,
- Or, through analysis by layer within the ranges
- Or, through other approaches to provide clearer guidance

Failing this, the relevancy of the disclosures will be impaired and the usefulness of having the disclosures at this level of detail could become debatable.

Financial Instruments – IAS 32 and IAS 39

IAS 32 and IAS 39 have been identified in regulators reports and in discussions with regulators and professional bodies as being complex and as an area of incomplete disclosures.

Our analysis of companies has also identified areas in which disclosures were incomplete or unclear, for example:

- Only 75% of small groups sampled disclosed accounting policies for the classification and treatment of non-consolidated financial investments carried on their balance sheets

- Only 47% of medium sized groups and 68% of small groups in our sample for non consolidated financial investments disclosed specific accounting policies on impairment of such assets and a fair number barely indicate that they recognise a reduction in value for problem assets.
  - 26% of groups providing incomplete information on effective interest rates on their financial debt
  - Inadequate disclosures on cash flow hedges in a number of cases
  - 37% of our sample did not satisfactorily meet the clarity of risk disclosures required

IFRS 7 defines more precisely the nature and content of financial risk disclosures and it is hoped that application of the standard will improve the quality of disclosures.

However, the issue of complexity remains, and should be addressed at the same time as the current re-examination of using “Mark-to-Market” and “Fair Value” for financial instruments in Banks and Financial Institutions.

Share Based Payment – IFRS 2

Both our review of the sample of 270 companies and also comments made by regulators and professional bodies indicate three main issues relating to IFRS 2:

- the amount of disclosure required by individual plan, in view of the number of plans implemented by certain groups, gives too large an amount of information and some form of simpler presentation, for example tabular format, would be more appropriate,
- it is often difficult to locate in the financial statements the amounts relating to share based payments, particularly in the Profit and Loss Account in which it is sometimes included in personnel costs without being identified separately,
- Groups often apply the “Black-Scholes” model, or sometimes other models, but often don’t explain the reasons behind the choice of the model and the implications of using it.

Accordingly, some revision of the standard would seem to be necessary if the financial statements are to provide clear, concise and easily understandable information.

Post employment benefits – IAS 19

As stated above, we noted a wide variety of disclosures, assumptions, and difference in pension plan handling between countries. While this reflects to a great extent the intrinsic differences between countries, obtaining a view between companies on a comparable basis is very difficult. In addition, many companies provide little or no information on sensitivity analysis of changes in assumptions.

We believe that the European Commission should discuss with the Actuarial Profession ways of improving the harmonisation across Europe of underlying data and economic assumptions used. Certain adaptations to the disclosure requirements in the standard may need to be considered after this consultation process.

Service Concession Arrangements – IFRIC 12

This interpretation has not yet been endorsed by the European Union.

Some major cases have been identified under which concession assets are considered to be out-of-scope of the new proposed accounting rules. Consequently, IFRIC 12 may not lead to the level or harmonisation required across Europe.

Some further work on IFRIC 12 may be needed before it can achieve totally the objective initially intended.

Insurance Contracts – IFRS 4

IFRS 4 does not provide any guidance in the treatment of several issues related to insurance contracts, in particular:

- Insurance contract acquisition costs. As a result different groups use different accounting and disclosure methods for these costs.
- Diversity also exists in the presentation of reinsurance costs in the Profit and Loss Account.
- The measurement of insurance liabilities is not yet addressed by IFRS.

On the other hand, the standard requires that groups perform impairment tests on reinsurance assets, but 8 out of 10 groups in our specific sample did not disclose the details of their policy for this.

It is to be hoped that real harmonisation in this area across Europe, and full disclosure, will be achieved with the future standard on insurance contracts.

1.6. Small and medium-sized companies

Our analysis has shown that a higher level of difficulty and non compliance has occurred with small and medium-sized companies, for example:

- Use of standard texts for accounting policy notes and describing accounting policies for items not subsequently disclosed in the Financial Statements
- Financial Instruments disclosures

Clearly the smaller and medium-sized companies will not in general be able to have the same sized financial reporting teams as the larger groups, and therefore meeting IFRS requirements may be a bigger challenge for them. At the same time, these companies will progressively go through a learning curve and become more familiar with IFRS, and much of their reporting will be of a similar nature from year to year unless they have significant changes in their operations, business model or financial components. In these latter cases they will probably need to refer to financial advisors and/or their auditors as appropriate.

This point was raised in discussions with certain regulators. The opinion was expressed that complying with IFRS was part of the responsibilities and “overhead” of being a listed company and therefore necessary even if the smaller and medium sized companies have more difficulties.

The position for non quoted companies however could be different, and several comments were received that the current examination of a “lighter” form of IFRS for smaller non quoted companies is needed, especially if the application of IFRS was to be generalised more widely to all companies.

2. Regulators and Professional Bodies Point-of-View

Summary of Conclusions

A number of Market Regulators and Professional Accounting bodies across Europe have performed studies on the extent and quality of application of IFRS in the 2006 Financial Statements.

We have conducted a number of interviews and also performed desk studies of published reports available. As a result we have formed the following conclusions on the assessments that they have made:

- The overall quality of financial reporting under IFRS appears to be better in 2006 than the previous year
- There was still a tendency towards “boilerplating” and use of standard texts for Accounting Policy Notes to Financial Statements but that this had improved since 2005
- Certain of the standards are judged to be complex or leading to or subject to incomplete disclosures regarding particularly assumptions and evaluation methodologies used by the entities to determine the asset’s fair value or parity:
    - IFRS 2 – Share-based Payment
    - IAS 32 – Financial Instruments: Disclosure and Presentation
    - IAS 39 – Financial Instruments: Recognition and Measurement
- A number of issues were also identified in the application of, and disclosures relating to IFRS 3 – Business Combinations and IAS 27 – Consolidated and Separate Financial Statements and SIC-12 – Consolidations – Special Purpose Entities
- Comparability and consistency of application may be impaired because of the variety of options and the lack of prescription in terms of format. Concerns were also expressed that issuers may need additional guidance on practicing Fair Value calculation
- Difficulties with IFRS were more prevalent in Small and Medium sized groups, notably:
    - Relating to the number of accounting issues identified, as mentioned above,
    - In the quality and relevance of their Accounting Policies Notes to Financial Statements and disclosures in their Notes.

2.1. Reporting on enforcement activities

We collected input from seven national enforcers through:

- desk review of the published conclusions and summary of their reviews of 2006 Financial Statements and/or guidance for 2007 Financial Statements for Finland, France, Germany, Netherlands, Poland, Portugal, and United Kingdom,
- meetings with enforcers for Poland, Portugal and United Kingdom

The reports from a number of other Authorities were reviewed but were not found to have any significant comments on the application of IFRS to the 2006 Financial Statements

National enforcers are required by European enforcement standards to report to the public[1] on their activities, which should provide a valuable insight about the application of IFRS in each Member State. We encountered however a variety of situations while trying to retrieve that information through the websites of the enforcers. The implementation of the enforcement process was still under way in 2006, and some enforcers we contacted directly advised us that their communication would be initiated in 2009 (dealing with 2007 financial statements).

The status of enforcement process within the European Union in 2005/2006 was described as follows by CESR[2]:

Table 1: Status of enforcement process within the European Union

2006 Enforcement activity fully compliant with CESR standard # 1	2006 Enforcement activity partially compliant with CESR standard # 1	No enforcement activity in 2006
Belgium	Czech Republic	Austria
Cyprus	Estonia	Hungary
Denmark	Latvia	Lithuania
Finland	Poland	Luxemburg
France	Netherlands	Sweden
Greece	Slovenia	Slovakia
Italy	Malta	Ireland
Portugal	Germany	
Spain		
United Kingdom		
10	8	7

After all Member States have implemented the enforcement process, we consider that standard communication on their activities should be further emphasized, in order to enhance comparability of financial reporting practices between Member States.

Professional bodies and academics

Fewer studies were conducted by professional bodies and academics regarding the application of IFRS in 2006 than were available regarding the transition to IFRS in 2005. Most of the studies were conducted at national level, and focussed on the differences between pre-IFRS GAAP and IFRS. The most comprehensive publication[3] available on the continuing application on an international basis was based on a scope of 73 companies in 9 countries (40 in France, 15 in United Kingdom, and 18 from seven other Member States).

[1] Principle 21, Standard #1 in Financial Information, Committee of European Securities Regulators

[2] Review of the enforcement of IFRS in the EU, Committee of European Securities Regulators, Ref 07-352

[3] IFRS – Les pratiques des grands groupes européens – Ernst &Young – June 2007

Coexistence of IFRS and other GAAP

A number of Market Regulators and Professional Accounting bodies across Europe have performed studies on the extent and quality of application of IFRS in the 2006 Financial Statements.

A few enforcers commented on the coexistence of IFRS and other GAAP, praising the growing penetration of IFRS.

DPR-FREP [Germany] noted that "*approximately 90% of the examined financial statements were prepared in accordance with IFRS. This figure also illustrates the penetration of IFRS, which have now been adopted by more than 100 countries*". KMF [Poland] indicated that in 2005, nearly 40% of Polish listed companies were individual companies. Nowadays, almost all companies listed in Poland have consolidated accounts. CNVM [Portugal] noted that "*all companies mentioned with a qualified opinion in the individual accounts, prepared the accounts in accordance with the Portuguese Accounting Standards (POC)*"

Overall Progress made towards clarification and compliance

In the course of 2007, the Committee of European Securities Regulators conducted a review among its members on the application and the enforcement of IFRS within their jurisdiction.

The report[4], although mainly based on the first year of application of IFRS and the enforcement activity in 2006 on 2005 Financial Statements provides valuable insight on the issues at stake, from the enforcers point of view: *"In general, EU enforcers (…) believe that the move to IFRS has improved the quality of financial reporting in their jurisdiction, mainly due to the increased transparency of disclosures and greater comparability between issuers"*.

The report also identified improvements mentioned by enforcers that would be to:

- Require more extensive and / or better quality disclosure in some areas (e.g. pensions, or share-based payments);
- Remove or reduce the number of accounting options available in certain areas (e.g. options to use fair value or not)
- Provide suggested formats for the profit and loss and the balance sheet;
- Introduce more market realistic reporting on financial instruments (e.g. with regards to their valuation)

Most of the enforcers reviews outline improvements of quality and clearness and overall progress towards full compliance in 2006 financial statements comparing to 2005. The AFM [Netherlands] commented "*Compared with its pre-supervision of 2004 and 2005 financial reports (…) the application of financial reporting standards improved in 2006. The AFM also found that companies in the local listings segment were clearly still in the process of making improvements in their transition to IFRS*"[5], and the CNVM [Portugal] noted that *"In the accounts for the 2006 financial year, presented in 2007, a decrease in the number of companies with a qualified opinion in the Reports and Consolidated Accounts was confirmed"*

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[4] CESR's review of the implementation and enforcement of IFRS in the EU, 07-352, November 2007

[5] Supervision of the 2006 Financial Reports of Listed Companies

Auditors explained that for the 2005 financial statements their overall priority was to ensure that correct disclosures were provided though the use of checklists and the audit of disclosures. Some disclosures (e.g. segment reporting) were omitted at the request of auditors, because figures provided by management were not substantiated enough to be considered as reliable.

Certain enforcers confirmed that from an enforcement point of view "the concerns in 2005 were mainly the correct application of measurement and recognition criteria; not the disclosures".

2.2. Issues regarding incomplete disclosures and accounting issues

The report of most enforcers lists the areas where improvements can be expected. Issues seem to be concentrated on qualitative disclosures and fair value accounting, as stated for example by DRP-FREP [Germany] "*The high frequency of errors in qualitative disclosures suggests that companies occasionally ascribe less significance to this part of financial reporting than to the pure financial statements"* and by CNVM [Portugal] "*The principal shortcomings detected were fundamentally based on the disclosures in the appendix of the financial statements with special emphasis on the disclosures of assumptions and evaluation methodologies used by the entities in determining the assets' fair value or parity*".

IAS 1 – Presentation of Financial Statements

A number of issues have been identified by enforcers, relating to the general disclosures required by IAS 1 – Presentation of Financial Statements.

Disclosure of accounting policies, "boilerplating", and resilience of pre-IFRS GAAP

Various enforcers had identified in 2005 the disclosure of accounting policies as an area of concern. Reference was also made to standard wording or "boilerplating" and little evidence of adaptation of accounting policies to suit companies' circumstances.

In discussions, the views were expressed that as companies are becoming more familiar with IFRS, they are progressively refining their accounting policy disclosures, bringing them more in line with the specific nature of their businesses and operations. However, in certain cases, it is felt that companies leave descriptions of accounting policies in the financial statements for transactions or operations for which no disclosures are made, probably on the basis that they may occur in the future or may become material at the time of preparation the Financial Statements.

However, further room for improvement exists, as also indicated by FRRP [United Kingdom] "*The panel also noticed an amount of redundant information in summaries of accounting policies and encouraged the deletion of references to accounting policies which companies had never applied or which had ceased to apply in past periods*" and "*…remains concerned however that too often these disclosures tend towards boiler-plate and do not refer to the specific issues faced by individual companies"*.

FIN-FSA [Finland] noted that "*In the financial statements of 2006, both the summaries of significant accounting policies and other explanatory notes were more extensive than in 2005. However, more focus should be paid on company specific accounting policies. In many financial statements it remained unclear whether and how the disclosed accounting policy was relevant to the company's business."*

Concern was also expressed that a number of companies still referred back to previous local standards, and that *"more attention also needs to be paid to the disclosure of judgements made in applying accounting policies, the use of estimates and the impact of new and revised IFRS."*

Based on our studies and interviews conducted this appears to have improved in the 2006 Financial Statements, FRRP [United Kingdom] commenting that "*The Panel did not find it necessary to ask many questions this year about accounting policies and, in particular, noted that the inappropriate retention of UKGAAP descriptive material had diminished*". And FIN-FSA [Finland] "*In financial statements of 2006, the companies had mainly relinquished the use of old Finnish GAAP terminology. Nor did the companies present the notes to the consolidated financial statements and to the parent company's financial statement side by side.*"

On the other hand, the AMF [France] mentioned that "*In the financial statements for 2006, it is not unusual to find non-voting securities classified in the balance sheet under the categories used in French GAAP*"

Judgement & Estimates

CESR highlighted the concern of enforcers regarding "*the extent to which the general requirement to disclose the nature of estimates and assumptions applies to areas covered by other standards. Enforcers found issuers varied greatly in the extent to which they made disclosures in response to the requirements of IAS 1 § 113 and 116 (Management judgements and estimates)*"

FIN-FSA [Finland] advised preparers "*It is also important that companies consider carefully the situations where management uses judgement and give information on this, as it helps investors to understand what kind of effect management's judgement has had on the items recognised in the financial statements*", whereas FRRP [United Kingdom] put the point in perspective with the on-going financial crisis : "*Directors will need to pay particular attention to disclosure of key assumptions and key sources of estimation uncertainties during the forthcoming season given recent developments and continuing difficulties within the financial markets*"

Presentation of the Income Statement

Opinions were also expressed on the need to work on the Income Statement presentation to improve the overall quality of the Financial Statements, to enable both a more consistent presentation of a number of key common indicators and meaningful additional information according to each company's business and operations.

CESR summarized the point of view of enforcers noting that "*IAS 1 does not specify a particular format for financial statements; (…) Enforcers found that this had led to confusion for some issuers particularly where previous local GAAP had been very specific in this area.(…) Many issuers included additional performance indicators (EBIT, EBITDA) in their financial statements. (…) Enforcers found that such indicators were often not defined in the accounts and that the definition of the same indicator varied from one issuer to the next.*

IAS 7 – Cash Flow Statements

Cash flow was identified by enforcers as an area of concern, including items such as the correct definition of profit when using the indirect method, the definition and handling of non cash items, and the disclosure of accounting policies.

AMF [France] encouraged preparers using the indirect method (adjustment of profit or loss for the effects of transactions of a non-cash nature) to provide a precise definition of the profit (or loss) line used as a starting point.

A thematic review carried on by the AFM [Netherlands] indicated that "*it was not yet possible to compare cash flow statements in all cases. IFRS has not resulted in greater comparability as a consequence of the alternative approaches provided by IAS 7 for the presentation of certain cash-flows. Not only the starting point may differ, but also the way cash flows regarding interest, dividend and to a lesser extent, income taxes are presented.*"

"*It is notable that only 60% of the companies reviewed by the AFM included accounting policies for their cash flow statements and just 38% included explanatory notes to their cash flow statements".* It also concluded that *"…users seeking good and useful cash flow information have to rely partly on companies providing more information in notes to the cash flow statement than strictly required under IAS 7*".

IAS 12 – Income Taxes

The disclosures on taxation have led to a number of concerns highlighted by several enforcers.

FIN-FSA [Finland], which carried out a specific survey on the accounting treatment of deferred tax liabilities in investment property acquisitions concluded that "… *companies had applied IAS 12 Income Taxes inconsistently* (…which…) *makes it difficult to compare the financial information of these companies*". DPR-FREP [Germany] identified Deferred Taxes as being one of the most frequent sources of issues. CNVM [Portugal] also cited "*discount of deferred tax assets for lack of requirements"* as one of the cases that led to the publication of supplementary information.

The most comprehensive discussion was provided by AFM [Netherlands], having performed a thematic review on the subject. It provides the following guidance on expected improvements of the disclosures of accounting policies on one hand, and specific disclosures on the other hand.

"… disclosure of accounting policies for income taxes was not extensive enough" and believes that "*disclosure of accounting policies for income taxes included in the financial statements can be improved by tailoring these policies to the circumstances of companies".*

"*… the (…) income taxes disclosures required under IAS 12 can be improved because they were incomplete or omitted:*

- disclosure of the nature and the evidence supporting the recognition of a deferred tax asset if the entity has suffered a loss (…) in the tax jurisdiction to which tax assets relates;
- disclosure of the separate components of income tax expense (income) and not limiting this disclosure to a breakdown into total current tax expense and income and total deferred tax expense and income;
- disclosure of the nature of the evidence supporting the recognition of a deferred tax asset if the entity has suffered a loss;
- when using the "Other" category in the reconciliation of tax expense (income) and accounting profit before income taxes (…) companies should refrain from netting relatively significant dissimilar items of tax expense and income;
- disclosure of an explanation of changes in the applicable tax rate(s) compared to the previous accounting period;
- disclosure of a breakdown of the tax expense relating to discontinued operations"

IAS 14 Segment Reporting

A few comments were made by enforcers on segment reporting, pointing out the undue reporting of a single segment. CESR had already mentioned on the basis of 2005 Financial Reports that "*Enforcers found that many issuers maintained that both their operational and geographical activities consisted of only one segment even where this was clearly not the case. Some issuers offered up small size as the justification for reporting in this fashion although the standard does not provide an exemption from providing segmental disclosure based on the size of the issuer, because in some cases, previous GAAP had offered such an exemption.*

FIN-FSA [Finland] conducted a thematic review on the subject in 2006 Financial Reports, concluding that "*nearly an third of all* (Finnish) *listed companies reported only one primary segment*." and taking the view that "*several Finnish companies still need to enhance their segment reporting to achieve higher transparency*."

IAS 17 Leases

This standard brought only minor remarks on disclosures by enforcers.

CNVM [Portugal] mentioned that "*the need to defer capital gains in sale transactions followed by lease*" as having determined the publication of supplemental information, and FRRP [United Kingdom] reminded preparers that "*the total of future lease payments (…) should be disclosed and not simply the annual commitment as required by UK GAAP*".

IAS 19 Employee benefits

AMF [France] found that "*groups opting to recognise actuarial gains and losses outside the income statement did not always comply with the standard. Some issuers presented two complete statements of changes, even though the standard asks for only one statement to be chosen, while other published a single statement by aggregating income and expenses with transactions involving equity holders*".

IAS 24 Related party disclosures

The difficulties in properly identifying "related parties" have been highlighted by enforcers.

AMF [France] commented "*The review of 2006 financial statements showed that key management personnel was given a wide variety of interpretations and generally too narrowly in comparison with the standard.*"

FRRP [United Kingdom] advised that *"(…) the nature of the relationship should be disclosed as well as the information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements.*"

AMF [France] proved also concerned by the detail and the clearness of disclosures: "*The breakdown of key management personnel compensation between short-term benefits, post-employment benefits, other long-term benefits, termination benefits and share-based payments was rarely provided nor was always disclosures in the financial statements consistent with the description in the management report, particularly in the case of termination indemnities.*"

IAS 36 Impairment of Assets

As noted by AMF [France], "*Because intangible assets account for a sizeable percentage of equity, impairment is a critical issue*". However, CESR had commented on the basis of 2005 Financial Statements that "*Enforcers found compliance with the standard, for instance disclosure requirements regarding how impairment testing had been carried out or how any eventual impairment charge has been calculated, was insufficient in some cases."*

FIN-FSA [Finland] conducted a thematic review on the subject, concluding that progress has been achieved "*In the 2006 financial statements the disclosure on business combinations was somewhat more extensive compared to the previous year. Especially information given on impairment testing has improved."* and noting "*a significant improvement compared to the previous year related to disclosure information on sensitivity analysis. Many companies presented information on the sensitivity of impairment test's outcome to change in assumptions more transparently than in the previous year".*

AMF [France] highlighted the difficulty to apply the standards requirements "*In practice, it may be difficult to obtain detailed information and identify listed/unlisted companies or transactions that can usefully compared with the assets or group of assets to be valued. For a meaningful comparison, the share price must be relevant, the transaction selected sufficiently recent to ensure that the economic climate has not significantly changed, and the peer sample should include entities operating in the same industry, with a similar scale and profitability as the issuer. As a result, a discounted cash flow method may be more appropriate to estimate fair value. However, issuers should ensure that this type of method is applied correctly.*"

IAS 39 Financial Instruments: Recognition and Measurement

CESR conveyed the challenge posed by the application if IFRS to financial instruments "*IAS 39 deals with the accounting treatment of a wide range of financial instruments, which can be complex in nature, and consequently introduces a number of concepts that were not previously applied in a number of European jurisdictions prior to the adoption of IFRS*" and identified two common areas of issues:

- the identification of situations where an impairment loss on a financial asset should be recognised
- the methods of calculating impairment on groups of financial assets

Apart from accounting considerations, it is the underlying subject of Financial Instruments which is in itself complex. AMF [France] commented *"This is a complex and sensitive area for issuers, in terms both of performance analysis and of reporting. Compound financial instruments often contain clauses that make it difficult to distinguish between these components and to measure the instruments upon initial recognition and at subsequent dates".*

On the one hand, during reviews of 2006 Financial Statements, enforcers identified a number of issues relating to incomplete or unclear disclosures concerning items such as:

- the split between individual and collective impairment testing and details of evidence used to determine the extent of any impairment
- identification of which held-for-trading instruments have had the fair value option provided
- identification of which instruments have embedded derivatives
- disclosure of the nature of risks being hedged
- difficulties of linkage between balance sheet items and the financial instruments described in the notes
- analytical criteria and bases of measurement applied to compound financial instruments

On the other hand, a number of opinions were given that the sheer weight of disclosures made, particularly for banks and financial institutions, made the size of financial statements (verbatim quote - *"… one set of financial statements per postman*") unwieldy and difficult for people other than specialists to comprehend.

Accordingly, opinions were expressed that some way needs to be found to simplify these standards.

Concerns were also raised on the consistency of standards and other regulatory requirements, for example by FIN-FSA [Finland], stating that "(…) *Accounting principles applied by the banks in their financial statements were partly based on capital adequacy requirements. Capital adequacy calculations are moving towards new Basel II framework, where the valuation requirements of loans are based on the concept of expected loss. On the other hand, IAS 39 principles are based on the concept of incurred loss with objective evidence. Due to differences between regulations, the recognised impairment losses were not always in accordance with IAS 39 requirements."*

IFRS 2 Share based payments

A number of comments were made both on the difficulty for non specialists to understand the principles applied and also in being able to clearly identify the financial elements of the application of the Standard. Certain people expressed the opinion that the standard needs to be changed.

CESR reported that "*Enforcers found that several important disclosures required by IFRS 2 were often omitted by issuers (e.g. the assumptions used in the valuation model for stock option plans such as risk-free interest rates, expected dividends rates, expected rates of exercise of options etc.)*".

FIN-FSA [Finland] insisted of improvements made by issuers "*In general reported disclosures in the 2006 financial statements on share-based payments, were more comprehensive than in the previous year. The improvement was most clearly observable in granted share option arrangements as disclosures on these included more information on fair values, valuation factors and required reconciliations. Also accounting policies for option and share-based payment arrangements had been presented on a more detailed level*", whereas AMF [France] still noted both variety and complexity in disclosures:

- "A detailed analysis of the disclosures made for the different assumptions reveals a wide variety of practices".
- "… Reference was also made to other pricing techniques such as Monte Carlo simulations. Since financial statement users are not necessarily familiar with these models … we recommend that issuers provide a general explanation of the relevance of the models, having regard to the terms and conditions of their share plans".

A number of major groups have multiple share option plans. Opinions were expressed that a tabular form of presentation rather than extended narrative would make assimilation of required information easier. It was also felt that the standard should encourage a greater degree of standard reporting, finding the income statement impact was sometimes difficult, as illustrated by AMF [France]: "*The vast majority of companies in our sample reported expenses arising on share-based payment transactions within personnel costs. However, in certain cases, the impact of share-based payment transactions on the income statement was not disclosed, and could not be determined from the personnel costs breakdown*".

IFRS 3 Business Combinations, IAS 27 Consolidated and Separate Financial *Statements*, IAS 28 *Investments in Associates* and *Special Purpose Entities* (SIC-12)

The areas of Business Combinations, Consolidations and handling of special purpose entities continue to cause regulators to focus their attention on ensuring compliance and identifying potential accounting treatment and disclosure issues.

CESR listed the main issues reported by enforcers on the basis of the 2005 Financial Statements:

- the identification of an acquirer
- insufficient information on factors affecting the recognition of goodwill
- allocation of acquisition costs

Other topics identified on 2006 Financial Statements included notably:

- the application of the concept of control and providing adequate explanation and rationale as to why an entity was treated in a particular way
- lack of explanations of changes in status of investments
- information about the purchase or disposal of material subsidiaries and other business units
- providing explicit information on business combinations accounted for using provisional values

FRRP [United Kingdom] expressed concerns on how companies apply the concept of control when determining whether entities should be consolidated, and reported having challenged "*a number of companies to provide the rationale to support their treatment, particularly where it seemed likely that considerable judgment had been exercised in the decision*."

AMF [France] expressed its expectations to see "*more issuers providing summarised information for the assets, liabilities, revenue and profit and loss of these investments*" regarding investments in associates.

FIN-FSA [Finland] noticed the shortcomings of the disclosures on business combinations: *"Only approximately 50% of the companies included in the survey presented* (combined) *pro forma revenue and profit and loss for accounting period".*

FIN-FSA [Finland] found that in some cases issuers have had difficulties in identifying the acquirer. (…) Also regulation related to the concept of de facto control, (…) has been inadequate to the extent that it could have led to some inconsistency in accounting treatment.

AMF [France] "*issuers sometimes failed to describe the type of contingent liabilities recognised, even though the material nature of the liabilities may require more extensive disclosures for users*."

DPR-FREP [Germany] identified the most accounting issues in the accounting of Mergers and Acquisitions activities, including purchase price allocation, calculation of goodwill, and treatment of discontinued operations.

2.3. Issues regarding consistency and comparability

Notwithstanding the improving compliance of 2006 Financial Statements, studies pointed out remaining issues regarding consistency and comparability.

The variety of options available under IFRS

IFRS offer many options, enabling the management to apply financial reporting requirements to the particular circumstances of their company.

The risk of impairing comparability and the need for extended comments on options has been highlighted[6] by the enforcers: *"[CESR] alerts users to a concern that because of available options and given the lack of IFRS guidance in certain specific areas, the comparability between different issuers is not necessary assured. It is therefore important for investors to carefully consider all accounting policies disclosed by the reporting issuers in order to understand the reported results and financial conditions."*

Without listing all the cases that arise, CESR[7] also pointed out the potential improvement of removing or reducing the number of accounting options available in certain areas.

AMF [France] noted in the 2006 Financial Reports that "*certain issuers no longer provided information about the options taken at the time of transition to IFRS, even through the disclosure would certainly help users understand the financial statements*."

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[6] CESR reminds issuers and investors about the importance of clear and transparent disclosure on the use of any option made available by applicable reporting standard, public statement, Committee of European Securities Regulators, Ref 05-758

[7] Review of the implementation of IFRS in the EU, Committee of European Securities Regulators, Ref 07-352

The lack of prescribed format for the financial statements

The AFM [Netherlands] commented that "*conversion to IFRS not yet resulted in improved comparability of cash flow statements in 2006, due to the alternative approaches offered by IAS 7 for presenting certain cash flows. In addition, (…) several companies, contrary to IAS 7, reported so-called non-cash items as cash flows, to the detriment of comparability*."

KNF [Poland] indicated that the transition had been disturbing for issuers, as pre-IFRS Polish GAAP used to provide a much more directive framework for the presentation of financial accounts. Users requesting guidance from KNF on this subject have been rejected, in accordance with European enforcement rules prohibiting enforcers to issue unauthorised interpretation of the standards. KNF mentioned that no complaint was made afterwards about diversity in format.

The consistency of parameters used in the calculations

CNVM [Portugal] mentioned that having observed a wide spread in interest rates used for the preparation of accounts, it suggested auditors to provide substantiated information on interest rate determination. The spread has significantly decreased since, and this enforcer is now satisfied with the level of consistency and comparability among preparers.

FIN-FSA [Finland] found that "*when applying IAS 36, techniques in the determination of discount rate components varied. One reason for this could be that reconciliation of standard's requirements and principles of financial theory is challenging in practice*".

The lack of guidance on complex issues (Fair Value…)

Some auditors as well as enforcers have the opinion that preparers would welcome additional guidance on such complex issues as the application of Impairment Tests or Fair-Value accounting. While the standard provides overall principles, there is still a need of disseminating practical rules to ensure proper application. As one auditor expressed its concern "*A lack of appropriate guidance in such sensitive areas could lead to huge differences in the results*."

As a matter of fact, DRP/FREP [Germany] listed Goodwill and Impairment test as the most frequent subject on which guidance had had to be provided on to examined companies in 2006. It is to be remembered that enforcement standards prevent[8] national enforcers to issue any general application guidance on IFRS, and limits their scope of intervention to the enforcing of standards and interpretations.

2.4. Appetite for Wider Application of IFRS

The opportunity to apply IFRS in other cases than consolidated financial statements of listed companies has been discussed with enforcers and auditors of Poland and Portugal. National regulations in these Member States allow subsidiaries and holding company of groups reporting in accordance with IFRS to report their individual accounts in IFRS.

[8] Principle 20, Standard #1 in Financial Information, Committee of European Securities Regulators

CNVM [Portugal] indicated that 56% of listed companies under its jurisdiction prepared their individual accounts in 2007 in accordance either with IFRS or with the NCA[9] framework. In addition, Portugal has engaged the reform of its local accounting framework to allow a larger proportion of companies to adopt some principles of IFRS, however with a restricted use of options. The new accounting framework is therefore not considered as IFRS, although implementation and change issues are very similar in nature.

IFRS for consolidated accounts of non-listed companies

A natural path to wider application of IFRS is to allow non-listed companies to report their consolidated accounts in IFRS. The benefits of comparability with listed companies are potentially useful, notably for groups with international operations, or for entities preparing their listing on a securities market.

While it was stressed that compliance with IFRS was sometimes more onerous and difficult for small and medium-sized entities, opinions were expressed that this was an unavoidable part of the workload necessary in order to be eligible for a listing on a quoted market.

For any wider application in non listed companies, it was felt however that the moves underway towards providing a lighter version of IFRS were essential.

Auditors pointed out the challenge for First-Time Applicants to reach the same level of quality and expressed concerns that it may become a significant barrier to access to capital markets.

IFRS for individual accounts of subsidiaries

The wider application of IFRS for individual accounts would help particularly in the case of the individual accounts of subsidiaries of listed groups (although the same standards as for the group will need to apply). In these cases, the choice of IFRS would enable the group to rely on a single set of accounting principles for all financial statements and basic accounting. Individual accounts of subsidiaries of IFRS groups: The choice of IFRS enables the group to rely on a single set of accounting principles. This is however a key decision (to be made in Poland by the Shareholders meeting, not only the Board of Directors)

Tax issues

The convergence of tax and accounting frameworks is considered to be an important milestone on the roadmap for wider use of IFRS.

For a more general application of IFRS to individual accounts, there is a need to close the gap with tax requirements through progressive alignment of tax rules to IFRS accounting standards.

Currently, whenever a company is permitted to adopt IFRS for its individual accounts, it has to rely on another system to maintain tax records. Should in the future, tax recognition and measurement rules be IFRS compatible, this would open ways to simplification, notably for small and medium-sized companies.

[9] NCA accounting framework applies to all Portuguese banks. It is widely consistent with IFRS, with three exceptions: No option of Fair Value for investment property, different *prorata temporis* calculation of interest rates, additional impairment guidance as provided by the Central Bank of Portugal

In examining the way forward on this topic, an approach through convergence of national accounting frameworks, on the basis of IFRS standards, with a reduced span of options (e.g. restrictive use of Fair Value) should be considered as a potential solution. This would enable national accounting bodies and tax authorities to work together on consistent harmonisation within their country.

Small and medium sized entities

Enforcers clearly admit that resources of small and medium-sized companies are limited in comparison with large groups. The point was made however that smaller companies were likely to have less numerous and less complex transactions, thus easing the task of reporting. This opinion is not completely shared by CESR which commented[10] on IAS 39 *Financial Instruments: Recognition and Measurement* "*The consequence of this is that the treatment of even quite simple transactions might not be in compliance with the standard as a result of the use by issuers of approaches that are too simplistic*".

Nevertheless, regarding listed companies under their jurisdiction, a proportionately higher number of issues and difficulties concerning small and medium-sized entities was highlighted by some enforcers reports, in particular by DRP-FREP [Germany] *"An analysis of the error rate by company size reveals a high concentration of errors among small and medium-sized companies: 80% of all cases involving accounting errors relate to firms with annual revenues below EUR 250 millions"* and relates it to "*the key cause is the enormous scope and high complexity of IFRS's. From the perspective of the enforcement procedure, the further development of the Standards should much more strongly reflect the need for simplicity, understandability and comparability of IFRS. Small and medium-sized companies and their auditors in particular often reach the limits of their abilities here."*

The cost of relying on independent experts to assess or validate the Fair Value of assets and liabilities has been mentioned by enforcers as a concern.

Comments were also made by auditors that implementation of IFRS 7 proved to be very demanding and that small insurance companies for example seem not to have yet the capability to conduct all the sensitivity analysis required by the standard.

The situation of small and medium-sized companies in relation to IFRS: less resources and skills, less transactions, less complexities to handle - does not, according to the view point of enforcers that we have met, justify two levels of standards for listed companies. However, in the case of individual accounts of non-listed companies, the situation is different and there is a case for having a more simplified version of IFRS to apply.

2.5. Issues regarding cultural changes

Both enforcers and auditors highlighted the cultural challenge for the business and accounting communities of adopting IFRS.

CESR has issued the following warning "*IFRS principle based standards rely on the experience and judgement of those preparing them, including auditors and users alike, applying them to the particular circumstances. Stakeholders must be aware that this is a new body of accounting standards for many preparers. Applying IFRS to particular circumstances must be a smooth learning curve."*[11]

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[10] CESR's review of the implementation and enforcement of IFRS in the EU, 07-352, November 2007

[11] CESR Press statement 07-121b, April 2007

IFRS positions the accounting profession and the management under a new situation of having to exercise judgement to record and report the financial transactions of a company. Thus adapting to IFRS not only encompasses learning new techniques but also playing new roles. In many instances, the evidence of proof has changed between local GAAP and IFRS. This is also a significant challenge for the future, notably if IFRS use is to be significantly expanded beyond the consolidated financial statements of listed companies.

Translating IFRS into a common accounting language

Concerns have been expressed during interviews by certain national enforcers and audit professionals regarding the availability of adequate IFRS documentation in the national languages.

English is the reference language in which the standards are drafted and distributed. IASC publishes and distributes reference standards and interpretations in several[12] languages yearly. However, neither does this cover all official languages of the Member States of the European Union, nor is the IASC reference fully aligned with IFRS-EU as endorsed by the European Commission.

Several initiatives mostly though national professional bodies with the technical support of audit firms and regulators have produced translation of the standards in local languages. Their limits appear however after a few years, on the one hand because they cannot keep abreast of the continuing flow of new standards, amendments and interpretations and on the other hand because some linguistic issues have not been fully resolved and seem to prevent straightforward understanding in certain languages. In some instances, the syntax and the wording appear unnecessary complex, because the translations seem to have been driven more by literal conversion of English technical terms than through rewriting in the national language. Moreover, some linguistic issues may have arisen. One example of it is one case of translation of “Disclosure” which has, in the national language the meaning of “Divulgation”, leading to reluctance to adhere to such language.

The task of keeping documentation informative and up to date in national languages may be so problematic that even some key stakeholders admit that while being legally required to abide by national language wording, they often also refer to English documentation to solve complex issues.

While this may be a pragmatically accepted practice within large entities with international exposure and management, this situation seems potentially detrimental to further widespread dissemination of the IFRS culture among medium and small companies, where management, accounting professionals as well as auditors are less likely to refer easily to English documentation.

Incidentally, another linguistic problem was raised during the interviews, which while not strictly relating to IFRS, may however impact the consistency and comparability of financial information disclosed to users. In each Member State, the process of preparation, audit and compulsory filing of financial statements with enforcers deals with financial statements prepared in local language. Whenever the preparer’s international investment profile justifies the publication of financial statements in English, these are not subject to the same formal control. Auditors who perform a compliance review of the English translation do it mostly as a service to clients, although it is not always a legal requirement. National enforcers which are not required to review financial statements in a foreign language would neither comment on their compliance nor on their strict conformity to the national financial statements.

Although no evidence of misleading translation or missing content in foreign language financial statements was produced by interviewed auditors and enforcers, there seems to remain a loophole. This may be an item of interest to ensure further enhancements of the IFRS as the global common language for financial reporting.

[12] including English, French, German, Spanish, Italian, and Dutch

Coping with change

Over the past years, considerable efforts have been developed by auditors and professional bodies to educate the accounting profession and the business leaders to IFRS. A special mention is devoted to "Big 4" international networks, which have been, due to their global reach, at the forefront of the evolution.

Another important agent of change has been the academic world. A new generation of "IFRS-minded" accountants and managers is already stepping up the corporate ladder wherever IFRS courses have been initiated in universities as early as five or ten years ago.

However, based on the results of our interviews, the accounting profession[13] as a whole across Europe and the overall business community have not yet fully become familiar with the new paradigm, and further significant efforts are needed, especially if wider application of IFRS is to be envisaged.

The ongoing role and focus of national stakeholders

The application of IFRS is felt as resulting to some extent in a loss of empowerment by national stakeholders, because decision making has moved away from them to international bodies. The teams from the international Audit Firm's also have to rely more and more heavily upon "Expertise Centres" to resolve technical issues and relay solutions to their clients.

Enforcers have tended to have a lesser role in standard application guidance, mainly to avoid any unauthorised interpretation of standards.

However, we believe that thought needs to be given to a better way of harnessing, developing, and effectively using the talent and organisations in the individual Member States. Thought should be given particularly on how to:

- Maintain, encourage and foster additional regular feedback to standard setters at a European and international level on local issues encountered and suggestions for improvements.
- How to assist and reinforce the national bodies in a wider and strengthened role of application enforcement and some form of co-ordinated application guidance.

[13] estimated to represent 2% of the active workforce for example in Portugal

3. Preparers view

We wrote to the chief financial officers of the 250 listed companies and 20 non-listed companies in our sample, inviting them or another officer of the company to complete an on-line survey, developed by INEUM to obtain the views of preparers.

Approximately, 10% replied. This percentage rate is not unusual for on-line surveys and we believe that the majority of groups replying had specific remarks to make which explains certain results presented below.

The overall impact on financial reporting

Comparability is deemed achieved mostly across countries, and to a lesser extent within and across industry sectors; quality and easiness of understanding by analyst and investors is ranked next.

This appears to be a clear statement from the preparers that while improving comparability, IFRS application may have come short of ensuring thoughtful disclosures which are easy to assimilate (and prepare).

The main beneficiaries of the transition to IFRS appear to be the regulators and supervisors.

Table 2 : IFRS impact on Consolidated Financial Statement in comparison with previous application of non-IFRS GAAP

Thinking about Consolidated Financial Statements, and in comparison with previous application of non-IFRS GAAP, the application of IFRS has made them…	**2006 %**
…easier to compare across countries	62%
…easier to compare across competitors within same industry sector	48%
…easier to compare across industry sectors	33%
…more relevant through enhanced quality of disclosure	24%
…easier for analysts and investors to understand	24%
and IFRS has …	**2006 %**
…improved the efficiency of EU capital markets	24%
…made financial statements easier for regulators/supervisors to use	43%
…changed the way our business is run	5%

Enhancing the relation with analysts and fund managers: Experience matters

The impact on the investment profile appears not to be decisive for a majority of preparers. Cross border investment and increased coverage by foreign analyst is perceived more accurately than increased competition on the financial market due to comparison with similar companies in other countries. Despite the globalization of financial markets, developing an international investment profile is a long-run endeavour, and it may take time until impact on preparers is fully recognized. As a matter of fact, continuing IFRS applicants show a much more positive opinion than First-Time applicants.

Table 3 : The application of IFRS has had an impact on the international investment profile of the groups

The application of IFRS has had an impact on the international investment profile of the groups	Continuing IFRS applicants	2005 IFRS First-Time Applicants	Total
More coverage by foreign analysts	43%	17%	24%
More cross border investment by foreign investors	43%	25%	29%
More challenge coming from the comparison with similar companies in other countries	29%	17%	19%

The feedback from fund managers and analysts to preparers is also considered overall positive; with a clear advantage for continuing IFRS applicants over 2005 First-Time applicants.

Table 4 : Feedback from fund managers and analysts

What feedback from fund managers and analysts did you get on the extent your IFRS consolidated financial statements meet their needs?	Continuing IFRS applicants	2005 IFRS First-Time Applicants	Total
Positive feedback	71%	25%	42%
Neutral feedback	14%	33%	26%
Negative feedback	14%	8%	11%
No feedback		33%	31%

Reciprocally, preparers are overall confident that fund managers and analyst understand their financial communication in IFRS, with results in line with last year survey. Here again, experience matters; continuing applicants have more satisfactorily relationship with analysts and investors than 2005 First-Time applicants.

Table 5 : Thinking about the IFRS impact understanding

How confident are you that fund managers and analysts fully understand the impact of IFRS on your group's consolidated financial statements?	Continuing IFRS applicants	2005 IFRS First-Time Applicants	Total
Not at all confident	-	17%	11%
Not very confident	29%	25%	26%
Fairly confident	29%	50%	42%
Very confident	43%	8%	21%

Verbatim comments from First-Time applicants confirm some disappointment about visibility on financial markets:" *It had very little impact in this way"* [14], or more bluntly *"IFRS hasn't really made any difference or impact. Just more information for the financial market which lacks the knowledge to apply and understand it. For small private investors it's a complete waste. That is the brutal reality. Anyone saying something else is lying*[15]*"*.

However, standards not having met the expectations of investors and analysts are, according to preparers, relatively seldom, and spread over the range of themes.

Two themes only draw a significant amount of dissatisfaction:

- Financial instruments,
- Business combinations,

Table 6 : Analysts and fund managers satisfaction about the application of IFRS

To your knowledge, for which standards has the application of IFRS in your group NOT SATISFIED or not met the expectations of analysts and fund managers in terms of quality of disclosure and usefulness of information ?	**Continuing IFRS applicants**	**2005 IFRS First-Time Applicants**	**Total**
Revenue recognition	13%	-	5%
Business combinations	14%	17%	15%
Financial instruments	29%	25%	23%
Leases	-	-	-
Consolidation	14%	-	-
Employee pensions	-	8%	-
Employee share options	14%	-	8%
Impairments	-	-	-
Deferred tax	-	17%	10%
Intangible assets	-	8%	5%
Derivatives	-	17%	10%
Debt / equity	-	-	-
Foreign currency	14%	-	5%
Joint Ventures	14%	8%	10%
Associates	-	-	-
Off balance sheet items	-	-	-
Other (IAS 41 Agriculture/ *see verbatim comment below*)	-	8%	5%

[14] First Time applicant [France]

[15] First Time applicant [Sweden]

Preparer commented verbatim to precise its concerns about the latest standard "*We are a company applying IAS 41 Agriculture. This standard is not suited for our business (fair value accounting for an asset that is productive for some 25 years and changes have to be recorded through the income statement). The analysts and fund managers are all reversing the impact of this standard*"[16].

Other verbatim illustrate the feeling that some standards may not satisfy the users: *"Earnings show a greater volatility and less predictability. As a result, analyst's job has become more difficult. Stock price volatility around results announcements has also increased. While this is helping the brokerage community, it is neither helping the investor's community, nor the issuers"*[17], and "*The way IFRS are applied are neither consistent from one country to another, nor from one company to another. IAS 39 is just nonsense."*[18]

IFRS for internal management reporting: welcomed collateral benefits

A majority of preparers have adopted IFRS for their internal management reporting, and the proportion is growing from 2005 to 2006. The trend reflects management priorities, and the time needed to redesign reporting processes, and the desire to work with only one set of standards. All continuing applicants claim to use IFRS for internal reporting. It is likely that 2005 First-Time applicants have led the transition for external reporting before engaging the adaptation of their internal reporting; the proportion of IFRS internal reporting should continue to increase in the future.

Of interesting note, a majority of companies now consider IFRS based internal reporting to be beneficial for management purposes. First-Time applicants show even more satisfaction here than continuing applicants, which contrasts with their respective attitude towards IFRS based external communication and relationship with investors and analysts. The development of an internal "accounting common language" may have emerges as the most rewarding short-term benefit of the transition to IFRS.

Table 7 : Use of IFRS accounting for the internal reporting

Do you use IFRS accounting for your internal reporting?	**Continuing IFRS applicants**	**2005 IFRS First-Time Applicants**	**Total**
Yes	100%	73%	82%
No		27%	18%
If yes, has it been beneficial for management purposes?			
Yes	50%	63%	57%
No	33%	38%	36%
Don't know	17%		7%

[16] First Time applicant [Belgium]

[17] First Time applicant [France]

[18] Continuing applicant [France]

Preparers using IFRS for their internal reporting clearly praise the benefits of consistency:

"Consistency of internal and external reporting" [19]*; "Consistency between public and internal reports"*[20] *"Important for us to communicate internally in the same financial language as we use externally"*[21] *"IFRS accounting is internally used to appraise the performance of units managers; there is no difference between internal reporting and IFRS consolidated financial statements "*[22] *""We use recognition and measurement under IFRS requirements for internal reporting to avoid two sets of accounts"* [23]

The benefits of a single language is however somewhat balanced by the perceived irrelevance of standards for business management: "*Figures are not polluted by various countries' different accounting rules/standards"*[24] but *"Some IFRS rules are against business sense"*[25]

Preparers provide the following reasons for not using IFRS for their internal reporting:

"No discernable change" [26]*, "We break the P&L down in a different way than in our reporting simply because it fits us better"* [27] *We use both IFRS accounting and FAS (Finnish Accounting Standards) on our internal reporting. The internal reporting is made mainly based on IFRS numbers"* [28]*.and "We use IFRS for internal reporting with the exception of standard IAS 41 which we believe is not relevant for our business. We still record our biological assets at amortised cost whereas according to IAS 41 we can not depreciate any more and acquisitions are recorded directly in the income statement"* [29]

The future development of financial reporting standards: IFRS and beyond

The majority of preparers welcome some form of extension of application of IFRS beyond the consolidated financial statements of listed companies. Whereas 2005 First-Time applicants seem reluctant to consider IFRS application for the individual accounts of all companies, continuing applicants are much more positive about it.

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[19] First-Time applicant [France]

[20] Continuing applicant [France]

[21] First-Time applicant [Denmark]

[22] First-Time applicant [France]

[23] Continuing applicant [France]

[24] First-Time applicant [Denmark]

[25] Continuing applicant [France]

[26] First-Time applicant [Ireland]

[27] First-Time applicant [Sweden]

[28] First-Time applicant [Finland]

[29] First-Time applicant [Belgium]

Table 8 : Relevant cases for extending use of IFRS

Some European countries have implemented IFRS beyond the scope of consolidated financial statements of listed companies. ***Which cases do you consider relevant for providing IFRS information?***	**Continuing IFRS applicants**	**2005 IFRS First-Time Applicants**	**Total**
consolidated financial statements of all groups, listed or not	29%	42%	33%
individual accounts of subsidiaries of IFRS groups	29%	25%	24%
individual accounts of all companies	43%	8%	19%
none of the above	43%	33%	33%

Preparers rank themselves and financial analysts and investors as being in the best position to provide IASB with qualified input for continued enhancements, followed by reviewers.

Regulators and standard setters, either at national or European level, lay far behind. Of interesting note, continuing applicants cited exclusively professional actors, with users at the forefront, to provide guidance for the future. It could appear to be a sign that the industry, while recognizing the benefits of common standards, wants to have influence on the future regulation and trusts professional bodies to bring valuable proposal to the table.

Table 9 : Stakeholders in the position to provide interesting input to IASB

Which stakeholders should be in the position to provide IASB with the most interesting input for continued enhancements of quality and relevance of financial reporting?	**Continuing IFRS applicants**	**2005 IFRS First-Time Applicants**	**Total**
Preparers	43%	75%	57%
Reviewers	43%	42%	38%
National level bodies (standard setters / enforcement authorities)	-	25%	14%
European level bodies	-	17%	10%
Financial analysts and investors	57%	67%	57%

Verbatim comments highlight expectations from preparers to be involved in the preparation of future regulations.

"From the preparers viewpoint certain standards are unduly complex, designed from the position of a certain industry sector or multi national scenario but then compulsory applied to less complex organisations yielding no benefit. The cross referencing between standards is poor and the IASB in addition to producing standards should produce comprehensive application notes"[30]

[30] First-Time applicant [Ireland]

"We would very much like to be part of the process, provided that we have any influence. Some of the IFRS initiatives that appear to be in the pipeline seem very theoretical and technical, and can lead to financial statements being far from the normal business persons understanding of the business performance, meaning that the "IFRS language" cannot longer be used for internal performance measurement. If that is going to be the case IFRS will lose importance in both the internal and external financial communication"[31].

[31] **First-Time applicant [Denmark]**

4. Fair presentation and accounting policies

Key points

The identification of IFRS-EU as the set of accounting principles applied for the preparation of consolidated financial statements, and the overall compliance has improved in 2006.

97% of the 270 financial statements under review (including 99% of 250 listed companies) were stated to have been prepared in accordance with IFRS-EU. 98% of those have an unqualified audit opinion. No company claimed to apply the provisions of Fair Presentation override.

6 companies (2 % of our sample) were IFRS first-time applicants in 2006, for various reasons:

- Two large German SEC issuers first adopted IFRS in 2006. In 2005 both had opted for the deferred IFRS adoption granted to companies already applying U.S. GAAP,
- Three companies (one from Luxemburg, one from Spain, one from Sweden) first published consolidated financial statements in 2006, following the acquisition or the creation of subsidiaries. The parent company had previously only reported individual, national GAAP compliant, financial statements.
- One Slovenian company adopted IFRS in 2006, following its listing on the Bratislava Stock Exchange.

A limited number of preparers (12% of companies) mentioned changes in their accounting policies due to application of new standards or interpretations.

- This mostly relates to the amendments to IAS 19 : Actuarial Gains and Losses, Group Plan and Disclosures and to IAS 39 : Cash Flow Hedge Accounting of Forecast Intragroup Transactions, fair Value Option and Financial Guarantee Contracts that became effective in 2006.
- No other single amendment of new interpretation was mentioned by more than 5 companies (2% of the sample).

29 companies (11 % of the sample) anticipated the adoption of standards, revised standards or interpretations not yet compulsory in 2006

- 17 companies (including 3 banks) adopted revised financial instruments disclosure (IFRS 7)
- 14 companies the revised scope of share based payments (IFRIC 8),
- 12 companies the IFRIC 9 modification of embedded derivatives,
- 11 companies IFRIC 7 on hyperinflationary economies
- IFRIC 12 on service concessions, although not yet endorsed by the EU, has been newly adopted by 2 companies
- IFRS 8 segment reporting early applied by two German SEC filers

159 companies (59% of 270) commented future standards, usually stating that impacts were being assessed or under investigation. No company reported figures on expected impacts.

220 companies (81% of 270) disclosed information on judgements and estimates. Most estimates deal with impairment, pension, tax position & provision for risks. The lack of 100% compliance appears to be an illustration of the misunderstanding of a significant number of preparers of the new IFRS paradigm.

IFRS Requirements

IAS 1 requires that IFRS financial statements present fairly the financial position, financial performance and cash flows of an entity and further states that, in virtually all circumstances, a fair presentation will be achieved by compliance with applicable IFRS. The nature of our survey is not such as to lead to a detailed analysis as to whether companies financial statements included in our sample do in fact comply or not with each IFRS or IFRIC requirements. In several chapters of our report statistics regarding compliance with disclosure requirements for selected standards will be presented; however the confirmation that all recognition and measurement attributes of standards and interpretations were met lies essentially with what companies and auditors have declared in published annual reports.

4.1. Accounting policies in accordance with IFRS applicable in the EU

IAS 1 requires an entity whose financial statements comply with IFRSs to make an explicit and unreserved statement of such compliance in the notes.

The IAS Regulation[32] requires EU listed preparers to present their consolidated financial statements in compliance with EU regulation that includes an endorsement process by the European Commission. Thus, the statement of compliance may usually refer either to IFRS-EU (IFRS and IFRIC endorsed by the European Commission), or both IFRS and IFRS EU when the limited discrepancies between IFRS and IFRS-EU do not generate any impact on the financial statements.

Amongst the 270 reviewed companies, 94% of listed companies and 70% of unlisted companies made reference in their Accounting policies note to IFRS-EU or both IFRS and IFRS-EU as the set of accounting principles applied for the preparation of their financial statements.

Among the 250 listed companies, 207 companies referred to IFRS-EU only and 28 companies, of which one third are SEC filers, declared their 2006 financial statements in accordance with both IFRS and IFRS-EU.

Audit reports generally confirm that financial statements are prepared in accordance with IFRS-EU.

6% of listed companies (and 30% of unlisted companies) specified in their accounting policies that their 2006 financial statements had been prepared in accordance with IFRS, without any reference to EC endorsement. Amongst the 15 listed companies that made no reference to EC endorsement:

- 12 audit reports made a clear reference to IFRS-EU as the principles applied by the company.
- 2 audit reports confirmed, without reference to IFRS-EU, the application of IFRS and one audit report only mentioned “in conformity with generally accepted principles regarding accounts”.

Consequently, it is altogether 99% of the surveyed 2006 listed companies audited financial statements that have stated either in the notes or in the audit report that accounting policies are compliant with IFRS-EU.

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[32] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards

Table 10 : Reference to IFRS-EU as the set of accounting principles

	Listed		Non Listed	
	Nb of companies	%	Nb of companies	%
IFRS-EU in the notes	207	82,8%	15	75,0%
IFRS-EU and IFRS in the notes	28	11,2%		
IFRS-EU only in the audit report	12	4,8%		
Total IFRS-EU	**247**	**98,8%**	**15**	**75,0%**
IFRS only	3	1,2%	5	25,0%
Total	**250**	**100%**	**20**	**100%**

22 % of companies (60 out of 270) made additional references to national standards and regulations notably in Denmark, the Netherlands, Austria and Germany.

Table 11 : National regulations referred to in accounting policies

State of incorporation	% of companies making additional reference to national regulation	national regulation referred to in accounting policies
Denmark	89 %	the Danish Financial Business Act
Netherlands	88 %	Part 9 of Book 2 of the Netherlands Civil Code
Austria	57 %	Applicable Austrian regulations pursuant to Section 245a HGB or Article 245a of the Austrian Corporate Commercial Code
Germany	57 %	Article 215a of the German Commercial Code
Poland	50%	The requirements of the Accounting Act dated 29 September 1994 (Official Journal from 2002, No. 76, item 694 with amendments) and respective bylaws and regulations
Finland	45 %	Finnish Accounting legislation
Ireland	33%	The requirements of Irish Statute comprising the Companies Acts 1963 to 2006
Cyprus	33 %	The requirements of the Cyprus Company Law
Hungary	33 %	The commercial, banking & fiscal regulations prevailing in Hungary
Portugal	17%	Bank of Portugal Instruction no. 4/96 of 17 June
Belgium	14 %	Belgian Gaap
Sweden	7 %	Recommendation RR 30:06 of the Swedish Financial Accounting Standards Council on Supplementary Accounting Rules for Groups
Italy	7 %	Italian regulations implementing article 9 of Legislative decree no. 38 of 28 February 2005
Total	60 companies	

4.2. Fair presentation override

In the extremely rare circumstances in which management concludes that compliance with a requirement in a Standard or an Interpretation would be so misleading that it would conflict with the objective of financial set out in the *Framework,* IAS 1 requires an entity to depart from this requirement.

None of the companies (listed and not-listed) surveyed disclosed the use of the fair presentation override.

4.3. Changes in accounting policies

IAS 1 states that an entity shall change an accounting policy only if and when the change is required by a Standard or an Interpretation or if it results in the financial statements providing more reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

Whenever changes in accounting policies are required, they are applied retrospectively in accordance with IAS 8 *Accounting policies, Changes in Accounting Estimates and errors,* unless the related standard specifies otherwise.

Change in accounting policy due to the new Standards and Interpretations application

12% of companies (33 out of 270) disclosed in their 2006 financial statements the existence of change in accounting policies due to application of newly amended standards and new interpretations. Some companies disclosed more than one change.

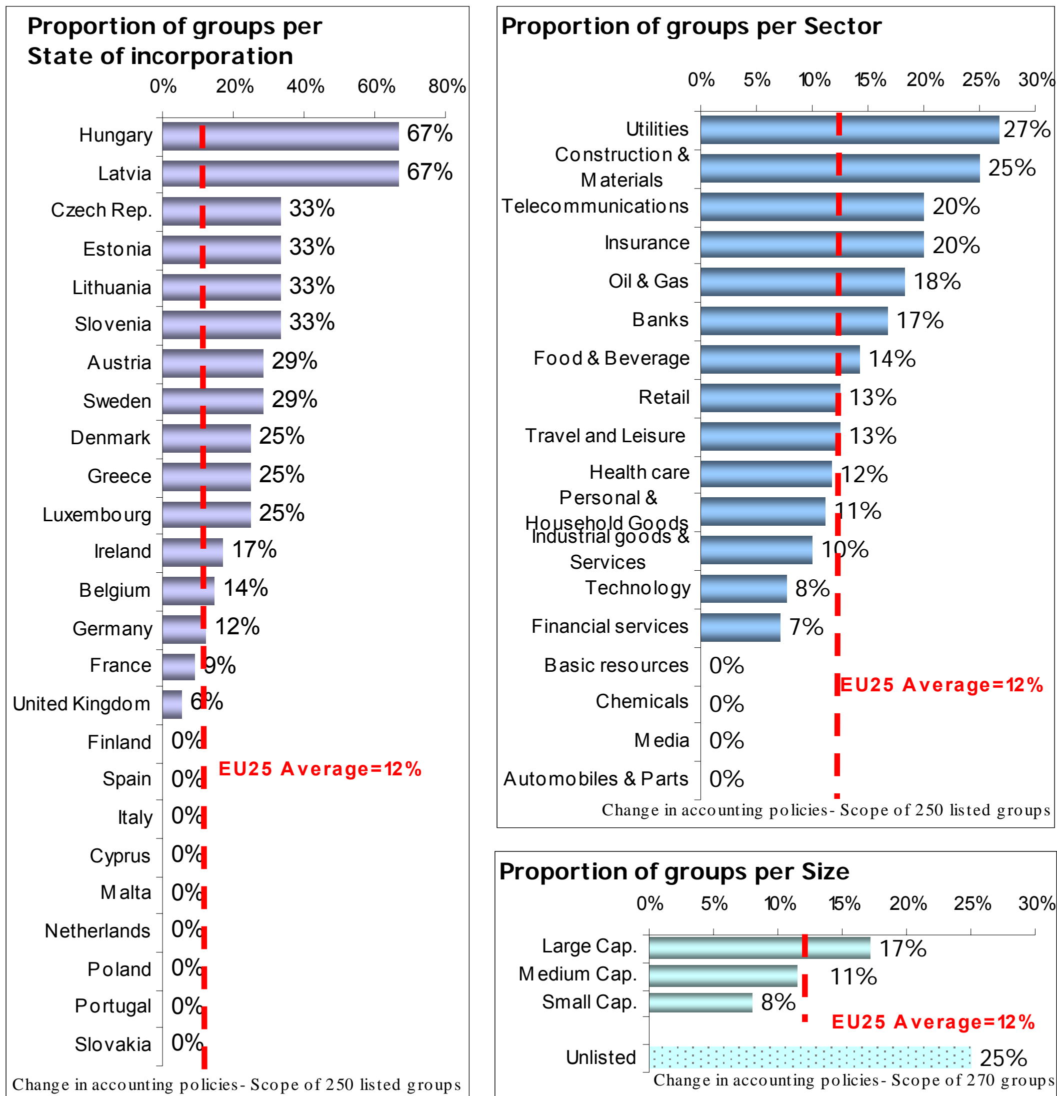
Table 12 : Change in accounting policy

Effective date	Standard mentioned in the change of accounting policies	number of companies	*% (out of 33 companies)*
1 January 2006	IAS 19	16	48%
1 January 2006	IAS 39	11	37%
1 January 2006	IFRIC 4	5	17%
1 January 2006	IAS 21	3	10%
1 January 2006	IFRS 6	1	3 %
1 January 2006	IFRIC 5	0	0%
1 January 2007	IFRS 7	2	7%
1 March 2007	IFRIC 11	2	3%
NA	Adoption of new standards without details	2	7%
NA	First application of IFRS	2	6%

The analysis by state of incorporation shows that companies from new incoming countries seem to be more subject to these new texts than companies from the rest of Europe: 67% of Hungarian and Latvian, 33% of Czech Republic, Estonia, Lithuania and Slovenia companies disclosed changes in their accounting policies, while only 12% of French and 6% of UK companies disclosed such information. It may also well be that these companies systematically mention a change even though there was no impact on their accounts.

More naturally, large companies (17%) are more impacted by new standards and interpretations or changes of presentation than small companies (with 8% only).

Table 13 : Cross analysis of proportion of companies disclosing a change in accounting policy



Amendment to IAS 19 *Employee Benefits – Actuarial Gains and Losses, Group Plans and Disclosures* (effective date: 1 January 2006)

Entities accounting for defined benefit plans are authorized to recognize actuarial gains and losses, in full in the period in which they occur, outside profit or loss through the retained earnings. When an entity applied this option, a statement of Recognised Income and Expense must be disclosed.

16 companies out of 270 disclosed the application of IAS 19 amended as a change in accounting policy.

Table 14 : Change in accounting policies due to the adoption of IAS 19 or IAS 19 amendment

Change in accounting policies due to the adoption of IAS 19 or IAS 19 amendment		
CEZ	Czech Republic	Utilities
Foyer	Luxemburg	Insurance
Grigiskes	Lithuania	Personal & Household Goods
Hennes & Mauritz	Sweden	Retail
Investor	Sweden	Financial services
MOL	Hungary	Oil & Gas
Munich Re	Germany	Insurance
OPAP	Greece	Travel & Leisure
Public Power Corporation of Greece	Greece	Utilities
RWE	Germany	Utilities
Saint-Gobain	France	Construction & Materials
Sanofi-Aventis	France	Health Care
Suez	France	Utilities
Zumtobel AG	Austria	Construction & Materials
Danfoss	France	Construction & Materials
Auchan	France	Retail

Sanofi-Aventis [France, Health Care], a SEC filer, mentioned[33] the change of accounting policies relating to the recognition of actuarial gains and losses under defined-benefit plans as follows:

> **A.4. Change of accounting method**
>
> On January 1, 2006, sanofi-aventis adopted (with retrospective effect from January 1, 2004) the option offered by the amendment to IAS 19 (Employee Benefits) to recognize all actuarial gains and losses under defined-benefit plans in the balance sheet, with the matching entry recorded as a component of equity, net of deferred taxes. Previously, sanofi-aventis applied the corridor method, under which actuarial gains or losses amounting to more than 10% of the greater of (i) the future obligation or (ii) the fair value of plan assets were recognized in the income statement over the expected remaining working lives of the employees.

Amendment to IAS 39 Financial Instruments – *Recognition and Measurement* (effective date: 1 January 2006)

Different amendments to IAS 39 Financial Instruments concern mainly the three following topics:

- The restriction of the use of the Fair Value option to the financial instruments that meet certain conditions:
  - the Fair Value option designation eliminates or significantly reduces an accounting mismatch, or
  - a group of financial assets, financial liabilities, or both is managed and its performance is evaluated on a Fair Value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel

[33] **Sanofi-Aventis** [France] Form 20-F, page F-11

Additionally, the amendment allows an entity to apply the Fair Value option for contracts containing an embedded derivate to the entire hybrid contract without separating the embedded

- The possibility, in the consolidated financial statements, for a forecast intragroup transaction to be designated as the hedged item in a foreign currency cash flow hedge, provided that:
  - The transaction is highly probable and denominated in a currency other than the functional currency of the entity entering into that transaction;
  - that if the hedge of a forecast intragroup transaction qualifies for hedge accounting, any gain or loss that is recognised directly in equity in accordance with the hedge accounting rules in IAS 39 must be reclassified into profit or loss in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated profit or loss.
- The third amendment deals with financial guarantee contracts. An entity may apply either IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 4 *Insurance Contracts* if financial guarantee contracts are defined as insurance contracts by the entity.

11 companies out of 270 disclosed a change in accounting policy due to the application of IAS 39 amended with various impacts.

Table 15 : Change in accounting policies due to the adoption of IAS 39 or IAS 39 amendment

Change in accounting policies due to the adoption of IAS 39 or IAS 39 amendment		
CEZ	Czech Republic	Utilities
Grigiskes	Lithuania	Personal & Household Goods
H.Lundbeck	Denmark	Health Care
Hennes & Mauritz	Sweden	Retail
Investor	Sweden	Financial services
Latvijas Kugniecība	Latvia	Industrial goods & services
Mania Technologie	Germany	Industrial goods & services
MOL	Hungary	Oil & Gas
RWE	Germany	Utilities
Ventspils Nafta	Latvia	Oil & Gas
Volvo	Sweden	Industrial goods & services

Volvo [Sweden, Industrial Goods & Services] stated[34] that *"with application of the supplement to IAS 39, Financial Instruments: Recognition and Measurement, pertaining to financial guarantee contracts, the comparison year is restated."*

RWE [Germany, Utilities] explained[35] in its "Changes in accounting policies" notes that "*The first-time application of these amendments had no material impact on the RWE Group's consolidated financial statements".*

[34] **Volvo** [Sweden] 2006 Annual Report 2006, page 91

[35] **RWE** [Germany] 2006 Financial statements, page 159

IFRIC 4 *determining whether an arrangement contains a lease* (effective date: 1 January 2006)

In accordance with IFRIC 4, an arrangement that is meeting some criteria is, or contains, a lease that should be accounted for in accordance with IAS 17 *Leases*.

The interpretation specifies that an arrangement contains a lease if it depends on the use of a specific asset conveys a right to control the use of that asset.

4 companies out of 270 disclosed a change in accounting policy due to the application of IFRIC 4.

Table 16 : Change in accounting policies due to the adoption of IFRIC 4

Change in accounting policies due to the adoption of IFRIC 4		
Danske Bank	Denmark	Banks
Grigiskes	Lithuania	Personal & Household Goods
Mania Technologie	Germany	Industrial goods & services
Volvo	Sweden	Industrial goods & services

Amendment to IAS 21 The effects of changes in foreign exchange rates (effective date: 1 January 2006)

The Amendment to IAS 21 aims to clarify the accounting for a net investment in a foreign operation. It specifies that:

- The accounting treatment in consolidated financial statements should not be dependent on the currency of the monetary item that forms part of an entity's investment in a foreign operation (IAS 21 specified only "functional currency");
- The accounting should not depend on which entity within the group conducts a transaction with the foreign operation (IAS 21 was not clear on the "member of a consolidated group" definition).

3 companies out of 270 disclosed a change in accounting policy due to the application of IAS 21 amended.

Table 17 : Change in accounting policies due to the adoption of IAS 21

Change in accounting policies due to the adoption of IAS 21		
Grigiskes	Lithuania	Personal & Household Goods
Mania Technologie	Germany	Industrial goods & services
MOL	Hungary	Oil & Gas

IFRS 6 Exploration for and Evaluation of Mineral Resources (effective date: 1 January 2006)

IFRS 6 *Exploration for and Evaluation of Mineral Resources* permits an entity to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements 11 and 12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. Thus, an entity adopting IFRS 6 may continue to use the accounting policies applied immediately before adopting the IFRS, provided that they result in information that is relevant to the economic decision-making needs of users and that is reliable.

Additionally, the Standard requires entities recognising exploration and evaluation assets to perform an impairment test on those assets when facts and circumstances suggest that the carrying amount of the assets may exceed their recoverable amount.

One company declared that the application of IFRS 6 generated an impact in its financial statement.

Table 18 : Change in accounting policies due to the adoption of IFRS 6

Change in accounting policies due to the adoption of IFRS 6		
RWE	Germany	Utilities

RWE [Germany, Utilities] specifies[36] in its "Accounting Policies" the nature of the impact linked to the application of IFRS 6.

> ***IFRS 6 "Exploration for and Evaluation of Mineral Resources"*** includes rules for accounting expenses related to the exploration and evaluation of minerals, oil, natural gas and similar finite resources before their technological and economic production can be proven. IFRS 6 does not mandate an accounting policy specific to exploration and evaluation expenses. Instead, it sets forth the basic conditions under which the company preparing the accounts selects an accounting method. Furthermore, IFRS 6 prescribes that impairment tests pursuant to IAS 36 be carried out on exploration and evaluation assets. First-time application of IFRS 6 only has an impact on the Notes to the RWE Group's consolidated financial statements.

IFRIC 11 Group and Treasury Share Transactions (effective date: 1 March 2007)

IFRIC 11 specifies the accounting treatment linked to share-based arrangements involving an entity's own equity instruments in which the entity chooses or is required to purchase to a third party its own equity instruments to settle the share-based payment obligation. This arrangement must always be considered and accounted for as an equity-settled transaction.

Additionally, IFRIC 11 prescribes for a subsidiary, in its separate financial statements, to account for:

- a cash-settled scheme, when a subsidiary grants rights to equity instruments of its parent to its employees
- an equity-settled scheme when the parent company grants rights to equity instruments to the subsidiary employees

  IFRIC 11 is mandatory for annual periods beginning on or after 1 March 2007. Early adoption is permitted.

[36] **RWE** [Germany], 2006 Financial statements, page 159

In the frame of this study, companies applying IFRIC 11 are early adopter.

Caledonia Investments [United Kingdom, Financial Services] declared[37] that the early adoption of IFRIC 11 lead to a change of accounting policies.

Table 19 : Change in accounting policies due to the adoption of IFRIC 11

Change in accounting policies due to the adoption of IFRIC 11		
Caledonia Investments	United Kingdom	Financial services

BHP Billiton [United Kingdom, Basic resources] declared[38] to be early adopter for IFRIC 11 but not leading to a change in accounting policies.

4.4. Restatements of the comparative period

Amongst the sample, some companies disclosed in their 2006 accounts restated information relating to the previous period (2005)

These restatements may be generated by different circumstances:

- a change of presentation;
- the application of a new standard or a new Interpretation;
- a change in accounting policy made on a voluntary basis in order for example to align the policy used by the company with dominant industry practices;
- a consequence of an IFRIC rejection;
- A correction of an error.

We have observed that the most frequent reasons to disclose a previous period restatement were changes of presentation and the application of new standards and interpretations.

Companies often justify prior year adjustments linked to the presentation of their financial statements in order to provide a better understanding of their financial position or a better alignment with their performance indicators.

Zumtobel AG [Austria, Construction & Materials] stated[39] that the change of presentation improved the consistence of the income statement.

Change in the structure of the income statement
In order to harmonise the income statement with the structure of internal reporting, research and development expenses are no longer shown as a separate functional area. Development expenses are allocated to the cost of goods sold, while research expenses are included under selling expenses. The prior year amounts were adjusted accordingly. This adjustment led to an increase of TEUR 20,456 in the cost of goods sold and TEUR 1,836 in selling expenses. Details on research and development are presented in section 2.5.4.2.

Additional information on adjustments related to discontinued operations (IFRS 5) is provided in section 2.5.5.12

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[37] **Caledonia Investments** [United Kingdom] Financial statements, page 34

[38] **BHP Billiton** [United Kingdom]

[39] **Zumtobel AG** [Austria] Financial Statements, page 68

Eesti Telekom [Estonia, Telecommunications] specified[40] that the modification of presentation "will provide reliable and more relevant information to the users of the financial statements".

Changes in the manner of presenting information in 2006

In 2006, the format of the Group's income statement was changed. In the past, operating expenses were aggregated according to their nature. Starting from 2006, the operating expenses are aggregated based on their function in the company. The comparatives for 2005 were reclassified accordingly. The management believes that the presentation by function will provide reliable and more relevant information to the users of the financial statements on the cost of different functions and how economic benefits are created in the company. Certain reclassifications were also made in the balance sheet and in the cash flow statement.

It may however be difficult to ascertain the true reason that motivated a company to restate the presentation of its comparative figures.

The second most frequently observed reason for a restated comparative period is the application of a new standard or an interpretation.

Deutsche Post [Germany, Industrial Goods & Services] presented[41] the effects of the application of IFRIC 4 for previous fiscal year (2005) as follows:

IFRIC 4: Determining whether an Arrangement contains a Lease

IFRIC 4 requires determining whether an arrangement is, or contains, a lease based on the respective economic substance of the arrangement. In so doing, an assessment must be made whether (a) fulfillment of the arrangement is dependent on the use of a specific asset or assets (the asset) and (b) the arrangement conveys a right to use the asset. The following agreements have been examined for a lease in connection with IFRIC 4:

- Service agreements with American air freight companies that handle express business in the USA for Deutsche Post World Net.
- IT agreement with a service provider; additional information can also be found under Note 56.

These determinations resulted in the following effects on the balance sheet and income statement:

Effects of IFRIC 4		
€m	2005	2006
Aircraft (finance lease)	164	123
IT hardware (finance lease)	69	47
Liabilities from finance leases	234	173
Depreciation or impairment losses	50	49
Interest expense	9	13
Materials expense	–59	–57

Retrospective application of IFRIC 4 changed income statement and balance sheet items for fiscal year 2005 (see also the tables "Restated consolidated balance sheet" and "Restated income statement" below).

However, not all companies did restate the amounts of their comparative period, as some standards or interpretations allow not restating the comparative period.

[40] **Eesti Telekom** [Estonia] Financial Statements, page 20

[41] **Deutsche Post** [Germany] Annual report 2006, page 112

Diageo [UK, Food & Beverages] referred[42] to the exemptions under IFRS 1 of providing a restated comparative period:

"Diageo adopted IFRS 7 early in its 2006 financial statements and applied the exemptions under IFRS 1, IFRS 7 and IAS 32 not to restate comparative information in respect of IFRS 7, IAS 32 and IAS 39 – Financial instruments: recognition and measurement. As a consequence, financial instruments are included in the 2005 comparative information in accordance with UK GAAP, whereas they are accounted for in accordance with IAS 39 in the 2006 and 2007 results. In accordance with the transitional provisions of IFRS, this was treated as a change in accounting policy."

Amongst the retrospective adjustments that may arise only a few companies referred to the IFRIC rejections relating to "puts and forwards held by minority interests" (November 2006):

RWE [Germany, Utilities] mentioned[43] a change in accounting policies relating to the accounting of commitments to purchase minority interests, explaining an alignment with the development of international accounting practice and without mentioning explicitly the IFRIC rejection:

In line with the development of international accounting practice, RWE is also applying this rule since January 1, 2006, analogously to forward purchases of minority interests and put options owned by minority shareholders. Certain minority interests are thus now presented as other liabilities. The difference between the agreed purchase price and/or the agreed exercise price and the carrying amount of the minority interest is recognized as contingent consideration that depends on future events, in line with the rules for the accounting of business combinations pursuant to IAS 22 and IFRS 3.

Prior-year figures were retrospectively restated. As of January 1, 2005, this resulted in additional other liabilities of €2,082 million (of which €749 million were non-current), additional goodwill of €1,444 million, a reduction in advance payments made of €100 million, and a reduction in equity of €738 million. The last of these amounts primarily includes the derecognition of minority interest (€663 million) and goodwill amortization (€121 million) which we had to recognize by the end of fiscal 2003. In fiscal 2005, net income attributable to minority interests declined by €132 million in the income statement. This is contrasted by an increase in finance costs of the same amount.

In fiscal 2006, financial liabilities for the present value of the redemption amount declined, resulting in an adjustment to goodwill of €174 million, without an effect on income.

IAS 32 "Financial Instruments: Disclosure and Presentation": According to IAS 32, a contract that contains an obligation for an entity to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount. This also applies if the obligation to purchase is conditional on the counterparty exercising a right to redeem, regardless of the probability of exercise.

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[42] **Diageo** [UK] Annual Report 2006-2007

[43] **RWE** [Germany] Annual report 2006

France Telecom [France, Telecommunications] stated[44] the following concerning the issue of commitments to purchase minority interests:

- Commitments to purchase minority interests (put options):

  Commitments to purchase minority interests and put options granted to minority shareholders are currently recognized as a financial debt and as a reduction in minority interests in equity, in accordance with IAS 27 "Consolidated and Separate Financial Statements" and IAS 32 "Financial Instruments: Disclosure and Presentation". Where the amount of the commitment exceeds the amount of the minority interest, the difference is recorded as a reduction in shareholders' equity attributable to the equity holders of France Telecom S.A.. The fair value of commitments to purchase minority interests is revised at each balance sheet date and the corresponding financial debt is adjusted with a contra-entry to financial income or expense. Since this accounting treatment does not reflect the economic substance of these transactions and given the lack of clarity in the standards as regards the scope of commitments covered, and particularly conditional commitments, the Group submitted the issue to the International Financial Reporting Interpretations Committee (IFRIC) for consideration, in order to obtain guidance on the appropriate accounting treatment and the scope of application of the related standards. The IFRIC has confirmed that a financial liability should be recognized but has not clarified the issue with regard to the contra-entry. The accounting treatment proposed by the Group has therefore been maintained.

  Conditional put options granted to minority shareholders amounted to 30 million euros at December 31, 2006 (73 million euros at December 31, 2005 and 547 million euros at December 2004). The overall effect on equity attributable to equity holders of France Telecom S.A. arising from the recognition of these commitments as a liability is 21 million euros at December 31, 2006 (45 million euros at December 31, 2005 and 422 million euros at December 31, 2004).

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[44] **France Telecom** [France] Consolidated financials 2006

Siemens [Germany, Industrial Goods & Services] presented[45] the impacts on comparative figures linked to a new discovery of facts:

2 Summary of significant accounting policies

The presentation of certain prior year information has been reclassified to conform to the current year presentation.

As previously reported, within the former Com Group, the Company's other Groups and regional companies, a number of Business Consultant Agreements and similar sales-related arrangements with third-party intermediaries have been identified. The Company identified a large volume of payments relating to fiscal years 2000–2006 made in connection with these agreements and other payments for which the Company has not been able either to establish a valid business purpose or to clearly identify the recipient. The payments identified were recorded as deductible business expenses in prior periods in determining income tax provisions. During fiscal 2007, the Company determined that certain of these payments were non-deductible under tax regulations of Germany and other jurisdictions. Due to these matters, the Company accounted in fiscal 2007 for an amount of €352 in income tax charges and €28 in related interest charges in respect of fiscal years 2000–2006. These income tax charges are in addition to income tax charges recorded in fiscal 2006 in the amount of €168 relating to income tax liabilities for certain payments for which Siemens was not able to establish a valid business purpose or to clearly identify the recipient. The charges were considered to be immaterial under the rollover method of quantifying misstatements and were accounted for in fiscal 2007 by adjusting the comparative amounts for fiscal years 2006 and 2005 and the opening balance of total equity as of October 1, 2004. The effect of the adjustment of these misstatements on net income for fiscal 2006 and 2005 and the opening balance of total equity as of October 1, 2004 amounted to an increase of €25, a decrease of €69 and a decrease of €336, respectively. These adjustments had no impact on segment information.

Further, certain commission liability accounts were identified at the Med Group which were created in fiscal years prior to 2005 and subsequently released in a manner that did not comply with applicable accounting principles. The release of those liabilities resulted in an overstatement of net income (loss) of €15 in both fiscal 2006 and 2005. As a result, the opening balance of total equity as of October 1, 2004 was understated by €30. Comparative amounts for fiscal 2006 and 2005 for net income (loss), equity and segment information for the respective periods have been adjusted accordingly.

The following table summarizes the effect of all adjustments described above on net income as reported for fiscal years 2006 and 2005 as well as the effect of correcting the cumulative misstatements for fiscal years 2000 – 2004 within the opening balance of total equity as of October 1, 2004:

	Effect of misstatements on *Net income (loss)* in Fiscal Year		Effect of Accumulated misstatements on *Total equity* as of Oct. 1,	
	2006	2005	2004	Total
Misstatement[(1)], related to				
Com Germany	(5)	(13)	(173)	(191)
Non-Com Germany	(28)	(39)	(208)	(275)
International	(15)	(17)	(50)	(82)
Less: Income tax adjustments previously recorded at September 30, 2006[(2)]	73	–	95	168
Income tax adjustments[(3) (4)]	25	(69)	(336)	(380)
Med commission liability	(15)	(15)	30	–
Misstatements adjusted September 30, 2007	10	(84)	(306)	(380)

(1) Including interest, where applicable.
(2) Includes €31 recorded in fiscal 2006 that was determined to relate to non tax deductible expenses recorded in fiscal 2006 and €42 recorded in fiscal 2006 relating to misstatements originating in fiscal years 2005 and 2004 of €17 and €25, respectively.
(3) Includes income taxes related to continuing operations and discontinued operations.
(4) The effect of accumulated misstatements on Total Equity as of Oct. 1, 2004 relates to fiscal years 2004: €(82); 2003: €(59); 2002: €(55); 2001: €(40); 2000: €(100).

45 **Siemens** [Germany] Annual Report 2006-2007

Rare also are the restatements that are imposed by a national regulator as was seen to be the case for a Danish Bank in 2006. **Danske Bank Group** [Denmark] stated[46] "*With effect from January 1, 2006, the Group has adjusted its policies for the recognition of provisions for unit-linked insurance contracts to comply with the new rules issued by the Danish FSA that complete the framework laid down by IFRS 4*".

4.5. Audit Opinion

Amongst the 250 auditor's reports reviewed, 205 of them gave a clean (non-qualified and without emphasis of a matter) short form audit opinion on the consolidated financial statements of the given companies.

39 audit reports draw attention on specific matters of interest. This includes all audit reports of French Groups (32 in our sample) since Provisions of Article L.823-9 of the French Commercial Code make compulsory the justification in the audit report of the auditor's assessments. This translates as an emphasis of a matter paragraph in French auditors' reports.

6 auditors only qualified their opinion.

Table 20 : Audit Opinion

Audit Opinion	Listed companies	%	Unlisted companies	%	Total	%
Clean	205	82%	18	90%	223	83%
Emphasis of a matter	39	15%	2	10%	41	15%
Including	*32 French companies*	*13%*	*1*	*5%*	*33*	*12%*
Qualified	3	1%	-	-	3	1%
Both qualified & Emphasis of a matter	3	1%	-	-	3	1%
Total	**250**	**100%**	**20**	**100%**	**270**	**100%**

The 6 qualified audit opinions (or even disclaimer of opinion) are to be found within Italian, Latvian, Lithuanian and Spanish companies. The following table quotes the reasons justifying the qualified opinion. The first mentioned reason appears twice in Italy.

Table 21 : Qualified audit opinions

Reasons	State of incorporation	Audit opinion
Disagreement on tax assets and continuity of operations (for 2 companies)	Italy	Disclaimer of opinion
Disagreement regarding the correction of errors not applied retroactively	Latvia	Qualified opinion
Disagreement regarding the use of government index rate for revaluation of PPE	Lithuania	Qualified opinion
Disagreement of non recognition of carbon dioxyde allowance in a business combination	Lithuania	Qualified opinion
Disagreement regarding the outcome of an uncertainty regarding certain subsidiaries in Italy	Spain	Qualified opinion

[46] **Danske Bank Group** [Denmark]

4.6. Early adoption of IFRS

Early adoption of standards and interpretations is generally permitted or encouraged by the IASB if properly disclosed.

Early adoption of standards and interpretations is generally permitted or encouraged by the IASB and by the European Commission after the endorsement process provided that such early adoption is disclosed.

Companies under review with reporting date beginning 1 January 2006 were in a position to early adopt the following standards and interpretations:

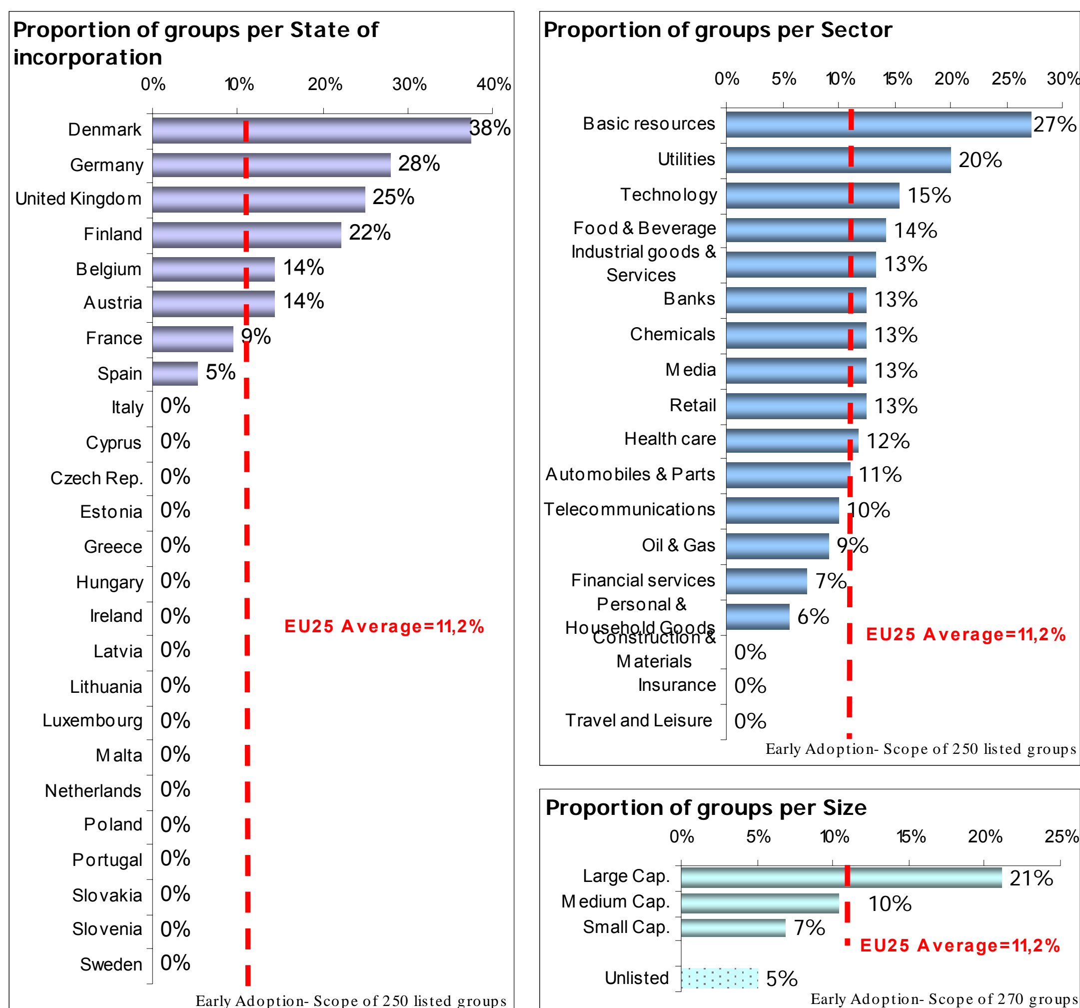
- IFRS 7 Financial Instruments: Disclosures
- IAS 1 Amendment – Capital disclosures
- IFRS 8 Operating Segments
- IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies
- IFRIC 8 Scope of IFRS 2
- IFRIC 9 Reassessment of Embedded Derivatives
- IFRIC 10 Interim Financial Reporting and Impairment
- IFRIC 11 IFRS 2 – Group and Treasury Share Transactions
- IFRIC 12 Service Concession Arrangements

28 companies corresponding to 11% of our sample specified the early adoption of one or several standards and interpretations

Table 22 : Early adoption of one or several standards

	Listed companies	%	Unlisted companies	%	Total	%
Yes	28	11%	1	5%	29	11%
No	222	89%	19	95%	241	89%
Total	250	100%	20	100%	270	100%

Table 23 : Cross analysis of early adoption of one or several standards by state, sector and size



IFRS 7 - *Financial instruments: disclosures*

IFRS 7 states that the objective of the standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:

- The significance of financial instruments for the entity's financial position and performance; and
- The nature and extent of risks arising from financial instrument of which the entity is exposed during the period and at the reporting date, and how the entity manages those risks

IFRS 7 supersedes IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and replaces the section relating to disclosures of IAS 32 Financial Instruments: Disclosure and Presentation. Moreover, the standard adds disclosures not previously required by IAS 32

The standard is effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged.

12 companies have been identified as IFRS 7 early adopters.

RWE [Germany, Utilities] stated[47] « *With the exception of the additional information in the notes, the first-time application of IFRS 7 does not have a material impact on the RWE Group's consolidated financial statements* ».

InBEV [Belgium, Food & Beverage] explained[48] the reasons of early applying IFRS 7:

(C) Summary of changes in accounting policies

The accounting policies applied are consistent with those of the previous financial year except for the early adoption of IFRS 7 *Financial Instruments: Disclosures* and the complementary amendment to IAS 1 *Presentation of Financial Statements—Capital Disclosures*. IFRS 7 introduces new requirements to improve the information on financial instruments that is given in entities' financial statements. It replaces IAS 30 *Disclosures in the Financial Statements of Banks and Similar Financial Institutions* and some of the requirements in IAS 32 *Financial Instruments: Disclosure and Presentation*. The amendment to IAS 1 introduces requirements for disclosures about an entity's capital. While these new IFRS requirements are only effective as from 1 January 2007 InBev decided to apply them already in the 2006 annual financial statements as part of our continued efforts to enhance transparency. Indeed, IFRS 7 is believed to lead to greater transparency with regard to the risks that InBev runs from the use of financial instruments. This, combined with the new requirements in IAS 1, should provide better information for investors and other users of our financial statements to make informed judgments about risk and return. The notes below have been amended to reflect the adoption of IFRS 7.

IAS 1 Amendment - Presentation of financial statements, relating to capital disclosures

The amendment to IAS1 requires an entity to disclose information allowing for the financial statements users to evaluate the entity's objectives, policies and processes for managing capital.

These requirements apply to all entities and are effective for annual periods beginning on or after 1 January 2007, with earlier application encouraged.

5 companies have been identified as early adopters for the amendment to IAS 1.

JC Decaux [France, Media] stated[49] in its "accounting methods and principles" note:

In addition, the Group has opted:

- for an early adoption of IFRS 7 *Financial instruments: disclosures* applicable as of January 1, 2007, and for the IAS 1 Amendment, *Capital Disclosures*, arising from IFRS 7;

IFRS 8 - Operating Segments

IFRS 8 *Operating Segments* replaces IAS 14 *Segment reporting* and is in line of convergence with U.S. Generally Accepted Accounting Principles (U.S. GAAP).

The standard requires an entity to report financial and descriptive information about its reportable segments.

The identification of reportable segments is based on internal reports that are regularly reviewed by the entity's chief operating decision maker in order to allocate resources to the segment and assess its performance.

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[47] **RWE** [Germany] Financial statements, page 160

[48] **InBEV** [Belgium] Annual Report 2006, page 64

[49] **JCDecaux** [France] Annual Report 2006, page 62

In addition, IFRS 8 requires information to disclose relating to:

- How the reportable segments are identified;
- Revenues by products and services for each reportable segment;
- Analyses of revenues by geographical area;
- Transactions with major customers for each reportable segment;
- Basis of measurement of disclosed components; and
- Reconciliations between the totals of segment revenues, segment profit or loss, segment assets, segment liabilities and other material items with reported items in the financial statements.

IFRS 8 is effective for annual periods beginning on or after 1 January 2009. An earlier application is encouraged.

As soon as the standard is effective, comparative periods must be presented unless the necessary information is not available and the cost to produce this information is excessive.

Two German SEC filers, **Siemens** [Germany, Industrial Goods & Services] and **DaimlerCrysler** [Germany, Automobile & Parts], have early adopted IFRS 8.

IFRIC 7 - Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies

IFRIC 7 *Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies* requires an entity to restate its financial statements in the first year it identifies the existence of hyperinflation in the economy of its functional currency.

IFRIC 7 is effective for annual periods beginning on or after 1 March 2006 with earlier application encouraged.

9 companies early adopted IFRIC 7.

BP [United Kingdom, Oil & Gas], an IFRIC 7 early adopter, specified[50]: «*There were no changes in accounting policy and no restatement of financial information consequent upon adoption of these interpretations* ».

IFRIC 8 - Scope of IFRS 2

The interpretation clarifies that the accounting standard IFRS 2 *Share-based Payment* applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration.

IFRIC 8 is effective for annual periods beginning on or after 1 May 2006 with earlier application encouraged.

10 companies early adopted IFRIC 8.

[50] **BP** [United Kingdom] Annual report 2006, page 107

IFRIC 9 - Reassessment of Embedded Derivates

IFRIC 9 requires an entity to assess whether an embedded derivate is required to be separated from the host contract and accounted for as a derivate only when the entity first becomes party to the contract.

IFRIC 9 is effective for annual periods beginning on or after 1 June 2006 with earlier application encouraged.

13 companies early adopted IFRIC 9.

- **Anglo American** [United Kingdom, Basic Resources], Annual report 2006, P92) stated[51] about the early adoption of IFRIC 9: "*These have not had a material impact on the Group and there have not been any other significant changes in accounting policies in the period".*
- **Bayer** [Germany, Chemicals] stated[52]: "*None of the following standards",* including IFRIC 9*," … had a material impact on the Group's net assets, financial position, results of operations or earnings per share in the current period".*

IFRIC 10 - Interim Financial Reporting and Impairment

The Interpretation addresses an inconsistency between the requirements of IAS 34 *Interim Financial Reporting* and those of IAS 36 and IAS 39 on the recognition and reversal of impairment losses on goodwill in subsequent financial statements. Thus, the interpretation requires an entity not to reverse an impairment loss recognised in a previous interim period in respect of goodwill or an investment in either an equity instrument or a financial asset carried at cost.

IFRIC 10 is effective for annual periods beginning on or after 1 November 2006 with an earlier application encouraged.

11 companies early adopted IFRIC 10.

IFRIC 11 - IFRS2 - Group and Treasury Share Transactions

IFRIC 11 specifies the accounting treatment linked to share-based arrangements involving an entity's own equity instruments in which the entity chooses or is required to purchase to a third party its own equity instruments to settle the share-based payment obligation. This arrangement must always be considered and accounted for as an equity-settled transaction.

Additionally, IFRIC 11 prescribes for a subsidiary, in its separate financial statements, to account for:

- a cash-settled scheme, when a subsidiary grants rights to equity instruments of its parent to its employees
- an equity-settled scheme when the parent company grants rights to equity instruments to the subsidiary employees

IFRIC 11 is effective for annual periods beginning on or after 1 March 2007, early adoption is permitted.

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[51] **Anglo American** [United Kingdom] Annual report 2006, page 92

[52] **Bayer** [Germany] Annual report 2006, page 109

2 companies out of 250 elected to early adopt IFRIC 11, of which **Caledonia Investments** [United Kingdom, Financial Services] declared[53] that the early adoption of IFRIC 11 led to a change of accounting policies.

IFRIC 12 - Service Concession Arrangements

In November 2006, the IFRIC issued IFRIC 12 "Service Concession Arrangements", which addresses how service concession operators should apply existing IFRS to account for the obligations they undertake and rights they receive in service concession arrangements. IFRIC 12 is the continuation of IFRIC D12, D13 and D14 published by the IFRIC in 2005. The provisions of IFRIC 12 are effective for annual periods beginning on or after January 1st, 2008. Early application is permitted.

At the time of writing this report, IFRIC 12 has not been endorsed by the European Union.

2 companies out 270 elected to early adopt IFRIC 12.

4.7. Comments on future standards

IFRS requires an entity to disclose the potential impacts of released but not yet effective new standards and interpretations.

59% of listed companies (159 out 270) disclosed comments on the future standards.

Generally, companies commenting the application of future standards or interpretations specified that the effects are currently being assessed or under investigation.

Even with companies that have finished the assessment few companies are able to provide estimated financial impacts on their financial statements.

Hornbach [Germany, Retail] declared[54] that the application of news standards: *"… will result in extended disclosures in the notes".*

Bayer [Germany, Chemicals] recalls[55] readers that the application of IFRS 7 *"will affect the nature and modality of financial instrument disclosures in the financial statements of Bayer Group, but not the recognition or measurement of the instruments".*

France Telecom [France, Telecommunications] disclosed[56] that the provisions of IFRS 8 *"…may affect the structure of segment reporting and the way in which cash-generating units (CGUs) are grouped for the purpose of goodwill impairment testing*".

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[53] **Caledonia Investments** [United Kingdom] Financial statements page 34

[54] **Hornbach** [Germany] Annual Report 2006-2007, page 82

[55] **Bayer** [Germany] Annual Report 2006, page 110

[56] **France Telecom** [France] Consolidated Financials 2006, page 113

None of the companies reported figures on expected impacts.

Table 24 : Comments on future standards

	Listed		Non Listed		Total	
	number of companies	%	number of companies	%	number of companies	%
Yes, comments on potential effects but without figures	145	58%	14	70%	159	59%
No	105	42%	6	30%	111	41%
Total	250	100%	20	100%	270	100%

4.8. Disclosure of judgements and estimates

The amended 2005 version of IAS 1 requires information relating management judgments and estimates. It requires an entity to disclose the judgements, apart those involving estimations, that management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognised in the financial statements (IAS 1.113). This information must be disclosed in the summary of significant accounting policies or other notes.

IAS 1 also requires to disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year [IAS 1.116].

Disclosure of the required information

Disclosures on judgements and estimates are done by 81% of companies of the sample. 50 companies out of 270 do not provide information relating to this topic.

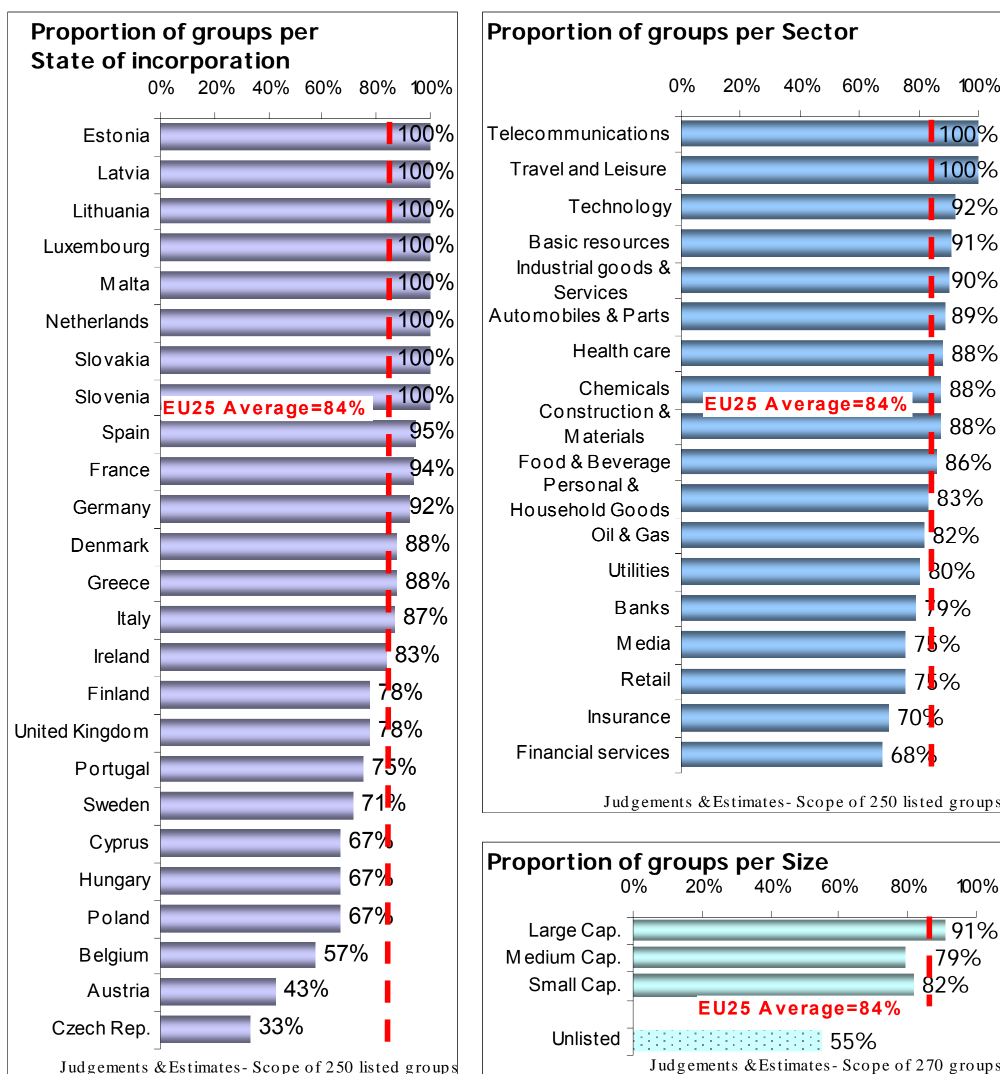
Table 25 : Disclosures on judgement and estimates

Disclosure of judgements and estimates	Listed companies	%	Non-listed companies	%	Total	%
Yes	209	84%	11	55%	220	81%
No	41	16%	9	45%	50	19%
Total	250	100%	20	100%	270	100%

Companies from financial activities present a lower proportion of compliance with IAS 1 relating to the disclosure of judgements and estimates with only 79% and 70% and of 68% from respectively "Banks", "Financial services" and "Insurance" of compliance. Amongst non financial activities, "Media" and "Retail" have lower rates of compliance than the average level. Cross analysis by state of incorporation reveals that the proportion of Spanish, French and German companies disclosing judgements and estimates is the highest with respectively 94,7%, 93,7% and 92%. Czech Republic and Austria are the countries for which the proportion of companies disclosing the required information is the lowest.

Analysis by company size is barely relevant with trends. 91% of large companies disclosed information relating to judgements and estimates and 79% of medium size and small companies producing the required disclosure.

Table 26 : Cross analysis on disclosures on judgement and estimates by state, sector and size



Related topics of estimation

The following table presents the main topics subject to estimates of the management:

Table 27 : Main topics subject to estimates of the management

	nb of companies	% (out of 220 companies)
Pension	111	50
Impairment	141	64
Provision for risks	109	50
Tax position	110	50
Fair value of financial instruments	71	32
Fair value of PPE	37	17
Others	75	34

Most estimates deal with impairment, pension, tax position and provision for risks.

Volvo [Sweden, Industrial Goods & Services] provided[57] significant information relating to the key sources of estimation including some related to its industry.

Note 2 Key sources of estimation uncertainty

Residual value risks

In the course of its operations, Volvo is exposed to residual value risks through operating lease agreements and sales combined with repurchase agreements. The products, primarily trucks, for which Volvo has a residual value commitment, are generally recognized in the balance sheet as assets under operating leases. Depreciation expenses for these products are charged on a straight-line basis

Key sources of estimation uncertainty

Volvo's significant accounting principles are set out in note 1, Accounting Principles and conform to IFRS as adopted by the EU. The preparation of Volvo's Consolidated Financial Statements requires the use of estimates, judgements and assumptions that affect the reported amounts of assets, liabilities and provisions at the date of the financial statements and the reported amounts of sales and expenses during the periods presented. In preparing these financial statements, Volvo's management has made its best estimates and judgements of certain amounts included in the financial statements, giving due consideration to materiality. The application of these accounting principles involves the exercise of judgement and use of assumptions as future uncertainties and, as a result, actual results could differ from these estimates. In accordance with IAS 1, preparers are required to provide additional disclosure of accounting principles in which estimates, judgments and assumptions are particularly sensitive and which, if actual results are different, may have a material impact on the financial statements. The accounting principles applied by Volvo that are deemed to meet these criteria are discussed below:

Impairment of goodwill, other intangible assets and other non-current assets

Property, plant and equipment, intangible assets, other than goodwill, and certain other non-current assets are amortized and depreciated over their useful lives. Useful lives are based on management's estimates of the period that the assets will generate revenue. If, at the date of the financial statements, there is any indication that a tangible or intangible non-current asset has been impaired, the recoverable amount of the asset should be estimated. The recoverable amount is the higher of the asset's net selling price and its value in use, estimated with reference to management's projections of future cash flows. If the recoverable amount of the asset is less than the carrying amount, an impairment loss is recognized and the carrying amount of the asset is reduced to the recoverable amount. Determination of the recoverable amount is based upon management's projections of future cash flows, which are generally made by use of internal business plans or forecasts. While management believes that estimates of future cash flows are reasonable, different assumptions regarding such cash flows could materially affect our valuations. Intangible and tangible non-current assets amounted to 73,997 whereof 8,849 represents goodwill. For Goodwill and certain other intangible assets with indefinite life-time an annual impairment review is performed at the year-end closing. Such an impairment review will require management to determine the fair value of Volvo's cash generating units, reporting units for US GAAP purposes, on the basis of projected cash flows and internal business plans and forecasts. Volvo has since 2002 performed a simliar impairment review in accordance with US GAAP. No impairment charges were required for the period 2002–2006.

tion with the customer). Warranty provisions are estimated with consideration of historical claims statistics, the warranty period, the average time-lag between faults occurring and claims to the company and anticipated changes in quality indexes. Differences between actual warranty claims and the estimated claims generally affect the recognized expense and provisions in future periods. Refunds from suppliers, that decrease Volvo's warranty costs, are recognized to the extent these are considered to be virtually certain. At December 31, 2006 warranty cost provisions amounted to 8,411.

Legal proceedings

Volvo only recognizes liabilities in the accounts where Volvo has a present obligation from a past event, a transfer of economic benefits is probable and Volvo can make a reliable estimate of the size of the amount. In instances such as these, a provision is calculated and recognized in the balance sheet. In instances where these criteria are not met, a contingent liability may be disclosed in the notes to the accounts. A contingent liability will be disclosed when a possible obligation has arisen but its existence will only be confirmed by future events not wholly within Volvo's control or in circumstances where an obligating event has occurred but it is not possible to quantify the size or likelihood of that obligation crystalizing. Realization of any contingent liabilities not currently recognized or disclosed in the financial statements could have a material effect on Volvo's financial condition. Volvo regularly reviews significant outstanding legal cases following developments in the legal proceedings in order to assess the need for provisions in our financial statements. Among the factors that Volvo considers in making decisions on provisions are the nature of the litigation, claim or assessment, the legal processes and potential level of damages in the jurisdiction in which the litigation, claim or assessment has been brought, the progress of the case (including progress after the date of the financial statements but before those statements are issued), the opinions or views of legal counsel and other advisers, experience in similar cases, and any decision of Volvo's management as to how Volvo intends to respond to the litigation, claim or assessment. To the extent the determinations at any time do not reflect subsequent developments or the eventual outcome of any claim, our future financial statements may be materially affected, with an adverse impact upon our results of operation, financial position and liquidity.

over the term of the commitment in amounts required to reduce the value of the product to its estimated net realizable value at the end of the commitment. Estimated impairment losses are immediately charged to income. The estimated net realizable value of the products at the end of the residual value commitments is monitored individually on a continuing basis. In monitoring estimated net realizable value of each product under a residual value commitment, management makes consideration of current price-level of the used product model, value of options, mileage, condition, future price deterioration due to expected change of market conditions, alternative distribution channels, inventory lead-time, repair and reconditioning costs, handling costs and overhead costs in the used product divisions. Provisions for residual value risk amount to 781.

Revenue recognition

Revenue from the sale of goods is recognized when significant risks and rewards of ownership have been transferred to external parties, normally when the goods are delivered to the customers. If, however, the sale of goods is combined with a buy-back agreement or a residual value guarantee, the sale is accounted for as an operating lease transaction under the condition that significant risks of the goods are retained by Volvo. In certain cases Volvo enters into a buy-back agreement or residual value guarantee after Volvo sold the product to an independent party or in combination with an undertaking from the customer that in the event of a buy-back to purchase a new Volvo product. In such cases, there may be a question of judgement regarding whether or not significant risks and rewards of ownership have been transferred to the customer. If it is determined that such an assessment was incorrect, Volvo's reported revenue and income for the period will decline and instead be distributed over several reporting periods.

Deferred taxes

Under IFRS, deferred taxes are recognized for temporary differences, which arise between the taxable value and reported value of assets and liabilities as well as for unutilized tax-loss carryforwards. Volvo records valuation allowances against deferred tax assets where management does not expect such assets to be realized based upon current forecasts. In the event that actual results differ from these estimates or management adjusts these estimates in future periods, changes in the valuation allowance may need to be done that could materially impact our financial position and the income for the period. At December 31, 2006, a valuation allowance of 213 was established for the value of deferred tax assets. Net of this valuation allowance, deferred tax assets net of 10,069 were recognized in the Group's balance sheet.

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[57] **Volvo** [Sweden] Annual report 2006, page 96

5. Presentation of Financial Statements

Key points

IFRS Financial statements generally contain detailed disclosures enabling an understanding of the company's operations and financial position. Based on discussion with regulators and other stakeholders and on our analysis, IFRS presentation of consolidated financial statements has brought an enhanced level of quality and relevance, but some comparability issues remain between different EU preparers.

Although most accompanying notes are structured in four parts (accounting policies, notes to income statements, notes to balance sheet, notes to specific items), disparities observed in the structure of accompanying notes make access to information sometimes challenging. A detailed table of contents is a necessity to enable easy use of the financial statements.

Several factors must be considered as constraints to genuine comparability of the primary financial statements of EU listed companies

- Differences in financial vocabulary used.
- Lack of standardisation for financial aggregates.
- Lack of harmonisation linked to the national legacy in terms of reporting requirements.

The average number of captions disclosed on the face of the three main financial statements (Balance Sheet, Income Statement and Cash Flow Statement) appears to be slightly under 100 lines, with 90% of companies disclosing between 65 and 130 lines.

The income statement is structured by function by 108 companies (53% of 203 companies excluding financial activities), and by nature by 92 companies (45% of 203 companies).

Key financial performance indicators highlighted in the management report are generally based on IFRS results, but certain companies tend to comment in the management report on alternative indicators:

- Operating result: 198 companies (78% of 270) commented directly their IFRS operating result in their management report, while 40 companies (15%) make no reference. 32 companies comment in their management report on an alternative operating result, with one quarter of those failing to provide a reconciliation of this with the IFRS operating result.
- Net result: 228 companies (84% of 270) comment directly their IFRS net result in their management report, while 40 companies (15%) make no reference. Only 2 companies comment in their management on an alternative net result.

Difficulties we encountered during our analysis of financial statements, and comments made by enforcers and other stakeholders, indicates that the issue of how far to go in standardising presentation formats for ease of reading and comparability needs to be addressed. This topic could potentially be examined in liaison with developments on potential computerisation and coding of financial statements disclosures.

IFRS Requirements

IAS 1 *Presentation of Financial Statements* main objective is *" to prescribe the basis for presentation of general purpose financial statements, to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content.* "

5.1. Ease of comparisons

Although our pan European review of IFRS financial statements indicate a fair level of consistency in the presentation of balance sheets (captions, sub totals, terminology used) the same is not true for the presentation of Income Statements where IAS 1 requirements are minimal. Comparative analysis between IFRS reporting entities suffer from a lack of homogeneity regarding items presented on the face of the Income Statement and an important variety of accounting terms used by preparers in the English version of their annual reports. Easier or more reader friendly comparisons will only be made possible if either IAS 1 is amended to prescribe mandatory captions and sub totals or if use of interactive tools to compare financial data is accepted by issuers across Europe.

As an illustration, we found that eight companies of the Chemicals sector use no less than three aggregates for revenue designation (revenue, sales and turnover), four aggregates for operating income (profit/loss, result, income, earnings), and two for net income (profit/loss and income).

Table 28 : Examples of aggregates in the Chemicals sector

Company	Country	Revenue designation	Operating profit designation	Net profit designation	Other aggregates used
Tessenderlo Chemie	Belgium	Revenue	Profit/loss from operations	Profit/loss for the period	Gross profit, Profit from operations before non-recurring items, Profit/loss before tax
Umicore	Belgium	Turnover	Result from operating activities	Profit (Loss) of the period	Profit/loss before income tax, Profit from continuing operations
SP Group	Denmark	Revenue	Profit/loss before financial items (EBIT)	Net profit/ loss for the year	Contribution margin, Profit before amortisation, depreciation and impairment losses (EBITDA), Profit/loss before tax, Allocation of profit/loss for the year
L'Air Liquide	France	Revenue	Operating income	Profit for the period	Operating income recurring before depreciation and amortization, Operating income recurring, Profit before minority interests and discontinued operations
BASF	Germany	Sales	Income from operations	Net income	Gross profit on sales, Income before taxes and minority interests, Income before minority interests
Bayer	Germany	Net sales	Operating result (EBIT)	Income after taxes	Gross profit, Non-operating result, Income before income taxes, Income from continuing operations after taxes, Income from discontinued operations after taxes
K+S AG	Germany	Revenue	Operating earnings (EBIT I)	Net income	Gross profit, Earnings after market value changes (EBIT II), Earnings before income taxes
Akzo Nobel	Netherlands	Revenues	Operating income	Profit for the period	Gross profit, Operating income less financing income and expenses

5.2. Length of Financial statements

The number of captions disclosed on the face of the three main financial statements (Balance Sheet Income Statement and Cash Flow Statement) varies significantly between companies. The captions disclosed averages 94 lines including aggregates, and ranges from less than 50 to more than 250.

Table 29 : Number of captions on the face of the three main financial statements (excluding lines related to "earnings per share")

Number of captions including aggregates	Minimum	Average	Maximum
Assets	5	**16,7**	54
Equity & Liabilities	8	**21,1**	70
Income Statement	10	**20,4**	66
Cash Flow Statement	14	**35,8**	86
TOTAL	**45**	**94,0**	**267**

More than 90% of companies however, disclosed between 65 and 130 lines:

- 4% of companies (10 out of 250) disclosed more than 130 captions;

Table 30 : 10 Companies having the longest financial statements lines (2006)

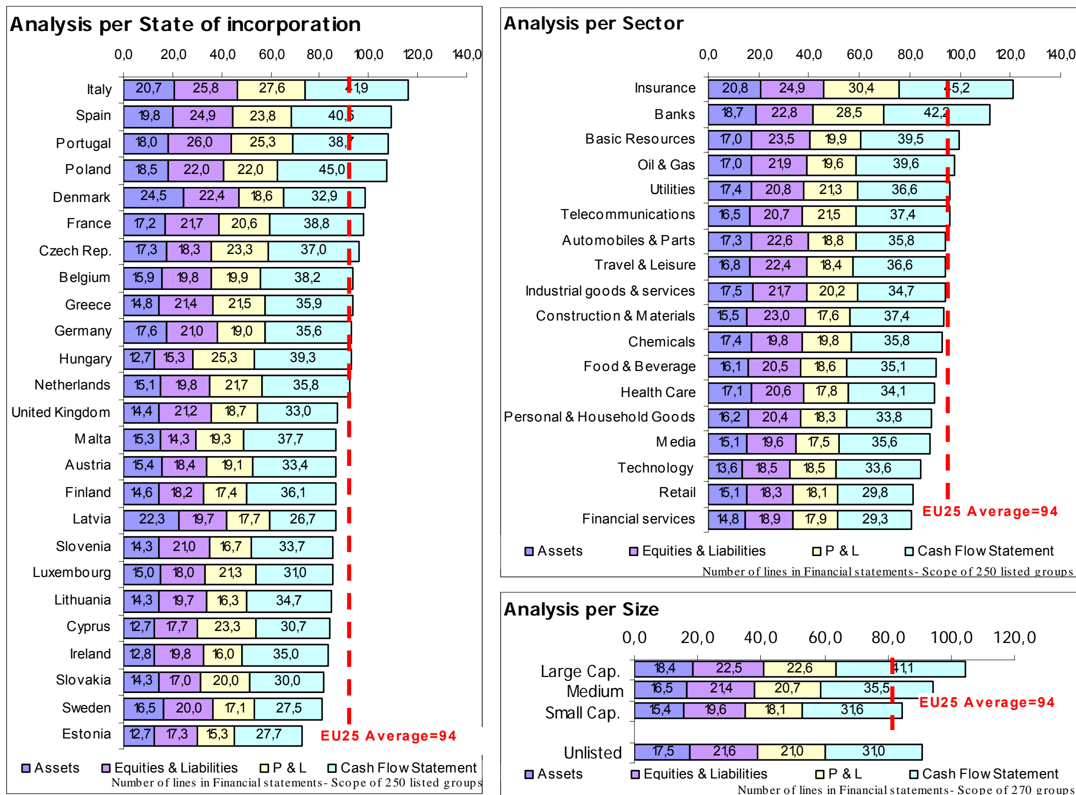
Country	ICB supersector	Assets	Equity & Liabilities	P&L (without e.p.s)	Cash-flow statement	Total of lines
Spain	Banks	53	70	66	78	**267**
Spain	Banks	54	56	63	86	**259**
Italy	Industrial goods & services	35	40	57	48	**180**
France	Insurance	27	41	32	71	**171**
Poland	Industrial goods & services	34	32	39	52	**157**
Italy	Banks	20	25	44	52	**141**
Italy	Insurance	27	33	37	38	**135**
Ireland	Banks	17	23	31	62	**133**
Italy	Insurance	27	33	35	37	**132**
France	Telecommunications	17	25	25	64	**131**

- 4% of companies (10 out of 250) disclosed less than 130 captions.

Table 31 : 10 companies having the shortest financial statements lines (2006)

Country	ICB supersector	Assets	Equity & Liabilities	P&L (without e.p.s)	Cash-flow statement	Total of lines
Ireland	Technology	8	9	12	16	**45**
Finland	Financial services	8	8	14	19	**49**
Portugal	Technology	13	24	18	Integrated within Balance Sheet	**55**
United Kingdom	Health Care	10	15	16	14	**55**
United Kingdom	Financial services	5	15	11	24	**55**
Estonia	Personal & Household Goods	10	14	13	23	**60**
Sweden	Construction & Materials	12	17	13	19	**61**
Ireland	Industrial goods & services	11	21	12	18	**62**
United Kingdom	Financial services	11	13	15	24	**63**
Malta	Financial services	13	12	15	24	**64**

Table 32 : Cross analysis by state, sector and size of the number of captions on the face of the three main financial statements



Cross analysis reveals national and sectors specificities regarding the volume of information disclosed on the face of the financial statements.

Companies of Latin countries, such as Italy, Spain, and Portugal lead the number of captions disclosed, with average higher than 105. Poland is at the same level as Portugal. On the other end, the companies of Nordic and Baltic countries have the lower average number of disclosures.

Companies from regulated financial sectors (Insurance and Banks) have the highest number of disclosures, with more than 110 lines on average for Balance Sheet, P&L and Cash-flow statement).

The size of companies also influences the number of disclosures, with large companies disclosing on average 10 more lines than medium companies, and 20 more lines than small companies. To that respect, half of the variance between large and small companies originates in the Cash Flow statement. Unlimited companies, with 91 lines, are close to listed companies' average of 94.

Number of aggregates disclosed

In addition to captions *per se* the number of aggregates also fluctuates from one company to another. For example, **BBVA** [Spain, Banks], presents 7 aggregates on the face of the Income Statement: Interest and Similar Income, Net Interest Income, Gross Income, Net Operating Income, Income before tax, Income from ordinary activities, Consolidated Income for the Year, where **Witan Investment Trust** [United Kingdom, Financial services] presents only 4 (Investment Income, Total Income, Profit before taxation and Profit attributable to equity holders of the parent company).

5.3. Income Statement Presentation (by Function, by Nature):

IFRS Income Statement presentation may be structured either by Function or by nature of expenses:

- ***Analysis by function*** disclosing cost of sales, selling and marketing costs, general and administrative costs, research and development costs;
- ***Analysis by nature*** disclosing changes in inventories of finished goods and work in progress and raw materials used, other supplies personnel costs and depreciation.

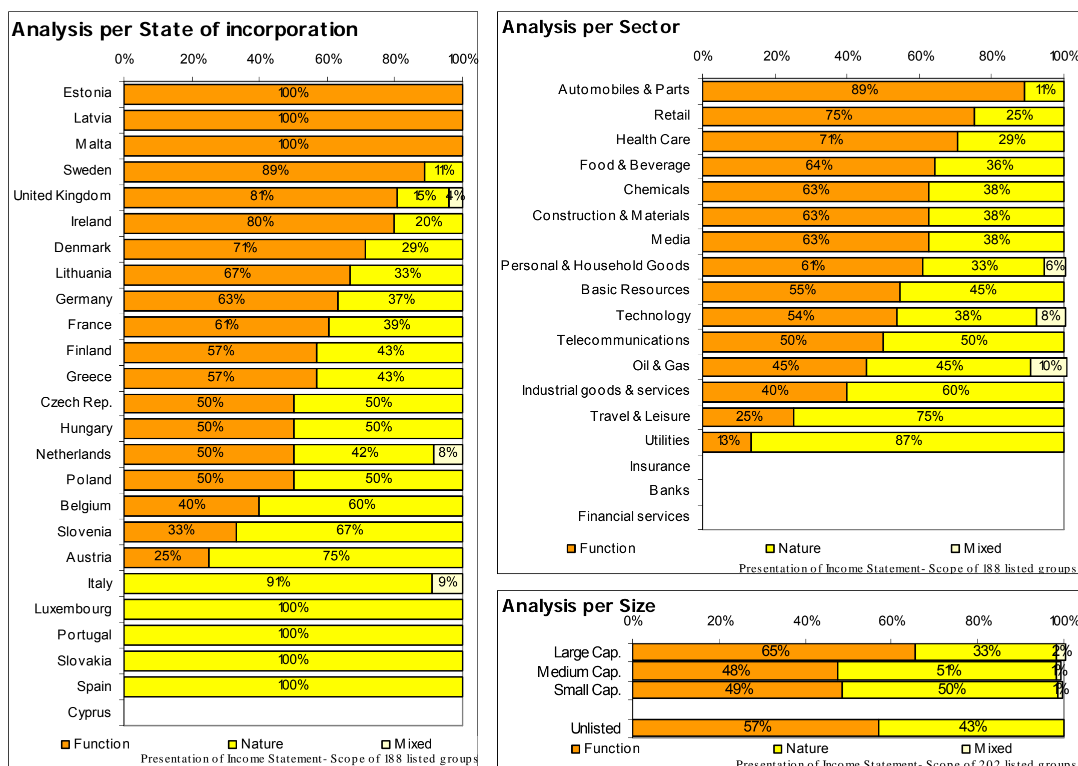
The choice of presentation is rather balanced with 53% of companies from industrial and services sectors disclosing an analysis by function of the income statement. Due to specificities of the sector, financial activities have been considered separately.

Table 33 : Type of presentation of the income statement

Income Statement Presentation	Industry and Services		Financial activities		Total	
	Number of companies	*%*	*Number of companies*	*%*	*Number of companies*	*%*
Analysis by function	100	53 %				
Analysis by nature	85	46 %				
Mixed presentation	3	1 %				
Sub-total Listed companies	**188**	**100 %**	**62**		**250**	
Analysis by function	8	57%				
Analysis by nature	7	43%				
Mixed presentation	-	-				
Sub-total Non-listed companies	**15**	**100%**	**5**		**20**	
Total	**203**		**67**		**270**	

The fact that companies can choose between a presentation of costs by function or costs by nature/costs type introduces an immediate difficulty in comparability of costs across companies, irrespective of country or industry sector. Full comparability can only be achieved by opting for one format of presentation or requesting both formats to be presented, which adds complexity.

Table 34 : Cross analysis by state, sector and size of the type of presentation of the income statement



Cross analysis by countries reveals a diversity of presentation reflecting historical trends in the use of management accounting and current national additional requirements.

The presentation by nature is unanimous in some Latin countries such as Spain, Italy and Portugal. The presentation by function dominates in United Kingdom and Ireland, and in Nordic and Baltic countries. Both presentations coexist in balanced proportion in most countries including France, Germany, Netherlands, Belgium and most central Europe countries.

Cross analysis by sector reveals few significant patterns. Income statement presentation by nature prevails for Utilities (where Italy and Spain are well represented) and income statements by function for Automobile & Parts. It is likely that balanced pattern shown by other sectors reflect more national trends than industry driven practice.

As well, cross analysis by size is unlikely relevant. Apparent slight prevalence of presentation by function among large cap companies may be caused by sampling bias with companies from UK larger on average than companies from Latin countries.

The following two examples (**Electrolux** [Sweden, Personal & Household Goods] and **Cintra Concesiones** [Spain, Industrial Goods & Services]), both of which are IFRS compliant, illustrate[58,59] the absence of direct comparability allowed by IAS 1 for the presentation of Income Statements.

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[58] **Electrolux** [Sweden] Annual Report 2006, page 53

[59] **Cintra Concesiones** [Spain] Annual Report 2006, page 68

Income Statement by Function – *Electrolux [Sweden]*

Consolidated income statement

SEKm	Note	2006	2005
Net sales	3, 4	**103,848**	**100,701**
Cost of goods sold		–79,664	–77,270
Gross operating income		**24,184**	**23,431**
Selling expenses		–15,294	–14,635
Administrative expenses		–4,467	–4,945
Other operating income	5	185	230
Other operating expenses	6	–33	–57
Items affecting comparability	7	–542	–2,980
Operating income	3, 4, 8	**4,033**	**1,044**
Financial income	9	538	225
Financial expenses	9	–746	–775
Financial items, net		**–208**	**–550**
Income after financial items		**3,825**	**494**
Taxes	10	–1,177	–636
Income for the period from continuing operations		**2,648**	**–142**
Income for the period from discontinued operations	30	**1,199**	**1,905**
Income for the period		**3,847**	**1,763**
Attributable to:			
Equity holders of the Parent Company		3,847	1,763
Minority interests in income for the period		0	0
		3,847	**1,763**
Earnings per share for continuing operations, SEK	20		
Basic		9.17	–0.49
Diluted		9.14	–0.49
Average number of shares, million	20		
Basic		288.8	291.4
Diluted		289.8	293.2

Income Statement by Nature – *Cintra Concesiones [Spain]*

Consolidated income statements for 2006 and 2005

Thousand euro	NOTE	2006	2005
Sales		884,557	696,223
Other operating revenue		10,279	17,293
TOTAL OPERATING REVENUE	**25**	**894,836**	**713,516**
Materials consumed and other external expenses		-7,209	-8,648
Staff expenses	**26**	-110,121	-91,165
a) Wages, salaries and similar compensation		-94,597	-77,934
b) Staff welfare expenses		-15,524	-13,231
Non-current assets depreciation and amortisation		-220,828	-159,307
Change in trade provisions		-12,357	-10,711
Other operating expenses		-184,475	-149,752
TOTAL OPERATING EXPENSES		**-534,990**	**-419,583**
OPERATING PROFIT / (LOSS)	**28**	**359,846**	**293,933**
Financial results, concession companies		-467,490	-354,013
Financial results, Other companies		-1,294	-3,025
Financial results, financing		-839	-2,599
Other financial results		-455	-426
FINANCIAL PROFIT / (LOSS)	**29**	**-468,784**	**-357,038**
SHARE OF RESULTS OF EQUITY-CONSOLIDATED COMPANIES	**7**	**7,174**	**10,363**
OTHER PROFIT AND LOSS	**30**	**202,422**	**34,060**
CONSOLIDATED PROFIT / (LOSS) BEFORE INCOME TAX	**31**	**100,658**	**-18,682**
Income tax	**23**	-24,239	8,214
CONSOLIDATED PROFIT / (LOSS) FROM CONTINUING OPERATIONS	**32**	**76,419**	**-10,468**
NET PROFIT / (LOSS) FROM DISCONTINUED OPERATIONS		**0**	**0**
CONSOLIDATED PROFIT / (LOSS) FOR THE YEAR		**76,419**	**-10,468**
(PROFIT) / LOSS ATTRIBUTED TO MINORITY INTEREST	**17**	**79,246**	**44,252**
PROFIT / (LOSS) FOR THE YEAR ATTRIBUTED TO THE PARENT COMPANY	**16**	**155,665**	**33,784**
EARNINGS PER SHARE			
From continuing operations	**33**		
Basic		**0.32**	**0.07**
Diluted		**0.31**	**0.07**

Notes 1 to 42 form an integral part of the Consolidated Financial Statements as at 31 December 2006

5.4. Type of captions used for the Income Statement

Most frequent type of expenses disclosed

We search for the various types of expenses disclosed on the face of the Income Statement and also in the accompanying notes dedicated to the Income Statement.

For Income Statements by Function, Cost of sales and Administrative and General Expenses are the most frequent captions (100% and 98% of companies), whereas Research & Development is only disclosed by 66% of companies.

For Income Statements by Nature, Personnel Costs and Amortization & Depreciation are disclosed by all companies, whereas only 60% of companies disclose Inventory Variations.

Table 35 : Captions most frequently used in the Income Statement

Presentation by function	Number of companies	%	Presentation by nature	Number of companies	%
Cost of Goods sold	100	100 %	Personnel costs	85	100 %
Administrative & General expenses	98	98 %	Amortisation & Depreciation	85	100 %
Selling *or* distribution expenses	85	85 %	Purchases	72	84 %
Research & Development expenses	66	66 %	Inventory variation	52	60 %
TOTAL	**100**	**100 %**		**85**	**100 %**

Other items represent additional information on various elements of the Income Statements. The most frequently "other items" presented are as follows:

Table 36 : Captions most frequently found in "Other items" of the Income statement

Main "Other items" encountered	Industry & Services sectors (88 companies)	Financial activities sectors (62 companies)	Total (250 companies)
Rents & Lease	68	23	91
Advertising & Promotion	33	11	44
Maintenance & Repair	37	4	41
Insurance	29	8	37
Transport & Travel	30	6	36
Marketing	28	7	35
Total of disclosures	**225**	**59**	**284**

Other captions may also be presented like: legal services and audit fees, trading, production, IT costs. Public grants, share-based payments and environmental costs.

Non-recurring items

The following data was collected regarding the main non-recurring items presented on the face of Income Statements or in related footnotes:

Table 37 : Captions most frequently found in "Non-recurring items" of the Income statement

Main "Non-recurring items" disclosures encountered	Industry & Services sectors (88 companies)	Financial activities sectors (62 companies)	Total (250 companies)
Assets disposal	**138**	**33**	**171**
Gains from the disposal of assets	95	23	118
Loss from the disposal of assets	43	10	53
Impairment charges	**62**	**19**	**81**
Currency Exchange gains & losses	**64**	**9**	**73**
Exchange gains	28	4	32
Exchange losses	36	5	41
Restructuring/Reorganization costs	**52**	**5**	**57**
Write-backs & Write-offs	**24**	**9**	**33**
Write-backs of assets, receivables	7	3	10
Write-offs of assets, receivables	17	6	23
Reversal of provisions	**24**	**4**	**28**
Legal claims & disputes	**16**	**7**	**23**
Gains on disputes	8	1	9
Loss on disputes	8	6	14
Total of disclosures	380	86	466

Other non-recurrent items not listed above may include: licences and royalties, compensation and termination fees, bad debts, badwills, credit losses, gains and losses on the disposal of shares.

5.5. Performance indicators disclosed in Management Reports:

Notwithstanding their obligation to identify clearly the financial statements from other information in the same published document, virtually all companies refer to key financial indicators in their management report. Indeed, 96 % of companies referred to either operating result or net result (or both) in their 2006 management report, and 83 % did so in a distinctive section with focus on financial highlights.

Table 38 : Location of references to financial indicators in Management reports

Reference to financial indicators in Management report	Listed		Non Listed	
	Number of companies	%	Number of companies	%
Financial highlights of Management report	207	83 %	15	75%
Other sections of Management report	28	11 %	1	5%
Both financial highlights and other sections of Management report	4	2 %	1	5%
No reference in the management report	11	4 %	3	15%
Total	**250**	**100 %**	**20**	**100%**

Key financial performance indicators highlighted in the management report are generally IFRS compliant. We considered profit indicators as IFRS compliant whenever they were identical to those disclosed in the audited financial statements. “Operating result” and “Net result” are the main financial highlights used by companies to signal their overall and operating performance:

- 74% of companies disclosed the same Operating profit in their Management Report and in the Financial Statements.
- 12% used an alternative Non-IFRS Operating profit:
- 14% of companies did not disclose any Operating profit.
- 85% of companies disclosed the same Net profit in their Management Report and in the Financial Statements.
- 14% of companies did not disclose any Net profit.

Table 39 : Reconciliation of financial indicators in Management report with IFRS financial statements

Reference in Management report	Operating result		Net result	
	Number of companies	%	Number of companies	%
Same definition in the management report as in the IFRS audited financial statements	184	74 %	212	85 %
Alternative definition in the management report, reconciled with the IFRS financial statements	23	9 %		
Alternative definition in the management report, unreconciled with the IFRS financial statements	8	3 %	1	
No reference in the management report	35	14 %	37	15 %
Sub total listed companies	**250**	**100 %**	**250**	**100 %**
Same definition	14	70%	16	80%
Alternative definition	1	5%	1	5%
No reference	5	25%	3	15%
Sub total non-listed companies	**20**	**100%**	**20**	**100%**

Results for non-listed companies do not differ significantly. All companies commenting their net profit but two (one listed, one none-listed) referred to their IFRS audited net profit.

6. Segment reporting

Key points

While segment reporting is globally covered by the companies, full disclosure as required by IFRS has still not yet been achieved:

- 252 companies (93% of 270) disclosed segment reporting. Most non-disclosing companies justified the absence of segment reporting by the fact that they operate a single activity in a single geographic area.
- 186 listed companies (79% of 250) disclosed both primary and secondary reporting. Business segmentation clearly leads Geographical segmentation for primary segment reporting.
- The number of segments disclosed averages 4 business segments and 4 geographical segments per company.
- However, disclosures for segment reporting are fully compliant for only 71% of the 235 listed companies disclosing primary and/or secondary reporting. Other disclosing companies (68 out 235) failed to disclose some of the indicators required by IAS 14.51-72.

More than half the companies already comment in some form on IFRS 8, but only two companies within our sample were early adopters:

- 145 companies (54% of 270) disclosed information on IFRS 8. Among the 69 companies (26% of 270) having already estimated the IFRS 8 impact on their financial statements, two thirds disclosed that they do not expect the application of IFRS 8 to lead to adjustments.
- Two German SEC filers and first-time IFRS applicants were the only companies to apply IFRS 8 by anticipation.

IFRS Requirements

According to the provisions of IAS 14 *Segment reporting*, an entity should determine its primary and secondary segment reporting formats (business or geographical) based on the dominant source of the entity's business risks and returns [IAS 14.26].

All segments representing more than 10% of either total revenue, total profit or total assets, must be separately disclosed [IAS 14.35].

Additional segments must be reported until at least 75% of consolidated revenue is included in reportable segments [IAS 14.37].

Mandatory disclosures for primary reporting format consist of: revenue, result, assets, liabilities, capital expenditure, depreciation & amortisation, the total amount of significant non-cash expenses and impairment losses [IAS 14.51-67].

Mandatory disclosures for secondary reporting format consist of: segment revenue, assets, and capital expenditure [IAS 14.69-72].

A "matrix presentation" – both business segments and geographical segments as primary reporting formats with full segment disclosures on each basis – is also possible, but IAS 14 does not require it [IAS 14.29].

6.1. Disclosure of segment reporting

Analysis of companies not disclosing any segment reporting

94 % of listed companies (235 out of 250) and 85% of non-listed companies (17 out of 20) disclosed segment reporting. 18 companies (15 listed and 3 non-listed), having one business and one geographical segment, did not disclose any segment reporting.

Table 40 : Disclosure of segment reporting

Segment reporting disclosures	*Listed*		*Non- listed*		*Total*	
	Number of companies	*%*	*Number of companies*	*%*	*Number of companies*	*%*
Yes	*235*	*94 %*	*17*	*85 %*	***252***	***93 %***
No	*15*	*6 %*	*3*	*15 %*	***18***	***7 %***
Total	***250***	***100%***	***20***	***100%***	***270***	***100%***

15 listed companies did disclose any segment reporting. Among them 7 companies are medium and small companies from the Financial services sector:

- 4 companies (26%) did not justify the non-disclosure (of which 3 small and medium companies from the financial sector and one medium retail company).
- 11 companies (74%) justified the absence of segment report. We considered here one relevant example:

  Elia System [Belgium, Utilities], justified[60] the absence of segment reporting by the fact that it operates a single activity on a single geographic area:

> *(w) Segment reporting*
>
> A segment is a clearly distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment) and which is subject to risks and rewards that are different from those of other segments.
>
> The company does not use segment reporting since the Group is a company that generates revenue from one activity, i.e. federal electricity transmission system operator in Belgium. Furthermore, the Group only operates in one geographical area (Belgium) where there are no differences between the different Regions as regards risks and returns.

[60] **Elia System** [Belgium] 2006 Annual report, page 60

Atlantia-Autostrade [Italy, Industrial Goods & Services] justified[61] the absence of segment reporting by the fact that it considers secondary activities to have risks and rewards closely related to the core business:

SEGMENT REPORTING

IAS 14 requires disclosure of information concerning the various business and geographical segments in which the Group operates in order to provide a clearer representation of results, risks and earnings of the Group. In particular, information about business and/or geographical segments must be provided when a segment's revenue, assets or profit are more than 10% of the corresponding aggregate amounts of all Group segments, in such a way that at least 75% of total consolidated revenue is reported by segment.

In accordance with the definitions of business and geographical segments established by IAS 14, based on the risks and rewards of a segment that are distinct from those of other segments, the analyses conducted of the specific segments in which the Group operates show that the segment relating to Italian motorway concessions represents over 90% of Group revenue. The operation of motorway concessions also includes all activities that are vertically integrated with the core business, such as, for example, engineering, road surfacing and road maintenance. Moreover, other segments, such as service area sub-concessions, mobile information services and the construction of fully equipped multi-operator sites for the telecommunications sector, are also linked to the core business, in that they are complementary activities and, in any event, closely connected to economic use of the main concession, from which they cannot be legally separated. In substance, these activities generate revenue related to motorway tolls, as the statistical regressions calculated for this purpose also demonstrate.

In view of the above, the information required by IAS 14 is not relevant and is, therefore, not provided.

Analysis of companies disclosing primary and secondary segment reporting:

235 listed companies disclosed segment reporting, among which:

- 80% of groups (186 out of 250) disclosed both primary and secondary segment reporting
- 18% of groups (42 out of 250) disclosed only primary segment reporting
- 2% of groups (7 out of 250) disclosed only secondary segment reporting.

- 82% of groups (193 out of 250) chose Business segmentation as primary (or sole) reporting format
- 16% of groups (8 out of 250) chose Geographical segmentation as primary reporting format
- 2% of groups (4 out of 250) chose full matrix presentation.

Table 41 : Segmentation for primary and secondary segment reporting

Segment reporting disclosures and primary formats used	Business as primary segment	%	Geographical as primary segment	%	Matrix	%	Total	%
Primary and secondary segment reporting	157	67%	25	11%	4	2%	186	79%
Only Primary segment reporting	29	12%	13	6%			42	18%
Only Secondary segment reporting	7	3%					7	3%
Total of segment reporting	**193**	**82%**	**38**	**16%**	**4**	**2%**	**235**	**100%**

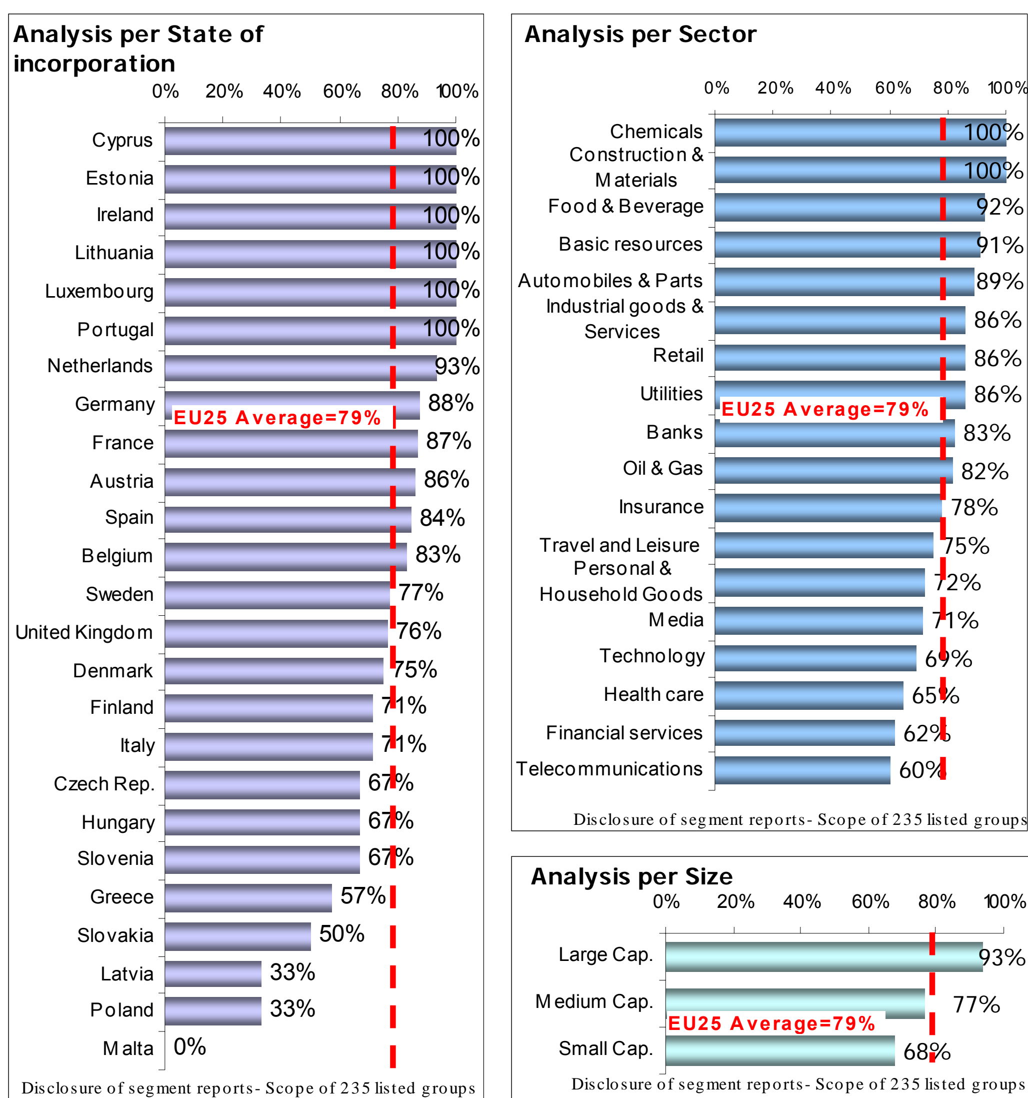
[61] **Atlantia Autostrade** [Italy] 2006 Annual report, page 172

Cross analysis by size shows that non-disclosing companies are essentially small and medium companies.

Cross analysis by sector of industry shows that segment reporting is more strategic to certain economic sectors (Automobiles & Parts, Construction & Materials, Chemicals, Food & Beverage, Basic Resources, Industrial goods & services, Oil & Gas) and less relevant for other sectors having a single activity (Financial sectors, Media) or operating in a single market (Telecommunications).

Large countries (Netherlands, France, Germany, Spain) have bigger segment disclosures due to their foreign/overseas activity and due to the complexity of corporate structure.

Table 42 : Cross analysis by state, sector and size of full disclosure of primary and secondary segment reporting



Analysis of companies disclosing only primary or secondary segment reporting:

Out of 235 companies disclosing segment reporting, a total of 49 non-disclosing companies were identified (42 companies not disclosing secondary segment, 7 companies not disclosing primary segment).

Companies disclosing only primary segment reporting

Out of 42 companies disclosing only primary segment reporting:

- 32 companies justified the absence of a secondary segment reporting:
  - **By the existence of a single activity**[62] **:** "*Therefore, each of the individual companies of the AWD Group is to be qualified as a one-product company. Their strategic and operational management and their internal reporting systems are structured along the lines of the respective national companies: As a consequence, segmentation takes place solely geographically*."
  - **For reasons of materiality**[63] **:** "*As the total revenue, segment results and assets of subsidiaries domiciled in the USA, the United Kingdom and Switzerland account for less than 5 percent of the respective Group totals, there is no requirement to report secondary geographical segments in accordance with IAS 14*."
  - **Because of the difficulty to determine segments in specific industries**[64] **:** "*The Group is operating on a worldwide basis. However, because of difficulty to determine geographical segment in shipping industry, no such information is provided*".
- 10 companies did not justify the non-disclosure.

Companies disclosing only secondary segment reporting

7 companies justified the absence of a primary segment reporting by the existence of a single operating business segment, as did **Abbeycrest** [United Kingdom, Personal & Household goods][65] :

"The single primary business segment of the Group is the manufacture and distribution of jewellery. The Group operates in three main geographical regions: the United Kingdom, the Rest of Europe and the Rest of the World".

The decision taken by these companies to consider their single reporting format as secondary may be influenced by the fact that the standard requires less mandatory financial indicators for secondary reporting than for primary reporting.

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[62] **AWD Group** [Germany, Financial services] Annual report 2006, page 108

[63] **Deutsche Börse** [Germany, Financial services] Annual report 2006, page 190

[64] **Latvijas Kugnieciba** [Latvia, Industrial goods & services] Annual report 2006, page 33

[65] **Abbeycrest** [United Kingdom, Personal & Household goods] – Annual report and financial statements 2006-2007, page 29

6.2. Disclosures for primary and secondary reporting

The level of financial mandatory disclosures by category of indicator for primary and secondary segment reports is as follows:

Table 43 : Compliance of segment reporting disclosures (1/2)

Primary segment mandatory disclosures	Compliant companies	%
Segment revenue	228	100%
Segment result	227	99%
Segment assets	217	95%
Segment liabilities	211	93%
Segment capital expenditures	194	85%
Segment amortization/depreciation	203	89%
Secondary segment mandatory disclosures	**Compliant companies**	**%**
Segment revenue	193	100%
Segment assets	167	87%
Segment capital expenditures	152	79%

Amongst mandatory financial segment disclosures, "Capital expenditures" is the less disclosed segment indicator (79% only in secondary segment reporting against 85% in primary segment reporting).

Revenue ("External sales") and Result are the most disclosed segment indicators, with respectively 100% and 99% of compliance in both primary and secondary reports.

The level of compliance regarding financial mandatory disclosures by category of segment report is indicated below: it is different from the statistics regarding the level of compliance by category of indicator as:

- Many companies failed to disclose various indicators.
- 3 categories of disclosures are considered here (in Primary, Secondary, and both Primary and Secondary reporting).

Table 44 : Compliance of segment reporting disclosures (2/2)

	Total of Disclosing Companies	Total of non-compliant companies	%	Companies having 1 indicator missing	Companies having 2 indicators missing	Companies having more than 2 indicators missing
Both in Primary and Secondary reporting	186	23	12%		5	18
In Primary reporting	228	46	23%	18	7	21
In Secondary reporting	193	45	20%	7	20	18

As a result, when we exclude the occurrences that concern the same entity, 68 entities were not fully compliant with the requirements of IAS14.

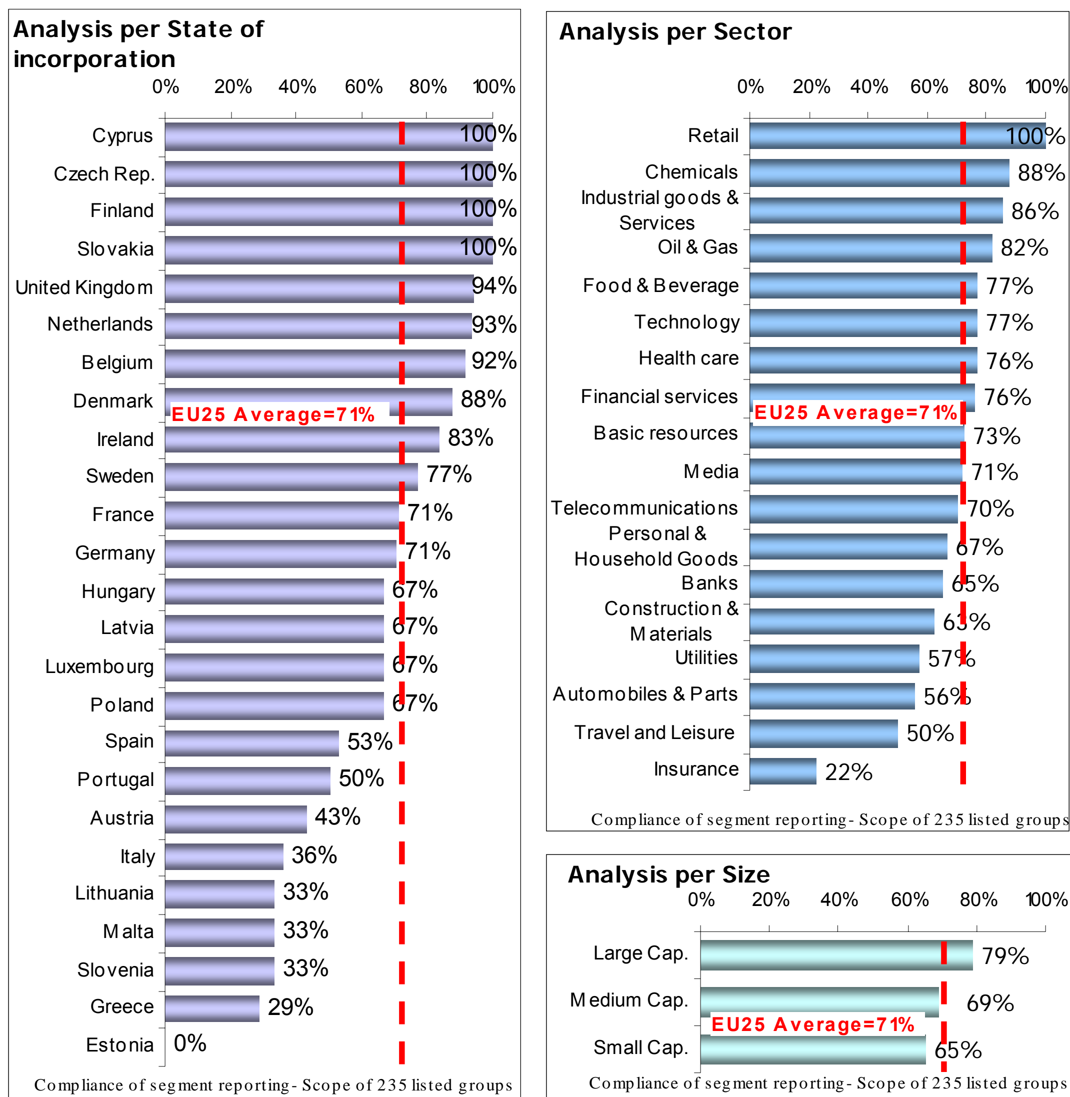
Breakdown of compliant companies

If we consider the total of 235 companies having disclosed segment reports:

- 167 (71%) were fully compliant.
- 68 (29%) were not fully compliant.

The breakdown of compliance by size of companies tends to indicate that larger companies are more respectful of IAS 14 mandatory key financial figures provisions than smaller companies.

Table 45 : Cross analysis by state, sector and size of compliance of segment reporting



The breakdown of compliant companies by sector of industry shows that the Retail, Chemicals and Oil & Gas sectors of industry (less than 20% of non-compliance) comprise the highest number of companies fulfilling all IAS 14 disclosures regarding key financial figures. On the contrary, in the Insurance sector of industry, non-compliance reaches 78% of encountered financial statements.

Focus on sectors of industry in which non-compliant companies account for more than 40% of total (17 companies, 24 non-disclosures) : Non-disclosure is mostly concentrated on Capital expenditures and Assets in Secondary reporting, due to sector of industry particularities, and presentation options (7 companies out of 17 disclosed partial matrix presentation).

Table 46 : Missing disclosures in segment reporting: focus by industry sectors

Missing disclosures in ICB supersectors	Primary reporting				Secondary reporting		Total missing disclosures
	Assets	Liabilities	Capex	Depreciation & Amortization	Assets	Capex	
Utilities			2	1		3	6
Travel & Leisure	1	1	3		3	2	10
Insurance				1	2	5	8
Total	1	1	5	2	5	10	24

The breakdown of non-compliant companies by country of incorporation shows that some countries are fully or nearly fully compliant towards IAS 14 financial key figures disclosures (Finland, UK, Netherlands).

A central group of countries is in an intermediary situation (Germany, France, Portugal, Spain, Poland) whereas some other countries have to make progress towards full compliance (Italy, Greece).

Focus on countries with non-compliant companies accounting for > 40% of Total : Non-disclosure concerns mainly small and medium companies (82% of total non-compliant companies).

Table 47 : Missing disclosures in segment reporting: focus by state of incorporation

Non-compliant companies by country	Large	Medium	Small	Total number of companies
Italy	3	3	3	**9**
Spain	1	4	4	**9**
Austria	2	1	1	**4**
Greece	1	2	2	**5**
Estonia		2	1	**3**
Portugal		1	1	**2**
Lithuania		1	1	**2**
Slovenia		1	1	**2**
Malta		1	1	**2**
Total	**7**	**16**	**15**	**38**

6.3. Disclosures for segment result

According to IAS 14, Segment result is defined as being segment revenue minus segment expenses, before deducting minority interests.

Compliance with segment result definition

Out of 235 listed companies disclosing segments, 227 companies (97%) disclosed segment result in their report (either business or geographical).

A wide range of names were used by companies to designate segment result, and the following main categories of designations were used:

- Operating profit or income (47%).
- Profit from operations (8%).
- EBIT (10%).
- EBITDA (6%).
- Profit before tax (10%).
- Segment result (7%).

Amongst other designations (9%) are found : net profit, operating profit before tax, Ebitdar, gross margin, gross operating income, gross profit, gross profit IFRS, income from ordinary activities, operating margin, operating earnings, operating profit before impairment losses and provisions, result per line of business, segment earnings, segment income before income taxes, activity contribution before depreciation, amortization, and provisions, earnings before taxes.

3 companies (1% of total) were fully non-compliant, disclosing Net Profit as their sole segment result indicator, which is not in accordance with the provisions of IAS 14.

6.4. Disclosure for segment revenue

According to IAS 14, non-segment result must represent less than 25% of total revenues (external sales).

Out of 235 companies disclosing at least either primary or secondary segment reporting, we identified 10 companies (4%) in which identified segment revenues account for less than 75% of consolidated revenues.

Table 48 : Companies with identified segment accounting for less of 75% of consolidated revenues

Country	ICB sector	Non-segment sales name	Segmentation report concerned	Non-segment sales amount (in M currency)	Consolidated sales amount (in M currency)	Percentage of non segment sales amount > 25%
France	Personal & Household Goods	"Rest of the World"	Secondary - Geographical	4 154	15 790	26%
Germany	Chemicals	"Overseas"	Secondary - Geographical	836	2 958	28%
Netherlands	Industrial goods & services	"Rest of World"	Secondary - Geographical	229	774	30%
Netherlands	Media	"Other activities"	Primary - Business	343	784	44%
Spain	Industrial goods & services	"Rest of the World"	Secondary - Geographical	65	137	47%
Spain	Automobiles & Parts	"Abroad"	Secondary - Geographical	244	805	30%
Spain	Basic resources	"Rest of the World"	Secondary - Geographical	38	121	31%
Spain	Financial services	"Foreign"	Secondary - Geographical	212	590	36%
Sweden	Industrial goods & services	"Other"	Secondary - Geographical	166	381	44%
UK	Health Care	"Rest of World"	Secondary - Geographical	7 048	25 238	28%

Note: Five companies were considered as compliant companies regarding the quantity of segment information to be disclosed for primary and secondary reporting. As for the particular issue of segment revenue limit, they could be considered as non-compliant in 2006, which means that the total number of full compliant companies regarding all aspects of segment financial reporting in 2006 would fall to 162 companies (69% of total) and the number of companies not being fully compliant would reach 73 (31%)

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6.5. Analysis of geographical and business segmentation

Geographical areas segmentation

206 out of 250 companies disclosed financial information (as primary or secondary format) regarding segment geographical reporting.

The distribution of segments according to principal geographical areas is as follows:

- Europe (42%) and Americas segments (33%) were the first disclosed areas in the geographical segmentation format of European companies.
- Asia-Pacific segments (17%) hold the third position.
- Africa & Middle East segments (8%) are the fourth geographical zone disclosed.

More observations can be inferred from geographical segment disclosures of 206 companies:

- 79 companies (38%) disclosed segment information by country (meaning here more than 1 country disclosed).
- 14 companies (7%) used partial matrix presentation (matrix presentation only for certain segment financial disclosures).
- 116 companies (56%) used the undefined type of disclosures “Other” (Other countries, Rest of the World, Abroad) in their geographical segmentation disclosure.
- 7 companies (3%) disclosed a segment called “European Union”.

Geographical segment breakdown reflects companies’ vision of their environment:

- 39% of companies seem to tailor the segmentation to their local footprint, mostly at country level
- 13% of companies present groups of countries as geographical segments
- 38% of companies present a global top-down approach, based on continental segments
- 10% of companies present concentric zones, usually their home country, their continent, and the rest of the world

“Europe” is disclosed as a separate segment by 74 % of companies.

Only 33 companies out of 154 disclosing a “European” segment precisely define the perimeter, either by listing specific countries, or referring to “EU”, “EEA”, EFTA” or “Euro zone”.

Other companies only mention “Europe” or part thereof (“western”, “eastern”, “continental”) as segment.

Home country is disclosed as a separate segment by 68 % of companies.

Companies from France (79%), Germany (74%), Italy (73%) and Spain (72%) have highest home country disclosure ratios.

Czech Republic, Hungary (50%), Sweden (40%), Belgium (36%) and Luxemburg (33%) have the lowest home country disclosures.

94% of companies consider either “Europe” or their home country as a segment, and 48% both.

Country segmentation

Out of 206 companies having geographical segment reports, the following key points were observed regarding EU countries occurrences in disclosed reports.

- 140 companies (68% of 206 companies) mentioned home country (country of incorporation) as a separate segment.
- In countries where a majority of companies operate primarily on a regional market (Ireland, Greece, Austria, Portugal), home country disclosures in segment reporting reach 100% of selected companies.
- In countries where a lot of companies operate primarily on international markets (Netherlands, Sweden, Belgium), home country disclosures concern less than 2/3 of selected companies.
- Among the largest countries, home-country disclosures are higher in France (79%) and Germany (74%) than in Netherlands (60%) and UK (59%).

Table 49 : Cross analysis by state of incorporation of disclosure of home country as a separate geographical segment

% of Home Country disclosures (A total of 206 companies considered)	Number of companies	% of Home country disclosure in each country
Austria	6	100%
Cyprus	2	100%
Greece	4	100%
Ireland	6	100%
Latvia	1	100%
Portugal	4	100%
Slovakia	1	100%
France	23	79%
Denmark	6	75%
Germany	17	74%
Italy	8	73%
Spain	13	72%
Estonia	2	67%
Finland	4	67%
Lithuania	2	67%
Poland	2	67%
Netherlands	9	60%
United Kingdom	19	59%
Czech Republic	1	50%
Hungary	1	50%
Sweden	4	40%
Belgium	4	36%
Luxemburg	1	33%
Malta	0	0%
Slovenia	0	0%
Total	**140**	**68%**

- Regarding the distribution of European countries segments between domestic disclosures and disclosures in foreign companies, it should be noticed that mentions of “France” prevails in France (67%), whereas mentions of “Germany” (63%) and “UK” (61%) outside Germany and UK. Disclosures regarding Germany and UK clearly surpass their weight in our sampling.

Table 50 : Disclosure of a country as a separate geographical segment by domestic vs. foreign companies

Country disclosures in domestic/foreign companies (A total of 206 companies considered)	Disclosures in domestic companies	% of Total	Disclosures in foreign companies	% of Total	Total disclosures
Ireland	6	75%	2	25%	8
Cyprus	2	67%	1	33%	3
France	23	62%	14	38%	37
Denmark	6	60%	4	40%	10
Greece	4	57%	3	43%	7
Netherlands	9	56%	7	44%	16
Spain	13	50%	13	50%	26
Austria	6	50%	6	50%	12
Portugal	4	50%	4	50%	8
Lithuania	2	50%	2	50%	4
Luxemburg	1	50%	1	50%	2
Finland	4	44%	5	56%	9
Italy	8	42%	11	58%	19
Belgium	4	40%	6	60%	10
United Kingdom	19	39%	30	61%	49
Germany	17	37%	29	63%	46
Estonia	2	33%	4	67%	6
Slovakia	1	33%	2	67%	3
Hungary	1	33%	2	67%	3
Sweden	4	31%	9	69%	13
Latvia	1	20%	4	80%	5
Poland	2	18%	9	82%	11
Czech Republic	1	17%	5	83%	6
Malta	0	0%	0	0%	0
Slovenia	0	0%	0	0%	0
Number of Country Disclosures	**140**	**45%**	**173**	**55%**	**313**

- Regarding the number of different European countries disclosed in their geographical report by European companies , we can identify two groups of companies :
  - Companies in which the number of EU countries disclosed is ≥ 5: these are companies registered in Finland (11 European countries disclosed), Lithuania (11), Netherlands (11), Denmark (9), Austria, Belgium and France (8), Spain (8), Estonia (7), Germany (6), Italy and Luxemburg (5).
  - Companies in which the number of EU disclosed is ≤ 5: the United Kingdom (4), Hungary, Ireland and Latvia (3), Cyprus, Greece and Portugal (2), the Czech Republic (1).

Business segmentation

214 companies out of 250 disclosed 800 business segments with a median of 3.7 segments / company

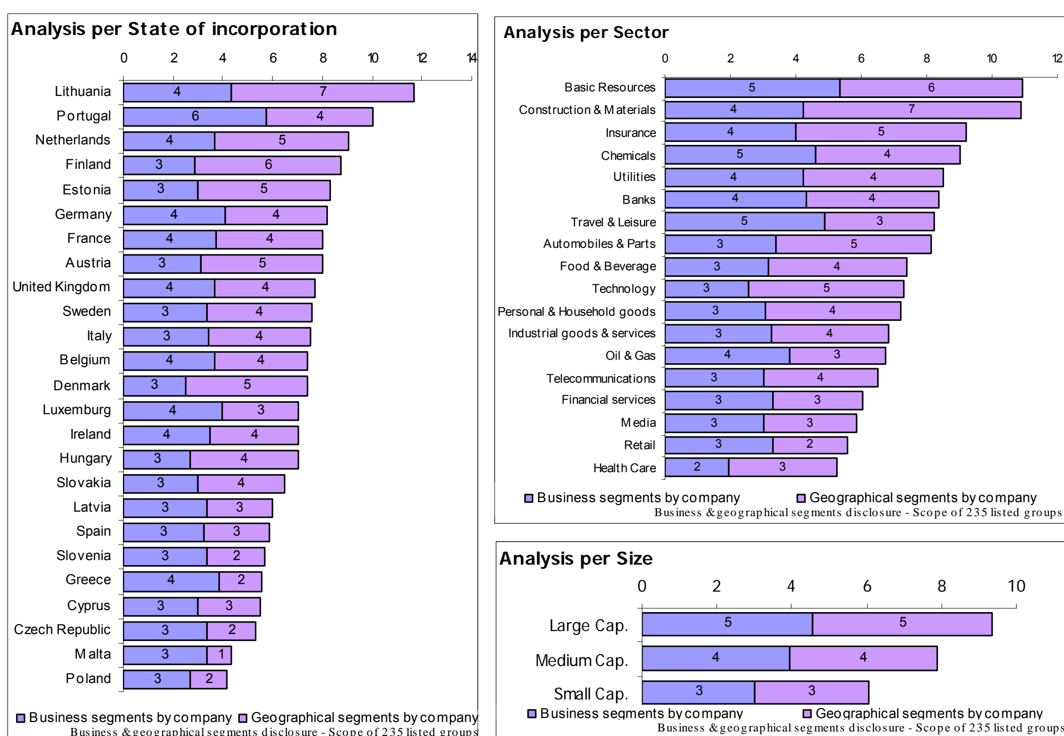
Identification of segment by products and service dominates business segmentation

- 72 % of companies refer to their products and services in their business segmentation
- 15 % of companies show influence of regulation in their definition of business segmentation
- Distribution channel (7%), customer (3%) and process (2%) lay behind in segment definition

Industry model significantly differs between sectors:

- Regulated sectors (banks, insurance, telecommunications, utilities), and process industries (chemicals, basic resources) tend to use similar segments across the industry.
- Manufacturing industries, technology and services tend to have company specific segments
  - 19 companies refer to trade or business group names in defining their segment
  - Except the case of investment entities which each subsidiary bears specific risks and opportunities, using brand names for segment does not help the users to capture the characteristics of the businesses

Table 51 : Cross analysis by state, sector and size of the number of business and geographical segments



The "Construction & Materials" and "Basic Resources " sectors are disclosing on average respectively 7 and 6 geographical segments. On the contrary, "Health Care" companies are disclosing on average 2 business segments and 3 geographical segments.

Analysis by country shows a rather homogeneous picture of number of segments disclosed.

However, in some markets where operations can be precisely segmented according to country/regional lines (central-European market, Baltic market), companies tend to disclose as much as 5 geographical segments on average (in Netherlands, Austria, Estonia, Finland, Lithuania).

Analysis by size of companies shows that larger companies tend to disclose more segments than smaller companies.

Disclosures on IAS 14 & IFRS 8

30% of companies (75 out of 250) mentioned explicitly "IAS 14" regulation in their financial statements.

54% of companies (134 out of 250) disclosed information on IFRS 8.

46% of companies (116 out of 250) did not disclose information on IFRS 8.

A majority of companies (69 companies, or 52% of companies having disclosed information on IFRS 8) estimated the impact of its implementation (mandatory from January 2009).

Table 52 : Information on IFRS 8 (1/2)

Information on IFRS 8 in Financial statements of EU countries	*Listed*		*Non- listed*		*Total*	
	Number of companies	*%*	*Number of companies*	*%*	*Number of companies*	*%*
Information not disclosed	*116*	*46%*	*9*	*45 %*	***125***	***46 %***
Information disclosed	*134*	*54%*	*11*	*55 %*	***145***	***54 %***
of which : Impact not estimated	*64*		*4*		***68***	
of which : Impact estimated	*69*		*7*		***76***	
Total	***250***	***100%***	***20***	***100%***	***270***	***100%***

Table 53 : Information on IFRS 8 (2/2)

Companies having not estimated IFRS 8 impact	*Listed*		*Non- listed*		*Total*	
	Number of companies	*%*	*Number of companies*	*%*	*Number of companies*	*%*
No disclosure on IFRS 8 impact	*29*	*12%*	*3*	*15%*	***32***	***12%***
Disclosure on IFRS 8 impact						
"Assessing the impact"	*26*	*10%*	*-*		***26***	***10%***
"Effect has not been estimated"	*9*	*4%*	*1*	*5%*	***10***	***4%***
Total of companies having not estimated IFRS 8 impact on financial statements	***64***	***26%***	***4***	***20%***	***68***	***25%***
No adjustments expected	*46*	*18%*	*-*		***46***	***17%***
Potential adjustment expected	*23*	*9%*	*7*	*35%*	***30***	***11%***
"Effect expected"	*11*	*4%*	*5*	*25%*	***16***	***6%***
"Adjustments to the disclosures in the notes"	*8*	*3%*	*1*	*5%*	***9***	***3%***
"Material Impact"	*2*	*1%*	*-*		***2***	***1%***
"Possible impact"	*2*	*1%*	*1*	*5%*	***3***	***1%***
Total of companies having already estimated IFRS 8 impact on financial statement	***69***	***28%***	***7***	***35%***	***76***	***28%***

A majority of the companies disclosing information of the potential impact of IFRS 8 on segment reporting were currently assessing this impact or did not anticipate any significant change in the presentation of segment reporting. Non-listed entities which have estimated the impact of IFRS8 all anticipate a change in the presentation of their segment reporting.

Two German SEC filers, **Siemens** [Germany, Industrial Goods & Services] and **DaimlerChrysler** [Germany, Automobile & Parts], as new IFRS adopters, were the only companies applying by anticipation IFRS 8.

7. Consolidation

Key points

The number of groups disclosing the existence of joint ventures is slightly up as compared with last year, and the proportionate method of consolidation is favoured:

- 154 companies (57% of 270) in the 2006 sample have disclosed the existence of joint venture entities (as compared to 51% in the 2005 sample)
- The proportionate consolidation is favoured by 63% of companies consolidating joint ventures entities. The equity method is chosen by 37% of such companies

Application of the different consolidation methods based on control and percentage of ownership appear to be globally well handled by the groups in our sample of 270 companies:

- As in last years' sample, only a few cases illustrate *de facto* control situations. We found two instances among the 270 companies sampled, which had already been identified in the 2005 sample.
- Eight cases of entities held at less than 20% and consolidated under the proportionate method or the equity method have been found (including 4 cases in France and 2 cases in Portugal).
- One case of an entity held between 20% and 50%, and carried at cost, has been found
- Seven cases of entities at 50% or more and not fully consolidated have been found (including 2 cases in Austria and 4 cases in France)

Perimeter

This section deals with specific topics relating to the definition of control for entities held at less than 50%, to the choice of accounting methods for investments held at higher or lower % than the two thresholds of 50% and 20%, and to the treatment of Joint ventures in consolidated financial statements. These items are addressed as follows:

- *De facto* control
- Thresholds and methods of consolidation
- Interests in Joint ventures

Guidance relating to the definition of control is mainly provided by IAS 27 *Consolidated and Separate Financial Statements* and SIC 12 *Consolidation – Special Purpose Entities.*

IAS 28 provides guidance for the equity accounting of investments in associated companies.

IAS 31 provides an option to proportionally consolidate jointly controlled entities.

7.1. De facto control

IAS 27 broadly defines control as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

IAS 27 states that control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity when there is:

- Power over more than half of the voting rights by virtue of an agreement with other investors;

- Power to govern the financial and operating policies of the entity under a statute or an agreement;
- Power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
- Power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

Nevertheless in practice, as IASB specified in the Update of October 2005, an entity holding a minority interest may be deemed to exercise control over another entity in the absence of any formal arrangements that would give it a majority of the voting rights. This is sometimes referred to as "*de facto* control".

The Board has made it clear that the control concept in IAS 27 includes de facto control even though it admitted that current wording of IAS 27 may be unclear.

Our sample includes 2 companies dealing with *de facto* control:

Eni [Italy, Oil & Gas] exercises[66] "de facto" control of its 43.54% held investment **Saipem SpA:**

A) CONSOLIDATION POLICY
Eni's consolidation policy is described under "Principles of consolidation" of the Notes to the Consolidated Financial Statements. In particular, under IFRS, the consolidated financial statements include also companies in which Eni holds less than 50% of the voting rights, but over which it exercises control in shareholders' meetings.
Under U.S. GAAP, investments of less than 50% are accounted for by applying the equity method. Under U.S. GAAP, Saipem SpA and its subsidiaries are excluded from consolidation and are accounted for under the equity method. Under IFRS, Eni exercises control of Saipem SpA also without holding the majority of voting rights (43.54%) exercisable in shareholders' meetings.

Within its financial statements, **LVMH** [France, Personal & Household Goods] indicated[67] that the subsidiaries in which the Group holds a direct or indirect *de facto* controlling interest are fully consolidated.

In order to enhance the analysis and for follow up reasons, companies mentioned in the 2005 Study, i.e. **Bouygues** [France] and **Klepierre** [France], were added in the sample under review for our 2006 study.

Bouygues [France] provides[68] a list of reasons justifying the existence of an "exclusive" control over its 41.9% investment in TF1:

"Bouygues holds 42.9% of the capital and voting rights of TF1. Exclusive control by Bouygues is demonstrated by the fact that:

- Bouygues has consistently and regularly held a majority of the voting rights exercised at TF1 shareholders' meetings.
- No other shareholder directly or indirectly controls a higher share of voting rights than Bouygues.
- Bouygues has clearly had exclusive power to determine decisions at TF1 shareholders' meetings during at least two consecutive financial years.

Other factors indicating the existence of exclusive control include:

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[66] **Eni** [Italy] Financial statements, page 211

[67] **LVMH** [France] financial documents, page 31

[68] **Bouygues** [France] Financial statements

- The large number of seats on the TF1 Board of Directors allocated to Bouygues;
- The role of Bouygues in appointing key executives of TF1.

All these factors clearly establish that Bouygues exercises exclusive control over TF1."

Klépierre [France] declared[69] that consolidation methods are not based solely on the percentage of control in the subsidiaries. Thus, majority control is "certified when the parent has the power to direct the entity's financial and operational policies, appoint, recall or convene most members of the board of directors or the equivalent management body". However, in its 2006 financial statements, **Klepierre** did not list any subsidiary held under 50% and fully consolidated.

7.2. Thresholds and methods of consolidation

IAS 28 specifies that a holding of 20% or more of the voting power (directly or through subsidiaries) will indicate significant influence unless it can be clearly demonstrated otherwise. If the holding is less than 20%, the investor will be presumed not to have significant influence unless such influence can be clearly demonstrated [IAS 28.6].

An enterprise in which an entity has significant influence must be reported in its financial statements using the Equity method of accounting.

Out of our sample, we found:

- 8 entities that disclose the existence of subsidiaries held at 20% or less and either consolidated under the proportionate method or accounted for under the equity method
- 1 entity that discloses the existence of subsidiaries held between 20% and 50% and carried at cost
- 7 entities that disclose the existence of subdiaries held at 50% or more, and not fully consolidated

No specific justification for these cases is given in the respective financial statements of the entities concerned, except the general rules applied to the construction of the scope of consolidation and generally described in the chapter "Accounting principles" within the notes.

7.3. Interests in Joint ventures

IAS 31 *Financial Reporting of Interests in Joint Ventures* defines a jointly controlled entity as a corporation, partnership, or other entity in which two or more venturers have an interest, under a contractual arrangement that establishes joint control over the entity [IAS 31.24]. Joint control means that the contractually agreed sharing of control over an economic activity such that no individual contracting party has control.

IAS 31 requires an entity to account for interests in jointly controlled entities in consolidated financial statements using either:

- Proportionate consolidation; or
- The equity method.

57% of listed companies (142 out of the 250) and 60% of non-listed companies (12 out of 20) disclosed existence of joint venture entities. Amongst these companies:

- 63% of them accounted for interests in consolidated financial statements using proportionate consolidation as recommended by IAS 31.

[69] **Klépierre** [France] Financial report 2006, page 89

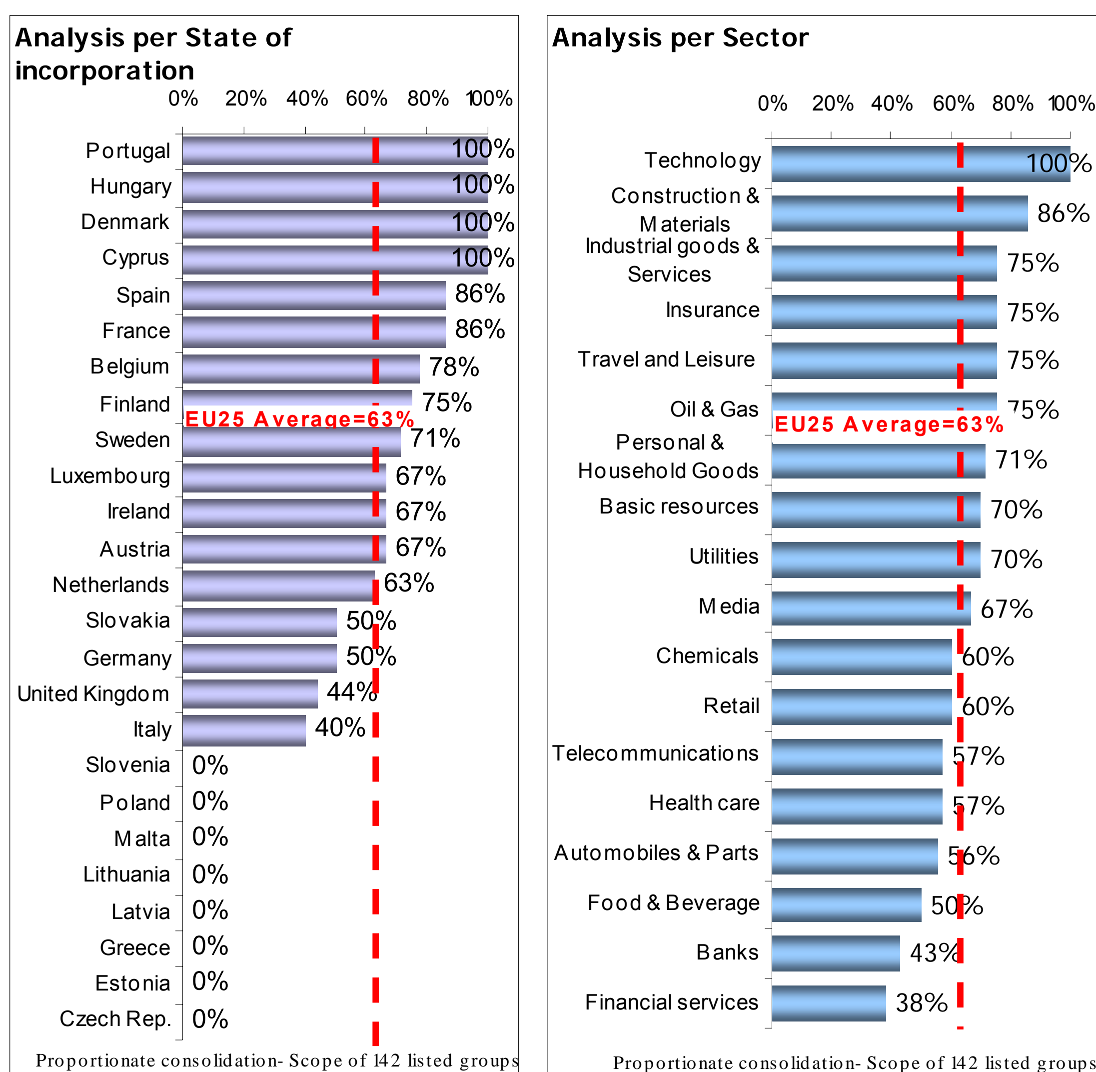
- 37% of companies used the equity method to account for interests in jointly controlled entities.

Table 54 : Method of consolidation for interests in jointly controlled entities

Companies having not estimated IFRS 8 impact	Listed		Non- listed		Total	
	Number of companies	%	Number of companies	%	Number of companies	%
Proportionate consolidation	89	63%	8	66%	97	63%
Equity method	53	37%	4	34%	57	37%
Total	**142**	**100%**	**12**	**100%**	**154**	**100,0%**

The choice of method does not differ significantly between listed and non-listed companies and is in line with the results of 2005 IFRS study (59% of proportionate method).

Table 55 : Cross analysis by state, sector and size of the choice of proportionate consolidation method for interests in jointly controlled entities



All companies that used proportionate consolidation combine their shares of each of assets, liabilities, income and expenses with similar items, line by line, in their financial statements.

Both **Diageo** [United Kingdom, Food & Beverage] and **Vodafone** [United Kingdom, Telecommunications] concluded[70] that some of their investments are jointly controlled entities under IFRS. Both opted to use proportionate consolidation under IFRS and continue to use the equity method for US GAAP purposes.

(o) Basis of consolidation The group has interests in a number of other jointly controlled entities. Under IFRS, the group reports its interest in jointly controlled entities using proportionate consolidation. The group's share of the assets, liabilities, sales, income and cash flows of jointly controlled entities are included in the appropriate categories of the group's financial statements on a line-by-line basis. Under US GAAP, these interests are accounted for using the equity method. Under the equity method, the group's share of the net income and net assets of the jointly controlled entities are reported as one line in the income statement and balance sheet.

Joint ventures

Under IFRS, the legal and contractual power to control or significantly influence is the key consideration when determining whether an entity is a subsidiary, joint venture or associate. Under UK GAAP, consideration is given to the control or significant influence actually exercised in practice when making this decision. A review of investments concluded that the group's beer interests in Malaysia and Singapore, currently subsidiaries under UK GAAP, will be classified as jointly controlled entities under IFRS. As a consequence, these entities previously fully consolidated (with a minority interest) under UK GAAP will, under IFRS, be proportionately consolidated. This adjustment does not affect the retained profit of the group.

IAS 31 – Interests in joint ventures defines a jointly controlled entity as an entity where all parties enter into a contractual arrangement that specifies joint control, by unanimous consent, of all strategic financial and operating decisions. IFRS allows the group to adopt either proportionate consolidation or the equity method when consolidating jointly controlled entities. Diageo has adopted proportionate consolidation as its group policy. This will result in some group entities, currently equity accounted under UK GAAP, being proportionately consolidated under IFRS.

For all proportionately consolidated entities, the IFRS balance sheet will include only the group's share of the assets and liabilities of those entities. Where an entity was previously fully consolidated under UK GAAP, the minority interest portion will not exist under IFRS.

The basis of consolidation under IFRS differs from that under US GAAP. The Group has interests in several jointly controlled entities, the most significant being Vodafone Italy. Under IFRS, the Group reports its interests in jointly controlled entities using proportionate consolidation. The Group's share of the assets, liabilities, income, expenses and cash flows of jointly controlled entities are combined with the equivalent items in the Consolidated Financial Statements on a line-by-line basis. Under US GAAP, the results and assets and liabilities of jointly controlled entities are incorporated in the Consolidated Financial Statements using the equity method of accounting. Under the equity method, investments in jointly controlled entities are carried in the consolidated balance sheet at cost as adjusted for post-acquisition changes in the Group's share of the net assets of the jointly controlled entity, less any impairment in the value of the investment. The Group's share of the assets, liabilities, income and expenses of jointly controlled entities which are included in the Consolidated Financial Statements are reported in note 13.

[70] **Diageo** [United Kingdom]
Vodafone [United Kingdom]

8. Goodwill, Intangible assets and Impairment

Key points

The topics under review are covered by IAS 38 *Intangible Assets* and IAS 36 *Impairment of Assets.*

The total of goodwill and other intangibles disclosed in the balance sheet of the 270 companies surveyed amounts to EUR 963 billions.

- Goodwill and other intangible assets represent an average of 15% of total assets in industry and services (excluding financial activities), and 2% of total assets in financial activities (bank, insurance and financial services).
- The largest share of goodwill however is not reported on the balance sheet at all. The 250 listed companies of our sample reported a cumulative shareholder's equity of EUR 1 887 billions, for a market value in excess of EUR 4 200 as of end of 2006. In the current crisis however, this "goodwill arising on quotation" will have been substantially reduced.

The largest goodwill and intangibles amounts appear to be concentrated in a few sectors, well known for major licence auctions and industry consolidation through mergers and acquisitions

- In the Telecommunications sector, goodwill and intangibles accounts for 28% of total assets
- In the Banking sector, it accounts for 14% of total assets

Further detailed analysis was conducted on 75 listed companies representing more than 90% of the total reported intangibles.

- All but one company displayed information on Intangible Assets in the accounting policies
- Most companies presented, whenever material, a table displaying the variation of net amount of intangible assets, presented by length of useful live of assets (finite life / infinite life) or by type of assets.
- All companies but one disclosed Intangible Assets with a finite useful life. However, the amortisation duration, based on the useful life, appears to spread over a large range.
- 85% of capitalized R&D relates to internally generated development costs, the majority of it in the Automobile & Parts industry. Acquired R&D, recognized as assets at cost, represents 15% of capitalized R&D, and occurs mainly in the Health Care and Chemicals industries.

The total of impairment charges reported by the 75 companies surveyed for impairment on Goodwill and Intangible Assets amounted to EUR 24 billion, of which Vodafone alone represented EUR 17 billion.

- 36 companies (47% of 75) posted impairment charges in 2006, 23 of which had already posted such charges in 2005. 14 companies (39% of the 36) indicated that the impairment test was triggered by the "annual review".
- 8 companies (11% of 75) posted impairment charges only in 2005.
- 29 companies (39% of 75) did not post any impairment charges on goodwill and intangible assets in either in 2005 or 2006.
- 2 companies (3% of 75) did not clearly disclose the split of impairment charges between tangible assets and goodwill and intangible assets in 2006.

All but one company included in the "Accounting policies" note the requirements relating to impairment, a large part of which used the wording stated in IAS 36 without further explanations relating to the specificities of the Group. Amongst the 36 companies accounting for an impairment charge in 2006:

- 14 companies (39% of 36) stated that the recoverable value is estimated as the higher of the fair value less costs to sell and the value in use
- 13 companies (36% of 36) calculated the value in use as the only basis of the recoverable value.
- 3 companies used the fair value less costs
- 6 companies did not disclose enough information to determine the method used to calculate the recoverable value.
- Most of companies disclosed the required information relating to the key assumptions. Nevertheless, a cross analysis indicates a large range of discount rate values and a diversity in the length of forecasts periods as basis of the calculation of the cash flows

8.1. Overview of Goodwill and other intangibles in the European companies

Intangible Assets represent an average 5% of total assets reported on the Balance Sheet and 50% of the value of net assets (total assets minus liabilities), with however significant disparities between industry sectors because of the difference of structure of the balance sheet.

- Intangible Assets represent as much as 15% of total assets for industry sectors excluding financial activities
- Intangible Assets represent only 2% of total assets for financial activities (banks, insurance and financial services)

The total of Intangible Assets reported by the 250 listed companies included in our sampling amounts to EUR 945 billions of which EUR 598 billions relate to Goodwill.

Table 56 : Amounts reported as Goodwill and other intangible assets (in % of total assets for listed companies)

Listed companies						
Intangibles assets in % of assets	Industry and Services		Financial activities		Total	
	% of total assets	% of net assets	% of total assets	% of net assets	% of total assets	% of net assets
Goodwill	9 %	35 %	1 %	24 %	3 %	32 %
Other intangible assets	6 %	24 %	< 1 %	8 %	2 %	18 %
Total intangible assets	15 %	59 %	2 %	32 %	5 %	50 %

Table 57 : Amounts reported as Goodwill and other intangible assets (in % of total assets for non listed companies)

Non Listed companies						
Intangibles assets in % of assets	Industry and Services		Financial activities		Total	
	% of total assets	% of net assets	% of total assets	% of net assets	% of total assets	% of net assets
Goodwill	7 %	18%	< 1 %	2 %	1%	11%
Other intangible assets	4 %	11%	< 1 %	2 %	1%	7%
Total intangible assets	11 %	28%	< 1 %	5 %	2%	18%

Cross analysis by sector further reveals the high concentration of intangible assets.

Among industry and services (excluding financial activities), five sectors concentrate 60 % of total intangibles: Telecommunication, Health Care, Food & Beverage, Media and Construction & Materials. A large part of the amount these intangible assets is the result of the recent major businesses combinations realized in these sectors. Telecommunications sector which tops the ranking, with one third of total intangibles excluding financial activities, has been known for business combinations and acquisition of UMTS licences.

Among financial activities, banks alone represent 63% of total intangibles, a very high proportion of which is goodwill. Nevertheless, due to their balance sheet structure intangibles account for only 1% of their total assets.

Table 58 : Cross analysis by sector of amounts reported as Goodwill and other intangible assets

Industry Sector	Total Intangible Assets including Goodwill		(of which) Goodwill weight	% Total of Assets	% of Net Asset
Telecommunications	241 919	26%	57%	43%	115%
Health Care	62 969	7%	50%	42%	80%
Food & Beverage	44 866	5%	69%	40%	115%
Media	34 327	4%	79%	40%	101%
Construction & Materials	53 269	6%	46%	37%	124%
Personal & Household Goods	36 295	4%	66%	28%	60%
Chemicals	36 993	4%	44%	27%	84%
Technology	18 155	2%	65%	26%	59%
Travel & Leisure	7 957	1%	86%	17%	56%
Retail	15 797	2%	89%	16%	46%
Industrial goods & services	60 605	6%	73%	12%	66%
Utilities	53 998	6%	78%	11%	49%
Basic Resources	11 776	1%	81%	6%	13%
Automobiles & Parts	25 067	3%	13%	5%	24%
Oil & Gas	25 465	3%	55%	5%	11%
Financial services	9 110	1%	68%	4%	15%
Insurance	70 110	7%	55%	2%	37%
Banks	136 645	14%	85%	1%	33%
TOTAL	**945 322**	**100%**	**63%**	**5%**	**50%**

Automobiles and Parts sector is the only sector where intangible assets are mainly the outcome of an internal development costs. All but four sectors (Automobile & Parts, Chemicals, Construction & Materials and Health Care) have more goodwill than any other type of intangibles.

Cross analysis by state of incorporation confirm the high concentration of intangibles, with the companies of three countries (France, United Kingdom and Germany) representing more than three quarters (77%) of the total of the net Intangible Assets carrying value, although they represent no more than 60% of EU25 total market capitalisation.

Table 59 : Cross analysis by state of incorporation of amounts reported as Goodwill and other intangible assets

Country of incorporation	Total Intangible Asset and Goodwill		(of which) Goodwill weight	% Total of Assets	% Net Asset
Portugal	8 140	1%	58%	19%	86%
France	322 657	34%	58%	10%	79%
Luxemburg	5 212	1%	81%	9%	20%
Germany	178 579	19%	50%	7%	59%
Belgium	19 755	2%	86%	5%	56%
Slovenia	168	0%	13%	5%	9%
Spain	70 303	7%	62%	5%	79%
Finland	2 676	0%	69%	5%	10%
Estonia	96	0%	18%	5%	10%
Sweden	6 227	1%	38%	5%	13%
United Kingdom	224 466	24%	76%	4%	39%
Hungary	1 598	0%	67%	4%	21%
Latvia	43	0%	0%	4%	5%
Austria	8 206	1%	72%	3%	55%
Cyprus	1 366	0%	93%	3%	31%
Czech Rep.	805	0%	63%	2%	9%
Italy	33 856	4%	76%	2%	27%
Ireland	4 092	0%	91%	2%	25%
Poland	956	0%	46%	2%	9%
Netherlands	48 713	5%	71%	2%	40%
Greece	1 422	0%	48%	2%	9%
Denmark	5 879	1%	40%	1%	16%
Slovakia	70	0%	24%	1%	8%
Lithuania	12	0%	31%	1%	1%
Malta	24	0%	20%	0%	4%
TOTAL	**945 322**	**100%**	**63%**	**5%**	**50%**

Quite naturally large Intangibles are concentrated in large cap companies.

Table 60 : Cross analysis by size of company of amounts reported as Goodwill and other intangible assets

Market capitalization	Total intangible asset and Goodwill		(of which) Goodwill weight	% Total of Assets	% Net Asset
Large	866 579	92%	62%	5%	51%
Medium	72 660	8%	75%	10%	44%
Small	6 084	1%	65%	9%	34%
Total listed companies	**945 322**	**100%**	**63%**	**5%**	**50%**
Non Listed	18 185	100%	60%	1	11%

30 companies, or 12% of our sample, concentrate more than 70 % of the intangibles, and illustrate the specificities of sectors and country of incorporation.

Table 61 : Top 30 companies with largest amounts reported as intangible assets

	Country	Industry Sector	Intangible Asset and Goodwill	% of Total Assets	% of net Asset
1	United Kingdom	Telecommunications	83 574	51%	84%
2	Germany	Telecommunications	58 014	45%	125%
3	France	Health Care	52 210	67%	114%
4	France	Telecommunications	50 230	49%	187%
5	Spain	Telecommunications	42 497	39%	247%
6	France	Insurance	39 365	5%	83%
7	France	Construction & Materials	28 508	59%	322%
8	United Kingdom	Banks	28 299	2%	34%
9	United Kingdom	Banks	28 067	2%	47%
10	Germany	Chemicals	24 034	43%	188%
11	France	Media	17 450	41%	88%
12	Netherlands	Food & Beverage	17 206	46%	153%
13	Germany	Industrial goods & services	17 120	19%	59%
14	Spain	Banks	16 957	2%	40%
15	France	Utilities	16 893	23%	87%
16	France	Technology	16 324	39%	105%
17	Germany	Utilities	14 901	16%	111%
18	Germany	Industrial goods & services	14 652	7%	131%
19	Germany	Insurance	14 013	1%	28%
20	Belgium	Food & Beverage	13 570	52%	111%
21	Italy	Banks	13 336	2%	35%
22	France	Personal & Household Goods	12 764	44%	120%
23	France	Construction & Materials	12 529	30%	88%
24	United Kingdom	Oil & Gas	12 147	7%	19%
25	France	Retail	11 890	25%	125%
26	France	Banks	11 731	1%	24%
27	United Kingdom	Personal & Household Goods	11 103	42%	116%
28	Netherlands	Industrial goods & services	10 855	15%	83%
29	United Kingdom	Banks	10 852	1%	37%
30	United Kingdom	Media	9 728	45%	171%
		Total Top 30	**710 819**	**8%**	**32%**

8.2. Detailed disclosures on Intangible Assets

Further detailed analysis was conducted on 75 companies representing 91% of the total disclosed Intangible Assets.

Disclosures of significant accounting policies relating to intangibles (other than in the context of a business combination)

All but one company displayed information on Intangible assets in their accounting policies, of which:

- Criteria of Recognition;
- Initial Measurement ;
- Indefinite or finite useful life criteria;
- Amortization method and rates applied; and
- Impairment tests conditions.

Electrolux [Sweden, Personal & Household Goods] presented[71] detailed information relating to its type of intangible assets:

Intangible fixed assets

Goodwill

Goodwill is reported as an indefinite life intangible asset at cost less accumulated impairment losses.

The value of goodwill is continuously monitored, and is tested for yearly impairment or more often if there is indication that the asset might be impaired. Goodwill is allocated to the cash generating units that are expected to benefit from the combination.

Trademarks

Trademarks are shown at historical cost. The Electrolux trademark in North America, acquired in May 2000, is regarded as an indefinite life intangible asset and is not amortized but tested for impairment annually and whenever there is an indication that the intangible asset may be impaired. One of the Group's key strategies is to develop Electrolux into the leading global brand within the Group's product categories. This acquisition has given Electrolux the right to use the Electrolux brand worldwide, whereas it previously could be used only outside of North America. All other trademarks are amortized over their useful lives, estimated to 10 years, using the straight-line method.

Product development expenses

Electrolux capitalizes certain development expenses for new products provided that the level of certainty of their future economic benefits and useful life is high. The intangible asset is only recognized if the product is sellable on existing markets and that resources exist to complete the development. Only expenditures, which are directly attributable to the new product's development, are recognized. Capitalized development costs are amortized over their useful lives, between 3 and 5 years, using the straight-line method. The assets are tested for impairment annually and whenever there is an indication that the intangible asset may be impaired.

Computer software

Acquired computer software licenses are capitalized on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortized over useful lives, between 3 and 5 years, using the straight-line method. Computer software is tested for impairment annually and whenever there is an indication that the intangible asset may be impaired.

Intangible value disclosures

IAS 1 requires an entity to disclose information relating to intangible assets carrying value, and especially:

- The gross carrying amount and any accumulated amortisation at the beginning and end of the period
- A reconciliation of the carrying amount at the beginning and end of the period showing:
  - Additions, indicating separately those from internal development, those acquired separately, and those acquired through business combinations;
  - Any amortisation recognised during the period;
  - Impairment losses recognised or reversed; and
  - Net exchange differences arising on the translation of the financial statements.

[71] Electrolux, Annual Report 2006, page 73

Most companies presented whenever material, a table displaying a detail of Intangible Assets by type of assets.

Lafarge [France, Construction & Materials] disclosed[72] three tables describing the variation of the net amount of intangible assets.

Note 11 - Intangible assets

(MILLION EUROS)	2006	2005	2004
CARRYING AMOUNT AT JANUARY 1,	355	308	300
Additions	97	81	41
Disposals	(4)	(2)	(4)
Amortization	(66)	(64)	(46)
Impairment losses	-	-	(47)
Acquisitions through business combinations	33	10	-
Other changes	49	(10)	71
Translation adjustments	(25)	32	(7)
Reclassification as assets held for sale	(13)	-	-
CARRYING AMOUNT AT DECEMBER 31,	426	355	308

Amortization and impairment losses on intangible assets from continuing operations are as follows:

	YEARS ENDED DECEMBER 31,		
(MILLION EUROS)	2006	2005	2004
Amortization	66	53	36
Impairment losses	-	-	45
TOTAL	66	53	81

The following table presents details of intangible assets which are subject to amortization:

	AT DECEMBER 31,								
	2006 *			2005			2004		
(MILLION EUROS)	COST	ACCUMULATED AMORTIZATION AND IMPAIRMENT	CARRYING VALUE	COST	ACCUMULATED AMORTIZATION AND IMPAIRMENT	CARRYING VALUE	COST	ACCUMULATED AMORTIZATION AND IMPAIRMENT	CARRYING VALUE
Software	376	201	175	356	204	152	265	158	107
Real estate development rights	109	64	45	107	60	47	103	56	47
Mineral rights	115	32	83	103	34	69	117	31	86
Other intangible assets	183	60	123	150	63	87	148	80	68
TOTAL INTANGIBLE ASSETS	783	357	426	716	361	355	633	325	308

InBev [Belgium, Food & Beverage] elected to present[73] a table by useful life (under the two headings “Indefinite” and “Finite”).

[72] **Lafarge** [France] form 20-F 2006, pages F-35, F-36

[73] **InBev** [Belgium, Food & Beverage], **Unilever** [Netherlands, Food & Beverage]

Million euro	2006				2005
	Useful life		Advance payments		
	Indefinite	Finite		Total	Total
Acquisition cost					
Balance at end of previous year	272	594	11	877	551
Effect of movements in foreign exchange	(7)	(29)	-	(36)	49
Change in interest percentage for proportionally consolidated entities	-	5	-	5	-
Acquisitions through business combinations	711	65	-	776	34
Acquisitions and expenditures	-	79	9	88	225
Adjustments arising from subsequent identification or changes in fair value of identifiable assets and (contingent) liabilities	-	-	-	-	78
Disposals	-	(27)	-	(27)	(19)
Disposals through the sale of subsidiaries	-	-	-	-	(14)
Transfer to other asset categories	18	(50)	(18)	(50)	(37)
Other movements	-	(5)	-	(5)	10
Balance at end of year	**994**	**632**	**2**	**1 628**	**877**

Unilever [Netherlands, Food & Beverage] elected for a comparable presentation as InBev.

Four companies used the following displays: "internally generated intangible asset" and “acquired/purchased intangible”.

Amongst these companies, three displayed a second level of information:

- **Wendel Investissement** [France, Financial Services] and **Deutsche Telekom** [Germany, Telecommunications] provided[74] details by type of assets for two of them
- **Unicredito Italiano** [Italy, Banks] presented[75] information relating to the length of useful live of assets (Finite life and indefinite life)

Moreover, four companies presented some specificity:

- **Allianz** [Germany, Insurance] decided to allocate “Software” in the line “Other Asset” displaying clearly the amount in the dedicated note[76]. Consequently, the total of “Intangible Assets” doesn’t include the amount relating to the Software;
- **OPAP** [Greece, Travel & Leisure] and **Cimentos de Portugal** [Portugal, Construction & Materials]: The goodwill amount relating to the companies accounted for under the Equity method is included in the line “Goodwill” separated from “Intangible Assets” but not allocated to the existing line “Investments in Associates”.
- **ABN AMRO** [Netherlands, Banks] included[77] Private Equity Goodwill within the caption Goodwill.

8.3. Finite-lived Intangible Assets

IAS 38 prescribes that an intangible asset with a finite useful life must be amortised.

The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.

[74] **Wendel** [France, Financial services], **Deutsche Telekom** [Germany, Telecommunications]

[75] **Unicredito Italiano** [Italy] form 20-F 2006, pages F-35, F-36

[76] **Allianz** [Germany, Insurance]

[77] **ABN AMRO** [Netherlands, Banks]

All companies but one disclosed Intangible Assets with a definite useful life.

Table 62 : Number of occurrences by type of Intangible Assets

Type of Intangible Assets	finite-lived asset
Mark, Tradename, brand	11
Customer relationships, client portfolio, purchased insurance portfolio	12
Software	42
Development costs and acquired R&D	22
Patents, licences, permits, emission rights	42
DAC (insurance), PVIF (insurance), exploration expenditure (oil)	8
Lease agreements	3

21 companies presented an amount relating to "Mark, Brand, Trade name" of whom 11 are described as finite-lived assets and 10 as indefinite-lived assets.

The amortization duration for a same type of Asset, based on the useful life period, is variable depending on the specificities of the Groups activities, and can spread over a large scale except for "Software" (for which the useful life is estimated over 3 to 7 years with a concentration around 5 years).

Table 63 : Estimations of useful life of Intangible Assets by type of assets

Types of Assets	up to 3	up to 5	up to 10	up to 15	up to 20	more than 20	not disclosed	Total
Mark, Tradename, brand	-	1	2	1	1	4	2	11
Customer relationships, client portfolio, purchased insurance portfolio	-	-	4	-	-	4	4	12
Software	7	24	8	1	1	-	1	42
Development costs, R&D	5	6	5	1	-		5	22
Patents, licences, permits, emission rights	-	3	4	4	14	8	9	42
DAC (insurance), PVIF (insurance), exploration expenditure (oil)	-	-	-	-	-	-	8	8
Lease agreements	1	-	-	-	-	1	1	3
Sundry other	1	5	13	-	1	3	6	29

The useful life of Software, development costs and research and development is over a period of maximum 10 years. The useful life of patents and licences is most of time estimated on a period higher to 10 years and sometimes over 40 years.

8.4. Split between acquired R&D and internally generated Development Costs

Under IAS 38, an intangible asset arising from development shall be recognized if, and only if, an entity can demonstrate all of the following:

- The technical feasibility of completing the intangible asset;
- Its intention to complete the project;
- Its ability to use or sell the intangible asset;

- The probability that the intangible asset will generate future economic benefits;
- The availability of adequate technical, financial and other resources to complete the intangible asset; and
- The ability to measure the development expenditure reliably.

Research is not eligible for capitalisation. No intangible asset from research shall be recognised.

However, an R&D project acquired in a business combination is recognised as asset at cost, even if a component is research.

A detailed analysis by industry of companies disclosing a line "Research & development" reveals that the largest amount of capitalized development costs is provided by the Automobiles and parts sector. The amount of R&D capitalized in the Health care and Chemicals sectors are linked to the acquisition of R&D.

Sanofi-Aventis [France, Health Care] specified[78] that internally generated development costs are in a large proportion expensed: *"Due to the risks and uncertainties relating to regulatory approval and to the research and development process, the criteria for capitalization are considered not to have been met until marketing approval has been obtained from the regulatory authorities."*

Table 64 : Repartition of acquired R&D and internally generated Development Costs

Industry Sector	Amounts	%	Development costs	Acquired R&D
Automobiles and parts	19 357	70%	100%	-
Health care	2 755	10%	-	100%
Industrial goods and services	1 795	6%	100%	-
Chemicals	1 276	5%	5%	95%
Other sectors	2 492	9%	100%	-
Total	**27 675**	**100%**		

(On the basis of the dedicated line "R&D and development costs" disclosed by companies)

8.5. Impairment on Goodwill and Intangible assets

IAS 36 *Impairment of Assets* requires that an asset is impaired when its carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's net selling price and the value in use. The fair value is defined as the amount obtainable in a binding sale agreement in an arm's length transaction between knowledgeable and willing parties.

The value in use is the discounted present value of estimated cash flows that the entity expects to derive from this asset, including cash flows from the continuing use and for the disposal of the asset at the end of its useful life.

If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the Cash-Generating Unit (CGU) to which the asset belongs. In this case, principles of the recoverable amount calculation of assets must be applied for the CGU.

[78] **Sanofi-Aventis** [France, Health Care] Form 20-F 2006, pages F-14, F-15

A CGU to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication the unit may be impaired. If a cash-generating unit must be impaired, the impairment loss must be allocated to reduce the carrying amount of assets of the unit in the following order:

- first, to reduce the carrying amount of any goodwill allocated to the CGU (group of units);
- Then, to the other assets of the unit (group of units) prorata on the basis of the carrying amount of each asset in the unit (group of units).

Impairment loss of goodwill can never be reversed in a later period.

47% of companies in our sample accounted for an impairment charges linked to the Intangible Assets in 2006, against 41% for 2005. 39% of companies did not post any impairment charges in 2005 and 2006.

Table 65 : Impairment on goodwill and other intangible assets

	Only 2005	Only 2006	2005 and 2006	Total
Impairment charges for the year	8	13	23	44
N/A for both 2005 and 2006			29	29
Not disclosed				2
Total				**75**

For two companies, the information was not clearly disclosed or not separately displayed from impairments linked to the tangible assets.

The total of impairment charges accounted for during 2006 amount to EUR 24 163 million of which **Vodafone** [United Kingdom, Telecommunications] for EUR 17 228 million[79].

Accounting Policies disclosures

All but one companies reminded in the “Accounting policies” note the requirement of IAS 36 *Impairment of Assets* (with or without reference to IAS 36)

A large part of the companies used the wording stated in IAS 36 without further explanations relating to the specificities of the Group. Thus, it is often difficult to obtain relevant information relating to the methodology is applied by the Group to calculate the recoverable value (fair value less to costs to sell, value in use or the higher of the previous methods)

[79] **Vodafone** [United Kingdom]

Xstrata [United Kingdom, Basic Resources] stated[80] in its “Accounting policies” note:

Impairment of assets

The carrying amounts of non-current assets are reviewed for impairment whenever events or changes in circumstances indicate the carrying amounts may not be recoverable. If there are indicators of impairment, a review is undertaken to determine whether the carrying amounts are in excess of their recoverable amounts. An asset's recoverable amount is determined as the higher of its fair value less costs to sell and its value-in-use. Such review is undertaken on an asset by asset basis, except where such assets do not generate cash flows independent of other assets, in which case the review is undertaken at the cash-generating unit level.

Where a cash-generating unit, or group of cash-generating units, has goodwill allocated to it, or includes intangible assets which are either not available for use or which have an indefinite useful life (and which can only be tested as part of a cash-generating unit), an impairment test is performed at least annually or whenever there is an indication that the carrying amounts of such assets may be impaired.

If the carrying amount of an asset exceeds its recoverable amount, an impairment loss is recorded in the income statement to reflect the asset at the lower amount. In assessing the recoverable amount of assets, the relevant future cash flows expected to arise from the continuing use of such assets and from their disposal are discounted to their present value using a market-determined pre-tax discount rate which reflects current market assessments of the time value of money and asset-specific risks for which the cash flow estimates have not been adjusted.

An impairment loss is reversed in the income statement if there is a change in the estimates used to determine the recoverable amount since the prior impairment loss was recognised. The carrying amount is increased to the recoverable amount but not beyond the carrying amount net of depreciation or amortisation which would have arisen if the prior impairment loss had not been recognised. After such a reversal the depreciation charge is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life. Goodwill impairments are not reversed.

Methodology held for the recoverable value calculation

IAS 36 requires an entity to disclose whether the recoverable amount of the asset is its fair value less costs to sell or its value in use.

14% of companies (36 out of 250) accounted for an impairment charges for 2006:

- 14 of the companies stated that the recoverable value is estimated as the higher of the fair value less costs to sell and the value in use. Nevertheless, 5 of them didn't provide any information relating to one of the method saying used;

  Thus, **Lafarge** [France, Construction & Materials] disclosed[81] the following information:

A summary of the range of main assumptions used for the valuation of CGUs are as follows:

	2006	2005	2004
Multiples of operating income before capital gains, impairment, restructuring and other, and before depreciation and amortization (fair approach)	7.8 - 9.4	6.2 - 7.9	6.6 - 7.1
Discount rate (value in use approach)	7.4%-9.5%	6.7% - 9.9%	7.2%-10.2%
Perpetual growth rate (value in use approach)	2.0%	1.5% - 2.0%	1.5% - 2.0%

- 13 of these companies provided information enabling to calculate the value in use as the basis for the recoverable value;
  Telegraaf Media Groep [Netherlands, Media] specified[82] the method of calculation of the recoverable amount of the CGU:

The recoverable amount of the cash-generating units is based on the value in use calculations. Those cash-flow projections based on actual operating results and cash flow forecasts, the budget 2007 and the long-term plans up to and including 2009. The cash flows after 2009, which are extrapolated on the basis of 0% growth, are also taken into account. The economic useful life is an estimate by the management relating to the expected cash-generating period of the investment. The forecast cash flows are calculated based on a pre-tax discount rate of 8.0% (2005: 7,7%). The discount rate and growth factors were determined on the basis of the risk profile for TMG as a whole. These assumptions have been applied to all cash-generating units in the Group.

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[80] **Xstrata** [United Kingdom]

[81] **Lafarge** [France, Construction & Materials] 20-F FORM 2006, page F-34

[82] **Telegraaf Media Groep** [Netherlands, Media] Annual report 2006, page 117

Pendragon [United Kingdom, Retail] declared[83] using value in use for the recoverable amount valuation of CGU:

> Goodwill is allocated across multiple cash-generating units and consequently a consistent approach in assessing the carrying value of this amount is taken. This value was determined by discounting the future cash flows generated from the continuing use of the unit and was based on the following key assumptions:
>
> Cash flows were projected based on actual operating results and the current business plan with regard to the long term strategy of the group in terms of business representation. These were extrapolated over a 20 year period. Management believes that this forecast period was justified due to the long term outlook for the industry and the groups dominant position in the market place.
>
> Whilst it is anticipated that the units will grow revenues in the future for the purpose of the impairment testing no growth has been assumed. A pre tax discount rate of eight percent was applied in determining the recoverable amount of the units which the group have estimated to be the approximate weighted average cost of capital of the group.

- 3 companies described in details the method used for the calculation of the fair value less costs to sell as the basis of the recoverable value. Amongst these 3 companies, 1 of them states that it used also the Method of the value in use to define the recoverable value depending of the activity of the CGU (2);

  InBev [Belgium, Food & Beverage] applied[84] the fair value method for the calculation of the recoverable amount of Intangible assets and Goodwill allocated to CGU:

> Impairment testing of intangible assets with an indefinite useful life is primarily based on a fair value approach applying multiples that reflect current market transactions to indicators that drive the profitability of the asset or the royalty stream that could be obtained from licensing the intangible asset to another party in an arm's length transaction.
>
> For goodwill, the recoverable amount of the cash generating units to which the goodwill belongs is based on a fair value approach. More specifically, a discounted free cash flow approach, based on current acquisition valuation models, is used. These calculations are corroborated by valuation multiples, quoted share prices for publicly traded subsidiaries or other available fair value indicators. As regards the level of goodwill impairment testing, InBev's overall approach is to test goodwill for impairment at the business unit level (i.e. one level below the segments).

  GlaxoSmithKline [United Kingdom, Health & Care] used[85] also the Method of the value in use to define the recoverable value depending of the activity of the CGU

> Goodwill is allocated to cash generating units which are tested for impairment at least annually. The recoverable amounts of the cash generating units are assessed using a value in use or a fair value less costs to sell model, depending on the nature of the unit. Value in use is calculated as the net present value of the projected risk-adjusted, five-year post-tax cash flows plus a terminal value of the cash generating unit to which

- 6 of the companies did not provide any significant (or partial) information allowing determining the method used to calculate the recoverable value.

Events and circumstances triggering the impairment tests

A Cash-Generating Unit to which goodwill has been allocated shall be tested for impairment annually, and whenever there is an indication the unit may be impaired

Generally companies declared that the impairment tests are performed as part of an "annual review" or the update of the forecast figures.

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[83] **Pendragon** [United Kingdom, Retail] Annual Report 2006, page 56

[84] **InBev** [Belgium, Food & Beverage] 2006 Annual report, page 68

[85] **GlaxoSmithKline** [United Kingdom, Health Care] Annual report, page 104

39 % of companies disclosed that they triggered an impairment tests following a specific event or circumstance

Thus, **Vodafone** [United Kingdom, Telecommunications] specified[86] the indications triggering the impairment test for Goodwill in Germany:

Germany

During the year ended 31 March 2007, the goodwill in relation to the Group's mobile operation in Germany was impaired by £6.7 billion following a test for impairment triggered by an increase in long term interest rates and increased price competition in the German market along with continued regulatory pressures.

Key assumptions held for the "value in use" calculation

IAS 36 requires an entity to disclose a description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units) recoverable amount is sensitive.

Cash flows from the most recent financial forecast figures

Generally companies disclosed the key assumptions relating to the origin of the cash flows calculation. Only three companies using the "value in use" methodology for the impairment tests did not provide the length of the internal forecast used as the basis of the cash flows calculation.

Use of a discounting rate

All companies, calculating the "value in use" for the impairment test purpose, declared to use a discounting rate except two companies which provided no information.

Analysis of main assumptions hold for the value in use calculation reveals a large diversity:

Table 66 : Assumptions for "value in use" calculation

Country	Length of forecast (years)	Growth rate	Discount rate	Comments
Cyprus	3	3%	12%	Specific growth rate for Serbia CGU
France	5	1% - 2%	8,5% - 9%	Specific growth rate and discount rate for Poland CGU
France	10	2%	7,4% - 9,5%	Presentation by Markets with potential risk of impairment (UK, Philippines, Greece, Malaysia)
France	3	2,5% - 3,5%	8% - 12%	Except for Studio Canal
United Kingdom	4 to 5	Depending on the CGU		
United Kingdom	8	5%	10%	
United Kingdom	Not discl.	Not discl.	10,6% - 11,5%	
United Kingdom	Max. 21	Not discl.	10,2% - 17,2%	

[86] **Vodafone** [United Kingdom, Telecommunications] 2006 Annual report, page 109

9. PPE & Investment property

Key points

This section is dedicated to Tangible Assets analysis and covers the topics covered by IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property.*

The total of tangible assets disclosed in the balance sheet of the 250 listed companies surveyed amounts to EUR 1.288 billions.

- Tangible assets represent an average of 30% of total assets in industry and services (excluding financial activities), and 1% of total assets in financial activities (bank, insurance and financial services).
- Three sectors (Oil & Gas, Utilities and Telecommunication) concentrate 50% of total tangible assets.

Further detailed analysis was conducted on 75 listed companies representing more than 80% of the total reported tangible assets.

- 97% of companies value Property, Plant and Equipment through the cost model; the use of the revaluation model remains marginal
- Among companies disclosing information on investment properties, only one out of five use the Fair Value model rather than the cost model.

Disclosures on estimated useful life by type of PPE contains mostly the method used, and the minimum and maximum instances of duration

- The information constituted by the wide range of minimum and maximum ranges of estimated useful lives for depreciation given by the entities under review is not in conflict with the standard, but may not be relevant for the users of the financial statements.

9.1. Overview of Tangible Assets in the 250 EU companies

The total of Tangible Assets reported by the 250 companies amounts to EUR 1.288 billion, representing:

- 30 % of total assets of industry and services sectors excluding financial activities
- 1% of total assets of financial activities (banks, insurance and financial services)

The tangible assets are mostly concentrated with a few sectors, with three sectors Oil & Gas, Utilities and Telecommunications accounting for 50% of the total.

Cross analysis by sector confirm large discrepancies in tangible assets / total assets ratio.

Table 67 : Amounts reported as tangible assets

Industry sector	Total Assets (M€)	Tangible Assets (M€)	Weight of tangible assets
Basic Resources	200 094	108 705	54 %
Utilities	498 982	240 149	48 %
Retail	101 724	45 200	44 %
Oil & Gas	557 369	240 689	43 %
Travel & Leisure	47 341	17 618	37 %
Chemicals	138 665	37 669	27 %
Telecommunications	557 679	140 651	25 %
Construction & Materials	144 057	33 374	23 %
Automobiles & Parts	511 141	117 623	23 %
Food & Beverage	110 805	21 187	19 %
Health Care	150 249	26 467	18 %
Industrial goods & services	511 705	81 624	16 %
Personal & Household Goods	128 268	16 641	13 %
Media	85 066	7 595	9 %
Technology	69 876	4 086	6 %
Sub total (industry and services)	**3 813 021**	**1 139 278**	**30 %**
Financial services	206 092	26 941	13 %
Banks	10 017 417	96 256	1 %
Insurance	3 729 606	25 104	1 %
Sub total (financial activities)	**13 953 115**	**148 301**	**1 %**
Total Listed	**17 766 136**	**1 287 580**	**7 %**
Non Listed (industry and services)	148 478	55 269	37%
Non Listed (financial activities)	857 704	8 754	1%
Total Non-Listed	**1 006 182**	**64 023**	**6 %**

9.2. Detailed disclosures on Property, plant and Equipment

Further detailed analysis regarding Property Plant Equipment and Investment property was performed on 75 listed companies representing 80% of the total tangible assets of listed entities.

Measurement: Cost Model or revaluation model

IAS 16 *“Property, Plant and Equipment”* requires that Property, Plant and Equipment should be recognised initially at cost and subsequently measured at each balance sheet date at either:

- on the basis of the “cost model”: cost less accumulated depreciation and write-down for impairment;
- on the basis of the “revaluation model”: fair value less any subsequent depreciation and any write down- down for impairment

Almost all companies (97,3%) disclosed in their financial statements the use of the cost model for all PPE. This proportion is in line with the findings of the 2005 IFRS study (95, 5%).

Table 68 : choice of method for valuation of tangible assets

	2006		2005
	Number of Companies	%	%
Cost model for all property, plant and equipment	73	97,3 %	95,5 %
Revaluation model for all property, plant and equipment	1	1,3 %	-
Revaluation model for all properties; cost model for all plant and equipment	0	-	2,5 %
Revaluation model for some properties; cost model for other properties and all plant and equipment	0	-	1,5 %
Cost model for all properties and plants, and revaluation models for some equipments	1	1,3 %	-
No own use property, plant and equipment	0	-	0,5 %
Total	**75**	**100 %**	**100 %**

Non-listed entities also mostly use the cost model for the valuation of their property, plant and equipment.

Public Power Corporation [Greece, Utilities] uses the revaluation model for all "property, plant and equipment" as explained in the accounting policies note:

(i) ***Fair value and useful lives of property, plant and equipment:*** PPC carries its property, plant and equipment at revalued amounts (estimated fair values) as determined by an independent firm of appraisers. Revaluations are performed periodically (every three to five years). The determination of the fair values of property, plant and equipment requires from management to make assumptions, estimates and judgements with respect to the ownership, the value in use and the existence of any economic, functional and physical obsolescence of property, plant and equipment. Furthermore, the management has to make certain estimates with respect to the useful lives of depreciable assets.

Telekom Slovenije [Slovenia, Telecommunications] opted[87] for the revaluation model for some classes of equipment:

Subsequent to initial recognition certain classes of property, plant and equipment are carried at revalued amount, being the fair value at the date of the revaluation less any subsequent depreciation and subsequent accumulated impairment losses. Those classes comprise Cable and lines, exchange switches and other equipment in fixed lines operations. When an asset's carrying amount is increased as a result of a revaluation, the increase is credited directly to equity as revaluation reserves. The revaluation to fair value of these assets is based on the report of an independent appraiser. The policy of the company is that revaluation will be carried out every five years.

[87] **Telekom Slovenije** [Slovenia] 2006 financial statements, page 105

Depreciation and useful life

For all depreciable assets, IAS 16 requires the depreciable amount (cost less prior depreciation, impairment, and residual value) should be allocated on a systematic basis over the asset's useful life [IAS 16.50].

The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS 8. [IAS 16.51]

IAS16 specifies that the depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the enterprise [IAS 16.60];

Table 69 : Types of depreciable tangible assets and range of estimated useful life

	Number of disclosures	% (out of 75 companies)	Depreciation in years			
			Min	Max	Average Min	Average Max
Buildings	67	89%	1	140	11	49
Fixtures	45	13%	2	50	5	14
Equipment and furniture	66	6%	2	75	6	22
Computer equipment	19	7%	2	17	3	8

The most frequently (89 %) disclosed item of Tangible Assets is "Building" with a length of depreciation spreading from 1 over 140 years.

On the other hand, "Computer equipment" is the less nominated item and the related length of useful life is comprised between 2 and 17 years.

The information constituted by wide range of minimum and maximum duration for depreciation disclosed by entities under review is respectful of the Standard, but may not be relevant for users of the financial statements.

Dispersion of length of depreciation

The most frequently range of length disclosed relating to Buildings is between 1 to 50 years (34% of disclosures).

Table 70 : Estimated useful life - Buildings

Buildings	Total	5-20	1-30	15-33	25-33	1-40	15-40	1-50	20-50	>60
Number of disclosures	67	2	5	2	3	12	3	23	9	8
% of total	100%	3%	7%	3%	4%	18%	4%	34%	13%	12%

12% of companies disclosing figures relating to the estimated useful life of Buildings above 60 years. Amongst these companies, **Paramo** [Czech Republic, Oil & Gas] disclosed[88] the following list of tangible assets, including Building:

Depreciation is charged to the income statement using the straight-line method over the estimated useful life of buildings and equipment and main assets shown separately. Lands are not depreciated. Estimated useful life of assets is as follows:

Asset	Method	Depreciation period
Buildings	Straight-line	25–77 years
Machinery and equipment	Straight-line	2–30 years
Catalysts and items from precious metals	Straight-line	1–15 years
Office fixtures and fittings	Straight-line	2–17 years
Vehicles	Straight-line	2–17 years
Provisions for acquired assets	Straight-line	15 years

The most frequently range of length disclosed relating to Fixtures is between 3 to 10 years (38% of disclosures).

Table 71 : Estimated useful life - Fixtures

Fixtures	Total	2 - 5	4-9	3-10	3-17	15-20	2-25	10-25	>30
Number of disclosures	**45**	6	2	17	10	1	4	2	3
% of total	**100%**	13%	4%	38%	22%	2%	9%	4%	7%

The range of length of estimated useful life disclosed relating to equipment and furniture spread from 2 until more than 45 years.

Table 72 : Estimated useful life - Equipment and furniture

Equipment and furniture	Total	3-8	3-10	3-15	8-15	5-16	2-20	3-25	2-33	15-30	3-40	>45	Not discl.
Number of disclosures	**66**	6	10	8	4	2	10	3	8	2	3	8	2
% of total	**100%**	9%	15%	12%	6%	3%	15%	5%	12%	3%	5%	12%	3%

The range of length of estimated useful life disclosed relating to computer equipment spread from 1 to 17 years.

Table 73 : Estimated useful life - Computer equipment

Computer equipment	Total	1-3	3-5	4-8	2-12	3-17
Number of disclosures	**19**	3	4	6	4	2
% of total	**100%**	16%	21%	32%	21%	11%

88 **Paramo** [Czech Republic] 2006 financial statements, page 111

9.3. Investment property

IAS 40 *Investment Property* defines investment property as ‘property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both’. It does not include owner-occupied property that is property held for use in the production or supply of goods or services or for administrative purposes. It does, however, include land which is held for an indeterminate use.

Investment property should be recognised initially at cost and subsequently measured at each balance sheet date at either:

- fair value (Fair Value Model); or
- Cost less accumulated depreciation and any write-down for impairment (Cost Model).

44% of companies (33 out of 75) disclosed information relating to investment properties in their accounting policies. Amongst them, the proportion of companies using the Fair Value Model rather than the Cost Model is much lower than found in 2005 IFRS study. 6 companies specified that they accounted for their investment properties using the Fair Value Model.

Table 74 : Choice of method of valuation of investment properties

	Number of companies	%
Fair Value Model	6	8%
Cost Model	27	36%
No investment property	42	56%
Total	**75**	**100%**

The cost model is also most used than the fair value model by non-listed entities.

The list of companies accounting for investment properties measured at Fair Value is as follows:

Table 75 : Companies measuring investment properties at Fair Value

Investment property measured at fair value		
CEZ	Czech Republic	Utilities
Tallink Grupp	Estonia	Travel & Leisure
Fabege	Sweden	Financial services
Land Securities Group	United Kingdom	Financial services
SP Group	Denmark	Chemicals
HSBC Holdings	United Kingdom	Banks

Fabege [Sweden, Financial Services] disclosed[89] the accounting treatment of Investment property measured at cost.

Investment property
All properties in the Group are classified as investment properties as they are held with the intention of generating rental revenues or increases in value or both. The term investment property includes buildings, land and land improvements, new constructions, additions or rebuilding in progress and property assets. Investment properties are recognised at fair value on balance sheet date. Gains and losses attributable to changes in the value of investment properties are recognised in profit or loss (in the income statement item Unrealised changes in value of investment properties) for the period in which they arise.

Gains or losses arising from the sale or disposal of investment properties comprise the difference between the sale price and carrying amount based on the most recently prepared revaluation to fair value. Results of sales or disposals are reported in the income statement in the item Realised change in value of investment properties.

Projects for refurbishment/maintenance and tenant adaptations are capitalised to the extent that the measures taken increase value in relation to the most recent valuation. Other expenditure is directly charged to expenses. In the case of major new constructions, extensions and conversions, interest expenses are capitalised during the period of production.

Property sales and property purchases are recognised in conjunction with risks and benefits associated with right of ownership passing to the buyer or seller, which normally takes place on the contract date.

HSBC [United Kingdom, Banks] specified90 the method of valuation of its investment properties.

HSBC holds certain properties as investments to earn rentals or for capital appreciation, or both. Investment properties are included in the balance sheet at fair value with changes therein recognised in the income statement in the period of change. Fair values are determined by independent professional valuers who apply recognised valuation techniques.

[89] **Fabege** [Sweden] 2006 financial statements, page 57

[90] **HSBC** [United Kingdom, Banks] 2006 financial statements, page 313

10. Financial instruments – non financial activities

Key points

Excluding Banks (24), Insurance companies (10) and Investments companies (11), covered in specific chapters of our survey, as well as companies providing investment services (10) - since either they manage and use financial instruments as banks do or they have virtually no financial instruments on their balance sheets - our research covers 195 companies from 24 countries operating in 16 industries.

These 195 groups generate total sales of 2 788 billion euro and their total assets amount to 3 858 billion euro.

Our review of amounts presented on the face of the balance sheet indicates that 192 groups carry financial debt on their balance sheets with outstanding balances amounting to 1 131 billion euro. At industry level, the average debt to Total Assets of the sample stands at 29,3 % with a maximum at 50,4 % for the "Industrial Goods and Services" industry (whose statistic is influenced by Deutsche Post as this group consolidates Deutsche Postbank) and a minimum at 10,1 % for the "Technology" industry.

165 groups in our sample present non-consolidated financial investments totalling 113 billion euro, excluding the loans and finance receivables carried by certain groups in their financial services activities. At industry level, the average weight of such non-consolidated financial investments relative to total assets is 2,9 %, ranging from 0,9 % to 5,9 % (disregarding the exceptional case of "Personal and Household Goods" which results from **L'Oréal** [France, Personal & Household Goods]'s interest in **Sanofi-Aventis** [France, Health Care]).

Geographical and industry concentrations reflect the relative weight of the largest groups in the overall sample. France, Germany, Italy, Spain and UK representing 85 % of total assets account for 82 % of total non-consolidated financial investments and 89 % of total debt. Similarly, Automobile and Parts, Industrial Goods, Oil and Gas, Telecommunications and Utilities representing more than 68 % of total assets, account for 64 % of non-consolidated financial investments, and 75 % of finance debt.

Table 76 : Overview on the use and importance of financial instruments (by decreasing order of finance debt – Amounts in EUR billion)

Industry Sector	Number of companies	Revenues	Total assets	Non-consolidated financial investments and loans	% of Total assets	Finance debt	% of total assets
Industrial goods & services	30	256	512	8	1,6%	258	50,4%
Automobiles & Parts	9	359	511	7	1,4%	226	44,3%
Telecommunications	10	244	558	15	2,7%	196	35,2%
Utilities	15	221	499	30	5,9%	108	21,6%
Oil & Gas	11	731	557	12	2,1%	65	11,6%
Construction & Materials	8	107	144	2	1,1%	53	36,8%
Basic resources	11	141	200	5	2,4%	40	20,0%
Chemicals	8	120	139	3	2,0%	40	28,7%
Food & Beverage	14	92	111	2	2,0%	33	29,7%
Personal & Household Goods	18	88	128	19	14,8%	25	19,4%
Retail	8	174	102	1	1,2%	24	23,6%
Health Care	17	94	150	2	1,3%	17	11,4%
Financial services	7	5	45	0	0,9%	13	30,2%
Media	8	44	85	3	3,9%	15	18,0%
Travel & Leisure	8	53	47	2	3,4%	10	22,1%
Technology	13	59	70	2	2,6%	7	10,1%
Total listed companies	**195**	**2 788**	**3 858**	**113**	**2,9%**	**1 131**	**29,3%**
Non-listed	16	140	149	12	8,1%	26	17,4%

NB: excluding loans and receivables from financial services activities

The statistics of the Industrial Goods and Services industry are heavily influenced by the special case of Deutsche Post [Germany, Industrial goods & services] consolidating Deutsche Postbank [Germany, Financial services]. To a much lower extent, the aggregate financial debt of this industry reflects the indebtedness of three transportation infrastructure operators. A significant portion of the financial debt in the Automobile and Parts industry results from the financing requirements of the Sales financing subsidiaries of the five large automotive groups included in our sample. Certain major players in the Retail industry (for instance, Carrefour [France, Retail]) are also involved in financial services activities that generate financing requirements. This contrasts with the situation prevailing in the Telecommunications industry or the Utilities industry where financial debt serves primarily to finance major investments.

The importance of financial investments in the “Utilities” industry relates in particular to **EDF** [France, Utilities] and **Areva** [France, Utilities] funding of their long-term decommissioning obligations with total 9,5 Bn € “dedicated assets”.

10.1. Presentation of the sample for the detailed analysis

Eighty groups have been selected for a detailed analysis of their treatment of financial instruments. We have reviewed the financial statements of the remaining companies included in our overall study to ensure that no other issue of interest was excluded.

Our sample for detailed analysis covers 22 different countries and 15 different industries.

Table 77 : Presentation of the sample for detailed analysis (EUR billion unless otherwise specified)

	Number of companies	Number of countries	Total sales	Total assets
Large groups	20	6	1 461	2 032
Medium-sized groups	20	15	57	60
Small groups	40	19	5	4
Total	**80**	**22**	**1 523**	**2 096**
Non Listed	16	8	140	149

In order to ensure a wide geographical coverage as well as a broad coverage of small groups, the number of large groups has been limited. As a consequence, they are not represented in 6 industries: “Construction and Materials”, “Food and Beverage”, “Media”, “Personal and Household goods”, “Technology”, Travel and Leisure”.

The key financials of the sample are presented in the following table. In order to better explain the magnitude of their assets and financial liabilities, we have included loans and receivables balances from the automotive industry (4 groups), the retail industry (1group) and the industrial goods and services industry (1group) which all have Sales finance subsidiaries. This results in non-consolidated financial investments and loans amounting to 251 Bn€.

Table 78 : Presentation of the sample for detailed analysis, breakdown by industry (by decreasing order of Finance debt – Amounts in EUR Billion)

Industry Sector	Number of groups	Revenues	Total assets	Non-consolidated financial investments and loans	% of Total assets	Finance debt	% of total assets
Automobiles & Parts	5	350	504	185	36,7%	224	44,6%
Telecommunications	5	212	507	15	2,9%	184	36,4%
Utilities	5	148	350	21	6,0%	72	20,5%
Oil & Gas	5	416	293	9	3,2%	33	11,2%
Chemicals	6	96	110	2	1,9%	32	29,6%
Industrial goods & services	11	115	167	10	5,8%	28	16,7%
Retail	2	85	51	5	10,6%	15	28,7%
Basic resources	3	42	49	2	3,7%	10	20,4%
Health care	8	35	39	1	2,4%	8	21,5%
Travel & Leisure	4	6	6	ns	4,4%	3	52,8%
Food & Beverage	5	8	7	ns	1,5%	3	34,6%
Construction & Materials	3	3	5	ns	3,5%	2	34,8%
Media	1	2	4	ns	1,2%	1	23,6%
Technology	8	4	4	ns	0,6%	ns	8,8%
Personal & Household Goods	9	1	1	ns	0,2%	ns	25,7%
Sub-total listed companies	**80**	**1523**	**2096**	**251**	**12,0%**	**616**	**29,4%**
Excluding loans and receivables from finance activities				64	3,0%		
Non listed companies	**16**	**140**	**149**	**12**	**8,1%**	**26**	**17,4%**
Excluding loans and receivables from finance activities				11	7,4%		

Within the sample, 6 groups (or 7 % of the sample) have early adopted IFRS 7:

- 4 large groups (**Siemens** [Germany, Industrial goods & services]**, Vodafone** [United Kingdom, Telecommunications], **Deutsche Telekom** [Germany, Telecommunications], **DaimlerChrysler** [Germany, Automobile & Parts]);
- 2 medium-sized groups (**JC Decaux** [France, Media], **Huhtamaki** [Finland, Industrial goods & services]); and
- No small group.
- no non-listed entities

Each category of companies - large, medium-sized and small - has distinct characteristics as to the way financial instruments are effectively used and managed:

- large groups address all aspects of financial risk management, financial investments, financing and hedging;
- medium-sized groups tend to concentrate on financing and hedging against financial risks;
- Small groups concentrate on financing.

10.2. Classification and presentation of non-consolidated financial investments

IFRS requirements

IAS 39 requires non-derivative financial assets to be classified in one of the following categories: [IAS 39.45]

- Available-for-sale financial assets;
- Loans and receivables;
- Held-to-maturity investments; and
- Financial assets at Fair Value through profit and loss.

Categories are used to determine how a particular financial asset is recognised and measured in the financial statements.

To comply with IAS 32.66, an entity must disclose all its significant accounting policies, including the general principles adopted and the method of applying those principles to transactions. In the case of financial instruments, such disclosure includes:

- the criteria applied in determining when to recognize a financial asset of financial liability;
- the basis of measurement applied to financial assets and financial liabilities on initial recognition and subsequently; and
- The basis on which income and expense arising from financial assets and financial liabilities are recognized and measured.

Observed practices

We have checked the disclosures on classification and accounting policies related to non-derivative and non-operating financial assets ("non-consolidated financial investments"). All large groups carry non-trading securities or non-current loans and receivables on their balance sheet; this is also the case of 17 medium-sized groups (85 %) and of 28 small groups (70 %).

Generally speaking, groups provide the classification by IAS 39 categories in the notes and not on the face of the balance sheet.

Non-trading securities are most often (49 cases) classified as available for sale; classification in the held-to-maturity category (6 cases) is infrequent.

Table 79 : Classification of "non-consolidated financial investments"

	Number of groups	with AFS portfolio	%	with HtM portfolio	%	with loans and receivables	%
Large groups	20	19	95%	4	20%	20	100%
Medium-sized groups	20	16	80%	0	-	16	80%
Small groups	40	14	31%	2	5%	22	55%
Total	**80**	**49**	**61%**	**6**	**8%**	**58**	**73%**
Non-Listed	16	8	50%	3	19%	6	38%

86 % of the companies disclose their accounting policies (the comprehensiveness of which varies) regarding the classification and treatment of non-consolidated financial investments. As the following table shows, large groups are fully compliant in this respect and the level of compliance decreases with the size of the group.

36% non-listed disclose their accounting policies regarding the class and treatments.

Table 80 : Disclosure of accounting policies on the classification and treatment of "non-consolidated financial investments"

	Number of groups	o/w having "financial investments"	o/w disclose	%
Large groups	20	20	20	100%
Medium-sized groups	20	17	15	88%
Small groups	40	28	21	75%
Total	**80**	**65**	**56**	**86%**
Non-Listed	16	11	4	36%

NB: percentages are calculated in relation to the number of groups that carry such financial assets on their balance sheets

Anecdotally, one small group discloses that it has retained the Held-for-Trading and the Available-for-Sale categories whereas it classifies financial investments in the Held-to-Maturity category for which no accounting policy is provided.

The measurement basis of available-for-sale equity securities is always disclosed by large and medium-sized groups whereas certain small groups happen neither to mention that they carry certain financial investments at cost nor to explain why they do so.

Many groups, particularly small ones, disclose accounting policies for categories of financial assets that they do not present as such on their balance sheet:

- 4 medium-sized groups or 20 % of the sub-sample
- 10 small groups or 25 % of the sub-sample

The same trend is observed within the sample of non-listed entities.

This practice does not facilitate the analysis of their financial statements.

Other comment

We have checked the relative importance of IAS 39 categories related to non-derivative non-operating financial assets on the balance sheets of large groups and small groups. In so doing, we have excluded loans and receivables arising from financial services of certain large groups involved in the financial sector for part of their operations. Cash and cash equivalents are also excluded from this analysis.

Altogether the proportion of financial assets with fair value risk flowing through the income statement (5%) is limited. Financial assets available for sale through equity are rare (less than 6 %) for small groups which measure substantially all their balance sheet items at cost or amortized cost.

Table 81 : Analysis of non-derivative non-operating financial assets other than cash and cash equivalents (Amounts in EUR Billion)

	Large groups	% of such assets	% of total assets	Small groups	% of such assets	% of total assets
Held-to-Maturity	756	1%	ns	1	1%	ns
Loans and Receivables	31 747	27%	2%	97	85%	2%
Available-for-Sale	80 904	68%	4%	7	6%	ns
At fair value through P&L	5 800	5%	ns	9	8%	ns
Total	**119 207**	**100%**	**6%**	**114**	**100%**	**3%**

10.3. Impairment of non-consolidated financial investments

IFRS requirements

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognised. [IAS 39.58]

For assets measured at amortized cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate [IAS 39.63]. For available-for-sale, the recoverable value of the investment is measured under current market conditions.

If, in a subsequent period, the amount of the impairment loss relating to a financial asset carried at amortised cost or a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit and loss. Impairments relating to investments in available-for-sale equity instruments are not reversed [IAS 39.65].

Observed practices

Accounting policies for the impairment of non-consolidated financial investments are disclosed by nearly all large groups. A significant number of medium and small groups do not disclose specific policies for the impairment of their financial assets.

Table 82 : Disclosure of accounting policies on impairment of non-consolidated financial investments

	Number of groups	with non consolidated financial investments	of which disclosed accounting policies	%
Large groups	20	20	19	95%
Medium-sized groups	20	17	8	47%
Small groups	40	28	19	68%
Total	**80**	**65**	**46**	**71%**

Only 41% of non-listed entities having non-consolidated financial investments disclose their accounting policies on impairment of such investments.

In addition, we have checked the disclosures of 4 large groups with available-for-sale portfolios in excess of EUR 7 billion to find that one only indicates how it calculates the cost of its available-for-sale financial assets to determine impairment losses (in this case, average weighted cost per security).

10.4. Issues related to debt/equity classification

IFRS requirements

The fundamental principle of IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. The reporting entity must make the decision at the time the instrument is initially recognised.

A financial instrument is an equity instrument only if the instrument includes no contractual obligation to deliver cash or another financial asset to another entity. As a consequence, if an enterprise issues preference (preferred) shares that pay a fixed rate of dividend and that have a mandatory redemption feature at a future date, the substance is that they are a contractual obligation to deliver cash and, therefore, should be recognised as a liability. In contrast, normal preference shares do not have a fixed maturity, and the issuer does not have a contractual obligation to make any payment. They are shown in equity. [IAS 32.18]

Compound financial instruments, such as convertible bonds, have both a liability and an equity component from the issuer's perspective. In that case, IAS 32 requires that the component parts be accounted for and presented separately according to their substance based on the definitions of liability and equity. The split is made at issuance and not subsequently revised.

Observed practices

A significant number of groups use hybrid financing instruments such as preference shares, subordinated debt and compound instruments.

Table 83 : Use and classification of hybrid instruments

	Number of groups	Of which have issued hybrid instruments	%	Preference shares	Subordinated debt	Convertible debt and similar
Large groups	20	15	75 %	9	4	6
Medium-sized groups	20	4	20 %	2	1	2
Small groups	40	10	25 %	2	2	7
Total	**80**	**29**	**36%**	**13**	**7**	**15**

No non-listed entity has issued hybrid instruments.

No improper classification between equity and liabilities has been observed. Preference shares classified as equity are generally described as non-voting shares entitling their holders to a preferred dividend. All preference shares described as cumulative and/or redeemable preference shares entitling their holders to a fixed-rate or cumulative dividends have been classified as debt. As explained[91] by **Nutreco** [Netherlands, Food & Beverage] "*Preference share capital is classified as a liability as the dividend payments are not discretionary. Dividends thereon are recognised in the income statement as interest expense."* Subordinated debts have all been classified as liabilities.

An example of full disclosure follows:

ASML Holding [Netherlands, Technology], a provider of lithography systems for the semiconductor industry, has issued convertible debt. The company discloses[92] its accounting policy for such transactions and details the change in the carrying amount of its convertible bonds in issue: » *Convertible Subordinated Notes are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible subordinated notes and the fair value assigned to the liability component, representing the embedded option for the holder to convert the loan note into equity of the Company, is included in equity. Issue costs are apportioned between the liability and equity components of the convertible subordinated notes based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly to equity. The interest expense on the liability component is calculated by applying the prevailing market interest rate for similar non-convertible debt to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible subordinated notes.*

The net proceeds received from the issue of the Company's Convertible Subordinated Notes have been split between a liability component and an equity component, representing the fair value of the embedded option to convert the liability into equity of the Company, as follows (excluding underwriting commission):

Year ended December 31 (in thousands)	2005 EUR	2006 EUR
5.75 percent convertible notes		
Liability component at January 1	372,593	**461,699**
Interest charged	55,305	**45,261**
Interest paid	(26,409)	**(11,886)**
Effect of exchange rates	60,210	**(26,342)**
Redemption	0	**(53)**
Conversion into company's shares	0	**(468,679)**
Liability component at December 31	461,699	**0**
Underwriting commission capitalized at December 31	(1,653)	**0**
Carrying amount at December 31	460,046	**0**
Nominal value at December 31	487,497	**0**
5.50 percent convertible notes		
Liability component at January 1	313,225	**324,694**
Interest charged	32,369	**32,790**
Interest paid	(20,900)	**(20,900)**
Liability component at December 31	324,694	**336,584**
Underwriting commission capitalized at December 31	(4,110)	**(3,364)**
Carrying amount at December 31	320,584	**333,220**
Nominal value at December 31	380,000	**380,000**

[91] **Nutreco** [Netherlands]

[92] **ASML Holdings** [Netherlands] Annual report 2006, page 71

10.5. Use of the Fair Value Option

IFRS requirements

IAS 39 permits entities to designate, at the time of acquisition or issuance, certain financial assets or financial liabilities to be measured at fair value, with value changes recognised in profit or loss. This option is available even if the financial asset or financial liability would ordinarily, by its nature, be measured at amortised cost – but only if fair value can be reliably measured. An amendment to IAS 39, which became effective for annual periods beginning on 1 January 2006 or after, restricted the fair value option to 3 specific circumstances:

- it eliminates, or significantly reduces, a measurement or recognition inconsistency (an "accounting mismatch");
- a group of financial assets, financial liabilities or both is managed and evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel ("group of financial assets or financial liabilities managed on a fair value basis"); or
- It contains one or more embedded derivatives that would otherwise require separation from their host contracts.

Observed practices

Several groups have taken advantage of the Fair Value Option (FVO); in particular 6 large groups have designated certain financial assets or liabilities as at fair value.

Table 84 : Use of the Fair Value Option

	Number of groups	Of which use the FVO	%
Large groups	20	6	30 %
Medium-sized groups	20	2	10 %
Small groups	40	-	-
Total	**80**	**8**	**10%**

Only one non-listed entity uses the fair value option (6%).

The reason for the designation is disclosed by 7 groups out of 8. The primary reason why they use the fair value option is to simplify the accounting treatment of complex contracts with embedded derivatives. **Renault** [France, Automobile & Parts] is[93] one of the groups that apply this solution to redeemable shares with a variable interest linked to consolidated revenues.

"[…] the Group considers that the variable interest on redeemable shares is an embedded derivative which cannot be valued separately. Consequently, the Group has stated all its redeemable shares at fair value. For these shares, fair value is equal to market value. Changes in fair value are recorded in financial income and expenses."

Three large groups (**Suez** [France, Utilities], **Electricité de France** [France, Utilities], and **EADS** [Netherlands, Industrial goods & services]) also designate non-trading financial assets at fair value through profit or loss to reconcile the accounting treatment of non-trading liquid assets with the related internal monitoring practices.

[93] **Renault** [France, Automobile & Parts] Annual report 2006, pages 180, 195

Table 85 : Reasons for using the Fair Value option

	Number of groups using the FVO	of which for embedded derivatives	of which for Groups of assets	of which for Accounting mismatch	of which for undisclosed reason
Large groups	6	3	3	-	1
Medium-sized groups	2	1	-	-	1
Small groups	-	-	-	-	-
Total	**8**	**4**	**3**	**-**	**2**

NB: one large group uses the FVO for 2 distinct reasons

The non-entity that uses the fair value option in order to reconcile the accounting treatment with the related internal monitoring practices (group of assets).

10.6. Embedded derivatives

IFRS requirements

Some contracts that themselves are not financial instruments may nonetheless have financial instruments embedded in them. For example, a contract to purchase a commodity at a fixed price for delivery at a future date has embedded in it a derivative that is indexed to the price of the commodity.

An embedded derivative is a feature within a contract, such that the cash flows associated with that feature behave in a similar fashion to a stand-alone derivative. In the same way that derivatives must be accounted for at fair value on the balance sheet with changes recognised in the income statement, so must some embedded derivatives. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when: [IAS 39.11]

- the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- The entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

If IAS 39 requires that an embedded derivative be separated from its host contract, but the entity is unable to measure the embedded derivative separately, the entire combined contract must be treated as a financial asset or financial liability that is held for trading (and, therefore, remeasured to fair value at each reporting date, with value changes in profit or loss). [IAS 39.12]

Observed practices

Fifteen groups, among which eleven large groups, disclose that they have identified significant embedded derivatives, some of them in sale or purchase contracts, others in debts in issue or in purchased debt securities.

Table 86 : Embedded derivatives

	Number of groups	of which have disclosed embedded derivatives	%	Sale or purchase contract	Debt in issue	Purchased debt securities
Large groups	20	11	55 %	8	3	-
Medium-sized	20	2	10 %	1	-	1
Small groups	40	2	5 %	1	-	1
Total	**80**	**15**	**19 %**	**10**	**3**	**2**

13% of non-listed entities disclose the existence of embedded derivatives (1 for sale or purchase contract, 1 for debt in issue).

The most frequent type of embedded derivatives is foreign currency derivatives embedded in purchase or in sale contracts. **EADS** [Netherlands, Industrial goods & services], **Electricité de France** [France, Utilities], **GlaxoSmithKline** [United Kingdom, Health Care], **Siemens** [Germany, Industrial goods & services], **Suez** [France, Utilities] identified such foreign currency derivatives. Other types of derivatives are embedded in purchase or sale contracts. **Umicore** [Belgium, Chemicals], a company involved in materials technology, explains[94] *"In 2006 a contractual situation is identified at Umicore Zinc Alloys France which links part of the electricity costs (host contract) to the evolution of the Zinc price (embedded derivative). […]*

Other embedded derivatives have been found in financial instruments. As already mentioned, **Renault** [France, Automobile & Parts] has identified[95] an embedded derivative in certain debt in issue: "*the Group considers that the variable interest on redeemable shares is an embedded derivative".*

Derivatives embedded in non-financial contracts have been separated; their fair value is disclosed in the notes.

Suez [France, Utilities] indicates[96]: *"The Group also holds certain purchase and sale contracts providing for the physical delivery of the goods, which are documented as being 'normal' purchases and sales but include clauses qualifying as embedded derivatives under IAS 39. For some of the contracts, these clauses are recognized and measured separately from the host contract with changes in fair value recognized in income. Specifically, certain embedded derivatives have been recognized separately from host contracts containing (i) price clauses that link the contract price to changes in an index or the price of a different commodity from the one that is being delivered; (ii) indexation clauses based on foreign exchange rates that are not considered as being closely linked to the host contract, or (iii) other clauses".*

[94] **Umicore** [Belgium]

[95] **Renault** [France]

[96] **Suez** [France] Annual Report 2006, page 277

The following table shows the notional amount of these instruments, expressed in MMBTU (millions of British Thermal Units – the standard conversion unit for energy contracts) and their maturities:

Commodity derivatives	Notional amounts (net)* In millions of MMBTU at December 31, 2006						
	2007	2008	2009	2010	2011	> 5 years	Total
Economic hedges not qualifying for hedge accounting under IAS 39	47.4	63.7	0.3	1.2	0.5		**113.1**
Arbitrage and optimization contracts	13.7	8.6	6.7	(0.0)			**29.0**
Other contracts qualifying as derivatives	(30.3)	(17.4)	(13.8)	(11.5)	(10.0)	(17.3)	**(100.3)**
Embedded derivatives	2.1	(3.2)	19.9	17.6	17.6	35.3	**89.3**
TOTAL	**32.9**	**51.7**	**13.1**	**7.3**	**8.1**	**18.0**	**131.1**

* *Long position/(short position)*

Fair value and maturities

The following table shows the fair values of commodity derivatives at December 31, 2006 by maturity:

Commodity derivatives	Fair value at December 31, 2006*						Total fair value
	2007	2008	2009	2010	2011	> 5 years	
Economic hedges not qualifying for hedge accounting under IAS 39	(106.0)	(82.3)	(14.3)	(1.0)	(0.7)		**(204.3)**
Arbitrage and optimization contracts	(90.4)	(0.7)	3.4	(0.0)			**(87.7)**
Other contracts qualifying as derivatives	(26.0)	(8.7)	(0.3)				**(35.0)**
Embedded derivatives	(27.9)	(26.2)	(8.7)	(9.0)	(8.0)	(14.0)	**(93.8)**
TOTAL	**(250.3)**	**(117.9)**	**(19.9)**	**(10.0)**	**(8.7)**	**(14.0)**	**(420.8)**

* *Fair value excluding adjustments to reflect credit risk and liquidity risk.*

Derivatives embedded in financial instruments have most often been treated under the fair value option so as to avoid the complexity of separating the derivative from its host contract. The 3 large groups, among which is **France Telecom** [France, Telecommunications] and 1 medium-sized group, have elected this solution. The small group facing this situation concluded that neither the fair value of the instrument nor the fair value of the derivative could be reliably measured and consequently did not separate the derivative.

France Telecom [France, Telecommunications] discloses[97]: *"Concerning the bonds redeemable for STM shares, it is not possible to measure the embedded derivative separately from the host contract either at acquisition or at a subsequent financial reporting date; consequently, the entire combined contract has been treated as a financial liability at fair value."*

[97] **France Telecom** [France]

10.7. Use of derivative instruments and of hedge accounting

Use of derivative instruments

The use of derivative instruments is widespread among the sample; it increases with the size of the group.

- 100 % of the large groups use derivative instruments
- 95 % of the medium-sized groups mention they use derivatives and one (5%) indicates that it occasionally uses them
- 75 % of the small groups either have derivatives on their balance sheet or may have had derivatives in a recent past

All groups indicate that their primary motivation for entering into derivative transactions is risk management, in other words hedging certain risk exposures. A vast majority mentions that their policies prohibit speculative transactions.

The use of derivative instruments is also quite widespread over the sample of non-listed entities (94% mention they use derivatives), for the same reasons as those given by listed entities (hedging certain risk exposures).

10.8. Use of hedge accounting

IFRS requirements

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is: [IAS 39.88]

- formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness; and
- Expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured. Hedge effectiveness must be assessed both prospectively and retrospectively.

IAS 39 defines three categories of hedges: fair value hedges, cash flow hedges, net investment hedges.

A **fair value hedge (FVH)** is a hedge of the exposure to changes in fair value of a recognised asset or liability. The gain or loss from the change in fair value of the hedging instrument is recognised immediately in profit or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss.

A **cash flow hedge (CFH)** is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. [IAS 39.86]

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and recycled to the income statement when the hedged cash transaction affects profit or loss. [IAS 39.95]

A **hedge of a net investment in a foreign operation (NIH)** as defined in IAS 21 is accounted for similarly to a cash flow hedge. [IAS 39.86]

IAS 32.58 requires the disclosure of the following information, by category of hedge:

- a description of the hedge
- a description of the financial instruments designated as hedging instruments and their fair value at the balance sheet date
- the nature of the risk being hedged
- for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur

The following disclosures about gains and losses on hedging instruments in cash flow hedges are also required:

- the amount that was recognized in equity during the period
- the amount that was removed from equity and included in profit or loss during the period
- The amount that was removed from equity during the period and included in the initial measurement of a non-financial asset or a non-financial liability in a hedged highly probable transaction.

Observed practices

Despite the fact that all groups use derivatives for risk management purposes and generally prohibit any speculative transaction, a fair number of them does not use or makes a limited use of hedge accounting. Our analysis shows that the use of hedge accounting depends on the size of the group:

- 100 % of large groups use at least one hedge category as defined by IAS 39
- 89 % of the medium-sized groups explicitly use at least one hedge category.
- 52 % of the small groups that enter into derivative transactions actually use hedge accounting. Remaining ones manage their risk exposures through economic hedging.

Thirty-one companies in the sample (or 45 %) report economic hedging arising as a result of having entered into derivatives transactions that do not qualify for hedge accounting or have not been designated as hedging instruments.

One small company reports using only economic hedges given the lack of structured procedures to determine hedge effectiveness.

Table 87 : Use of hedging and of hedge accounting

	Number of groups	of which use derivatives	of which use hedge accounting	FVH	CFH	NIH	Economic hedges
Large groups	20	20	20	18	18	10	10
Medium-sized groups	20	19	16	11	15	9	11
Small groups	40	29	15	4	11	1	11
Total	**80**	**68**	**51**	**33**	**44**	**20**	**32**
				in % of groups using derivatives			
Large groups			100%	90%	90%	50%	50%
Medium-sized groups			84%	58%	79%	47%	58%
Small groups			52%	14%	38%	3%	38%
			75%	**49%**	**65%**	**29%**	**47%**
Non-listed	**16**	**15**	12	9	11	1	11
Non-listed			80%	60%	73%	7%	73%

NB: FVH stands for Fair Value Hedge, CFH for Cash Flow Hedge and NIH for Net Investment Hedge

Early-adopters of IFRS 7 homogeneously provide compliant and informative disclosures. Several other groups are compliant or mostly compliant with IAS 32 requirements but altogether disclosures on hedges remain too often insufficiently specific as to the hedge categories actually used, the nature of hedged items and the risks that are hedged. Small groups, in particular, tend to disclose accounting policies on hedge accounting despite the fact that they do not enter into derivative transactions.

Hedging instruments are mostly interest rate swaps for hedges of interest rate risk, forward contracts and cross-currency swaps for hedges of currency risk. A number of other instruments such as caps, options and currency options are used; sometimes plain vanilla ones, sometimes more complex ones.

All groups in the sample have disclosed the hedged item and/or the nature of the hedged risk; not necessarily the precise risk factor that is hedged.

Table 88 : Disclosure of hedged risk in fair value hedges and cash flow hedges

	Groups using hedge accounting	of which using FVH	of which disclosing the hedged risk	of which using CFH	of which disclosing the hedged risk
Large groups	20	18	100%	18	100%
Medium-sized groups	16	11	100%	15	100%
Small groups	15	4	100%	11	100%
Total	**51**	**33**	**100%**	**44**	**100%**

NB: FVH stands for Fair Value Hedge, CFH for Cash Flow Hedge and NIH for Net Investment Hedge

The disclosure on hedged risk for non-listed entities is at the same level as for listed entities.

Hereunder is the very comprehensive disclosure of **Siemens**[98] [Germany, Industrial goods & services], an early-adopter of IFRS 7:

Hedging activities

The Company's operating units applied hedge accounting for certain significant anticipated transactions and firm commitments denominated in foreign currencies. Specifically, the Company entered into foreign exchange contracts to reduce the risk of variability of future cash flows resulting from forecasted sales and purchases and firm commitments resulting from its business units entering into long-term contracts (project business) and standard product business which are denominated primarily in U.S.$.

Cash flow hedges

Changes in fair value of forward exchange contracts that were designated as foreign-currency cash flow hedges are recorded in Other components of equity. During the years ended September 30, 2007 and 2006, net gains of €1 and €3, respectively, were reclassified from "Other components of equity" into net income (loss) because the occurrence of the related hedged forecasted transaction was no longer probable.

It is expected that €119 of net deferred gains in "Other components of equity" will be reclassified into "Cost of goods sold and services rendered" during the year ended September 30, 2008, when the hedged forecasted foreign-currency denominated sales and purchases occur.

[98] **Siemens** [Germany]

As of September 30, 2007, the maximum length of time over which the Company is hedging its future cash flows associated with foreign-currency forecasted transactions is 184 months.

Fair value hedges

As of September 30, 2007 and 2006, the Company hedged firm commitments using forward exchange contracts that were designated as foreign-currency fair value hedges of future sales related primarily to the Company's project business and, to a lesser extent, purchases. As of September 30, 2007 and 2006, the hedging transactions resulted in the recognition of financial assets of €2 and €6, respectively, and financial liabilities of €31 and €7, respectively, for the hedged firm commitments, whose changes in fair value were charged to Cost of goods sold and services rendered. Changes in fair value of the derivative contracts were also recorded in Cost of goods sold and services rendered.

Interest rate risk management

Interest rate risk arises from the sensitivity of financial assets and liabilities to changes in market rates of interest. The Company seeks to mitigate such risk by entering into interest rate derivative financial instruments such as interest rate swaps (see also Note 32), options and, to a lesser extent, cross-currency interest rate swaps and interest rate futures.

Derivative financial instruments not designated as hedges

The Company uses a portfolio-based approach to manage its interest rate risk associated with certain interest-bearing assets and liabilities, primarily interest-bearing investments and debt obligations. This approach focuses on mismatches in the structure of the interest terms of these assets and liabilities without referring to specific assets or liabilities. Such a strategy does not qualify for hedge accounting treatment under IAS 39, Financial Instruments: Recognition and Measurement. Accordingly, all interest rate derivative instruments used in this strategy are recorded at fair value, either as Other current financial assets or Other current financial liabilities, and changes in the fair values are charged to Financial income (expense), net. Net cash receipts and payments relating to interest rate swaps used in offsetting relationships are also recorded in Financial income (expense), net.

Fair value hedges of fixed-rate debt obligations

Under the interest rate swap agreements outstanding during the year ended September 30, 2007, the company agrees to pay a variable rate of interest multiplied by a notional principle amount, and receive in return an amount equal to a specified fixed rate of interest multiplied by the same notional principal amount. These interest rate swap agreements offset an impact of future changes in interest rates on the fair value of the underlying fixed-rate debt obligations. The interest rate swap contracts are reflected at fair value in the Company's Consolidated Balance Sheets and the related portion of fixed-rate debt being hedged is reflected at an amount equal to the sum of its carrying amount plus an adjustment representing the change in fair value of the debt obligations attributable to the interest rate risk being hedged. Changes in the fair value of interest rate swap contracts and the offsetting changes in the adjusted carrying amount of the related portion of fixed-rate debt being hedged are recognized as adjustments to the line item Financial income (expense), net in the Consolidated Statements of Income. The net effect recognized in Financial income (expense), net, representing the ineffective portion of the hedging relationship, amounted to €7 in fiscal 2007. Net cash receipts and payments relating to such interest rate swap agreements are recorded as interest expense, which is part of Financial income (expense), net. The Company had interest rate swap contracts to pay variable rates of interest (average rate of 5.2% and 5.0% as of September 30, 2007 and 2006, respectively) and received fixed rates of interest (average rate of 5.7% and 5.7% as of September 30, 2007 and 2006, respectively). The notional amount of indebtedness hedged as of September 30, 2007 and 2006 was €7,326 and €5,752, respectively. This resulted in 82% and 44% of the Company's underlying notes and bonds being subject to variable interest rates as of September 30, 2007 and 2006, respectively. The notional amounts of these contracts mature at varying dates based on the maturity of the underlying hedged items. The net fair value of interest rate swap contracts (excluding accrued interest) used to hedge indebtedness as of September 30, 2007 and 2006 was €20 and €207, respectively.

Fair value hedges of available-for-sale financial assets

During the year ended September 30, 2007, the Company applied fair value hedge accounting for certain fixed-rate available-for-sale financial assets. To offset the impact of future changes in interest rates on the fair value of the underlying fixed-rate available-for-sale financial assets, interest rate swap agreements were entered into. The interest rate swap contracts and the related portion of the available-for-sale financial assets are reflected at fair value in the Company's Consolidated Balance Sheets. Changes in the fair value of interest rate swap contracts and the offsetting changes in fair value of the available-for-sale financial assets being hedged attributable to the interest rate risk being hedged are recognized as adjustments to the line item Financial income (expense), net in the Consolidated Statements of Income. The net effect recognized in Financial income (expense), net, representing the ineffective portion of the hedging relationship, amounted to €9 in fiscal 2007.

Cash flow hedges of revolving term deposits

During the years ended September 30, 2007 and 2006, the Company applied cash flow hedge accounting for a revolving term deposit. Under the interest rate swap agreements entered into, the Company agrees to pay a variable rate of interest multiplied by a notional principle amount, and to receive in return an amount equal to a specified fixed rate of interest multiplied by the same notional principal amount. These interest rate swap agreements offset the effect of future changes in interest payments of the underlying variable-rate term deposit. The interest rate swap contracts are reflected at fair value and the effective portion of changes in fair value of the interest rate swap contracts that were designated as cash flow hedges are recorded in Other components of equity. Net cash receipts and payments relating to such interest rate swap agreements are recorded as interest income, which is part of financial income (expense), net.

There are numerous instances of groups failing to provide the other disclosures required for cash flow hedges (i.e., periods in which hedged cash flows are expected to occur, the gain or loss recognized in equity and the gain and loss removed from equity).

Table 89 : Disclosure on cash flow hedges

	Groups using CFH	of which disclosing the maturity of hedged cash flows	of which disclosing the amounts recognized in and removed from equity*
Large groups	18	6	9
Medium-sized groups	15	4	5
Small groups	11	2	-
Total	**44**	**12**	**14**
%	**100 %**	**27 %**	**32 %**

(*) several other groups disclose the net change in equity

The maturity of hedged cash-flows is disclosed by 25% of non-listed entities which use CFH, and amounts recognized and removed from equity is disclosed by 41% non-listed entities, which is globally in line with the observation made for listed companies.

IAS 32 requires that hedged forecast transactions that are no longer expected to occur be disclosed. In our sample, one group only discloses the fact that such an event had occurred in 2006 and 2007 entailing the reclassification of deferred gains from equity to the income statement, but provides no further description of these forecast transactions.

10.9. Debt disclosures

IFRS requirements

Under IAS 32.62, an entity must disclose the terms and conditions of financial instruments that are individually significant. If no single instrument is individually significant to the future cash-flows of the entity, the essential characteristics of the instruments are described for homogeneous groupings.

The standard also states that "in the case of an instrument for which cash flows are denominated in a currency other than the entity's functional currency, [an entity must disclose] the currency in which receipts or payments are required.

Observed practices

Most groups provide information about the characteristics of their financial liabilities with various levels of details.

All groups describe significant transactions in the notes and/or they detail classes of financial liabilities in the notes (bonds, medium-term notes, commercial paper, other long-term loans,). The maturity profile of financial debt is provided by most groups that carry such liabilities on their balance sheets. For the remaining groups, users of their financial statements would usually be able to analyse the run-off of debt, though not necessarily easily. These are the two requirements of IAS 32 regarding debt disclosures that are rather well complied with.

Table 90 : Debt disclosures – maturity profile

	Number of groups	of which have outstanding debts	of which disclosed debt details	%	of which disclosed a maturity profile	%
Large groups	20	20	20	100%	19	95%
Medium-sized groups	20	20	20	100%	15	75%
Small groups	40	34	34	100%	28	82%
TOTAL	**80**	**74**	**74**	**100%**	**62**	**84%**
Non listed	16	15	15	100%	14	93%

Other IAS 32 requirements on financial debt are not so often met. IAS 32.64 requires effective interest rate information. Such information (IAS 32.64c) may be disclosed for individual financial instruments or, alternatively, weighted average rates or a range of rates may be presented for classes of financial instruments.

In fact, a number of groups do not disclose any interest rate or disclose the contractual interest rate of their financial liabilities and not the effective interest rate. Certain groups disclose the index to which their floating rate debts are pegged and do not disclose the spread over the index. Others do not qualify the interest rates that they disclose; hence users are not able to easily understand whether or not such interest rates actually are effective interest rates after hedge (when the group hedges interest rate risk). Some groups disclose so large interest rate brackets that the usefulness of information is questionable. *("Nominal interest is between 0 and 8.0% for public bonds (previous year: 0 to 8.375%), and between 0.78 and 10.0% for private placements, as in the previous year (depending on currency, term and time of issue)").* Altogether, 26 % of the groups actually present the weighted average effective interest rate after hedge (where applicable) of their indebtedness or of significant classes of liabilities. The statistic is surprisingly low for large groups which in fact appear to more often disclose interest rates at the individual level and before hedge.

Table 91 : Debt disclosures – effective interest rates after hedge

	Groups with outstanding debts	o/w disclose effective interest rate after hedge	%
Large groups	20	3	15%
Medium-sized groups	20	8	40%
Small groups	34	8	24%
Total	**74**	**19**	**26%**
Non listed	15	4	27%

Adequate disclosure of the currency in which classes of financial liabilities are denominated or individual transactions are denominated has been found checked for large groups but one. Twelve groups analyse directly their financial debt by currency; five others disclose the currency in which significant borrowings are denominated. Two groups present a detailed analysis of their exposure to currency risk with a sensitivity analysis.

Table 92 : Debt disclosures – analysis by currency for large groups

	Groups with outstanding debts	Direct analysis by currency	%	Other disclosure of currency	%
Large groups	20	12	60%	7	35%

An example of a comprehensive IAS32 debt disclosures is provided[99] hereunder by **BASF** [Germany, Chemicals].

Financial indebtedness

Million €	Nominal volume	Effective interest rate	Carrying amounts based on effective interest method 2006	2005
3.5% Euro Bond 2003/2010 of BASF Aktiengesellschaft	1,000	3.63 %	995.7	994.8
3.375% Euro Bond 2005/2012 of BASF Aktiengesellschaft	1,400	3.42 %	1,396.8	1,396.0
4% Euro Bond 2006/2011 of BASF Aktiengesellschaft	1,000	4.05 %	998.2	–
4.5% Euro Bond 2006/2016 of BASF Aktiengesellschaft	500	4.62 %	495.6	–
3-Month EURIBOR Bond 2006/2009 of BASF Aktiengesellschaft	500	variable	499.7	–
Other bonds			613.8	308.9
Commercial paper			3,219.3	–
Bonds and other liabilities to the capital markets			**8,219.1**	**2,699.7**
Liabilities to credit institutions			1,264.0	1,241.3
			9,483.1	**3,941.0**

Breakdown of financial liabilities by currency

Million €	2006	2005
U.S. dollar	4,250.1	718.9
Euro	4,545.1	2,631.9
Malaysian ringgit	18.3	16.3
Brazilian real	125.4	2.0
Chinese renminbi	504.3	529.1
Other	39.9	42.8
	9,483.1	**3,941.0**

Maturities of financial liabilities

Million €	2006	2005
Following year 1	3,694.9	259.3
Following year 2	43.7	12.3
Following year 3	694.4	97.8
Following year 4	1,062.1	45.7
Following year 5	1,058.0	1,041.3
Following year 6 and thereafter	2,930.0	2,484.6
	9,483.1	**3,941.0**

Bonds and other liabilities to the capital markets

Other bonds consist primarily of industrial revenue and pollution control bonds that are used to finance investments in the United States. In addition, bonds with a value of €299.2 million were assumed in connection with the acquisition of Engelhard Corp. The weighted-average interest rate was 3.8% in 2006, and 2.7% in 2005. The weighted-average effective interest rate was 3.8% in 2006, and 2.7% in 2005. The average maturity amounted to 214 months as of December 31, 2006 and 317 months as of December 31, 2005.

Liabilities to credit institutions

Liabilities to credit institutions relate to a large number of different credit institutions in various countries. Liabilities to credit institutions denominated in ringgit and renminbi result from the local financing of investments in Malaysia and China.

BASF Aktiengesellschaft had committed and unused credit lines with variable interest rates of €4,898.3 million as of December 31, 2006, and €2,119.2 million as of December 31, 2005. Additional uncommitted credit lines of BASF Aktiengesellschaft amounted to €227.0 million as of December 31, 2006, and €227.0 million as of December 31, 2005 - these are free of any commitment fees.

The weighted-average interest rate on borrowings was 6.1% on December 31, 2006 and 4.7% on December 31, 2005.

[99] **BASF** [Germany, Chemicals] Annual Report 2006, page 151

10.10. Disclosures on financial risks and financial risk management

IFRS requirements

IAS 32.56 requires that entities describe their financial risk management objectives and policies including their policies for hedging each main type of forecast transaction of which hedge accounting is used. The discussion of management's policies for controlling the risks associated with financial instruments should include policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risk.

For each class of financial assets and financial liabilities, an entity must disclose information about its exposure to interest rate risk including contractual repricing of maturity dates, whichever dates are earlier and effective interest rates when applicable. If this entity has a variety of instruments, it may present a maturity profile of the carrying amounts of financial instruments exposed to interest rate risk. The effect of hedging transactions on effective interest rates and on interest rate risk of hedging transactions must be disclosed. Interest rate information may be disclosed for individual financial instruments or for relevant groupings. [IAS 32.67]

For each class of financial assets and other credit exposures, an entity must disclose information about the exposure to credit risk, including the amount that best represents its maximum credit risk exposure and significant concentrations of credit risk. [IAS 32. 76]

The standard has no explicit disclosure requirement as to the presentation of liquidity risk, currency risk and other price risks.

Observed practices

Financial risk factors

All but three groups (two medium-sized and one small group) have included a presentation of their risk factors and of their financial risk management policies either in their financial statements or in a "Risk management" section of their annual reports with a cross-reference to the notes. Not surprisingly, financial risk factors primarily relate to credit risk, liquidity risk, interest-rate risk and currency risk with variations depending on size and scope of operations. Several large groups also address equity price risk. Other price risk is addressed by a number of groups in reference to:

- Fuel
- Electricity
- Coal, gas, oil prices
- CO^2 emission rights
- Raw materials (naphta, benzene, …)
- Metals (copper, zinc, aluminium, rhodium, platinum, ...)
- Core products (sugar, soya, …)

Two large groups similarly discuss country risk as they have significant operations in Latin America.

Table 93 : Type of financial risks disclosed or discussed

	Number of groups	of which disclose or discuss	Credit	Liquidity	Interest rate	Currency	Equity	Other price risk
Large groups	20	20	20	20	20	20	5	10
Medium-sized groups	20	19	17	17	19	18	1	8
Small groups	40	39	38	34	33	30	-	9
Total	**80**	**78**	**75**	**71**	**72**	**68**	**6**	**27**
		% of groups which discussed or disclosed						
Large groups			100%	100%	100%	100%	25%	50%
Medium-sized groups			89%	89%	100%	95%	5%	42%
Small groups			97%	87%	85%	77%	-	23%
Total			**96%**	**91%**	**92%**	**87%**	**8%**	**35%**
Non-Listed	16	14	13	10	13	11	-	3
Non-Listed			93%	71%	93%	79%	-	21%

Credit risk

Most groups in the sample indicate that customer credit risk is their primary credit risk; in addition groups that carry significant financial investments on their balance sheets or enter into derivative transactions discuss counterparty risk. In large groups, in most medium-sized groups and a fair number of small groups, this risk is generally described as being under control due to appropriate risk management principles, as well as monitoring and mitigation policies. Most groups (among which a fair number of small groups) additionally state that their managements consider the level of bad debt allowances to be adequate.

Pendragon [United Kingdom, Retail], a medium-sized group, indicates: *The group is exposed to credit risk primarily in respect of its trade receivables and financial assets. Trade receivables are stated net of provision for estimated doubtful receivables. Exposure to credit risk in respect of trade receivables is mitigated by the group's policy of only granting credit to certain customers after an appropriate evaluation of credit risk. Credit risk arises in respect of amounts due from manufacturers in relation to bonuses and warranty receivables. This risk is mitigated by the range of manufacturers dealt with, the group's procedures in effecting timely collection of amounts due and management's belief that it does not expect any manufacturer to fail to meet its obligations. Financial assets comprise cash balances and assets arising from transactions involving derivative financial instruments. The counterparties are banks with sound credit ratings and management does not expect any counterparty to fail to meet its obligations. The maximum exposure to credit risk is represented by the carrying amount of each financial asset, including derivative financial instruments, in the balance sheet."*

Disclosures on concentrations of credit risk have been checked for all large groups in the sample with the following results.

Table 94 : Disclosures on concentrations of credit risk exposures

	Number of groups	of which do not disclose on concentrations	of which disclose absence of concentrations	of which disclose existence of concentrations
Large groups	20	9	10	1
%		**45 %**	**50 %**	**5 %**

Only one large group, **GlaxoSmithKline** [United Kingdom, Health Care] indicates[100] that it is exposed to a concentration of credit risk. "*In the USA, in line with other pharmaceutical companies, the Group sells its products through a small number of wholesalers in addition to hospitals, pharmacies, physicians and other groups. Sales to the three largest wholesalers amounted to approximately 80% of the Group's US pharmaceutical sales. At 31st December 2006, the Group had trade receivables due from these three wholesalers totalling £1,044 million (31st December 2005 – £1,051 million). The Group is exposed to a concentration of credit risk in respect of these wholesalers such that, if one or more of them is affected by financial difficulty, it could materially and adversely affect the Group's financial results."*

We have noted that one medium-sized group, **ASML Holding** [Netherlands, Technology], whose customers consist of integrated circuit manufacturers located throughout the world, states[101]: "*Additionally, as a result of the limited number of our customers, credit risk on our receivables is concentrated. Our three largest customers accounted for 35 percent of accounts receivable at December 31, 2006…*"

Datalex [Ireland, Technology], a small group, similarly discusses[102]: "*The group has implemented policies that require appropriate credit checks on potential customers before sales are made and monitors exposure to potential credit loss on a regular basis. During the year ended 31 December 2006, a significant portion of the group's revenue was derived from a limited number of customers. One customer individually accounted for 16% of the group's trade debtors at 31 December 2006.This customer is a large multinational with a strong credit rating*."

Liquidity risk

Liquidity or funding risk is addressed in most risk reports or notes to the financial statements. Among medium-sized groups, two have not mentioned it as a risk factor; this is also the case of five small groups. Objectives, policies, organisation and monitoring are described in the reports of all large groups, most medium-sized groups and less frequently in small groups.

RWE [Germany, Utilities] discloses[103]: *"As a rule, RWE AG centrally handles refinancing for all RWE Group companies."*

Exposure to liquidity risk is generally captured either through the presentation of the maturity profile of borrowings and of financial assets where applicable (as seen in paragraph VII.2) or through narrative statements. Before IFRS 7 the standards had no prescriptive requirements as to the presentation of liquidity risk.

[100] **GlaxoSmithKline** [United Kingdom]

[101] **ASML Holding** [Netherlands]

[102] **Datalex** [Ireland]

[103] **RWE** [Germany]

Table 95 : Analysis of liquidity risk

	Number of groups	of which provide a maturity profile	%
Large groups	20	19	95 %
Medium-sized groups	20	15	75 %
Small groups	40	28	70 %
Total	**80**	**62**	**78%**
Non-Listed	16	13	81%

Certain groups provide the maturity profile of their net financial debt. Sometimes, the maturity profile is broken down by currency.

DaimlerChrysler [Germany, Automobile & Parts] presents[104] the maturity profile of its gross liabilities together with its off-balance sheet loan commitments along IFRS 7 requirements.

The liquidity runoff shown in the following table provides an insight into how the liquidity situation of the Group is affected by the cash flows from financial liabilities as of December 31, 2006. It comprises a runoff of:

- *The undiscounted principal and interest cash outflows of the financing liabilities,*
- *The undiscounted sum of the net cash outflows of the derivative financial instruments for the respective time band,*
- *The undiscounted cash outflows of the trade payables,*
- *The undiscounted payments from other financial liabilities and*
- *The maximum amount to be drawn from irrevocable loan commitments of the Financial Services segment.*

(in millions of €)	Total	2007	2008	2009	2010	2011	≥ 2012
Financing liabilities	119,407	49,690	23,340	15,097	5,427	7,457	18,396
Derivative financial instruments	2,417	533	1,110	142	64	72	496
Trade payables	13,716	13,714	2	-	-	-	-
Other financial liabilities	9,860	8,268	821	509	130	48	84
Irrevocable loan commitments from the Financial Services segment	2,458	2,458	-	-	-	-	-
Total	147,858	74,663	25,273	15,748	5,621	7,577	18,976

Telefonica [Spain, Telecommunications] comments[105] on liquidity risk in a narrative statement: "*As of December 31, 2006, the average maturity of the Group's 52,145 million euros net financial debt was 6.5 years. The Group would need to generate around 8,000 million euros per year to repay the debt in this period if it used all its cash for this purpose. Cash generation in 2006 amply exceeded this amount, so that if it maintains the same pace of cash generation during the average lifetime of the debt, the Group would repay the debt in its entirety before 6.5 years if it used all its cash for this purpose.*

Gross debt maturities in 2007 (8,381 million euros, including hedges) are lower than the availability of funds calculated as the sum of:

[104] **DaimlerChrysler** [Germany] Annual Report 2006, page 61

[105] **Telefonica** [Spain]

- *Current financial investments and cash at December 31, 2006 amounting to 5,472 million euros,*
- *Annual cash generation projected for 2007 (which is expected to be higher than the 2006 figure),*
- *Unused credit lines arranged with banks whose initial maturity is over one year (more than 5,400 million euros, including the lines for Cesky Telecom, Endemol B.V. and the O2 Group) The existing excess is sufficient to accommodate dividend payment*
- *Commitments and the acquisition of pending treasury shares to conclude the current share repurchase program."*

Interest rate risk

IAS 32.67 requires disclosure of information about exposure of interest rate risk. This information may be presented in tabular form through a maturity profile of financial assets and financial liabilities by repricing date. This is how **GlaxoSmithKline** [United Kingdom, Health care] presents[106] interest rate risk.

Interest rate profiles of financial assets and liabilities

The following tables set out the exposure of financial assets and liabilities to either fixed interest rates, floating interest rates or no interest rates. The maturity profile of financial assets and liabilities exposed to interest rate risk in the tables below indicates the contractual repricing and maturity dates of these instruments.

At 31st December 2006 Financial assets	Investments £m	Liquid investments £m	Cash and cash equivalents £m	Receivables £m	Other financial assets £m	**Total £m**
Less than one year	–	1,035	1,952	211	1	**3,199**
Between one and two years	–	–	–	3	–	**3**
Between two and three years	–	–	–	1	–	**1**
Between three and four years	–	–	–	–	–	**–**
Between four and five years	–	–	–	–	–	**–**
Greater than five years	–	–	–	–	104	**104**
Total interest earning	–	1,035	1,952	215	105	**3,307**
Analysed as:						
Fixed rate interest	–	285	12	207	104	**608**
Floating rate interest	–	750	1,940	8	1	**2,699**
Total interest earning	–	1,035	1,952	215	105	**3,307**
Non-interest earning	441	–	53	4,558	351	**5,403**
Total	441	1,035	2,005	4,773	456	**8,710**

At 31st December 2006 Financial liabilities	Debt £m	Interest rate swaps £m	under finance leases £m	Payables £m	financial liabilities £m	**Total £m**
Less than one year	(895)	(1,883)	(106)	(14)	–	**(2,898)**
Between one and two years	(1,166)	1,164	(10)	–	–	**(12)**
Between two and three years	(339)	–	(7)	–	–	**(346)**
Between three and four years	(1)	–	(8)	–	–	**(9)**
Between four and five years	–	–	(6)	–	–	**(6)**
Greater than five years	(2,948)	719	(2)	–	–	**(2,231)**
Total interest bearing	(5,349)	–	(139)	(14)	–	**(5,502)**
Analysed as:						
Fixed rate interest	(4,721)	2,138	(46)	(6)	–	**(2,635)**
Floating rate interest	(628)	(2,138)	(93)	(8)	–	**(2,867)**
Total interest bearing	(5,349)	–	(139)	(14)	–	**(5,502)**
Non-interest bearing	(2)	–	–	(4,567)	(332)	**(4,901)**
Total	(5,351)	–	(139)	(4,581)	(332)	**(10,403)**

[106] **GlaxoSmithKline** [United Kingdom] Annual Report 2006, pages 132, 133

Interest rate risk may also be presented through the proportion of fixed rate debt versus floating rate debt. IAS 32 suggests a breakdown by currency when interest rates by currency are substantially different.

Suez [France, Utilities] displays[107] :

26.4.3 Borrowings and long-term debt by interest rate

In millions of euros	Including the impact of derivative financial instruments				Excluding the impact of derivative financial instruments			
	Dec. 31, 2006	Dec. 31, 2005	Jan. 1, 2005	Dec. 31, 2004	Dec. 31, 2006	Dec. 31, 2005	Jan. 1, 2005	Dec. 31, 2004
Floating rate	11,099.8	16,226.9	11,613.1	11,423.4	8,844.7	13,644.7	6,915.1	6,933.8
High	14.4%	20.9%	21.6%	21.6%	14.4%	20.9%	21.6%	21.6%
Low	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
Weighted average	**4.7%**	**3.7%**	**3.6%**	**3.6%**	**4.3%**	**3.5%**	**3.7%**	**3.7%**
Fixed rate	8,399.6	8,836.9	8,895.4	8,895.7	10,654.7	11,419.1	13,593.4	13,385.3
High	13.9%	18.2%	17.3%	17.3%	16.8%	18.2%	21.3%	21.3%
Low	0.1%	0.1%	0.0%	0.0%	0.1%	0.1%	0.0%	0.0%
Weighted average	**5.8%**	**5.6%**	**5.0%**	**5.0%**	**5.7%**	**5.5%**	**5.4%**	**5.4%**

Floating interest rates are generally linked to interbank rates offered in the relevant currency zones. The weighted average interest rate applied to bank overdrafts was at December 31, 2006, 2.8%, versus 2.6% at December 31, 2005, and 2.8% at December 31, 2004. The weighted average interest rate applied to long-term debt was 5.3% at December 31, 2006 versus 4.4% at December 31, 2005 and 4.3% at December 31, 2004.

Cash and cash equivalents are mainly subject to floating rates.

A fair number of groups present the maturity profile of their indebtedness. Disclosure about the fact that it is drawn before hedge or after hedge is not always provided, which limits the usefulness of the related table. Some groups disclose the proportion of fixed-rate debt versus floating-rate debt. As previously mentioned, disclosures about effective interest rates are often insufficient.

Currency risk

IAS 32 defines currency risk as the risk that the value of a financial instrument will fluctuate because of changes in foreign exchange rates. The standard has no prescriptive requirement as to the presentation of an entity's exposure to currency risk. It only requires that the currency in which certain financial assets or financial liabilities be disclosed if it is different from the functional currency of the holder or of the borrower. IAS 32 further suggests that outstanding balances or maturity profiles be analysed by currency for the purpose of interest-rate risk disclosure.

Disclosures in respect to currency risk are varied:

- narrative statements ("the group ensures that the net exposure is kept at an acceptable level")
- breakdown of outstanding balances at balance sheet date by currency
- maturity profile of borrowings by currency
- maturity profile of net exposures (borrowings by currency and (where applicable) and maturity profile of the hedging instrument

[107] **Suez** [France] Annual Report 2006, page 266

Suez [France, Utilities] discloses[108] the breakdown of its borrowings before hedge and after hedge.

26.4.2 Borrowings and long-term debt by currency

Gross debt

In millions of euros	Including the impact of derivative financial instruments							
	Dec. 31, 2006	%	Dec. 31, 2005	%	Jan. 1, 2005	%	Dec. 31, 2004	%
EUR zone	12,561.0	64%	16,178.1	65%	11,946.1	58%	13,200.2	65%
USD zone	3,912.3	20%	5,816.1	23%	5,544.8	27%	4,276.3	21%
GBP zone	878.5	5%	564.8	2%	995.8	5%	853.9	4%
Other currencies	2,147.6	11%	2,504.8	10%	2,021.8	10%	1,988.7	10%
TOTAL	**19,499.4**	**100%**	**25,063.8**	**100%**	**20,508.5**	**100%**	**20,319.1**	**100%**

In millions of euros	Excluding the impact of derivative financial instruments							
	Dec. 31, 2006	%	Dec. 31, 2005	%	Jan. 1, 2005	%	Dec. 31, 2004	%
EUR zone	15,216.2	78%	19,497.0	78%	15,459.7	75%	15,270.0	75%
USD zone	2,042.5	10%	3,367.0	13%	2,997.6	15%	2,997.6	15%
GBP zone	383.4	2%	77.5	0%	142.5	1%	142.5	1%
Other currencies	1,857.3	10%	2,122.3	9%	1,908.7	9%	1,909.0	9%
TOTAL	**19,499.4**	**100%**	**25,063.8**	**100%**	**20,508.5**	**100%**	**20,319.1**	**100%**

Siemens [Germany, Industrial goods & services] presents [109]its exposure and the sensitivity of its exposure to currency risk**.** *"We calculate foreign exchange rate sensitivity by aggregating the net foreign exchange rate exposure of the Operations, Financing and Real Estate Groups and Corporate Treasury. The values and risks disclosed here are the unhedged positions multiplied by an assumed 10% appreciation of the euro against all other currencies. As of September 30, 2007, a parallel 10% negative shift of all foreign currencies would have resulted in a decline of €47 million in future cash flows compared to a decline of €38 million the year before. Such decline in euro values of future cash flows might reduce the unhedged portion of revenues but would also decrease the unhedged portion of cost of materials. Because our foreign currency inflows exceed our outflows, an appreciation of the euro against foreign currencies, would have a negative financial impact to the extent that future sales are not already hedged. Future changes in the foreign exchange rates can impact sales prices and may lead to margin changes, the extent of which is determined by the matching of foreign currency revenues and expenses. We define foreign currency exposure generally as balance sheet items in addition to firm commitments which are denominated in foreign currencies, as well as foreign currency denominated cash inflows and cash outflows from anticipated transactions for the following three months. This foreign currency exposure is determined based on the respective functional currencies of our exposed entities.*

The tables below show the net foreign exchange transaction exposure by major currencies as of September 30, 2007 and 2006. In some currencies we have both substantial sales and costs, which have been offset in the table:

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[108] **Suez** [France] Annual report 2006, page 265

[109] **Siemens** [Germany] Annual Report September 2007, page 184

	September 30, 2007*			
	USD	GBP	Other	Total
Gross balance sheet exposure	223	321	208	752
Thereof: Financial assets	*7,858*	*3,642*	*4,769*	*16,269*
Thereof: Financial liabilities	*(7,635)*	*(3,321)*	*(4,561)*	*(15,517)*
Gross exposure from firm commitments and anticipated transactions	3,730	392	1,193	5,315
Foreign exchange transaction exposure	3,952	713	1,398	6,063
Economically hedged exposure	(3,893)	(567)	(1,132)	(5,592)
Change in future cash flows after hedging activities resulting from a 10% appreciation of the Euro	(6)	(15)	(27)	(47)

**: including SV*

Effects of Currency Translation: *Many of our subsidiaries are located outside the euro zone. Since our financial reporting currency is the euro, we translate the financial statements of these subsidiaries into euros so that we can include their financial results in our Consolidated Financial Statements. To consider the effects of foreign exchange translation risk in our risk management, our working assumption is that investments in our foreign-based operations are permanent and that reinvestment is continual. Whenever a divestment of a particular asset or entity is made, we incorporate the value of this transaction risk in our sensitivity analyses. Effects from currency fluctuations on the translation of net asset amounts into euro are reflected in the Siemens consolidated equity position*

Other price risks

Other price risks refer various underlyings such as equity or other financial investment risk carried by treasury departments. Those price risks are described, and exposures are presented along the usual practice in this respect.

This category of risk also includes commodity price risks. The related disclosures of the 10 large groups that discussed commodity price risk and monitor this risk with derivative instruments have been analysed. All groups that hedge such risks present their position in derivative instruments (notional amounts and fair value). Four groups indicate monitoring their exposures through Value-at-Risk, among which one group, **Suez** [France, Utilities], discloses[110] the value-at-risk of its commodity trading activities at 2006 year end.

10.11. Clarity of the presentation of financial risks

Our analysis also included an assessment of the clarity of disclosures about the presentation of financial risks. We have considered those disclosures to be clear when the following criteria were met:

- risk factors are clearly described;
- their presentation in the risk report and in the notes is consistent;
- management objectives are expressed for the identified risk factors;
- policies are explained;

[110] **Suez** [France, Utilities] Annual Report 2006, page 276

- the difference between economic hedging and qualification for hedge accounting is mentioned; and
- A relevant measure of exposures is provided (or in the case of small groups, sufficient details are provided for users to correctly assess those exposures themselves).

Regarding the presentation of risk factors, all large groups provide comprehensive descriptions; a comparison of the risk factors disclosed by groups within the same industry reveals no apparent inconsistency.

In the medium-sized and small sub-sample, comprehensiveness appears to be more difficult to achieve. Two medium-sized groups do not mention customer credit risk among risk factors whereas they probably should have, given the amounts carried on their balance sheets. Similarly, five small groups have been found not to mention liquidity risk whilst this risk factor should likely not be ignored in their context. Two other small groups appear to be inconsistent since they describe in the notes a management objective and a policy for currency risk, a risk factor that is not identified or that is deemed immaterial in the global risk report.

Large groups obviously are at an advantage when presenting their risk management frameworks, their risk management objectives and policies. Certain smaller groups are not yet sufficiently familiar with such practice nevertheless a majority of medium-sized and even of small groups presents adequate disclosures.

Generally speaking, groups indicate that risks are monitored under explicit limits defined by management and that risk exposures are periodically reported to the appropriate level of management. However disclosures on risk exposures have overall been found of a lower level than disclosures about objectives and policies. Certain groups have gone beyond the explicit requirements of IAS 32, which is not very prescriptive in this field, to present their risk exposures in a comprehensive and relevant way; others have barely complied with the provisions of the standard.

Altogether, we have found that 63 % of our sample provided entirely clear financial risks disclosures. Two preliminary remarks should be made about the respective “score” of large groups and small groups.

Achieving clarity may be more difficult for large groups, which have complex issues to depict, than for smaller ones. A balance is then particularly desirable between (1) the appropriate level of detail in the notes which users will likely refer to so as to understand a specific point and (2) a summary that will allow users to grasp the global picture. This balance is not reached when users are left with extensive details they cannot use (such as a 3 pages' long list of interest rate or currency derivatives with no indication about their characteristics) or with a global measure that would warrant more explanations than those provided (such as the Value-at-Risk of structural debt at year end calculated at a 95 % confidence level and for 1 day holding period). In such cases, the financial risk disclosures have been considered to be unclear.

Though certain small groups are not yet fully trained in the presentation of disclosure, clarity is facilitated in their contexts by the fact that the use of financial instruments is limited and financial strategies are simple. Users are then able to identify and analyse risk exposures with limited time and effort.

Table 96 : Comprehensiveness and clarity of the presentation of financial risks

	Number of groups	of which disclose or discuss	Comprehensive and entirely clear disclosures	%
Large groups	20	20	13	65%
Medium-sized groups	20	19	11	58%
Small groups	40	39	25	64%
Total	**80**	**78**	**49**	**63%**
Non-Listed	16	14	8	57%

NB: % are calculated in proportion of groups that disclose or discuss financial risk management policies

Effective from 1 January 2007, IFRS 7 supersedes IAS 32. IFRS 7 requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk.

The requirements of the new standard are more comprehensive and prescriptive than those of IAS 32. Moreover IFRS 7 requires that disclosures be approached from the perspective of information provided to management. Notably, for each type of risk arising from financial instruments, summary quantitative data is to be disclosed based on the information provided internally to key management personnel. Hopefully, this will bring greater clarity and relevance in the disclosures about financial risks from 2007.

Hereunder is the clear and synthetic disclosure[111] of its risk management principles and risk exposures by **Huhtamaki** [Finland, Industrial goods & services], a medium-sized group which is an early-adopter of IFRS 7:

[111] **Huhtamaki** [Finland, Industrial goods & services]

27. MANAGEMENT OF FINANCIAL RISKS

The objective of the financial risk management is to ensure that the Group has access to sufficient funding in the most cost efficient way and to minimize the impact on the Group from adverse movements in the financial markets. As defined in the Group Treasury Policy, management of financial risks is guided and controlled by a Finance Committee, led by the CEO. The Finance Committee reviews risk reports on the Group's interest bearing balance sheet items, commercial flows and derivatives and approves required measures on a monthly basis.
The Group Treasury Department at the Espoo headquarters is responsible of the Group's funding and risk management and serves the business units in daily financing, foreign exchange transactions and cash management co-ordination.

Currency risk

The Group is exposed to exchange rate risk through intra-company cross-border trade, exports and imports, funding of foreign units and currency denominated equities.
Transaction risk: The largest transaction exposures derive from capital flows, imports, exports and royalty receivables. The objective of currency transaction risk management is to protect the Group from negative exchange rate movements. Business units are responsible for actively managing their currency risks related to future commercial cash flows, in accordance with policies and limits defined by the business unit and approved by the Finance Committee. As a rule, commercial receivables and payables recorded on the balance sheet are always fully hedged, as well as 25% of probable flows over a minimum 12-month horizon. Eligible hedging instruments are currency forwards and in authorized subsidiaries also currency options. Business units' counterpart in hedging transactions is mainly Huhtamäki Oyj.

Foreign exchange transaction exposure

EUR million	EUR exposure in companies reporting in GBP		USD exposure in companies reporting in EUR		USD exposure in companies reporting in AUD		EUR exposure in companies reporting in CZK		USD exposure in companies reporting in GBP	
	31.12.06	31.12.05	31.12.06	31.12.05	31.12.06	31.12.05	31.12.06	31.12.05	31.12.06	31.12.05
Trade receivables	5	2	7	3	3	0	1	1	0	0
Trade payables	-4	-2	-1	0	-7	-1	0	0	-1	0
Net balance sheet exposure	2	0	6	3	-5	-1	1	1	-1	0
Forecasted sales (12 months)	8	6	38	42	16	0	9	9	0	0
Forecasted purchases (12 months)	-48	-36	-8	-9	-24	-4	-2	0	-6	-5
Net forecasted exposure	-40	-30	30	32	-8	-4	7	9	-6	-5
Hedges										
Currency forwards (12 months)	7	10	-25	-19	11	2	-7	-10	3	0
Total net exposure	-31	-20	11	16	-1	-3	1	0	-3	-5

Translation risk:

As a main rule individual subsidiaries do not carry translation risk as they are financed in local currencies. As an exception, the Finance Committee has approved the use of foreign currency borrowing in countries with high local interest rates, totaling EUR 13.1 million at balance sheet date.
The main translation exposures derive from equities and permanent loans, which in substance form a part of the net investment in US, Australian and UK subsidiaries. The Group hedges its translation risks selectively by using foreign currency loans and derivatives. Equity hedging decisions are made by the Finance Committee, who in its decision-making considers the hedge's estimated impact on the consolidated income statement and balance sheet ratios, long-term cash flows and hedging cost. At balance sheet date the Group had outstanding translation risk hedges of USD 249 million (thereof USD 150 million in the form of currency loans and USD 99 million in the form of derivatives) and of GBP 50 million (thereof GBP 25 million in the form of currency loans and GBP 25 million in the form of derivatives).

Foreign exchange translation exposure

Effect in EUR million	10% appreciation of EUR				10% depreciation of EUR			
	31.12.2006		31.12.2005		31.12.2006		31.12.2005	
	Equity	Income Statement	Equity	Income Statement	Equity	Income Statement	Equity	Income Statement
USD	-14.1	-3.1	-13.5	-1.6	17.3	3.7	16.5	3.0
GBP	-7.9	0.8	2.3	1.3	9.7	-1.0	-2.8	-1.4
AUD	-0.1	-0.1	-1.8	-0.4	0.1	0.1	2.2	0.0

Interest rate risk

The interest bearing debt exposes the Group to interest rate risk, namely re-pricing- and price risk caused by interest rate movements. Management of interest rate risk is centralized to the Group Treasury.
The Group's policy is to maintain in the main currency debt portfolios a duration that matches a benchmark duration range based on the Group's estimated cash flow, selected balance sheet ratios, assumed business cyclicality and also the shape of the yield curve. The objective of interest rate risk management is to reduce the fluctuation of the interest charge, enabling a more stable net income.
The Group manages interest rate risk by selection of debt interest periods and by using derivatives such as futures, forward rate agreements, interest rate swaps and options.

Currency split and repricing schedule of outstanding net debt including hedges

EUR million	December 31, 2006										December 31, 2005		
				Rate	Debt repricing in period, incl. derivatives								
Currency	Amount mEUR	Avg. duration	Avg. rate	sensitivity[1) mEUR	2007	2008	2009	2010	2011	Later	Amount mEUR	Avg. duration	Avg. rate
EUR	235	0.7y	4.1%	1.9	185	1	6	6	26	12	258	0.7 y	3.6%
USD	200	1.3y	5.1%	0.9	123	22	19	36			243	1.7 y	4.9%
AUD	49	0.5y	6.3%	0.6	37	12					46	1.3 y	6.0%
GBP	89	0.8y	5.3%	0.3	74		7	7			86	1.1 y	5.2%
Other	138	0.4y	7.2%	0.8	132	2					79	0.6 y	9.1%
Total	**711**	**0.8y**	**5.3%**	**4.5**	**551**	**38**	**32**	**49**	**26**	**15**	712	1.1 y	5.0%

[1)] Effect of one percentage point rise in market interest rates on the Group's net interest expenses over the following 12 months.
A similar rise in interest rates would increase Group equity with EUR 2.4 million due to mark-to-market revaluations of interest rate swaps.
All other variables, such as FX rates have been assumed constant.

Liquidity and re-financing risk

The Group maintains sufficient liquidity reserves at all times by efficient cash management structures such as cash pools, concentration accounts and overdraft financing facilities.
The Group utilizes a EUR 400 million Finnish commercial paper program and uncommitted credit facilities with relationship banks for short-term financing purposes. Unused long term committed credit facilities ensure adequate financing resources in all circumstances.
Re-financing risk is managed by maintaining a diversified maturity structure of loans and debt facilities, that takes into account the estimated cash flow of the Group.

Debt structure

EUR million	December 31, 2006									December 31, 2005		
				Maturity of facility/loan								
Debt type	Amount drawn	Amount available of committed	Total	2007	2008	2009	2010	2011	Later	Amount drawn	Amount available of committed	Total
Committed revolving facilities	174	352	527		50			476		229	326	555
Loans from financial institutions	163		163	127	7	6		10	7	165		165
Finance Lease Liabilities	3		3	1	1	1				2		2
Private placements	109		109	5	5	4	26		70	117		117
Commercial Paper Program	291		291	291						257		257
Total	**740**	**352**	**1,092**	**424**	**63**	**10**	**32**	**486**	**77**	771	326	1,097

Credit risk

The Group is exposed to credit risk from its commercial receivables and receivables from financial institutions based on short-term investment of liquid funds as well as derivatives transactions.
The business units are responsible for the management of commercial credit risk in accordance with policies defined by the business units and approved by the Finance Committee. A Group policy to be implemented during 2007 sets out certain minimum requirements as to credit quality, sales terms and collection. The commercial credit risk is considered low for the Group as a whole as the receivable portfolio is diversified and historical credit loss frequency is low (see note 19).
Liquid funds are from time to time invested in short-term bank deposits at relationship banks with a solid credit rating, in government bonds, treasury bills or in commercial papers issued by corporate borrowers with an investment grade rating. Credit risk stemming from receivables from financial institutions, including derivative transaction settlements, is considered small and is managed centrally by the Group Treasury Department, in accordance with limits set by the Finance Committee.

11. Borrowing costs

Key points

IAS 23 prescribes the accounting treatment for borrowing costs as well as the additional information to disclose in the accompanying notes to the financial statement.

68 companies (25% of 270), of which 64 were listed, opted for the capitalisation of borrowing costs. Other companies recognize borrowing costs as expenses, or do not have qualifying assets:

- Only 30 companies (47% of the 64 listed companies that capitalise borrowing costs) disclosed the amount capitalised. The total interest capitalised by the 30 companies' amounts to EUR 1.494 billion.
- Capitalized interest disclosed are heavily concentrated on two sectors (Oil & Gas and Basic resources) which represent more than 70% of total

Only 14 companies (22% of the 64 listed companies that capitalise borrowing costs) disclosed both the amount capitalised, and the interest rate compound for capitalization:

- With two exceptions, interest rates range from 3.72 % to 6.60 %

On 29th March 2007, the IASB issued a revised IAS 23 *Borrowing costs* in the frame of the convergence project with the US GAAP. However at the time of writing this report, this revised standard has not yet been endorsed by the European Commission.

Companies closing their accounts at a later date than 29th March 2007 were nevertheless potential candidates for an early adoption of the revised standard.

11.1. Accounting scheme

IAS 23 requires recognizing borrowing costs as an expense in the period in which they are incurred. The Standard allows however, as an alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction directly or production of a qualifying asset, under the conditions that they will result in future economic benefits to the enterprise and the costs can be measured reliability.

In line with previous US GAAP, the revised IAS 23 makes mandatory the capitalization of borrowing costs that are directly attributable to the acquisition, construction directly or production of a qualifying asset. It applies to borrowing costs relating to qualifying assets for which the commencement date for capitalization is on or after 1 January 2009 with the possibility of an earlier application.

75% of companies under review did not provide information relating to the capitalization of borrowing costs, either:

- they don't have any borrowing costs linked to a qualifying assets, or
- they recognized borrowing costs as an expense

25 % of companies (26% of listed companies and 20% of unlisted companies) stated explicitly that they capitalized borrowing costs. This proportion is the same as found in the 2005 IFRS study.

Table 97 : Choice of method of accounting of borrowing costs

	Listed		Non-listed		Total	
	Number of companies	%	Number of companies	%	Number of companies	%
Capitalised	64	25,6%	4	20%	68	25,2%
Expensed	186	74,4%	16	80%	202	74,8%
Total	**250**	**100%**	**20**	**100%**	**270**	**100%**

Fortum [Finland, Utilities] provides[112] some information relating to the criteria to meet allowing the borrowing costs capitalization:

Borrowing costs

Borrowing costs are recognised as an expense in the period in which they are incurred, except if they are directly attributable to the construction of an asset that meets the determined criteria. The determined criteria is as follows (a) the costs incurred for the construction of an investment exceed EUR 100 million (b) it will take more than 18 months to get the related asset(s) operational (c) it is an initial Greenfield investment.

Umicore [Belgium, Chemicals] elected[113] to expense its borrowing costs:

2.5 PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment is recorded at historical cost, less accumulated depreciation and impairment losses. Cost includes all direct costs and appropriate allocation of indirect costs incurred to bring the asset to working condition for its intended use.

There are no borrowing costs capitalized in the costs of the assets. All borrowing costs are recognized as expenses in the period when incurred.

Cross analysis by industry sector and state of incorporation reveals significant different patterns in the adoption of the capitalization method.

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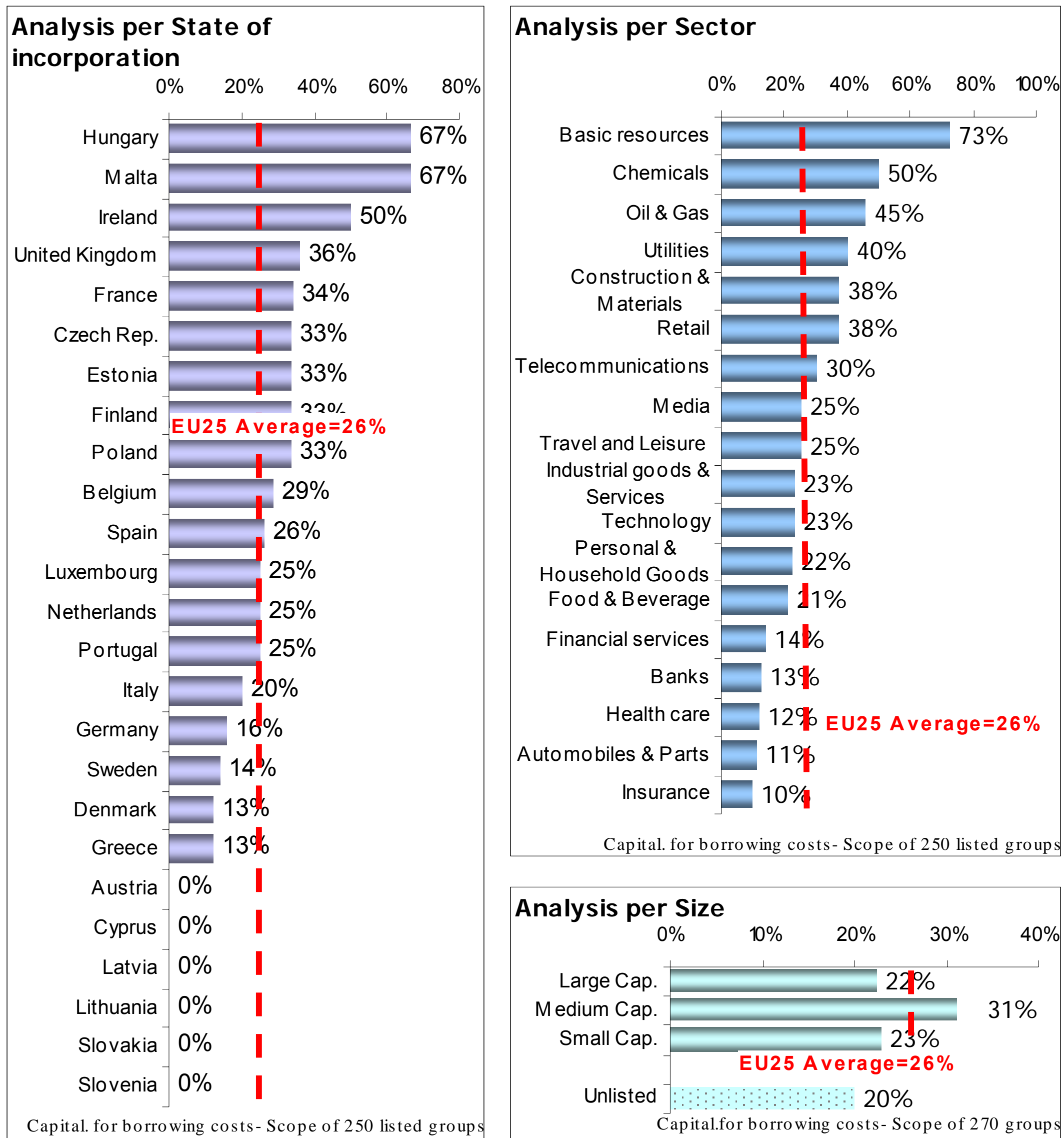
[112] **Fortum** [Finland] Financial statements, page 23

[113] **Umicore** [Belgium] Financial Statements, page 78

Table 98 : Cross analysis by state, sector and size of the choice of capitalisation of borrowing costs



The breakdown by state of incorporation shows UK/Ireland and France have high rates of borrowing costs capitalization as was often the case in their previous national GAAP.

Benelux Spain or Italy have average rates of borrowing costs capitalization.

Germany and Nordic countries (Sweden, Denmark) have low rates of borrowing costs capitalization, consistent with prior national practices.

The breakdown by sector displays that amongst industrial sectors bearing heavy capital expenditures:

- companies from “Basic Resources” and to a lesser extent “Chemicals”, “Oil & Gas”, “Utilities” and “Construction & Materials” sectors are more likely to capitalize borrowing costs
- However, companies from “Health Care” and “Automobile & Parts” tend not to capitalize borrowing costs.

Companies from industrial sectors with less intensive capital expenditures (Retail, Telecommunications, Media, Travel & Leisure, Industrial Goods & Services, Technology, Personal & Household, Food & Beverage) have various average practices of borrowing costs capitalization, in line with the average of our sample.

Financial sector companies (Bank, Insurance and Financial services) mostly do not capitalize borrowing costs.

Finally, the breakdown by size reveals that_cross analysis by size of companies does not bring strong indication of a pattern : Medium size companies capitalize borrowing costs in a larger proportion (31%) than small and large companies (respectively 23% and 22%).

11.2. Information disclosed

IAS 23 requires an entity to disclose in the financial statements, in addition of the accounting policy adopted:

- the amount of borrowing costs capitalized during the period;
- the capitalization rate used to determine the amount of borrowing costs eligible for capitalization

Table 99 : Disclosures on capitalised borrowing costs

	Listed	
	Number of companies	%
Amounts mentioned	30	46.9
Amounts not mentioned	34	53.1
Total	**64**	**100**
Interest rates mentioned	16	25
interest rates not mentioned	48	75
Total	**64**	**100**

Amongst the 64 listed companies capitalizing borrowing costs, 30 (47%) of them mentioned the amounts capitalized and 15 (23%) disclosed the capitalization rate used, in accordance with IAS 23.

Only 14 companies out of 64 companies capitalizing borrowing costs provided both amount and capitalization rate, as required by IAS 23.

The total amount of capitalized borrowing interests disclosed by the 30 companies amount to EUR 1 494 million, a significant increase (50%) compared to their 2005 capitalized amounts.

None of the 4 non-listed companies disclosed information on amounts of capitalized borrowing costs.

Table 100 : Reported amounts of capitalized borrowing costs, breakdown by industry sector (in EUR million)

	2006			2005		
	Amounts (EUR millions)	Number of companies	%	Amounts (EUR millions)	Number of companies	%
Oil & Gas	680	4	46%	428	4	43%
Basic resources	396	5	27%	221	5	22%
Retail	120	3	8%	104	3	10%
Construction & Materials	105	2	7%	73	2	7%
Utilities	63	4	4%	59	4	6%
Chemicals	57	4	4%	60	4	6%
Financial services	49	3	3%	45	2	5%
Health Care	14	1	1%	-	0	-
Travel & Leisure	6	1	0%	6	1	1%
Insurance	2	1	0%	0	1	0%
Personal & Household Goods	1	1	0%	0	1	0%
Food & Beverage	1	1	0%	1	1	0%
Total	**1 494**	**30**	**100%**	**996**	**28**	**100%**

Capitalized interests amounts disclosed are heavily concentrated on two sectors. “Oil & Gas” and “Basic Resources”, representing altogether 73% of the total of the borrowing costs amount disclosed for 2006.

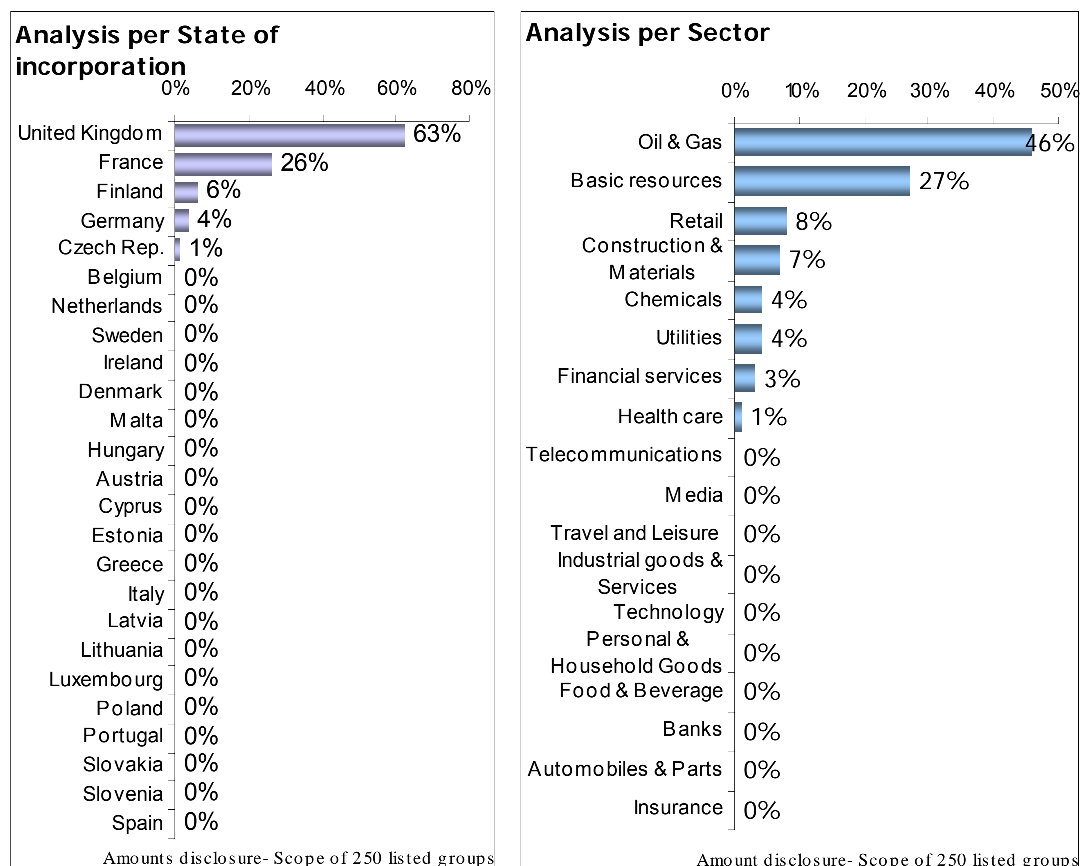
Also, the borrowing costs disclosed are mainly concentrated on two countries. UK and France represent EUR 1 327 million of capitalized interests, corresponding to 88% of the total amount disclosed by the 30 companies, as shown by the following table:

Table 101 : Reported amounts (M€) of capitalized borrowing costs, breakdown by state of incorporation

	2006		2005	
	Amounts (EUR millions)	Number of companies	Amounts (EUR millions)	Number of companies
United Kingdom	935	9	639	9
France	392	7	211	6
Finland	90	3	73	3
Germany	52	3	51	3
Czech Republic	19	1	18	1
Belgium	2	1	2	1
Netherlands	2	1	0	1
Sweden	1	1	1	1
Ireland	1	1	1	1
Denmark	0	1	0	1
Malta	0	1	0	0
Hungary	0	1	0	1
Total	**1 494**	**30**	**996**	**28**

The graphs beneath underline the previous comments:

Table 102 : Distribution by state, sector and size of the reported amount of capitalized borrowing costs



The companies fully compliant with the standard disclosing both amount and interest rates represent 60% of the total amounts in our sample EUR 895 million out of EUR 1 494 million):

Table 103 : Reported amounts of capitalised borrowing costs and interest rate for 2005 and 2006

Country	Industry Sector	Amounts 2006 (EUR millions)	Amounts 2005 (EUR millions)	Interest rate 2006	Interest rate 2005
United Kingdom	Oil & Gas	427,5	323,7	4,00%	3,00%
United Kingdom	Basic Resources	267,6	109,2	5,70%	5,00%
France	Construction & Materials	92,3	63,3	4,48%	4,29%
Germany	Chemicals	36,6	43,0	4,50%	
Czech Rep	Utilities	19,2	18,4	5,90%	6,30%
United Kingdom	Oil & Gas	17,0	3,8	6,60%	-
United Kingdom	Basic Resources	12,1	37,1	8,20%	8,70%
Germany	Chemicals	12,0	4,0	5,00%	4,00%
France	Travel & Leisure	6,0	6,0	4,72%	-
Germany	Retail	3,8	4,4	5,90%	5,90%
Sweden	Financial services	0,7	1,1	3,72%	3,65%
United Kingdom	Retail	0,4	0,1	5,75%	-
Finland	Basic Resources	0,1	3,0	3,87%	5,73%
Hungary	Oil & Gas	0,0	0,0	8,40%	4,10%
United Kingdom	Oil & Gas	-	-	5,25%	4,25%
	15 Companies	**895,4**	**617,2**	**Average 5,47%**	**Average 4,99%**

Disclosed interest rates for 2006 range from 3.72% to 6.60% with the exception of two companies:

- **Anglo American** [United Kingdom, Basic resources], a basic resources group, disclosed a rate rising at 8.2% related to investments in South Africa and financed in SA Rand;
- **MOL** [Hungary, Oil & Gas], disclosed a rate of 8.4% related to investments financed in HUF

12. Share Based Payment

Key points

IFRS 2 *Share-based Payment* states the principles of accounting and presentation linked to share-based payment transactions between an entity and another party including employees. Such transactions must be recorded in the profit and loss and balance sheet and detailed information must be disclosed enabling to the user of financial statement the understanding of impacts of these arrangements.

As, generally, share-based payments are related to transactions with employees, our review of financial statements was focused on share-based payments settled with equity instruments or cash or with a combination of shares and cash related to transactions with employees.

As, most of the time, share-based payments are related to transactions with employees, the review of the financial statements has focussed on the share-based payments settled with equity instruments or cash, or with a combination of shares and cash, related to the transactions with employees.

Such transactions must be recorded in the profit and loss and balance sheet and detailed information must be disclosed enabling the user of financial statement the understanding of impacts of these arrangements. The review of the financial statements shows that:

- It is sometimes difficult to locate in the financial statements the specific information linked to the share-based payments with employees.
- The large range of types of share-based compensation plans for some companies and the detailed presentation of each plan in accordance with IFRS 2 can lead to a multitude of information within which it is sometimes difficult to find the significant information.
- The “Black-Scholes” model is the most frequently used in the context of the measurement of share-based transactions. Nevertheless, few of companies explain the reason for this choice.

12.1. Weight of share-based payments

53% of companies (143 out of 270 companies) disclosed in their 2006 financial statements a profit and loss impact relating to share-based arrangements with employees in accordance with IFRS 2, for a total amount of EUR 8 127 million.

Such impacts are presented either on the face of the Profit and Loss, or in a dedicated note to the financial statements:

The major impacts relate to a limited number of companies:

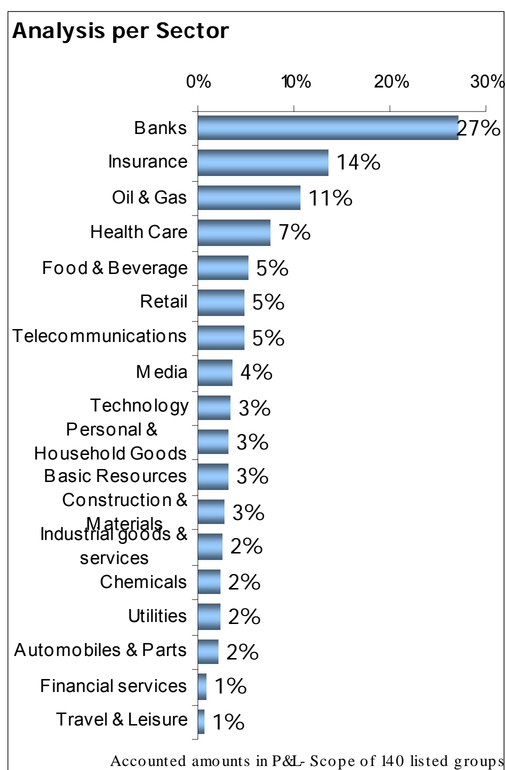
- 3 companies disclose more than EUR 500 million each and account for 25% of the total
- 20 companies disclose more than EUR 100 million each and account for 70 % of the total

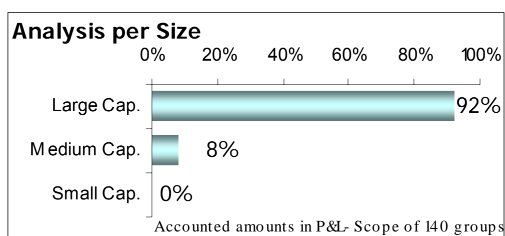
Table 104 : Top 20 companies reporting the largest amounts of share-based payments with employees

Country of incorporation	Industry Sector	Company Size	Expense recognized through the P&L	Expense / Net Profit
United Kingdom	Banks	Large	950	12%
Germany	Insurance	Large	783	11%
United Kingdom	Banks	Large	681	5%
United Kingdom	Oil & Gas	Large	368	2%
United Kingdom	Oil & Gas	Large	334	2%
United Kingdom	Health Care	Large	332	4%
United Kingdom	Retail	Large	307	11%
Ireland	Food & Beverage	Medium	199	300%
Finland	Technology	Large	192	4%
France	Insurance	Large	185	3%
France	Oil & Gas	Large	157	1%
Germany	Telecommunications	Large	157	4%
France	Health Care	Large	149	3%
United Kingdom	Telecommunications	Large	136	N/A
Netherlands	Food & Beverage	Large	120	2%
France	Media	Large	113	2%
Netherlands	Insurance	Large	112	1%
United Kingdom	Health Care	Large	109	2%
Netherlands	Personal & Household Goods	Large	107	2%
United Kingdom	Media	Medium	104	15%
		in M Euros	**5 595**	

This palmares is based on the information disclosed by the entities regarding their share-based payments recognized through the P&L.

Table 105 : Distribution by sector and size of reported amounts of share-based payments with employees





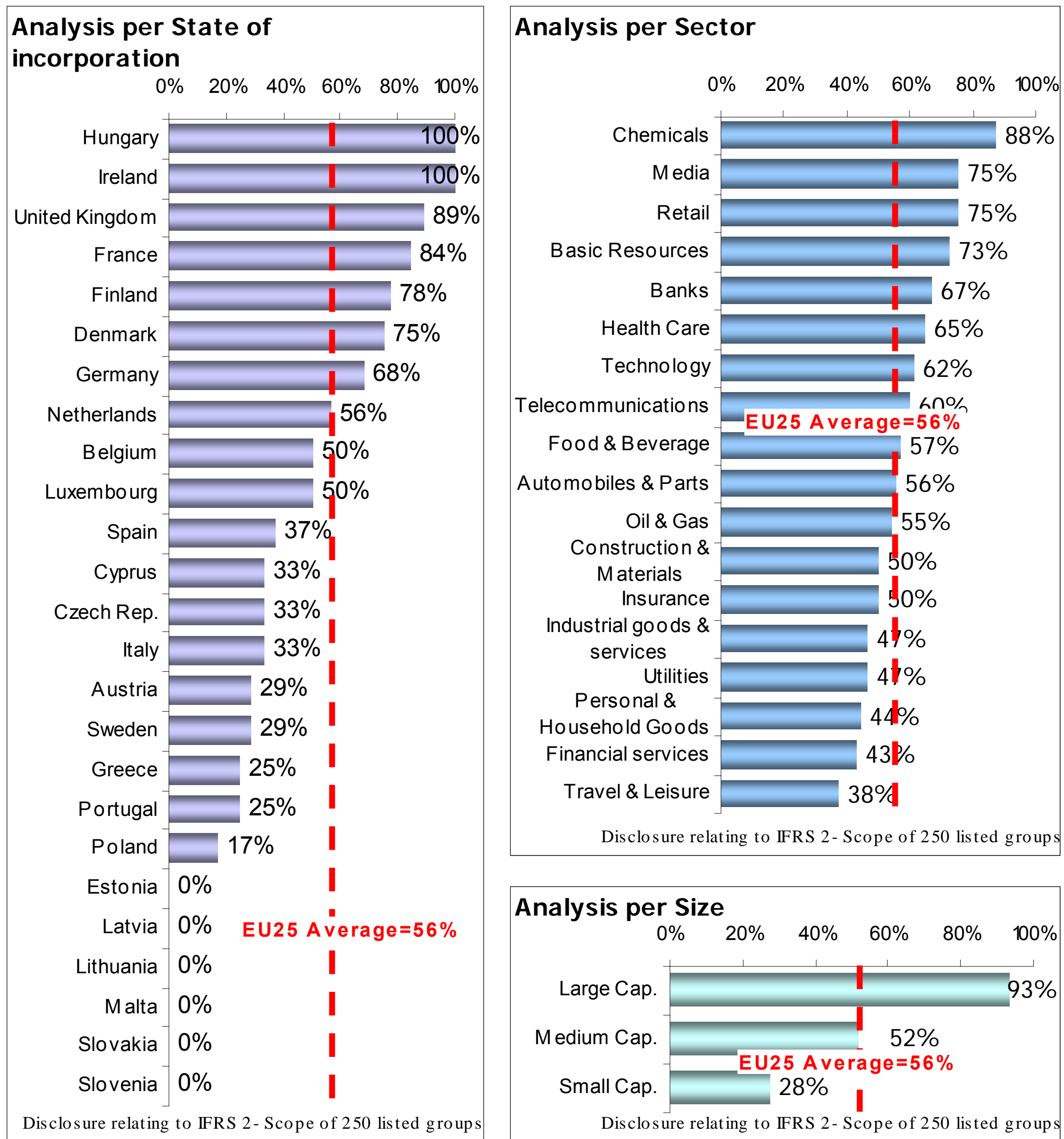
44 % of companies (110 out of 250) didn't make any reference to IFRS 2 in their 2006 financial statements nor provided any information enabling to identify a recorded entry concerning some share-based payment arrangements with employees.

A detailed analysis by industry shows the predominance of the financial activities, with Banks and Assurance reporting respectively 27% and 14% of the total, or 41% altogether.

Among non financial activities, Oil and Gas and Health Care lead the industry sectors for the amount of share-based payments.

However, it is in other sectors Chemicals (88%), Retail, Media and Basic Resources that the proportion of companies reporting share-based payments is the highest.

Table 106 : Cross analysis by state, sector and size of disclosure of share-based payments



Also by size, there is a wide difference of practices between large companies (93 % recorded an impact in their income statement linked to the share-based payment transactions), and medium (52%) and small (28%) companies.

12.2. Type of share-based transactions disclosed

Further detailed analysis regarding share-based payments was conducted on 75 companies with the highest share based payment impact / net result ratio. These companies represent 82% of the total amount reported of EUR 6 634 million.

IFRS 2 requires to provide the type of settlements for each share-based payment transaction. The type of settlement is a major component determining the method of measurement and the accounting scheme linked to the share-based payment transaction.

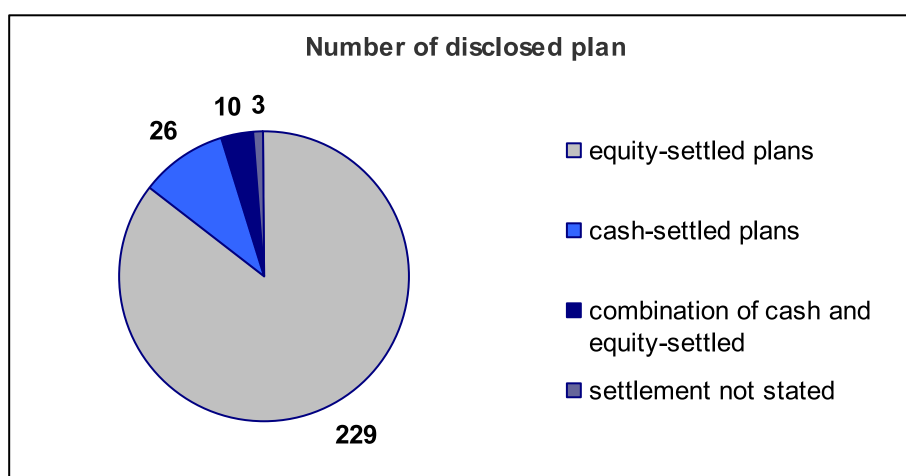
IFRS 2 states three types of share-based payment transactions:

- Equity-settled share-based payment transactions, in which the entity receives or acquires goods or services as consideration for equity instruments of the entity;
- Cash-settled share-based payment transactions, in which the entity receives or acquires goods or services by incurring liabilities for amounts that are based on the price of equity instruments of the entity;
- Transactions in which the entity receives or acquires goods or services and with a settlement in cash or by issuing equity instruments.

265 identified equity or cash-settled (or combinations of both) plans are disclosed in the financial statements of the 75 companies. The equity-settled arrangements are by far the most frequently disclosed ones. Few of award plan are based on a combination of cash and equity settlement:

- 229 (86,4%) are equity-settled arrangements
- 26 are cash-settled arrangements
- 10 are a combination of cash and equity-settled transactions

Table 107 : Number of share-based payments plans disclosed



The following list provides the type of equity-settled plans most frequently disclosed in the 75 financial statements**:**

- All-employee share options plan (with no individual target to be met)
- Global Performance Share Plan (with a performance target and limited to key employees)
- TSR Long-Incentive Plan (award limited to Top Executives with a target performance based on the TSR)
- Medium and Long terms Performance plan (for senior employees and based on a multi performance measurement)
- Deferred annual bonus plan (the award value is equal to a percentage of the annual bonus)
- Share save plan (savings-related share option plan)

The following list provides the type of cash-settled plans most frequently disclosed in the 75 financial statements**:**

- Stock appreciation rights (SARs) (no performance conditions)

- Stock option plan (payment based on the difference between the share price upon exercise and the exercise price)
- Long-term incentive plan (payment based on the difference between the share price upon exercise and the exercise price

IFRS 2 requires entities to disclose a description of each type of share-based payment arrangement that existed at any time during the period, including the method of settlement.

The indication of the type of settlement is not always directly specified and sometimes only on in depth analysis allows identifying the type settlements linked to the different share-based payment arrangements.

The average number of share-based plans is above 4 plans for each large size companies against 3 for the medium cap segment and 2 for the small cap segment.

Table 108 : Cross analysis by size of the number of equity-settled transactions plans by company

Company Size	Number of plans disclosed	Number of companies	Average plans by companies
Large groups	130	31	4,19
Medium-sized groups	66	23	2,87
Small groups	33	17	1,94
No disclosure	N/A	4	
TOTAL	**229**	**75**	

In many financial statements, the large number of plans prevents providing significant information of the material impact of each plan.

However, some companies disclose the impact of each plan displayed by nature of settlement or/and the accounting scheme.

Vivendi [France, Media] provided[114] a breakdown of type of settlement for each plan with the related impact through the profit or loss:

21.1. Analysis of the expense related to share-based compensation plans for the years ended December 31, 2006 and 2005

As of December 31, 2006 and 2005 the compensation cost recognized with respect to all outstanding plans is as follows:

(In millions of euros)	Note	Year Ended December 31, 2006	2005	
Equity-settled instruments				
Vivendi stock option plans	21.2.1	€ 32	€ 48	
Vivendi restricted stock plans - 2006	21.2.1	14	-	
Employee stock purchase plans	21.6	7	7	
		53	*55*	(a)
Cash-settled instruments (b)				
Vivendi stock appreciation rights plans	21.2.2	12	-	
Vivendi "restricted stock units" plans - 2006	21.2.2	6	-	
UMG employee equity unit plan	21.5.1	30	24	
Blizzard employee equity unit plan - 2006	21.5.2	12	-	
		60	*24*	
Share-based compensation cost		**€ 113**	**€ 79**	

DaimlerChrysler [Germany, Automobile & Parts] disclosed[115] a full reconciliation between each share-based payments plans and the related impact in the balance sheet and profit or loss, including the tax impact:

The effects of stock-based compensation arrangements in the income statements and balance sheets were as follows:

	Compensation expense / (income)		Tax effect expense / (income)		Provision at December 31,		Reserve (before tax) within the Capital Reserve at December 31,	
	2006	2005	2006	2005	2006	2005	2006	2005
(in millions of €)								
PPSP	59	30	(23)	(11)	69	25	-	-
MTI	.	(25)	.	10	6	17	-	-
SAR	.	(42)	.	16	8	8	-	-
SOP	38	88	(15)	(33)	-	-	341	363
	97	51	(38)	(18)	83	50	341	363

12.3. Valuation of share-based transactions

Disclosure of valuation models

The measurement of the share-based payment transactions is depending on the type of settlement.

- Equity-settled plans are measured at Fair Value at the date of grant (excluding the effect of non market-based vesting conditions). The fair value is expensed over the vesting period;
- For cash-settled share-based payments, a liability equal to the portion of the goods or services is recognised at the current fair value determined at each balance sheet date.

Different valuation models enabling to value share-based payments are disclosed by companies under review, and sometimes several models are declared to be used depending on the type of plan to value.

[114] **Vivendi** [France] 2006 Financial statements, page 129

[115] **DaimlerChrysler** [Germany] Financial statements, page 39

For equity-settled plans, the Black-Scholes model is the most frequently mentioned model. The Monte Carlo model is often used for plans including a performance target

However, few companies explain the justification of their choice of a particular valuation model rather than another one.

Table 109 : Occurrence of models of valuation disclosed for the measurement of share-based plans (used for at least one plan)

	Equity-settled	Cash-settled
Black-Scholes	39	7
Binomial	15	3
Trinomial	4	0
Monte-Carlo	14	3
Market value of underlying shares	8	0
Other	9	0
Valuation model unstated	9	10

WPP Group [United Kingdom, Media] disclosed[116] information relating to the choice of the valuation model:

Valuation methodology
For all of these schemes, the valuation methodology is based upon fair value on grant date, which is determined by the market price on that date or the application of a Black-Scholes model, depending upon the characteristics of the scheme concerned. The assumptions underlying the Black-Scholes model are detailed in note 27, including details of assumed dividend yields. Market price on any given day is obtained from external, publicly available sources.

Market/Non-market conditions
Most share-based plans are subject to non-market performance conditions, such as margin or growth targets, as well as continued employment. The Renewed LEAP scheme is subject to a number of performance conditions, including TSR, a market-based condition.

For schemes without market-based performance conditions, the valuation methodology above is applied and, at each year end, the relevant accrual for each grant is revised, if appropriate, to take account of any changes in estimate of the likely number of shares expected to vest.

For schemes with market-based performance conditions, the probability of satisfying these conditions is assessed at grant date through a statistical model (such as the 'Monte Carlo Model') and applied to the fair value. This initial valuation remains fixed throughout the life of the relevant plan, irrespective of the actual outcome in terms of performance. Where a lapse occurs due to cessation of employment, the cumulative charge taken to date is reversed.

For cash-settled awards, the Black-Scholes model is also the most used of the pricing models, before the Binomial and Monte Carlo models.

[116] **WPP Group** [United Kingdom] 2006 Financial statements, page 163

Nevertheless, information is often lacking relating to the use of valuation model in the case of cash-settled awards. 10 companies disclosing at least a cash-settled plan did not provide any information enabling to identify the method of valuation.

Valuation factors disclosure

IFRS 2 requires an entity to disclose the valuation input factors to the valuation model, including:

- Exercise price of the option
- Life of the option
- Current price of the underlying shares
- Dividends expected on the shares (if appropriate), and
- Risk-free interest rate for the life of the option

76% of the companies provided detailed assumptions input to the valuation model enabling the valuation of the share-based plans.

Alcatel [France, Technology] provided[117] information relating to the valuation factors under a narrative form:

Assumptions for the Alcatel plans representing more than 1,000,000 outstanding options are as follows:

- expected volatility: 60% for the 2002 and March 2003 plans, 40% for the 2004 and 2005 plans and 32% for the 2006 plans;
- risk-free rate: 4.58% for the 2002 plans, 3.84% for the March 2003 plan, 3.91% for the March 2004 plan, 3.50% for the March 2005 plan and for the March 2006 plan;
- distribution rate on future income: 0% in 2003, 2004 and 2005 and 1% for later years.

Based on these assumptions, the fair values of Alcatel options used in the calculation of compensation expense for share-based payments are as follows:

- 2002 plans: weighted average fair value of €2.48;
- March 2003 plan with an exercise price of €6.70: fair value of €3.31;
- March 2004 plan with an exercise price of €13.20: fair value of €5.06;
- March 2005 plan with an exercise price of €10.00: fair value of €3.72;
- March 2006 plans with an exercise price of € 11.70: fair value of €3.77.

Other plans have fair values between €2.19 and €4.90 and a weighted average fair value of €3.75.

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[117] **Alcatel** [France, Technology] 2006 Financial statements, page 135

However, generally, the information is provided under a table form. Thus, **Lafarge** [France, Construction & Materials], a SEC filer, presents[118] the following table:

The Group estimated the fair value of the options granted in 2006, 2005 and 2004 based on the following assumptions:

	LAFARGE S.A. OPTIONS YEARS ENDED DECEMBER 31,			LAFARGE NORTH AMERICA INC. OPTIONS YEARS ENDED DECEMBER 31,		
	2006	2005	2004	2006	2005	2004
Expected dividend yield	3.1%	2.7%	2.7%	1.5%	1.6%	1.9%
Expected volatility of stock	28.3%	28.6%	30.0%	24.4%	30.0%	32.0%
Risk-free interest rate	3.8%	3.3%	3.5%	4.4%	4.2%	4.1%
Expected life of the options (in years)	8.0	8.0	8.0	4.2	4.5	5.1

Most companies disclosed, in accordance with IFRS 2, the information on how expected volatility was determined. Generally, the expected volatility is determined based on the historical volatility over periods corresponding to the expected average maturity of the options granted.

Vivendi [France, Media] disclosed[119] information relating to the expected volatility

The computed volatility corresponds to the average of Vivendi 3-year historical volatility and its implied volatility, that is determined with Vivendi put and call options traded on the MONEP with a maturity of six months or more. The characteristics and assumptions used to value the instruments granted since 2002 are as follows:

12.4. Effect of share-based payment transactions on the profit or loss

An entity should disclose information that enables users of the financial statements to understand the effect of share-based payment transactions on its profit or loss.

- The most frequent presentation for disclosing the profit or loss impact linked to the share-based payment compensations is the presentation of a dedicated line in the note relating to “Staff/Employees/Personnel expenses” or “Operating expenses” with a cross reference to the dedicated note “Share-based compensation”.

  51 companies elected this kind of presentation.

  KBC Group [Belgium, Banks] presented[120] in the note “Operating expenses”, the effect of share-based arrangements amongst the staff expenses:

Note 12: Operating expenses

In millions of EUR	2005	2006
Total	-4 914	-4 925
Staff expenses	-2 849	-2 970
○ of which share-based payment (equity-settled)	-2	-2
○ of which share-based payment (cash-settled)	-34	-61
General administrative expenses	-1 599	-1 631
Depreciation and amortisation of fixed assets	-389	-359
Provisions for risks and charges	-77	36

[118] **Lafarge** [France, Construction & Materials] 20-F form, page F-46

[119] **Vivendi**[France] 2006 Financial statements, page 132

[120] **KBC Groupe** [Belgium] 2006 Financial statements, page 119

Agora [Poland, Media] disclosed[121] directly in the note "Staff expenses", the impact of share-based payments:

Agora SA
Notes to the consolidated financial statements for the year ended 31 December 2006
(all amounts in PLN thousands unless otherwise indicated) translation only

23. Staff costs

	2006	2005
Wages and salaries	210,953	195,120
Social security costs	42,799	41,135
Share-based payments	34,823	7,121
	288,575	243,376

Nevertheless, the presentation for all these companies seems not to be homogeneous, as sometimes it is not clearly stated whether the amount includes or not the social taxes or income taxes effects linked to the share-based compensations.

Moreover, the presentation in the staff cost does not provide the information whether the expense is included in the "operating result" or "Discontinued operations" or "non recurring» captions. Some companies provide this information under a narrative form or a table.

AXA [France, Insurance] specified[122] that a part of the impact linked to the share-based payments with employees is accounted for in the non-recurring caption:

The total employee share-based compensation cost of €155.3 million shown above does not include the cost generated by the liquidity guarantee granted by AXA SA to old AXA IM stock option plans, which amounted to a non-recurring cost of €30 million recorded in 2006. In accordance with IFRS 2, the cost shown above includes equity-settled share-based payment instruments for grants made after November 7, 2002 which had not yet vested at December 31, 2003.

- 8 companies declared to record the impact in staff cost or operating expenses but without any dedicated line in the notes previously mentioned.
- 5 companies elected to present a dedicated line on the face of the income statement, on the basis of the example provided by IAS1

[121] **Agora** [Poland] Financial statements, page 44

[122] **AXA** [France] Financial statements, page 416

Danisco [Denmark, Food & Beverage] disclosed[123] directly the impact of share-based payments on the face of the Income statement:

Income statement

1 May 2006 - 30 April 2007

INCOME STATEMENT

(DKKm)	Note	2006/07	2005/06
Revenue	2	20,362	20,912
Cost of sales	3, 4, 5	(13,234)	(13,672)
Gross profit		7,128	7,240
Research and development expenses	4, 5	(874)	(943)
Distribution and sales expenses	4, 5	(2,771)	(2,637)
Administrative expenses	4, 5, 6	(1,301)	(1,390)
Other operating income		128	157
Other operating expenses	4, 5	(92)	(55)
Share-based payments	7	21	(213)
Operating profit before special items		2,239	2,159
Special items	5, 8	(186)	(768)
Operating profit		2,053	1,391
Financial income	9	433	483

- 11 companies provide the amount of the recorded expenses but without any information enabling to identify in which line of the profit and loss this expense is included.

[123] **Danisco** [Denmark] financial statements, page 47

13. Post-employment benefits

Key points

The topic of post-employment benefits is one of the most complex subjects in IFRS, both for preparers and users of the financial statements. Additionally, it represents a heavy financial impact in the accounts of Groups.

IAS 19 prescribes the accounting and disclosure for employment benefits. The amendments from December 2004 effective from 1 January 2006 introduce additional requirements about trends in the assets and liabilities in a defined benefit plan, as well as detailed assumptions underlying the components of the defined benefit cost.

The study below focuses on the post-employment obligations including pensions, post-employment life insurance and health benefits, the significance of post-employment obligations in the financial statements and the presentation methods for the various aspects to be disclosed.

Reconciliation between gross amount obligation (as disclosed in the accompanying notes) and net provision on the face of the balance sheet is straightforward for 84% of the 75 companies.

Breakdown by country, when disclosed, indicates that 60% of obligations lay in UK, Germany and North America, and 63% of Plan Assets are located in the same three countries. Ratios plan assets / DBO are very different country by country.

The disclosure of actuarial assumptions and geographical split is not comprehensive

Analysis of disclosed assumptions reveals some noticeable features:

- Full disclosure on average discount rates, expected increase in salaries and expected return on Plan assets are the highest for North America, UK and Ireland and the lowest for France and Spain.
- Higher values are found in North America, lower values in Germany.
  - Discount Rates range from 3,65 % (Sweden) to 6,25% (North America).
  - Expected rates of increase in salaries range from 1,5% (Germany) to 5,80 % (North America)
  - Expected return on Plan Assets ranges from 3,62 % (Germany) to 8,75 % (North America)
- Within the European Union area, higher values of actuarial assumptions are observed in UK:
  - Discount Rates: 6% (UK)
  - Expected rate of increase in salaries: 5,10 % (UK).
  - Expected return on Plan Assets: 7,89 % (UK).
- The most frequently used accounting treatment of actuarial gains and losses in 75 companies is the “Equity option” (in accordance with IAS19 revised).
- The impact of changes in the expected return on plan assets and interest costs is mainly accounted for in Operating result.
- Several incomplete or disparate disclosure situations have been identified:
- Assumptions regarding life expectancy are not fully disclosed and show discrepancies within similar environments.
- Sensitivity analysis on changes in actuarial assumptions is performed by only half of companies and generally focuses only on a portion of actuarial information.
- 53 companies (71% of the sample examined in detail) provide the required analysis of DBO arising from plans wholly funded and DBO arising from plans that are partly funded or unfunded

13.1. Significance of Defined Benefit Obligations

The following elements are based on figures arising from the analysis of the notes to the financial statements. This analysis is based on the gross value of post-employment obligations through the amount of Defined Benefit Obligations, rather than a net amount of obligations directly available on the face of the balance sheet.

88% of companies (238 out of 270) disclosed post-employment benefits. There is no difference between listed and non-listed companies.

The total value of Defined Benefit Obligations of 221 listed companies amounts to EUR 755 billion, which corresponds to 18% of the Market capitalization and 4% of the total assets of the 250 companies.

Table 110 : Reported amounts of Defined Benefit Obligations

Weight of Defined Benefit Obligations (DBO) in European companies (250 entities)	
Total DBO in € Billions	755
Total Turnover in € Billions	3 473
DBO / Turnover	**22%**
Total Market Cap in € Billions	4 238
DBO / Market Cap	**18%**
Total Assets in € Billions	17 767
DBO / Assets	**4%**

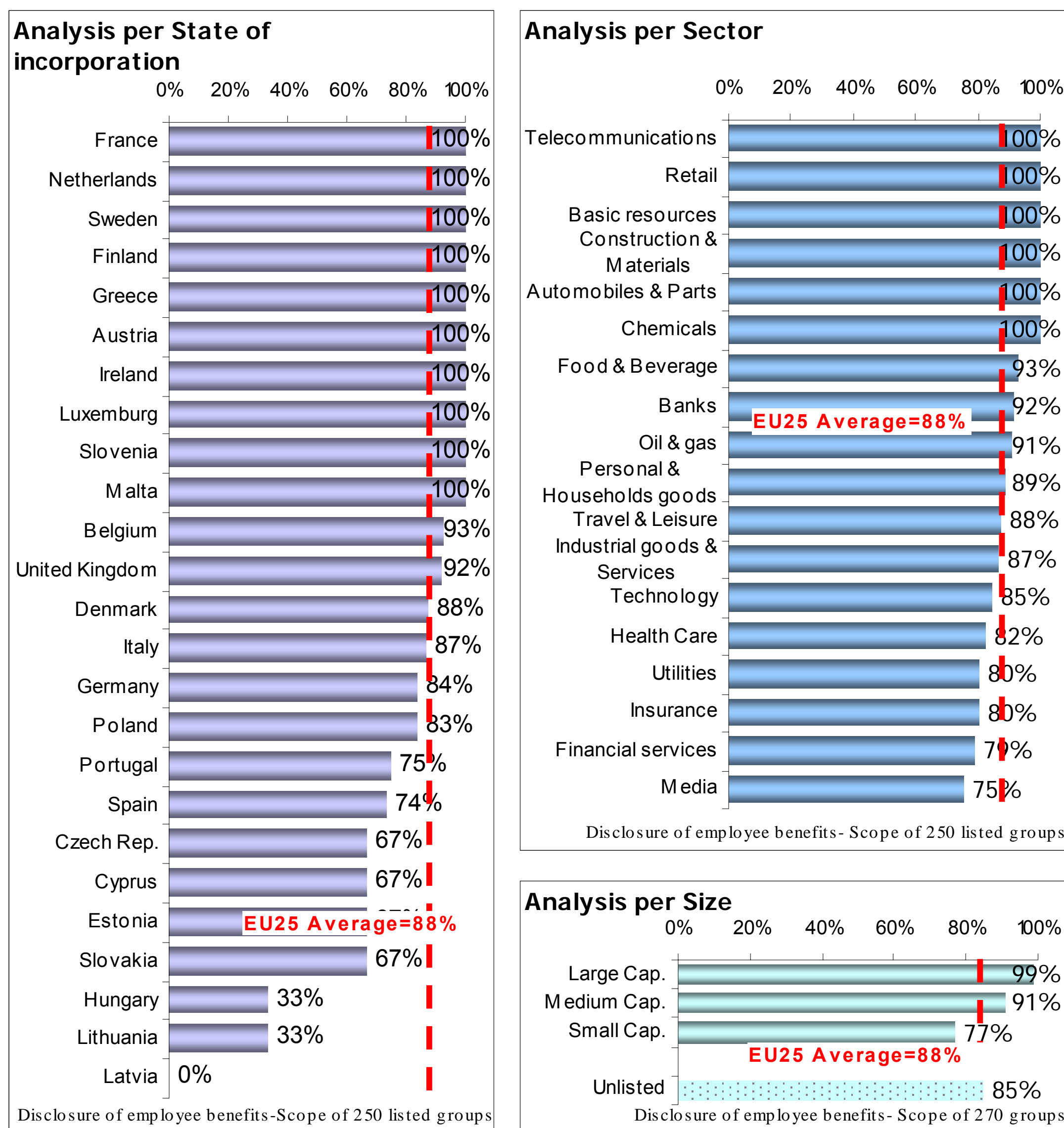
A cross-analysis by state of incorporation shows that 88% of post-employment obligations (by value) is concentrated in the United Kingdom, Germany, France and Netherlands, while the Market capitalisation of these four countries represents 70% of the total European market capitalisation.

Defined Benefit Obligations are virtually absent in countries who have recently joined the European Union (Slovenia, Hungary, Czech Republic, Estonia, Latvia, Lithuania) based on the companies in our sample.

Table 111 : Distribution by state of incorporation of reported amounts of Defined Benefit Obligations

Main countries of incorporation for companies having DBO	DBO (EUR Billions)	Market Cap (EUR Billions)	Ratio DBO/Mket Cap
United Kingdom	234	1 325	18%
Germany	205	490	42%
France	129	913	14%
Netherlands	86	248	35%
Subtotal four countries	**654**	**2 976**	**22%**
Other countries	**101,0**	**1261,9**	**8%**
Spain	37,3	286,3	13%
Italy	15,0	285,6	5%
Sweden	12,3	149,0	8%
Ireland	7,7	42,4	18%
Portugal	6,9	29,3	24%
Belgium	5,9	80,4	7%
Luxemburg	4,5	42,7	11%
Denmark	3,9	80,5	5%
Finland	3,0	91,6	3%
Austria	2,0	41,8	5%
Greece	1,0	43,6	2%
Cyprus	1,0	8,3	12%
Poland	0,1	23,5	0%
Slovania	0,1	5,1	2%
Malta	0,1	1,4	7%
Hungary	0,1	19,1	1%
Estonia	0,1	2,0	5%
Czech Republic	0,0	25,0	0%
Latvia	0,0	0,8	0%
Lithuania	0,0	2,9	0%
Slovakia	0,0	0,6	0%
Total Sample of 250 listed companies	**755**	**4 238**	**18%**

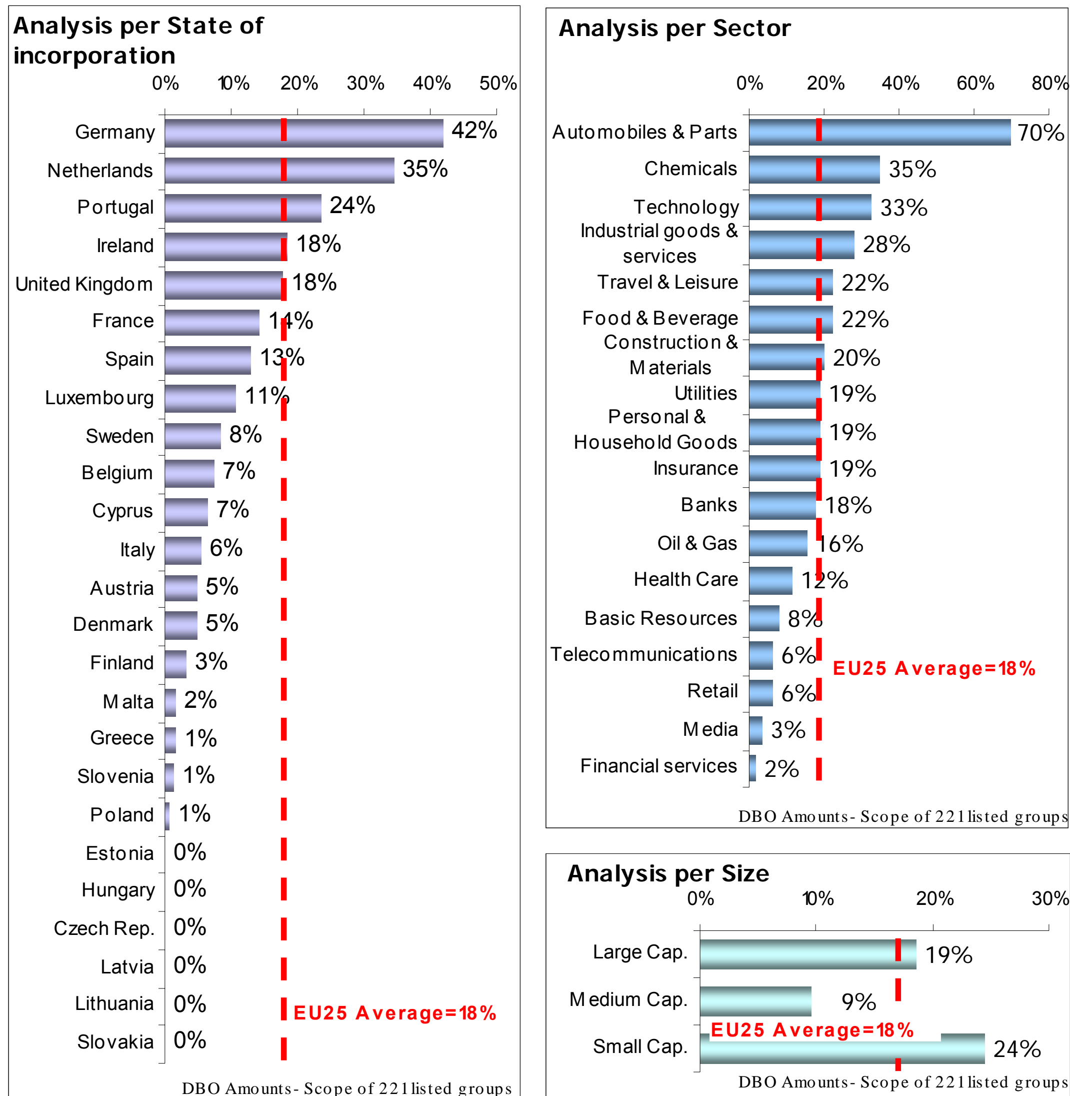
Table 112 : Cross analysis by state, sector and size of proportion of companies disclosing information about employee benefits



A cross analysis by industry shows that four sectors (Banks, Automobiles & Parts, Oil & Gas and Utilities) account for more than 52% of total amounts of DBOs in our sample. On the contrary, defined benefit plans are not material in the Media and Financial services sectors.

The breakdown by industry sectors is presented in the following table compared to the market capitalization of the sector:

Table 113 : Cross analysis by state, sector and size of DBO vs. Market Capitalization Ratio



Cross-analysis by size of company is likely unrelevant.

13.2. Detailed analysis

Further detailed analysis is based on a selection of 75 companies representing the top 65 companies according to the ratio post-employment obligation amount/net equity and 10 additional companies.

The 75 companies represent an amount of EUR 688 billion of DBO, corresponding to more than 90% of the total amount disclosed by the 250 companies (EUR 755 billion).

Czech Republic, Latvia, Lithuania, and Slovakia in which no DBO figures were found in the companies in our sample, and Estonia, Hungary, Malta, where amounts collected were not material are not included in this sample.

Table 114 : Distribution of companies in the sample for detailed analysis of Defined Benefits Obligations

Company Size	Number of companies	%	DBO amount in M€	%
Large sized market capitalisation	45	18%	651 712	86%
Medium sized market capitalisation	19	8%	32 969	4%
Small sized market capitalisation	11	4%	3 620	1%
Sub-total	**75**	**30%**	**688 301**	**91%**
Other companies	146	58%	66 759	9%
Total of companies disclosing Defined Benefit Obligations	**221**	**88%**	**755 060**	**100%**
Companies not disclosing Defined Benefit Obligations	29	12%		
Total sample of listed companies	**250**	**100%**	**755 060**	**100%**

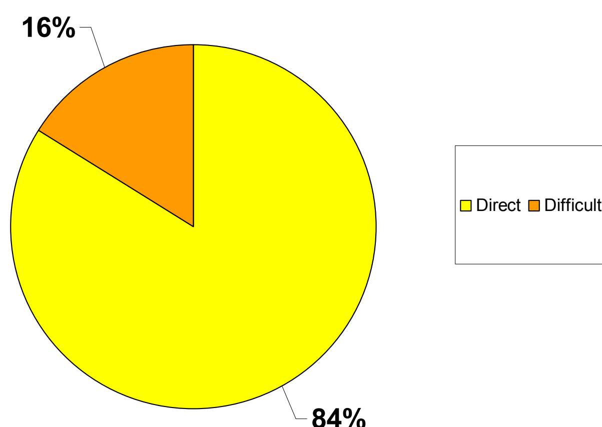
13.3. Reconciliation between financial statement disclosures and disclosures in accompanying notes regarding post-employment obligations

The following analysis is based on the application or not of the provision of IAS 1 relating to the required cross reference between the face of the balance sheet, income statement, statement of changes in equity and cash flow statement, and the related note (IAS1.104). In addition to the correct application of this requirement, the ability to easily match figures between the net provision on the face of the balance sheet and the related note was taken into account to provide the following analysis.

84% of companies (63% out of 75) disclosed information on IAS 19 enabling easily to match figures between the face of the balance sheet and the accompanying notes.

16% of companies (12 out of 75) were not successful in facilitating the analysis of employee benefits. In particular, the reconciliation between "employee benefits" in the Liabilities section of the face of the balance sheet, and its reconciliation with the "defined benefit obligation" (DBO) in the accompanying notes was rather difficult or impossible.

Table 115 : Ease of reconciliation between Financial statements and accompanying notes regarding employee benefits



13.4. Analysis of Defined Benefit Obligations (DBO) and Plan Assets (PA):

IAS 19 *Employee Benefits* states that defined benefit plans as post-employment plans other than defined contribution plans under which the entity's obligation is to provide the agreed benefits to current and former employees.

Under defined benefit, actuarial risk that benefits will cost more than expected and risks linked to the funding of the obligation fall on the entity.

IAS 19 requires to recognize in the balance sheet the present value of the defined benefit obligation adjusted for unrecognised actuarial gains and losses and unrecognised past service cost, and reduced by the fair value of plan at the balance sheet date.

Defined Benefit Obligations and related Plan Assets – overall funding status

A general analysis based on the total amount of DBO and PA at present value disclosed by the 75 companies reveals that 64 companies (85%) disclosed a present value of plan asset inferior to the related Defined Benefit Obligations.

3 companies (4%) disclosed a present value of plan assets superior to defined benefit obligations (**Philips Electronics** [Netherlands, Personal & Household goods], **BP** [United Kingdom, Oil & Gas], and **Bank of Cyprus** [Cyprus, Banks]).

8 companies (11%) seem not to have any Plan Asset to cover post-employment obligations.

The average ratio of defined benefit obligation at present value covered by plan assets (expressed at fair value) amounts to 73%, as shown in the following table

Table 116 : Funding status of Defined Benefit Obligation through Plan Assets

Global DBO and Plan Assets statistics in M€ (75 companies considered)	
Present value of Defined Benefit Obligation (DBO) amount	688 301
Fair Value of Plan Asset (PA) amount	500 431
Overall difference between DBO and PA amounts	187 870
Overall Ratio PA / DBO	73%

Defined Benefit Obligations and Related Plan Assets - funding status disclosures

In accordance with IAS 19, an entity must disclose information relating to defined benefit plans, for which the present value of obligations, is wholly funded, wholly unfunded and partly unfunded.

- 71% of companies (53 out of 75) disclosed information about the funding status (partly or wholly funded vs. unfunded) of their defined benefit plan. The disclosing companies represent a higher share of DBO amount: EUR 565 billion i.e. 82% of EUR 688 billion.

  For example, **BASF** [Germany, Chemicals] disclosed[124] in the Notes related to employee benefit, the following table:

[124] **BASF** [Germany] - Financial report 2006, page 144

Current funding situation of the plan	2006		2005	
Million €	Defined benefit obligation	Plan assets	Defined benefit obligation	Plan assets
Unfunded pension plans	676.0	–	606.3	–
Partially funded pension plans	2,872.3	2,586.4	7,299.2	6,758.5
Total of pension plans that are not fully funded	**3,548.3**	**2,586.4**	**7,905.5**	**6,758.5**
Fully funded pension plans	9,145.1	9,492.1	4,002.0	4,256.7
	12,693.4	**12,078.5**	**11,907.5**	**11,015.2**

For the companies providing the disclosure information, the value of the funded part represented 85% of the DBO total amount (EUR 479 billion) and the value of the unfunded part 15% of the DBO total amount (EUR 86 billion).

In the cases of 4 large groups in our sample, the unfunded part exceeded the funded part of DBO.

- 29% of companies, corresponding to 18% of the total DBO amount (EUR 123 billion), did not disclose the required information. The fair value of the Plan Assets relating to these companies amounted to only EUR 21 billion. Consequently, for companies not disclosing the information, the unfunded part of DBO represents 83%.

Defined Benefit Obligations and Plan Assets - other post-employment benefits disclosures

21% of companies disclosed information on other post-employment benefits and 9 companies disclosed detailed information on health care and life insurance benefits.

Out of a total of EUR 688 billion of DBO, post-employment benefits not pertaining to retirement represent less than 5% - EUR 33 Billion (of which B€ 27 are explicitly dedicated to health care and life insurance).

Table 117 : Reported amounts of post-employment benefits not pertaining to retirement

Other post-employment benefits in Europe in 2006 (11 companies)	
DaimlerChrysler	17,4
Alcatel-Lucent	4,3
British Petroleum	2,5
Royal Dutch Shell	2,4
Glaxosmithkline	1,6
Other companies	4,7
Total in EUR Billions	**32,9**

As an example, **DaimlerChrysler** [Germany, Automobile & Parts] presents[125] the following information relating to other post-employment health and life insurance:

Other post-employment benefits

Certain DaimlerChrysler operations in the United States and Canada provide post-employment health and life insurance benefits to their employees. Upon retirement from Daimler-Chrysler, the employees may become eligible for continuation of these benefits. The benefits and eligibility rules may be modified.

Funded status. The funded status (before reimbursement rights) is as follows:

	At December 31, 2006	2005
(in millions of €)		
Present value of defined benefit obligations	17,359	19,275
Less fair value of plan assets	(1,928)	(1,912)
Funded status (before reimbursement rights)	15,431	17,363

Geographical segmentation of Defined Benefit Obligations and Plan Assets – Geographical Segmentation

In terms of total value, half the financial information concerning Defined Benefit Obligations and Plan Assets, corresponding to 41% of the 75 companies, was geographically segmented.

For those companies providing the information, the geographical segmentation of the Defined Benefit Obligations and Plan Assets gave the results as set out in the table below. The extent to which the Defined Benefit Obligations were funded varies significantly between the different countries in which the obligations arose.

The top three countries in terms of DBO and PA - United Kingdom, Germany and North America, represented 60% of the total Defined Benefit Obligations and 63% of the total Plan Assets. The “other countries caption”, represents EUR 94 billion (26%) of DBO and EUR 72 billion (28%) of PA. This caption includes both individual countries with smaller DBO and PA and the captions “Other Countries” declared in the financial statements of the companies.

[125] **DaimlerChrysler** [Germany, Automobile & Parts] IFRS consolidated financial statements 2006, page 46

Table 118 : Breakdown by geographical zone of reported amounts of Defined Benefit Obligation and Plan Assets

Main geographical zones disclosed regarding post-employment benefits	Defined Benefit Obligations (EUR Billions)	% of total segmented information	Fair Value of Plan Assets (EUR Billions)	% of total segmented information	Ratio Plan Assets/DBO
United Kingdom	115,2	31%	110,8	42%	96%
Germany	65,4	18%	35,9	14%	55%
North America	40,3	11%	19,6	7%	49%
Subtotal	**221**	**60%**	**166**	**63%**	**75%**
France	19,9	5%	5,8	2%	29%
Spain	17,7	5%	0,7	1%	4%
Netherlands	12,4	3%	14,5	5%	117%
Sweden	2,7	1%	2,2	1%	81%
Other countries	94	26%	72	28%	77%
Total of segmented information	**368**	**100%**	**262**	**100%**	**71%**
Total amount in the sample (75 companies)	**688**		**500**		**73%**

Volvo [Sweden, Industrial goods & services] disclosed[126] a geographical segmentation of the variation of DBO during the period, including the information relating to the funded part (in SEK million):

Obligations in defined benefit plans	Sweden Pensions	United States Pensions	France Pensions	Great Britain Pensions	US Other benefits	Other plans	Total
Acquisitions, divestments and other changes	(125)	81	–	–	6	(1)	**(39)**
Current year service costs	203	304	37	80	184	169	**977**
Interest costs	303	637	97	195	321	83	**1,636**
Unvested past service costs	–	3	–	(12)	–	–	**(9)**
Vested past service costs	(72)	44	–	–	1	11	**(16)**
Termination benefits	104	–	–	–	–	44	**148**
Curtailments and settlements	(371)	–	–	–	–	–	**(371)**
Employee contributions	–	–	–	34	–	(2)	**32**
Actuarial (gains) and losses	810	281	(12)	714	(66)	151	**1,878**
Exchange rate translation	–	2,171	92	287	1,222	238	**4,010**
Benefits paid	(248)	(763)	(435)	(109)	(592)	(224)	**(2,371)**
Obligations at December 31, 2005	**6,841**	**13,279**	**1,858**	**4,635**	**7,151**	**2,757**	**36,521**
of which							
Funded defined benefit plans	6,342	12,962	–	4,135	3,772	1,744	**28,955**
Acquisitions, divestments and other changes	(54)	–	14	–	(44)	301	**217**
Current year service costs	248	246	41	103	104	190	**932**
Interest costs	277	686	70	220	345	92	**1,690**
Unvested past service costs	–	6	2	–	(8)	–	**-**
Vested past service costs	4	–	8	–	(17)	6	**1**
Termination benefits	122	–	–	–	–	(2)	**120**
Curtailments and settlements	(146)	(15)	(4)	–	1	(1)	**(165)**
Employee contributions	–	–	–	33	–	–	**33**
Actuarial (gains) and losses	113	437	10	173	201	44	**978**
Exchange rate translation	–	(1,844)	(69)	(86)	(962)	(213)	**(3,174)**
Benefits paid	(263)	(778)	(359)	(91)	(572)	(350)	**(2,413)**
Obligations at December 31, 2006	**7,142**	**12,017**	**1,571**	**4,987**	**6,199**	**2,824**	**34,740**
of which							
Funded defined benefit plans	6,560	11,830	–	4,451	3,978	1,996	**28,815**

[126] **Volvo** [Sweden, Industrial goods & services] Annual report 2006, page 121

Ranking of groups by total DBO and PA amounts

The Top 30 groups by DBO amounts represent 87% (EUR 596 billion) of the total DBO amount (EUR 688 billion). There is a very wide band of % funding of DBO by PA within this population – from 106% funded DBO to only 19% funded DBO. Only 3 groups not in the Top 30 for DBO are in the Top 30 for PA. This data is presented in the table below:

Table 119 : Top 30 companies for reported Defined Benefit Obligations

Country of incorporation	Defined Benefit Obligation (EUR Millions)	Plan assets (EUR Millions)	Difference in amount (EUR Millions)	PA / DBO (%)
Germany	54 825	37 104	17 721	68%
United Kingdom	48 073	51 149	-3 076	106%
United Kingdom	32 164	30 252	1 912	94%
United Kingdom	31 116	28 158	2 959	90%
France	30 230	30 197	33	100%
United Kingdom	27 213	26 000	1 213	96%
Germany	25 831	24 016	1 815	93%
France	25 667	9 346	16 321	36%
United Kingdom	25 282	21 100	4 182	83%
Spain	23 412	8 930	14 482	38%
Netherlands	20 783	21 352	-569	103%
Netherlands	20 358	17 278	3 080	85%
Germany	17 955	6 119	11 836	34%
Germany	17 280	10 888	6 392	63%
United Kingdom	16 943	13 735	3 208	81%
Germany	16 887	3 159	13 728	19%
Germany	16 708	6 494	10 214	39%
Netherlands	16 243	14 361	1 882	88%
France	15 338	8 225	7 113	54%
Germany	15 205	7 784	7 421	51%
Germany	12 693	12 078	615	95%
Netherlands	12 440	11 209	1 231	90%
Germany	11 430	6 432	4 998	56%
Netherlands	9 584	3 833	5 751	40%
France	9 508	5 631	3 877	59%
France	9 390	6 401	2 989	68%
France	8 813	6 799	2 014	77%
Spain	8 253	1 816	6 437	22%
United Kingdom	8 051	7 454	597	93%
United Kingdom	7 929	6 497	1 432	82%
Total of top 30 DBO Amounts	**595 606**	**443 796**	**151 809**	**75%**

Table 118: Companies with Plan Assets within the Top 30, not included in the top 30 DBO

Country of incorporation	Defined Benefit Obligation (EUR Millions)	Plan assets (EUR Millions)	Difference in amount (EUR Millions)	PA / DBO (%)
United Kingdom	7 362	5 951	1 411	81%
United Kingdom	6 566	5 867	699	89%
Netherlands	6 052	3 942	2 110	65%

13.5. Actuarial assumptions regarding defined benefit plans

The review of actuarial assumptions disclosures in the sample of 75 companies reveals that the information disclosed is more consistent regarding “discount rates” and “rates of increase in salaries” than for “expected return of plan assets”:

- 71 companies disclosed information on “discount rate” (95%).
- 69 companies disclosed information on “expected rate of salary increase” (92%).
- 65 companies disclosed information on “expected rate of return of plan assets” (87%).

Diversity of information disclosed for the same geographical segment (calculated by the standard deviation formula) is higher regarding expected return of plan assets than for the two other actuarial assumptions.

Actuarial assumptions - discount rates disclosures

The following table presents the discount rate percentage data for the 71 companies out of 75 which provided the information according to the geographical zones disclosed in the financial statements:

Table 120 : Breakdown by geographical zones of assumptions regarding the discount rate

"Discount rate" disclosures in the financial statements of EU companies in 2006 (71 companies considered)					
Geographical zones	Number of disclosures	Average rate (%)	Minimum value	Maximum value	Standard deviation within each zone
North America	23	5,66	4,70	6,23	0,37
UK	35	5,18	4,90	6,00	0,25
Ireland	4	4,83	4,60	5,30	0,32
Portugal	3	4,75	4,75	4,75	0,00
Eurozone	13	4,55	4,25	4,75	0,18
Germany	17	4,47	3,92	5,10	0,25
Netherlands	3	4,47	4,20	4,60	0,23
France	8	4,41	4,10	4,75	0,23
Spain	2	4,00	4,00	4,00	0,00
Sweden	2	3,83	3,65	4,00	0,25
Total & Average	**110**	**4,61**	**4,31**	**4,95**	**0,21**

The average “discount rates” disclosed is the highest in North America (the United States, Canada), the United Kingdom and Ireland and the lowest in Sweden. Information regarding discount rate is more homogeneous regarding the United Kingdom and Irish segment than regarding the United States one.

Actuarial assumptions - rate of increase in salaries disclosures

The following table provides the rate of increase in salaries data for the 69 companies out of 75 which provided the information according to geographical zones:

Table 121 : Breakdown by geographical zones of assumptions regarding the rate of increase in salaries

"Rate of increase in salaries" disclosures in the financial statements of EU companies in 2006 (69 companies considered)					
Geographical zones	Number of disclosures	Average rate (%)	Minimum value	Maximum value	Standard deviation within each zone
Ireland	4	4,18	3,50	4,75	0,51
UK	31	4,10	2,75	5,10	0,51
North America	18	3,97	3,00	5,80	0,59
Eurozone	10	3,23	2,25	4,50	0,72
Sweden	1	3,00	3,00	3,00	N/A
Portugal	3	2,98	2,25	3,70	0,73
France	8	2,77	2,00	3,50	0,58
Germany	19	2,67	1,50	3,50	0,51
Spain	2	2,60	2,50	2,70	0,14
Netherlands	2	2,40	2,40	2,40	0,00
Total & Average	**98**	**3,19**	**2,52**	**3,90**	**0,48**

The average “rate of increase in salaries” disclosed is the highest in Ireland, UK and North America and the lowest in Spain and Netherlands.

Actuarial assumptions - expected return on plan assets disclosures

The following table provides the expected return on plan assets disclosures for 65 companies out of 75 in our sample which provided the information according to geographical zones:

Table 122 : Breakdown by geographical zones of assumptions regarding the return on plan assets

"Expected return on plan assets" disclosures in the financial statements of EU companies in 2006 (65 companies considered)					
Geographical zones	**Number of disclosures**	**Average rate (%)**	**Minimum value**	**Maximum value**	**Standard deviation within each zone**
North America	21	7,36	5,00	8,75	0,95
UK	31	6,59	4,50	7,89	0,72
Portugal	3	6,00	4,50	7,50	1,50
Netherlands	3	6,00	5,70	6,60	0,52
Ireland	4	5,83	4,88	6,60	0,79
Germany	15	5,43	3,62	7,50	1,14
Sweden	2	5,33	5,00	5,65	0,46
Eurozone	11	5,30	4,13	6,50	0,74
France	6	4,62	3,69	5,10	0,54
Spain	1	4,00	4,00	4,00	N/A
Total & Average	97	5,65	4,50	6,61	0,82

The degree of variation in the disclosed information is illustrated by the frequent use of ranges of rates in the calculations by certain groups, regarding expected return on plan assets, and as measured by the standard deviation within each geographical zone disclosed, and appears to be linked with:

- The difficulty to assess such information.
- The breakdown of scheme assets by class of investment (divided in equities, bonds, property, other).

Actuarial assumptions – year-on-year variations of rates disclosed

The following table shows [127]an example of year-on-year variations of rates disclosed by **Alcatel** [France, Technology]:

The above rates are broken down by geographical segment as follows for 2006, 2005 and 2004:

	Discount rate	Future salary increases	Estimated long-term return on assets
2006			
France	4.10%	3.41%	5.10%
Belgium	4.11%	3.71%	4.48%
United Kingdom	5.21%	4.53%	6.59%
Germany	4.13%	2.76%	4.26%
Rest of Europe	4.20%	2.54%	4.14%
United States of America	5.72%	4.01%	7.62%
Other	4.12%	4.18%	4.35%
2005			
France	3.75%	3.49%	4.27%
Belgium	3.75%	3.70%	3.75%
United Kingdom	5.00%	4.25%	6.50%
Germany	3.75%	2.75%	3.50%
Rest of Europe	3.32%	2.86%	3.85%
United States of America	4.98%	4.93%	5.37%
Other	4.25%	4.89%	5.12%
2004			
France	4.32%	2.82%	4.73%
Belgium	4.30%	5.98%	4.00%
United Kingdom	5.25%	4.50%	6.50%
Germany	4.31%	2.75%	4.50%
Rest of Europe	3.96%	2.55%	4.68%
United States of America	5.27%	4.76%	5.37%
Other	5.03%	4.16%	3.37%

The discount rates are obtained by reference to market yields on high quality bonds (government and prime-rated corporations – AA or AAA) in each country having maturity dates equivalent to those of the plans.

The returns on plan assets are determined plan by plan and depend upon the asset allocation of the investment portfolio and the expected future performance.

Actuarial assumptions - Health Care cost trend rates disclosures

Average health care cost trend rate for the next years disclosed in the 2006 financial statements under review, was 9.6% in North America and 8% in United Kingdom. Ultimate rate was 5.6% in North America and 5.8% in United Kingdom.

13.6. Accounting treatment of actuarial gains and losses

Actuarial gains and losses comprise adjustments based on previous plan performance and the effects of changes in actuarial assumptions in a pension plan. If the actual interest rate earned on pension assets exceeds the estimated rate, an actuarial gain results.

IAS 19 *Employee benefits* allows the three following accounting options regarding actuarial gains and losses:

- The immediate recognition of all actuarial gains and losses through the profit or loss ("Profit or loss treatment")
- The "corridor method" allowing to defer the actuarial gains and losses recognition. The part of actuarial gains and losses exceeding 10% of the higher of the plan asset or DBO value is recognised through the profit and loss and spread over a period inferior to the average expected remaining life of employees.
- The recognition of actuarial gains and losses in full in the period in which they occur, through the retained earnings. When an entity applies this option, a statement of Recognised Income and Expense must be disclosed ("Equity method") (amendment to IAS 19).

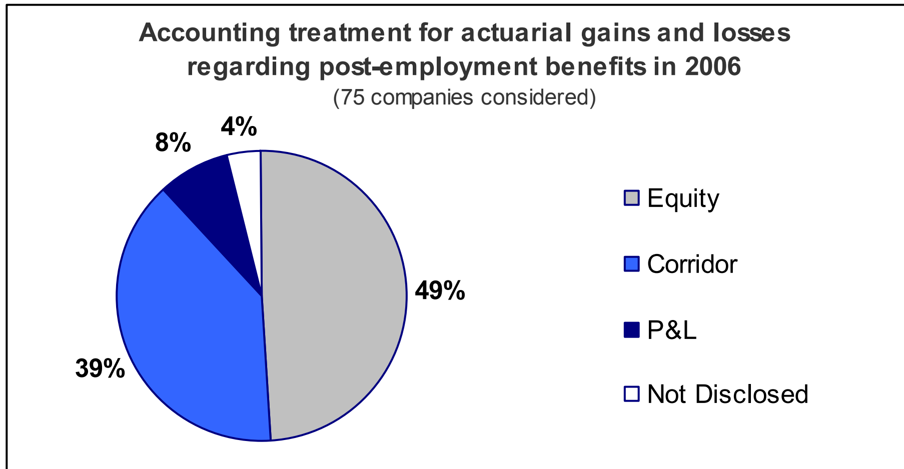
Accounting treatment of actuarial gains and losses

[127] **Alcatel** [France, Technology] 2006, page 142

49% of companies (37 out of 75) opted for the “Equity method”, 29 companies for the “Corridor method”, 4 companies for the “Profit or loss method” and 1 applied both “Profit and loss model” and “Equity method”

3 companies out of 75 did not disclose their accounting policy regarding the treatment of actuarial gains and losses.

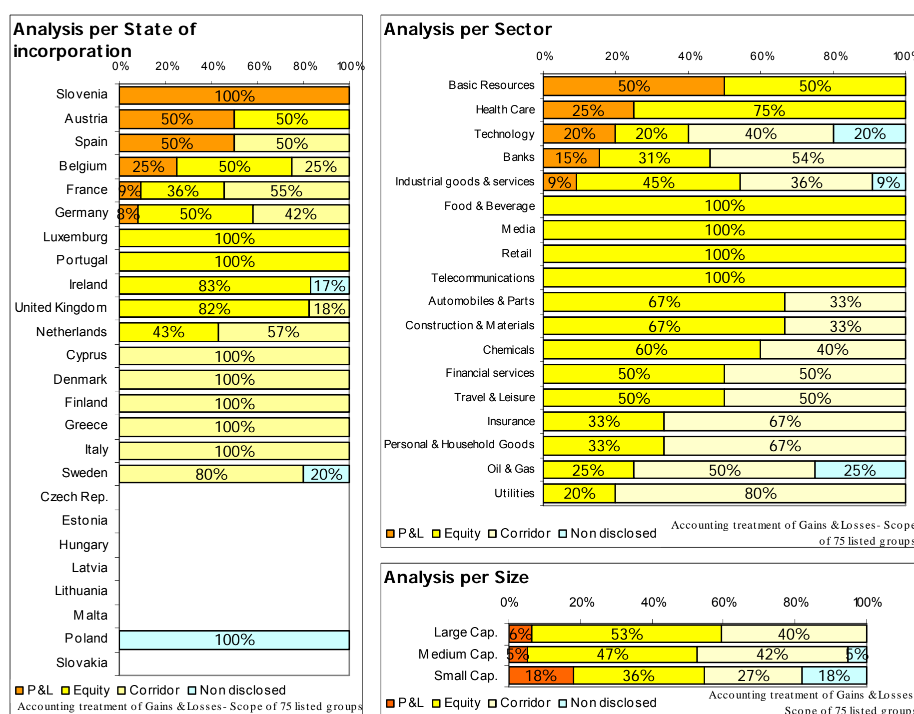
Table 123 : Accounting treatment of actuarial gains and losses



A cross-analysis by industry sector shows that:

- The “equity model” is the most frequently used by Food & Beverage, Automobiles & Parts, Construction & Materials and Chemicals sectors. Whereas, Banks, Insurance, Personal & Household Goods, Oil & Gas and Utilities companies opted more frequently for the “corridor model”.
- On the other hand, the analysis does not reveal any clear trend relating to the use of one particular authorised option in companies in Financial Services, Travel & Leisure, Industrial Goods & Services, Technology and Basic Resources sectors.

Table 124 : Cross analysis by state, sector and size of accounting treatment of gain & losses



Countries left blank have no entity included in the dedicated sample under review (75 entities), because no or nearly no DBO was reported by the entities of these countries. Refer to the table 113.

A cross-analysis by State of incorporation reveals some noticeable trends.

- The United Kingdom, Ireland, Luxemburg and Portugal opted mainly for the “equity model”. 82% of British companies and 83% of Irish companies accounted for actuarial gains and losses by the “Equity Method”. This trend is mainly due to the quasi full convergence between FRS17 *Retirement Benefits* in UK GAAP and the amended IAS19.
- On the other hand, companies from Greece, Italy, Cyprus, Finland and Sweden elected mainly for the “Corridor Model” to account for actuarial gains and losses.
- In Belgium, France, Germany, the use of options is balanced between the “Equity model” and the “Corridor model”.

Large companies were more inclined to adopt the equity accounting treatment in 2006, whereas no relevant trend appears regarding medium and small companies. No large company in our sample failed to disclose its accounting treatment regarding actuarial gains and losses.

Accounting treatment of expected return on plan assets and interest costs

The Expected Return on Plan Assets (EPRA) is determined by multiplying the amount of plan assets by an expected long-term rate of return on plan assets.

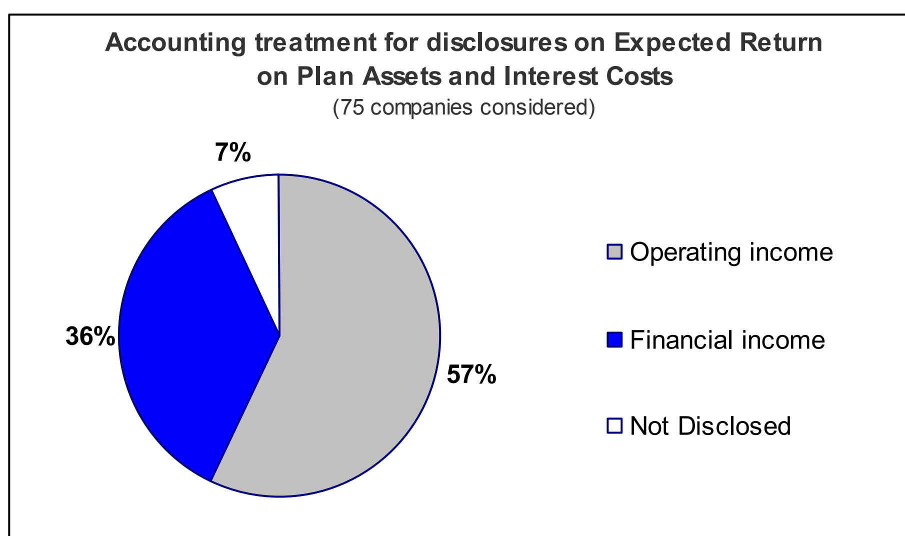
The ERPA is a reduction of pension expense: the higher it is, the lower the pension expense.

Interest cost is the annual interest cost on the pension obligation (the equivalent of interest payments on debt).

Two accounting treatments have been observed regarding Expected Return on Plan Assets and Interest Costs that vary according to sector of industry, country and companies size.

These accounting treatments consist in including both items either in “Operating income” or in “Financial income”. 57% of companies (43 out of 75) opted to disclose information in operating income, 27 companies in financial income, and 5 companies failed to disclose this information.

Table 125 : Accounting treatment of expected return on plan assets and interest costs



A cross-analysis by industry sector shows that the “Operating Income” treatment is most frequently used by Banks, Insurance, Personal & Household goods sectors. Whereas, Automobiles & Parts, Construction & Materials, Travel & Leisure, Retail and Basic Resources opted in majority for the “Financial Income” treatment.

Table 126 : Cross analysis by industry sector of accounting treatment of expected return on plan assets and interest costs

Accounting treatment of Expected Return on Plan Assets and Interest Costs in 2006 (75 cies)				
Industry Sector	**Operating income**	**Financial income**	**Not disclosed**	**Total**
Automobiles & Parts	1	5		6
Banks	12			12
Basic Resources		2		2
Chemicals	2	3		5
Construction & Materials	1	2		3
Financial services	2			2
Food & Beverage	3	2		5
Health Care	3	1		4
Industrial goods & services	7	3	1	11
Insurance	2		1	3
Media		1		1
Oil & Gas	3	1		4
Personal & Household Goods	2		1	3
Retail		2		2
Technology	2	1	1	4
Telecommunications	1			1
Travel & Leisure		2		2
Utilities	2	2	1	5
Total (number of companies)	**43**	**27**	**5**	**75**
Total (%)	**57%**	**36%**	**7%**	**100%**

A cross-analysis by State of incorporation indicates that the "Operating Income" treatment is the most frequent treatment used in Netherlands, Sweden, Finland, Spain, Portugal, whereas no clear prevailing treatment appears in the United Kingdom, France, Belgium. A major share of German companies opted for the "Financial Income" treatment.

Table 127 : Cross analysis by state of incorporation of accounting treatment of expected return on plan assets and interest costs

Accounting treatment of Expected Return on Plan Assets and Interest Costs in 2006 (75 companies)				
Country	Operating income	Financial income	Not disclosed	Total
Austria	1			1
Belgium	2	2		4
Cyprus	1			1
Denmark	1			1
Finland	2			2
France	6	4		10
Germany	2	9	1	12
Greece			1	1
Ireland	3	2	1	6
Italy	1			1
Luxemburg		1		1
Netherlands	5	1	1	7
Poland	1			1
Portugal	2			2
Slovenia	1			1
Spain	2			2
Sweden	4		1	5
United Kingdom	9	8		17
Total (number of companies)	**43**	**27**	**5**	**75**
Total (%)	**57%**	**36%**	**7%**	**100%**

The majority of large and medium sized companies tend to disclose Expected Return on Plan Assets and Interest Costs in operating income.

Table 128 : Cross analysis by size of accounting treatment of expected return on plan assets and interest costs

Accounting treatment of Expected Return on Plan Assets and Interest Costs in 2006 (75 European companies)				
Company size	Operating income	Financial income	Not disclosed	Total
Large - sized market cap	26	17	2	45
Medium - sized market cap	13	5	1	19
Small - sized market cap	4	5	2	11
Total (number of companies)	**43**	**27**	**5**	**75**
Total (%)	**57%**	**36%**	**7%**	**100%**

13.7. Other disclosures

Other disclosures studied concern Life Expectancy assumptions and Sensitivity Analysis.

Life Expectancy assumptions disclosures

49% of companies (37 out of 75) disclosed information on life expectancy.

Table 129 : Disclosures on assumptions regarding life expectancy

Life expectancy disclosures in 2006 (75 companies)		
	Number of companies	%
Disclosure of the sources used to determine mortality rates	9	12%
Disclosure of estimates of life expectancy	15	20%
Disclosure of both estimates and the source	13	17%
Total of companies disclosing information on life expectancy	**37**	**49%**
Total of companies not disclosing information on life expectancy	38	51%
Total of companies in the working sample	**75**	**100%**

Amongst these companies, 13 of them provided both estimates and source on mortality rates, of which:

- 10 British companies (**Barclays** [United Kingdom, Banks], **British American Tobacco** [United Kingdom, Personal & Household goods], **Diageo** [United Kingdom, Food & Beverage] **GlaxoSmithKline** [United Kingdom, Health Care], **GKN** [United Kingdom, Automobile & Parts], **HSBC** [United Kingdom, Banks], **Pendragon** [United Kingdom, Retail], **RPC Group** [United Kingdom, Industrial goods & services], **Tesco** [United Kingdom, Retail], **Zetex** [United Kingdom, Technology]). It must be noted that all 17 British companies of the sample disclosed information on life expectancy.
- 1 Dutch company (**Unilever** [Netherlands, Food & Beverage])
- 1 Irish company (**AIB** [Ireland, Banks])
- 1 Danish company (**Danske Bank** [Denmark, Banks])

HSBC [United Kingdom, Banks] disclosed[128] life expectancy for male and female staff respectively and the related mortality table:

Mortality assumptions are increasingly significant in measuring the Group's obligations under its defined benefit pension and post-employment healthcare plans, particularly given the maturity of the plans. The mortality tables and average life expectancy at 65 used at 31 December 2006 were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
UK	PA92[1]	20.3	21.6	23.3	24.6
Hong Kong	n/a	n/a	n/a	n/a	n/a
US	RP 2000 projected to 2005	18.7	18.7	20.9	20.9
Jersey	PA92[1]	20.3	21.6	23.3	24.6
Mexico	GAM83	16.6	16.6	16.6	16.6
Brazil	RP 2000 imp 2006	18.9	20.5	21.0	21.9
France	TG 05	22.8	25.6	26.3	29.1
Canada pension plans	Between UP94 C2015 and UP94 C2027	19.0 and 20.0	19.0 and 20.0	21.6 and 22.1	21.6 and 22.1
Canada healthcare plan	UP94 C2025	19.8	19.8	22.0	22.0
Switzerland	EVK2000 and BVG2000	17.6 and 17.8	17.6 and 17.8	20.4 and 21.1	20.4 and 21.1
Germany	Heubeck 2005 G	18.1	20.8	22.2	24.9

1 *PA92 with standard improvements to 2005 and medium cohort improvements thereafter.*

The mortality tables and average life expectancy at 65 used at 31 December 2005 were as follows:

	Mortality table	Life expectancy at age 65 for a male member currently:		Life expectancy at age 65 for a female member currently:	
		Aged 65	Aged 45	Aged 65	Aged 45
UK	PA92U2005	19.53	20.89	22.57	23.86
Hong Kong	n/a	n/a	n/a	n/a	n/a
US	RP 2000 imp 2005	17.90	17.90	20.25	20.25
Jersey	PA92C2036	20.83	20.83	23.75	23.75
Mexico	GAM83	16.56	16.56	16.56	16.56
Brazil	AT83	18.51	18.51	21.89	21.89
France	TPG93	23.02	25.32	23.02	25.32
Canada pension plans	UP94 C2012 and UP94 C2027	18.65 and 19.84	18.65 and 19.84	21.37 and 22.00	21.37 and 22.00
Canada healthcare plan	GAM94M/F	17.88	17.88	21.32	21.32
Switzerland	EVK2000	17.6	17.6	20.4	20.4
Germany	Heubeck 2005 G	18.06	20.84	22.20	24.85

A comparison of the 10 United Kingdom companies disclosing lifetime estimates and source, reveals that lifetime estimates for staff retiring at 65 vary from 17,5 to 20,6 years for a man aged 65 and from 21.9 to 23.3 years for woman aged 65.

In addition, the study for man aged 45 with retirement at 65 shows that lifetime estimates spread from 18.4 to 21.6 and from 23 to 24.6 for woman aged 45.

Two companies quoted Life Expectancy based on 60 as opposed to 65 for the others.

[128] **HSBC** [United Kingdom, Banks]² Annual report 2006, page 324

Table 130 : Expected future lifetime – Example of UK companies

Expected future lifetime from Age 65 - The example of UK companies (2006)				
Company	**Man Aged 65**	**Woman Aged 65**	**Man Aged 45 retiring at 65**	**Woman Aged 45 retiring at 65**
Tesco	17,5	21,9	18,4	23,0
British American Tobacco	18,5	21,3	21,2	24,0
GKN	18,5	not available	20,0	not available
Diageo	19,4	22,1	21,7	24,4
Pendragon	19,6	22,7	20,9	23,9
RPC Group	20,0	23,0	22,0	24,0
HSBC	20,3	23,3	21,6	24,6
Zetex	20,6	not available	not available	not available

Expected future lifetime from Age 60 - The example of UK companies (2006)				
Company	**Man Aged 60**	**Woman Aged 60**	**Man Aged 40 retiring at 60**	**Woman Aged 40 retiring at 60**
Glaxosmithkline	25,3	26,8	26,9	28,6
Barclays	25,8	29,5	27,1	30,7

29% of companies (22 out of 75) disclose sources used to determine mortality rates, the most frequently mentioned tables are:

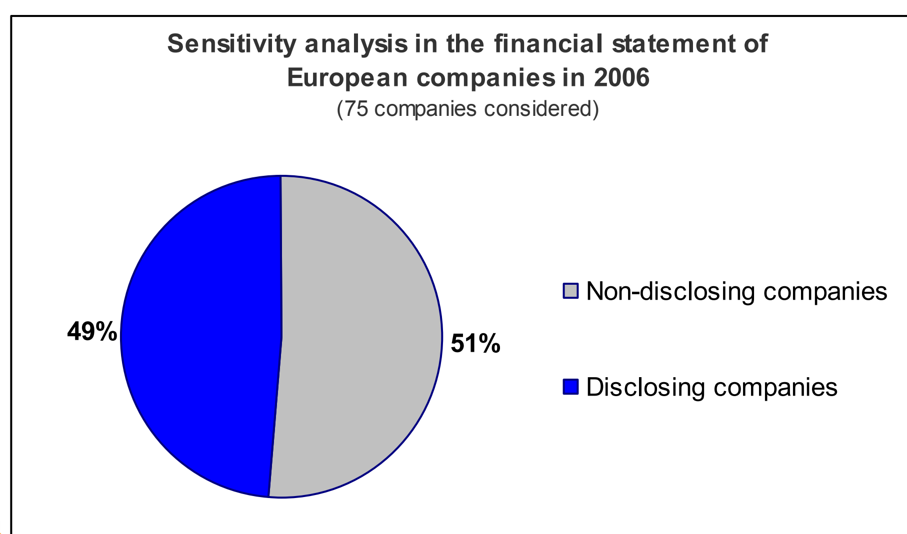
- PMA/PFA and PA92 tables in the United Kingdom,
- Heubeck tables in Germany,
- Insee's TV 88-90 tables in France,
- PERM-F2000 tables in Spain.

Sensitivity Analysis disclosures

Sensitivity Analysis aims to estimate the effect of changes in key assumptions regarding Defined Benefit Obligations commitments valuations.

49% of companies (37 out of 75) disclosed Sensitivity Analysis on changes in actuarial assumptions.

Table 131 : Disclosures on sensitivity analysis



The size of the companies is the main factor affecting the disclosures:

- 64% of large companies (29 out of 45) disclosed sensitivity analysis.
- 37% of medium companies (7 out of 19) did the same.
- 9% of small companies (1 out of 11) disclosed sensitivity elements.

State of incorporation and sector of industry do not seem to constitute major factors affecting the disclosure/non disclosure of Sensitivity Analysis.

GKN [United Kingdom, Automobile & Parts] presents[129] the impact on DBO of the changes in discount rate, Inflation rate and the increase/decrease of the medical costs:

Assumption sensitivity analysis

The impact of a one percentage point movement in the primary assumptions on the defined benefit net obligations as at 31 December 2006 is set out below:

	UK £m	Americas £m	Europe £m	ROW £m
Discount rate +1%	282	36	35	2
Discount rate –1%	(382)	(45)	(44)	(2)
Rate of inflation +1%	276	–	26	–
Rate of inflation –1%	(280)	–	(27)	–
Rate of increase in medical costs +1%	2	9	–	–
Rate of increase in medical costs –1%	(2)	(7)	–	–

BP [United Kingdom, Oil & Gas] estimated[130] that a one percentage point increase in the discount rate leads to a change of EUR 3 800 million on pension and other post-retirement benefit obligations as of December 2006, whereas a one percentage point decrease in discount rate leads to a change of EUR 4 876 million at the same date, which represents respectively 11.8% and 15.2% of the total Defined Benefit Obligation amounting EUR 32 164 million at end 2006.

Table 132 : Sensitivity analysis disclosed by BP [United Kingdom, Oil & Gas] – Key figures

	Discount rate	
Change in assumptions in %	Increase assumption +1%	Decrease assumption -1%
Effect of Change in assumptions in M€	-3 800	4 876
Amount of DBO in M€	32 164	32 164
% of DBO	-11,8%	15,2%

[129] **GKN** [United Kingdom, Automobile & Parts] Annual report 2006, page 98

[130] **BP** [United Kingdom, Oil & Gas]

In another example, **Bayer** [Germany, Chemicals] indicated[131] that a 0.5% increase in discount rate leads to a change of EUR 1 087 million on pension and other post-retirement benefit obligation as of December 2006, whereas a one percentage point decrease in discount rate leads to a change of EUR 1 203 million at the same date, which represents respectively 6.5% and 6.9% of the total Defined Benefit Obligation amounting EUR 32 164 million at end 2006.

Table 133 : Sensitivity analysis disclosed by BAYER [Germany, Chemicals] - Key figures

	Discount rate	
Change in assumptions in %	Increase assumption +0,5%	Decrease assumption -0,5%
Effect of Change in assumptions in M€	-1 087	1 203
Amount of DBO in M€	16 708	16 708
% of DBO	-6,5%	6,9%

[131] **Bayer** [Germany, Chemicals]

14. Government Grants

Key Points

Guidance on the treatment of government grants is provided by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*. This chapter covers the analysis of the following topics:

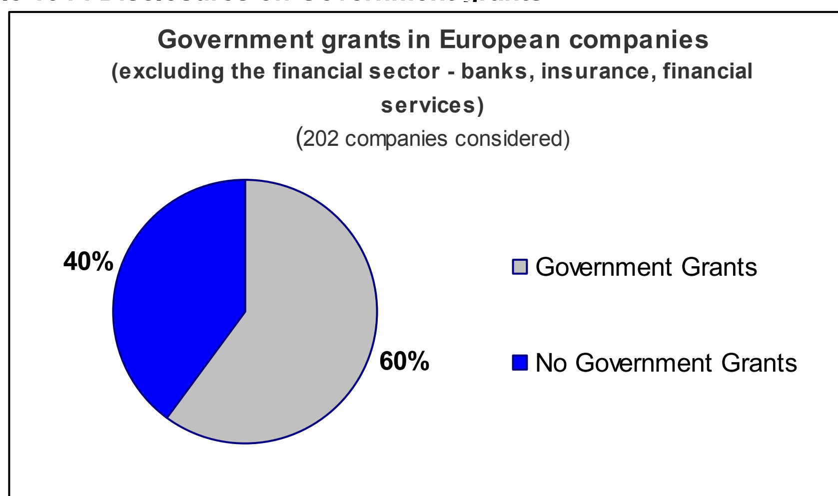
- The significance of government grants in the financial statements of the 270 selected companies
- The accounting and disclosure treatment of government grants related to assets

46 % of companies (116 listed and 5 non-listed out of 270) mentioned government grants, including:

- 60% (121 out of 202) of companies from sectors excluding financial activities. Amongst them, government assistance disclosure appears much more frequent amongst listed companies (62%) than non-listed companies (36%).
- 4 % (3 out of 68) of companies from financial activities; No bank, no insurance company and only 11% of companies from Financial services sector disclosed government assistance.

Further detailed analysis is performed on 202 companies from sectors excluding financial activities.

Table 134 : Disclosures on Government grants

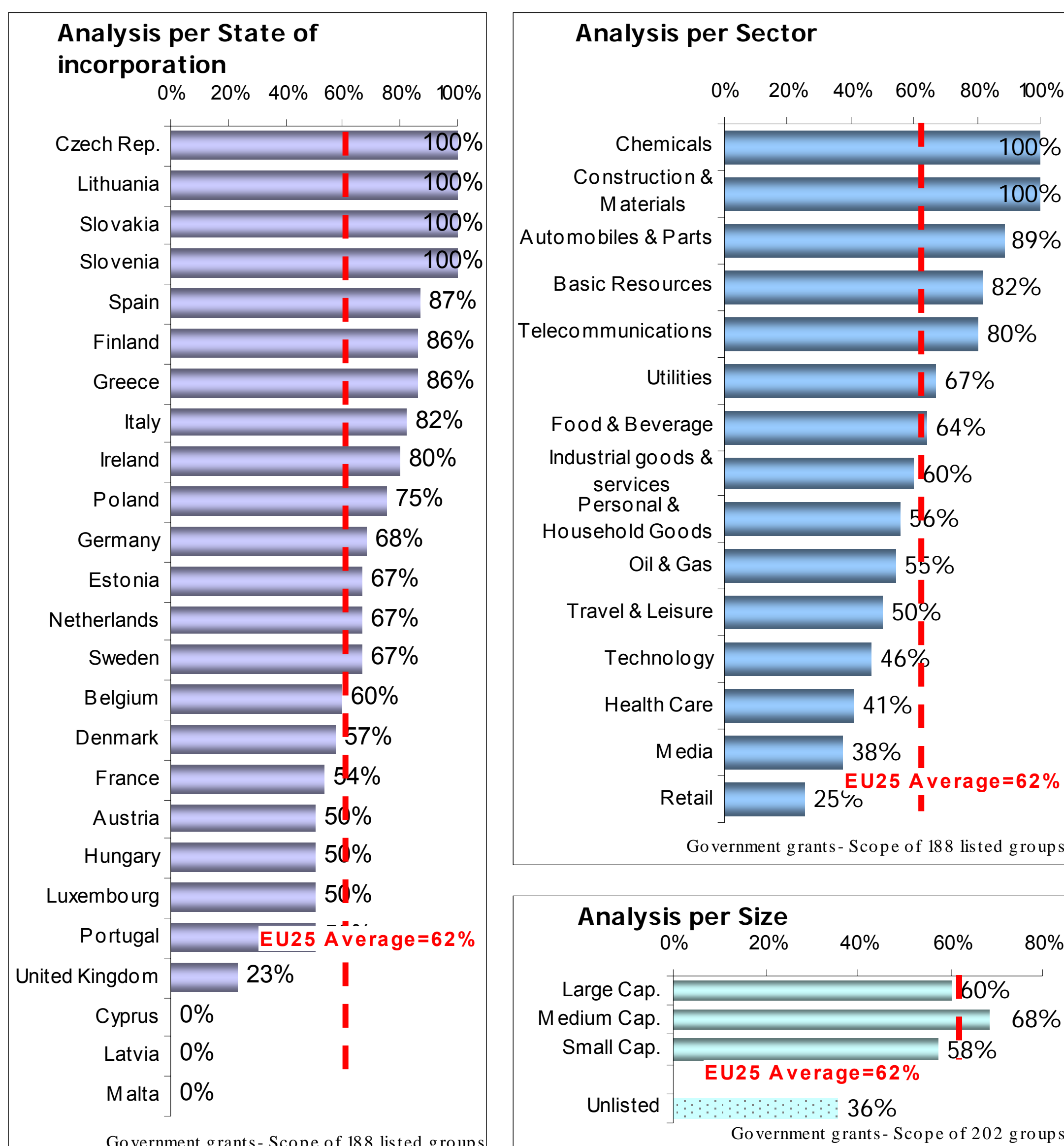


Cross analysis by industry sector shows that Chemicals (100%), Construction & Materials (100%), Automobiles & parts (89%), Basic resources (82%), Telecommunications (80%) are the sectors presenting the highest ratio of subsidised companies.

Cross analysis by state of incorporation shows the following main trends:

- New Member States have very different patterns (sample size for these countries may however limit the relevance of analysis) with countries at the top (Czech Republic, Lithuania, Slovakia, Slovenia), high rate (Poland), average (Estonia), low (Hungary) and minimum (Latvia). Results for Malta and Cyprus shall not be considered.
- Amongst longstanding EU members, countries with highest rate disclosure of government assistance are Mediterranean countries (Spain, Greece and Italy), Finland and Ireland, while United Kingdom has the lowest rate of reported government assistance.

Table 135 : Cross analysis by state, sector and size of the proportion of listed groups receiving government grants



14.1. Accounting and disclosure of government grants related to assets

According to IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*, Government grants that are reasonably measured are recognized when there is reasonable assurance that the company will comply with the conditions related to them, and that the grants will be received. [IAS 20.7]

Government grants must be recognised as income over the period necessary to match them with the related costs, for which they are intended to compensate, on a systematic basis and should not to be credited directly to equity. [IAS 20.12]

Grants related to assets may be presented either as deferred income or deducting the grant from the asset's carrying amount one of the following options. [IAS 20.24]

Additionally, the Standard requires an entity to disclose the following information. [IAS 20.39]

- Accounting policy adopted for grants, including method of balance sheet presentation
- Nature and extent of grants recognised in the financial statements
- Unfulfilled conditions and contingencies attaching to recognised grants

Out of 121 companies having received government grants, 116 companies received government grants related to assets.

Amongst them, 112 disclosed the required information relating to the accounting treatment.

The following table presents the reported methods relating to the treatment of government grants related to assets:

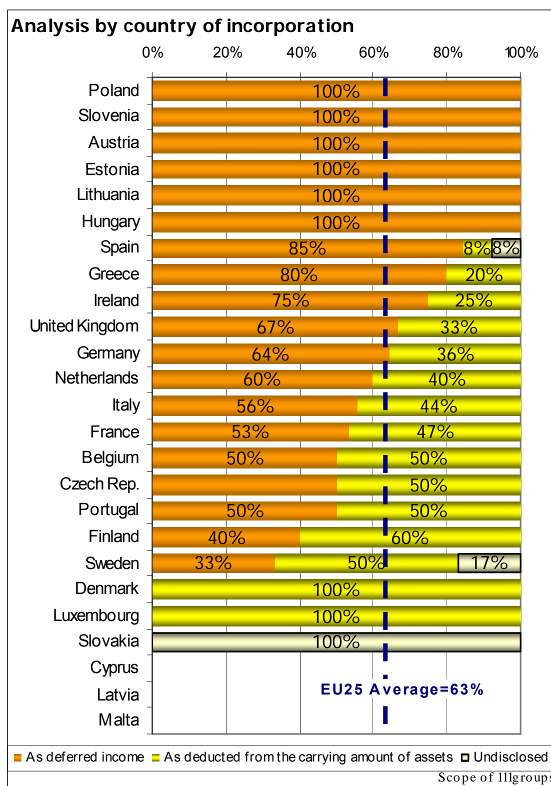
Table 136 : Accounting option regarding Government grants related to assets

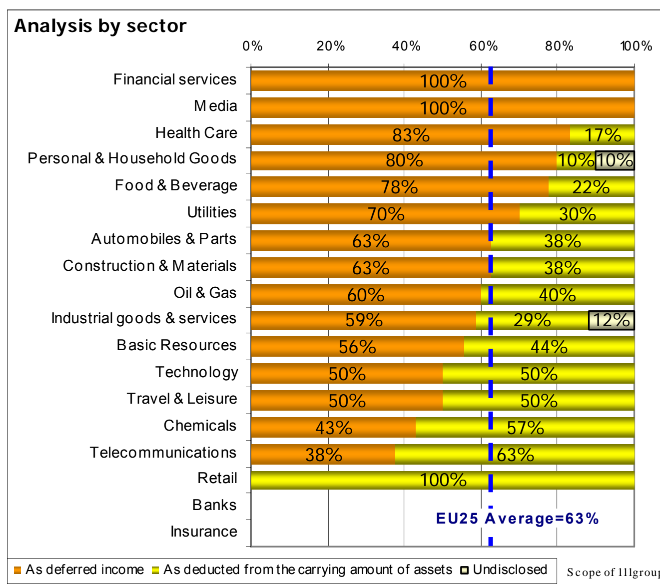
	Number of Companies	%
Recognized as deferred income	70	60%
Deducted from the carrying amount of the assets	42	36%
Option not disclosed	4	3%
Sub-total companies disclosing Government Grants related to Assets	**116**	**100%**
Sub-total companies not disclosing Government Grants related to Assets	134	
Total sample of listed companies	**250**	

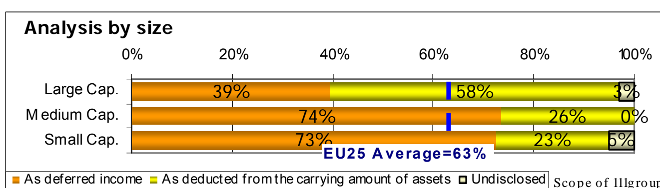
- 60 % of companies receiving grants relating to assets (70 out of 116) recognised the amount as deferred income in the balance sheet.
- 36% of companies disclosing the accounting treatment deducted government grants from the carrying amount of the assets
- 3 companies did not disclose their choice between the two options in their disclosure regarding government grants related to assets

As shown in the following table, companies included in Telecommunications and Chemicals industries tend mainly to present in the Balance Sheet governments grants as a deduction of underlying assets. Other sectors elected to recognise mainly the government grant in deferred income, excepted for the “Travel & Leisure” and “Technology” sectors for which the choice between the both options is well balanced.

Table 137 : Cross analysis by state, sector and size of accounting option regarding Government grants related to assets







A cross analysis by state of incorporation shows that companies disclosing the accounting treatment of government grants related to assets are divided into three groups:

- Countries in which companies use primarily the deferred income option such as Germany, UK, Italy, Spain, Greece.
- Countries in which companies have a balanced position towards both options: France, Italy, Belgium, Czech Republic, Portugal.
- Countries in which companies use primarily the option to deduct the grants from the carrying value of assets: Sweden, Denmark, Luxemburg.

A cross analysis by size shows that the deduction from the carrying amount of assets is preferred by large companies, while small and medium size companies opted mainly for the option to recognise grants as deferred income.

15. Environment

Key points

This section deals with environmental exposures as provisions, contingent liabilities and indemnities accrued for past or future environmental risks. Social matters, health and safety topics are not included in the review.

In addition to IAS 37 *Provisions, contingent liabilities and contingent assets*, guidance covering environmental matters is provided by IFRIC 1 *Changes in existing decommissioning, restoration and similar liabilities,* IFRIC 5 *Rights to interests arising from decommissioning, restoration and environmental funds* and IFRIC 6 *Liabilities arising from participating in a specific market – waste electrical & electronic equipment.*

The objective of IAS 37 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions and contingent liabilities and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

- Reconciliation between opening and closing balances: additions, used, reversed and unwinding of the discount [IAS 37.84]
- Description [IAS 37.85] including nature, timing, uncertainties and assumptions

IFRIC 5 and IFRIC 6 are new interpretations with an effective date for annual periods beginning on or after 1st January 2006.

The disclosure of provisions for environmental matters has been checked for the 250 listed companies:

- Provisions disclosed are heavily concentrated on two sectors: Utilities (61%) & Oil & Gas (26%)
- This topic is not really relevant for Banks, Insurance, Financial services, Retail, Media and Travel & Leisure

The quality and clarity of disclosure vary significantly:

- Some companies do not provide explanations on the type of risk exposure
- Some companies do explain the risk exposure but do not disclose assumptions used for the calculation of the amount of the provision

An analysis of companies disclosing environmental liabilities and/or contingent liabilities shows the following pattern:

- About 80% have recognized only provisions
- Only one company has registered only contingent liabilities
- The remaining companies (20%) have disclosed both provisions and contingent liabilities

15.1. Definition of the sample under review

Twelve industry sectors are relevant for the analysis of environmental provisions. Thus, companies of Banks, Insurance, Financial Services, Retail, Media and Travel & Leisure are excluded of this study being in principle not concerned by environmental issues. Within these relevant sectors, 61 companies have been selected.

15.2. Environmental issues or related subjects disclosures

54% of companies (33 out of 61) disclosed environment provisions and/or contingent liabilities.

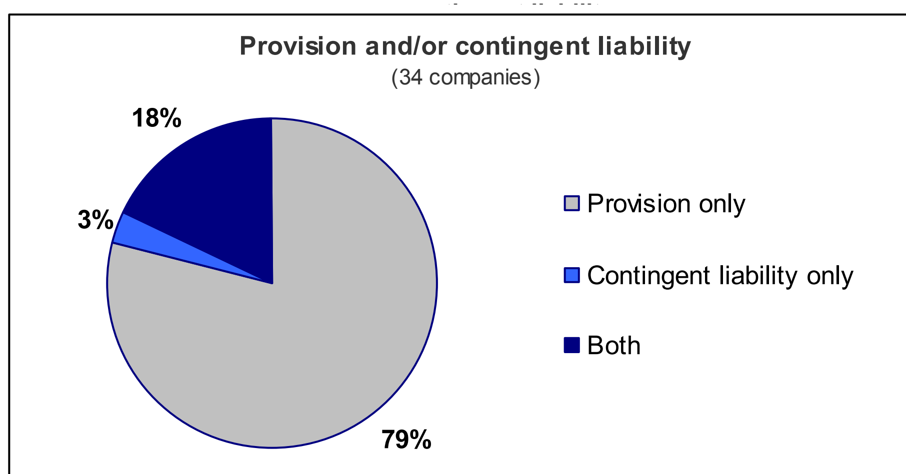
Table 138 : Cross analysis by industry sector of disclosure of environment provisions and/or contingent liabilities

Industry Sector	Number of entities	% (among each sector)
Basic resources	5	100%
Construction & Materials	4	100%
Utilities	8	100%
Chemicals	3	75%
Oil & Gas	4	67%
Health care	2	50%
Automobiles & Parts	2	50%
Industrial goods & services	2	33%
Food & Beverage	1	25%
Personal & Household goods	1	25%
Telecommunications	1	14%
Technology	0	0%
Sub-total companies disclosing environmental provisions	**33**	**54%**
Sub-total companies not disclosing environmental provisions	28	46%
Total sample of 61 listed companies	**61**	**100%**

Amongst the 33 companies disclosing environmental impacts:

- 79% recognized only provisions,
- 18% recognized both provisions and contingent liabilities,
- 3% (one company) disclosed only contingent liabilities.

Table 139 : Accounting method of environment related provision and/or



The total of provisions related to environment topics amounted to EUR 90 billion.

A cross analysis by industry sector shows that disclosed provisions are heavily concentrated on Utilities (EUR 54.5 billion) and Oil & Gas (EUR 23.7 billion) sectors.

Table 140 : Breakdown by industry sector of reported amounts of environment related provisions

Industry Sector	Total amounts (EUR Millions)	%
Utilities	54 539	61%
Oil & Gas	23 714	26%
Basic resources	7 945	9%
Industrial goods & services	1 088	1%
Chemicals	762	1%
Personal & Household goods	576	1%
Health care	462	1%
Construction & Materials	451	1%
Food & Beverage	439	0%
Automobiles & Parts	81	0%
Telecommunications	1	0%
Technology	0	0%
Total (33 companies)	**90 058**	**100%**

15.3. Detailed disclosures

The principles of the standards and interpretations are most often mentioned in the accounting policies in a dedicated paragraph relating to provisions and contingent liabilities or commitment.

In addition, companies provided a numerical analysis in the dedicated notes.

Thus, **Anglo American** [United Kingdom, Basic Resources] disclosed[132] in its accounting policies the treatment linked to Restoration, rehabilitation and environmental costs:

Restoration, rehabilitation and environmental costs
An obligation to incur restoration, rehabilitation and environmental costs arises when environmental disturbance is caused by the development or ongoing production of a mining property. Such costs arising from the decommissioning of plant and other site preparation work, discounted to their net present value, are provided for and capitalised at the start of each project, as soon as the obligation to incur such costs arises. These costs are charged against profits over the life of the operation, through the depreciation of the asset and the unwinding of the discount on the provision. Costs for restoration of subsequent site damage which is created on an ongoing basis during production are provided for at their net present values and charged against profits as extraction progresses.

Changes in the measurement of a liability relating to the decommissioning of plant or other site preparation work that result from changes in the estimated timing or amount of the cash flow, or a change in the discount rate, are added to, or deducted from, the cost of the related asset in the current period. If a decrease in the liability exceeds the carrying amount of the asset, the excess is recognised immediately in the income statement. If the asset value is increased and there is an indication that the revised carrying value is not recoverable, an impairment test is performed in accordance with the accounting policy above.

For some South African operations annual contributions are made to dedicated environmental rehabilitation trusts to fund the estimated cost of rehabilitation during and at the end of the life of the relevant mine. The Group exercises full control of these trusts and therefore the trusts are consolidated. The trusts' assets are recognised separately on the balance sheet as non-current assets at fair value. Interest earned on funds invested in the environmental rehabilitation trusts are accrued on a time proportion basis and recognised as interest income.

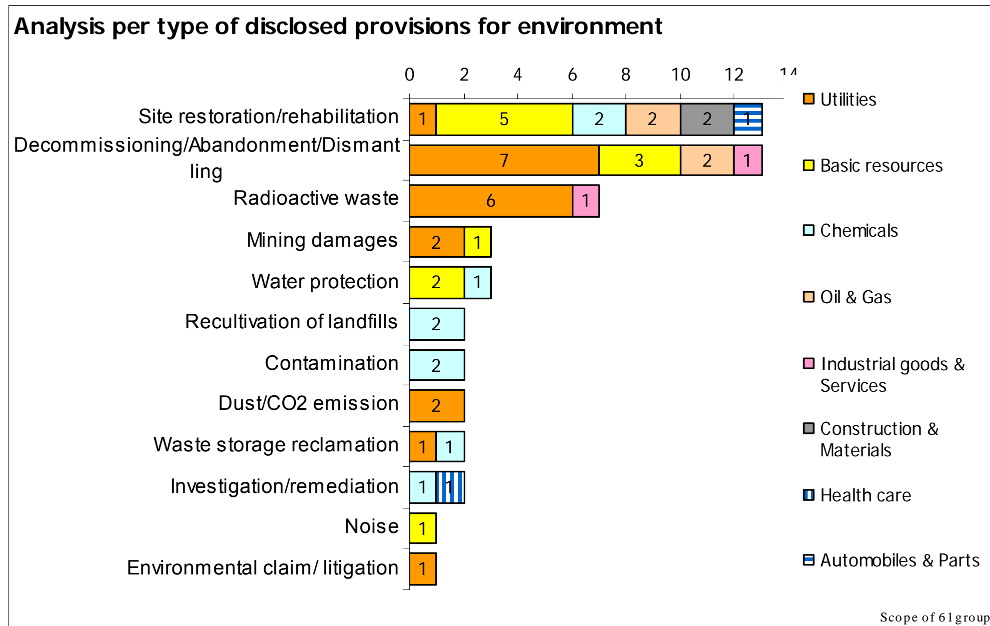
The quality and clearness of disclosure varies significantly depending on the companies and the underlying subjects.

[132] **Anglo American** [United Kingdom, Basic Resources] Annual report 2006, page 94

Table 141 : Types of disclosed provisions for environment

Type of provisions and detail by industry sector	Number of disclosures	% (contribution by sector)	% (of total disclosures)
Site restoration/rehabilitation	13		**25%**
Basic resources	5	38%	
Chemicals	2	15%	
Oil & Gas	2	15%	
Construction & Materials	2	15%	
Utilities	1	8%	
Automobiles & Parts	1	8%	
Decommissioning/Abandonment/Dismantling	13		**25%**
Utilities	7	54%	
Basic resources	3	23%	
Oil & Gas	2	15%	
Industrial goods & services	1	8%	
Radioactive waste	7		**14%**
Utilities	6	86%	
Industrial goods & services	1	14%	
Mining damages	3		**6%**
Utilities	2	67%	
Basic resources	1	33%	
Water protection	3		**6%**
Basic resources	2	67%	
Chemicals	1	33%	
Recultivation of landfills	2		**4%**
Chemicals	2	100%	
Contamination	2		**4%**
Chemicals	2	100%	
Dust/CO2 emission	2		**4%**
Utilities	2	100%	
Waste storage reclamation	2		**4%**
Utilities	1	50%	
Chemicals	1	50%	
Investigation/remediation	2		**4%**
Chemicals	1	50%	
Health care	1	50%	
Noise	1		**2%**
Basic resources	1	100%	
Environmental claim/litigation	1		**2%**
Utilities	1	100%	
Total	**51**	**100%**	**100%**
Utilities	20	39%	
Basic resources	12	24%	
Chemicals	9	18%	
Oil & Gas	4	8%	
Construction & Materials	2	4%	
Industrial goods & services	2	4%	
Automobiles & Parts	1	2%	
Health Care	1	2%	

Table 142 : Types of disclosed provisions for environment



The most mentioned types of disclosed provisions for environment are:

- 13 related to Site restoration/ rehabilitation
- 13 related to Decommissioning/ Abandonment/ Dismantling costs
- 7 related to Radioactive waste
- 3 related to Water protection
- 3 related to Mining damages
- 12 miscellaneous topics relating mainly to Diverse contamination (soil pollution, noise, dust or CO^2 emission, chemical contamination or mining damages)

Arcelor [Luxemburg, Basic Resources] states[133] its environmental risks in the "Other provisions" note:

20.3 – Environmental risks

Provisions for environmental risks, analysed by geographic zones, are as follows:

In EUR million	2006	2005
Belgium	108	100
France	66	68
Luxembourg	67	53
Canada	31	-
Other	5	7
TOTAL	**277**	**228**

The provisions cover the anticipated costs relating to both protection and remediation of soil, ground water and surface water (2006: EUR 184 million; 2005: EUR 135 million), waste management (2006: EUR 35 million; 2005: EUR 35 million) and other environmental measurements (2006: EUR 58 million, 2005: EUR 58 million). The provisions are calculated in accordance with local and national legal standards and regulations.

[133] **Arcelor** [Luxemburg, Basic Resources] Annual report 2006, page 96

Xstrata [United Kingdom, Basic resources] specifies[134] the issue related to the environmental provision:

Rehabilitation costs

Rehabilitation provision represents the estimated costs required to provide adequate restoration and rehabilitation upon the completion of mining activities. These amounts will reverse when such rehabilitation has been performed. These costs are expected to be incurred over the next 24 years (2005: 16 years) (refer to note 24).

In ten cases, presentation of provisions relating to environment is blurred and did not provide a detailed list of topics.

The variance in disclosure quality and clearness shows no pattern linked to country, sector or company.

Even though provisions or contingent liabilities were not recognized in the financial statements, companies commented a lot about an environmental attitude in the management report and presented some environmental expenditure/ investment and studies made for the purpose of ecological efficiency and protection.

[134] **Xstrata** [United Kingdom, Basic Resources] Annual report 2006, page 221

16. Concession Services

Key points

Service concessions are arrangements whereby a government or other public sector entity as the grantor grants contracts for the supply of public services – such as roads, airports, prisons and energy and water supply and distribution facilities – to private sector entities as operators.

Previous standards on Property Plant and Equipment or Leases did not address specifically these types of arrangements. As a result, IFRIC 12 “Service Concession Arrangements” was issued in November 2006, which addresses how service concession operators should apply existing IFRS to account for the obligations they undertake and rights they receive in service concession arrangements. The provisions of IFRIC 12 are effective for annual periods beginning on or after January 1st, 2008. Early application is permitted, even though at the time of writing this report, IFRIC 12 has not been endorsed by the European Union yet.

The specific sample reviewed for this topic comprised 15 entities, of which:

- 33% early applied IFRIC 12 for their 2006 financial statements,
- 33% still apply in 2006 an accounting treatment (tangible asset) that is not consistent with those defined in IFRIC 12 (intangible asset and/or financial asset),
- The remainder 33% apply an accounting treatment close to IFRIC 12, but do not disclose the potential amount of the impacts of its application.

Of the entities that still apply in 2006 an accounting treatment not consistent with those defined in IFRIC 12:

- A major concession operator (EDF – France) foresees that its concession assets are out of the scope of IFRIC 12, when endorsed by EU.
- another one (Atlantia Autostrade – Italy) discloses that the transformation of the grantor into a public limited company sets its concession assets out of the scope of IFRIC 12, which excludes private-to-private concessions.

As a consequence, IFRIC 12 may not lead to the harmonization of accounting treatments of public-to-private concessions across Europe.

Furthermore, even if 10 entities (66%) out of the 15 companies from our specific sample disclose an accounting treatment on the asset side consistent with those defined in IFRIC 12, the interpretation may have an impact on the accounting treatment on the liability side (provisions for repair or renewal) for non early-appliers.

16.1. Definition of the sample under review

9 companies in our sample of 250 listed entities disclose the existence of service concessions. In order to enhance the analysis and for follow-up reasons, the review has been extended to 6 additional companies, bringing to total number of companies under study to 15:

- Five companies that had been surveyed in the IFRS Study 2005 for follow-up purposes
  - **Acea** [Italy]
  - **Bouygues** [France]
  - **Brisa** [Portugal]
  - **Gas Natural** [Spain]
  - **Gaz de France** [France]

- A major player in the industry, **Veolia** [France]

13 companies out of 15 are located either in France (6 companies), Spain (4 companies), Italy (3 companies), pointing out the tradition of State intervention in Utilities in these countries.

Table 143 : Reported amounts of net book value of Concessions

Entity	Country	Net book value of concession assets (EUR Millions)	Accounting treatment used - Asset side	Early application of IFRIC 12
Electricité de France	France	66 960	PPE	No
Vinci	France	24 689	Intangible asset	No
Cintra Concesiones	Spain	9 579	Intangible asset / Separate non-current asset	No
Abertis Infraestructuras	Spain	8 327	PPE	No
Atlantia (Autostrade)	Italy	7 538	PPE	No
Gaz de France	France	5 704	Intangible asset	Yes
Brisa	Portugal	3 048	PPE	No
Véolia	France	2 346	Intangible asset / Financial asset	Yes
ENEL	Italy	2 214	PPE	No
Suez	France	2 135	Intangible asset	Yes
Gas Natural	Spain	841	Intangible asset	No
RWE	Germany	605	Intangible asset	No
Acea	Italy	288	Intangible asset	No
CAF	Spain	97	Intangible asset	Yes
Bouygues	France	56	Financial asset	Yes

16.2. Accounting treatment of concession services

Before the issuance of IFRIC 12, the accounting treatments mostly used was either the booking of a tangible asset or intangible assets, both against rights of grantor on the liability side.

IFRIC 12 requires that depending on the consideration the operator receives from the grantor, the operator recognizes a financial or an intangible asset:

- Financial asset model: a financial asset is recognized if the operator has an unconditional contractual right to receive cash or another financial asset from the grantor in return for constructing or upgrading the public sector asset.
- Intangible asset model: if the consideration the operator receives from the grantor is a right to charge users, an intangible asset is recognized.
- Mixture of both models (bifurcation): depending on the contractual arrangements, recognition of both a financial and an intangible asset is possible as well.

In the 2006 financial statements Concessions were accounted for under a variety of methods:

- 53% of companies (8 out of 15) accounted for concession services under the “intangible asset model”,
- 33% of companies (5 out of 15) as tangible assets (PPE). These companies which booked concession services in the tangible asset caption against rights of grantor on the liability side have not yet applied IFRIC 12,
- 7% (1 company **Bouygues** [France], an early applier of IFRIC 12) as financial assets,

- 7% (1 company, **Veolia** [France] an early applier of IFRIC 12) as a mixture of financial & intangible assets (bifurcation model).

For all the entities under review, amortization / depreciation on concession assets, either under the intangible asset model or in the tangible asset treatment, is calculated over the shorter of the term of the concession and the remaining useful life of the assets.

16.3. Early application of IFRIC 12

5 companies out of 15 (33%) early applied IFRIC 12 in their 2006 financial statements, 4 of them didn't require a change of accounting method.

Table 144 : Early appliers of IFRIC 12 and disclosure relating to the estimated impact

Entity	Country	Early application of IFRIC 12	Change of accounting method	Description of forthcoming impacts
Electricité de France	France	No		No
Vinci	France	No		Yes
Cintra Concesiones	Spain	No		No
Abertis Infraestructuras	Spain	No		No
Atlantia (Autostrade)	Italy	No		Yes
Gaz de France	France	**Yes**	Yes	
Brisa	Portugal	No		No
Véolia	France	**Yes**	No	
ENEL	Italy	No		No
Suez	France	**Yes**	No	
Gas Natural	Spain	No		No
RWE	Germany	No		No
Acea	Italy	No		No
CAF	Spain	**Yes**	No	
Bouygues	France	**Yes**	No	

Suez [France, Utilities] for example was already applying IFRIC exposure drafts D12, D13 and D14 in its 2005 financial statements.

Only **Gaz de France** [France] has had to change[135] its accounting policies to comply with the requirements of IFRIC 12. In its accounting policies, the company specifies that the application of IFRIC 12 lead to recognize additional revenue on the exchange of assets and change the method of accounting for replacement costs

concession agreements fall outside the scope of IFRIC 12.

1/ Reminder: accounting policies applied for the preparation of the 2005 financial statements under IFRS

Three draft interpretations released by the IFRIC for comment (D12, D13 and D14) had not been completed at the end of 2005, and Gaz de France therefore decided to account for its service concession agreements in the 2005 financial statements under IFRS based on the consequences of their terms and conditions, including:

- The obligation to return the concession assets to the grantor at the end of the concession without compensation.
- The obligation to maintain the infrastructure to a specified level of serviceability throughout the concession.

This decision led to certain changes compared with the accounting treatment of these agreements under French GAAP. In particular:

- The concession assets and the liability corresponding to the obligation to return the assets to the grantor at the end of the concession continued to be recognized in the balance sheet.
- The concession assets were reported on a separate line of the balance sheet, between intangible assets and property, plant and equipment.
- The provision for replacement costs was discounted in accordance with IAS 37.

2/ Effects of applying IFRIC 12

The effects of applying IFRIC 12 are as follows:

- Effects on the presentation of the financial statements:
  - Concession assets and the related liability have been netted off, and

Change in the method of accounting for replacement costs.

A provision is recorded to cover the cost of replacement of assets, in accordance with IAS 37.

Prior to adopting IFRIC 12, these costs were qualified as capital expenditure and included in cash flows from investing activities in the cash flow statement, then recognized in the balance sheet under "Concession assets" once the work had been completed, meanwhile a corresponding amount from the provision for replacement was released through balance sheet.

IFRIC 12 states that replacement costs should not be added to the intangible asset recognized by the operator. As a result, these costs are no longer recognized in the Group's balance sheet.

Instead, they are recognized in operating expenses and are offset by the release of a corresponding amount from the provision for replacement.

2.1.2 IFRIC 4 – Determining whether an Arrangement Contains a Lease

This interpretation deals with the method of identifying and recognizing service, purchase and sale contracts that do not take the legal form of a lease but convey a right to use an asset in return for a payment or series of payments. The lease element may constitute an operating lease or a finance lease. If a contract is assessed as containing a finance lease where the Group is lessor, a finance receivable should be recorded to reflect the financing provided to the customer.

IFRIC 4 applies to one of Gaz de France's contracts with an industrial customer, which provides for the operation by the Group of dedicated assets.

Application of IFRIC 4 led to the reclassification from "Property, plant and equipment" to "Other non-current assets" (long-term receivables) of 196 million euros at December 31, 2006, 233 million euros at December 31, 2005 and 200 million euros at December 31, 2004. The impact on equity and profit was not material.

As for the 10 companies out of 15 which did not early apply IFRIC12 in their 2006 financial statements:

- 2 companies, **Vinci** [France, Construction & Materials] and **Atlantia Autostrade** [Italy, Industrial goods & services] described the forthcoming impacts in their 2006 financial statements, without providing however an estimation of likely impacts
  - **Vinci** [France, Construction & Materials] specifies[136] that the application of IFRIC 11 will lead to the adaptation of the accounting rules and procedures applicable to concession contracts, in particular as regards the accounting treatment of provisions for major repairs:

[135] **Gaz de France** [France]

[136] **Vinci** [France, Construction & Materials] Annual report 2006, page 186

VINCI has not elected for early application of this Interpretation, which is in the course of endorsement by the European Union. The application of IFRIC 12 by VINCI will require the accounting rules and procedures applicable to concession contracts to be adapted, in particular as regards the accounting treatment of provisions for major repairs.

- **Atlantia Autostrade** [Italia, Industrial goods & services] declared[137] that the application of IFRIC 12 should lead to account for concession services under the "Intangible asset" model.

Prior to the end of 2006, there was no specific IFRS addressing the accounting treatment of concession services. In December 2006, the IFRIC (International Financial Reporting Interpretation Committee) released IFRIC 12 interpreting the accounting treatment for assets (to be relinquished), liabilities (provisions for repair and replacement) and revenues and costs relating to concessions granted by government or other public bodies to private operators for the provision of services, while excluding private-to-private concessions. In a comment of 28 February 2007 issued by the Italian accounting standards setter (Organismo Italiano di Contabilità or "OIC") and addressed to EFRAG, OIC observed that the transformation of ANAS (the grantor) into a public limited company (SpA), meant that ANAS had taken on the legal form of a private company and, therefore, Italian concessions granted by ANAS (and, consequently, those granted to the Group) should be outside the scope of IFRIC 12.
Once approved by the European Commission, IFRIC 12 will be mandatory for annual periods beginning on or after 1 January 2008. Very briefly stated, the interpretation suggests two accounting treatments: the "intangible asset model" and the "financial asset model". Initial analyses show that if the interpretation is adopted, the Autostrade Group should apply the intangible asset model which primarily entails recognition of assets to be relinquished as intangible assets to be amortised over the concession period. Autostrade Group has commenced a study coordinated by AISCAT into the applicability of the interpretation and the potential impact on concession company financial statements as a result of adopting the interpretation. Given the uncertainty regarding the scope of the interpretation and the time needed to conduct the study, the interpretation has been ignored for the purposes of preparing these financial statements.

- 7 companies mentioned that the potential impacts in their financial statements were in the process of being assessed
- 1 company, Enel [Italy, Utilities] did not mention IFRIC 12.

We looked at 2007 financial statements already published to determine whether new information was available to estimate the future accounting treatment of concessions by these groups.

In addition to disclosures made for 2006 financial year we found two companies which have described in their 2007 financial statements the forthcoming impact of IFRIC 12 :

- **Cintra Concesiones** [Spain, Industrial goods & services] declared that concession contracts are accounted for in a similar manner as IFRIC 12.
- **Electricité de France** [France, Utilities], the largest European player in the industry considers[138] its concession assets to be out of the scope of IFRIC 12, because it was estimated that the grantor in most of the Group's concessions does not control (based on IFRIC definition) the assets.

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[137] **Atlantia Autostrade** [Italia, Industrial goods & services] Annual report 2006, page 167

[138] **Electricité de France** [France, Utilities] pages 234, 235

3.1 IFRIC 12

The IFRIC issued interpretation IFRIC 12, "Service Concession Arrangements", in November 2006. Subject to completion of the endorsement process by the European Commission, application of this interpretation will be mandatory in the EU for financial years beginning on or after January 1, 2008. EDF has not opted for early application.

Nevertheless, a full review of the concession agreements concerning each of the Group's French and foreign entities was instigated in late 2006 and continued into 2007, to determine the treatment applicable in the light of interpretation IFRIC 12.

This treatment depends on whether the grantor has control, as defined by IFRIC 12, over the infrastructures and services during the concession:

- If the grantor controls the infrastructures and services, the concession falls into the scope of IFRIC 12 and the associated infrastructures are recorded in the operator's accounts as either an intangible asset or a financial asset;
- Otherwise, the concession is not governed by IFRIC 12 and the infrastructure is accounted for under the IFRS applicable.

Analysis of the control exercised by the grantor involves examining, for each contract, the type of infrastructure concerned (electricity generation, transmission or distribution) but also the legal aspects (the respective rights and obligations of the grantor and operator as defined in the agreements) and business environments (particularly tariffs and regulations), both in and outside France.

Based on this analysis, further to the changes in presentation introduced in 2007 (see note 2.11), the Group considers that IFRIC 12, when applicable, will have only a limited impact on its balance sheet and income statement.
This concerns the following items:

3.1.1 Public electricity distribution concessions in France

For these concessions agreements, the analysis took into consideration legal and contractual specificities as described in note 3.2.1.
It also took into consideration the fact that EDF, which holds more than 95% of French public electricity distribution concessions, plays a major role in the French distribution model through supra-concession operator assignments reaffirmed by law (French Law of February 10, 2000, amended by the Law of August 9, 2004).

The Group considers in this context that in substance, there are no determinant factors indicating that the grantors have control over the infrastructures as defined by IFRIC 12.

3.1.2 All other concession agreements

For concessions other than French public electricity distribution concessions, the Group notes that the grantors do not have control over the infrastructures as defined by IFRIC 12:

- In France, for each of the major categories of concession: hydropower generation and transmission networks;
- In the United Kingdom, for EDF Energy's electricity networks;
- In other countries (Hungary, Slovakia) for all other significant concession agreements.

The Group is awaiting finalization of the positions regarding EnBW's distribution networks in Germany, and Edison's gas distribution networks in Italy.

		2006	2007	2007
Company	**Country**	**Description of forthcoming impacts**	**Description of forthcoming impacts**	**Comments**
Electricité de France	France	No	Yes	Concession assets out of the scope of IFRIC 12
Vinci	France	Yes	Yes	No change compared to 2006 disclosure
Cintra Concesiones	Spain	No	Yes	Contracts recognised in a similar manner as IFRIC 12
Abertis Infraestructuras	Spain	No	No	The Group is analysing the impacts of its application
Atlantia (Autostrade)	Italy	Yes	Yes	No change compared to 2006 disclosure
Brisa	Portugal	No	No	The impact cannot be determined at this time
ENEL	Italy	No	No	The Group is assessing the impact of the adoption of IFRIC 12
Gas Natural	Spain	No	No	No change compared to 2006 disclosure
RWE	Germany	No	No	The impact of IFRIC 12 is currently being reviewed
Acea	Italy	No	No	No change compared to 2006 disclosure

17. Extractive industry

Key points

IFRS 6 *Exploration for and Evaluation of mineral resources* marks only the initial phase of the IASB's project on extractive activities, pending a comprehensive review of all the relevant issues. The IASB project team currently estimates that a discussion paper will be published in late 2008. IFRS 6 applies to accounting periods beginning on or after January 1st, 2006.

IFRS 6 *Exploration for and Evaluation of mineral resources* enables a company to develop an accounting policy for exploration and evaluation assets without specifically considering the requirements 11 and 12 of IAS 8. Thus, an entity adopting IFRS 6 may continue to use the accounting policies applied immediately before adopting IFRS, provided that they result in information that is relevant to the economic decision-making needs of users and that is reliable

The analysis of our specific sample, composed of 14 entities, shows that the successful efforts accounting method is currently predominant:

- 85% of the entities within the specific sample capitalize costs, and all of these entities use this accounting method. No entity in our specific sample uses the full cost method.
- The remainder 15% book their exploration and evaluation costs either as an expense or they capitalize them and then fully amortize them.

The information disclosed in the notes to the financial statements of the companies is consistent with the requirements of IFRS 6, but is not homogeneous within the sample when dealing with the treatment of suspended wells (nor dry neither positive). This may lead to some discrepancy in the timing when the suspended wells are charged to expense.

17.1. Definition of the sample under review

Out of the sample of 250 listed entities, companies belonging to the three relevant industry sectors (Basic Resources, Oil & Gas and Utilities) have been reviewed to determine whether they disclose information relating to exploration and evaluation costs.

The following table summarize for each targeted sector, the existence or not of exploration and evaluation costs:

Table 145 : Disclosure of exploration and evaluation costs

Industry Sector	Disclosure of exploration and evaluation costs				Total	
	Yes	%	No	%	Number of Companies	%
Basic Resources	4	36%	7	64%	11	100%
Oil & Gas	5	45%	6	55%	11	100%
Utilities	5	33%	10	67%	15	100%
Total	**14**	38%	**23**	62%	**37**	**100%**

Amongst the 37 companies belonging to the above mentioned sectors, 14 of them disclosed information relating to exploration and evaluation costs for a total value amounting to EUR 6.6 billions.

The financial statements of the 14 companies which disclose the existence of exploration and evaluation costs have been further studied focusing on:

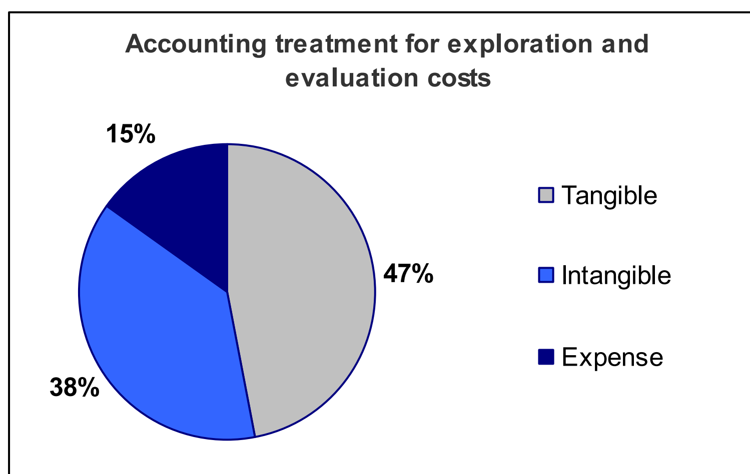
- the accounting and classification methods for exploration and evaluation costs
- The existence of disclosures required by IFRS 6.

17.2. Accounting methods and classification of exploration and evaluation costs

The accounting treatments for exploration and evaluation costs used by the 14 entities studied is the following:

- 11 entities booked their exploration costs as an asset (intangible or tangible) in part. The other part of exploration costs is booked as an expense (successful effort method).
- 3 entities booked all their exploration costs as an expense
  - **Anglo American** [United Kingdom, Basic Resources] disclosed that *"exploration expenditures is written off in the year in which it is incurred"*
  - **CEZ** [Czech Republic, Utilities] disclosed that *"expenditures on exploration are charged to expense when incurred"*
  - **ENI** [Italy, Oil & Gas] disclosed that *"costs associated with exploratory activities for oil & gas are capitalized and amortized in full when incurred"*

Table 146 : Distribution of accounting treatment for exploration and evaluation costs



17.2.1. Cost Capitalisation

According to the successful effort accounting method, costs of successful projects (i.e. that lead directly to the discovery of reserves) are capitalised, while costs of unsuccessful projects are charged immediately to expense. Capitalised costs applicable to subsequent production are amortised based on the amount of reserves.

According to the full cost accounting method, all costs incurred in searching for, acquiring, and developing reserves in a cost centre/area such as a country or continent are capitalised, irrespective of whether an individual project was or was not successful. The overall capitalised cost is then amortised against the reserves in that cost centre/area.

All the entities that capitalized their exploration costs disclosed that they used the successful effort method. No entity included in the sample under review used the full cost accounting method.

17.3. Existence of disclosures required by IFRS 6

According to IFRS 6, a company should make the following disclosures:

- information that identifies and explains the amounts recognised in its financial statements arising from the exploration for and the evaluation of mineral resources
- its accounting policies for exploration and evaluation expenditures including the recognition of exploration and evaluation assets
- the amounts of assets, liabilities, income and expense and operating and investing cash flows arising from the exploration for and evaluation of mineral resources
- information required by either IAS 16 or IAS 38 consistent with how the assets are classified

The information disclosed by the entities that we have reviewed is consistent with the requirements of IFRS 6 as set out above.

For example, **Rio Tinto** [United Kingdom, Basic Resources] provided all the required disclosures as well as a reconciliation of the cash effect of exploration and evaluation costs with the capitalized amount and the expensed amount:

- the accounting treatment is clearly stated in the accounting policies
- the disclosure of the amounts booked in its financial statements generated by the exploration and evaluation of mineral resources is presented:
  - on the face of the cash-flow statement
  - in the detailed disclosure of the net operating costs booked in the profit and loss
  - in the statement of change in intangible assets
  - through a reconciliation of the cash effect with the amount capitalized and the amount charged for the year

Exploration and evaluation expenditure

The charge for the year and the net amount of intangible assets capitalised during the year are as follows:

	2006 US$m	2005 US$m
Cash expenditure in year (net of proceeds on disposal of undeveloped properties)	**345**	264
Changes in accruals (including non cash proceeds on disposal of undeveloped properties)	**(36)**	24
Amount capitalised during year	**(72)**	(38)
Charge for year	**237**	250

The only exception to this overall compliance is the information disclosed on suspended wells which is not homogeneous between all the companies, as noted in an IFRS study on the 2006 financial statements performed by E&Y.

The main actors, **BP** [United Kingdom], **Shell** [United Kingdom, Oil & Gas] and **Total** [France, Oil & Gas] representing 81% of the capitalized costs of the sample, disclosed their accounting methods regarding the suspended wells treatment as follows:

Exploration expenditure
Geological and geophysical exploration costs are charged against income as incurred. Costs directly associated with an exploration well are capitalized as an intangible asset until the drilling of the well is complete and the results have been evaluated. These costs include employee remuneration, materials and fuel used, rig costs, delay rentals and payments made to contractors. If hydrocarbons are not found, the exploration expenditure is written off as a dry hole. If hydrocarbons are found and, subject to further appraisal activity, which may include the drilling of further wells (exploration or exploratory-type stratigraphic test wells), are likely to be capable of commercial development, the costs continue to be carried as an asset. All such carried costs are subject to technical, commercial and management review at least once a year to confirm the continued intent to develop or otherwise extract value from the discovery. When this is no longer the case, the costs are written off. When proved reserves of oil and natural gas are determined and development is sanctioned, the relevant expenditure is transferred to property, plant and equipment.

Shell [United Kingdom, Oil & Gas] displays[139] :

EXPLORATION COSTS
Shell Group companies follow the successful efforts method of accounting for oil and natural gas exploration costs. Exploration costs are charged to income when incurred, except that exploratory drilling costs are included in property, plant and equipment, pending determination of proved reserves. Exploration wells that are more than 12 months old are expensed unless (a) proved reserves are booked, or (b) (i) they have found commercially producible quantities of reserves, and (ii) they are subject to further exploration or appraisal activity in that either drilling of additional exploratory wells is under way or firmly planned for the near future or other activities are being undertaken to sufficiently progress the assessing of reserves and the economic and operating viability of the project.

Total [France, Oil & Gas] presents[140] :

- costs of exploratory wells are temporarily capitalized until a determination is made as to whether the well has found proved reserves if both of the following conditions are met:

  – the well has found a sufficient quantity of reserves to justify its completion as a producing well, if appropriate, assuming that the required capital expenditures are made;

  – the Group is making sufficient progress assessing the reserves and the economic and operating viability of the project. This progress is evaluated on the basis of indicators such as whether additional exploratory works are under way or firmly planned (wells, seismic or significant studies), whether costs are being incurred for development studies and whether the Group is waiting for governmental or other third-party authorization of a proposed project, or availability of capacity on an existing transport or processing facility.

[139] **Shell** [United Kingdom, Oil & Gas] Annual report 2006, page 109

[140] Total [France, Oil & Gas] Registration document 2006, page 175

18. Insurance contracts

Key points

Our analysis is related to 10 insurance groups (5 large groups, 4 medium-sized groups, 1 small group) involved in the life and non-life insurance business. For Insurance companies, the main impacts of the adoption of IFRSs result from IFRS 4, *Insurance contracts*. We have found that the main provisions of this standard are correctly applied by the 9 large and medium-sized groups in our sample.

One of the main purposes of IFRS 4 is to better define insurance contracts and to differentiate them from investment contracts. In last year's survey, the ICAEW had noticed that this led to the reclassification of many life assurance contracts as investment contracts under IAS 39 because they did not contain significant insurance risk. Eight large and medium-sized groups (or 80 % of the sample) disclose the difference between insurance contracts and investment contracts or explain how they have classified their contracts according to the definition of investment contracts.

The option, offered by IAS 39, *Financial instruments: recognition and measurement*, to designate certain assets or certain liabilities at fair value through profit or loss is used by 8 out 10 groups in our sample. The primary reason for using the fair value option is to avoid an accounting mismatch in life insurance; 7 of these 8 groups explicitly disclose it, one leaves it to users to understand this fact.

We have observed that an industry practice seems to be developing as to the presentation of unit-linked investment contracts on the balance sheet. Presentation under a separate caption such as "Financial liabilities for unit-linked contracts" next to insurance reserves is gaining in importance.

Insurers are required to perform liability adequacy tests in order to check that their insurance liabilities are adequate. IFRS 4 mandates that any inadequacy be charged to the income statement. All 9 large and medium-sized groups of our sample did comply with the requirement. No overall inadequacy has been reported. One group reports an inadequacy in a foreign operation and explains how the situation is dealt with under the group's policies by a surplus in other regions.

IFRS 4 allows that insurance liabilities be measured on an undiscounted basis. It permits an insurer to change its accounting policy from an undiscounted to a discounted basis; it prohibits the reverse change. Nine groups, or 90 % of the sample, disclose that life insurance liabilities are measured on a discounted basis (as they were pre-IFRS). The same 9 groups disclose or allow users to understand that non-life insurance liabilities are measured on an undiscounted basis except for certain long-term commitments (asbestos, environment, disability)

The treatment of acquisition costs, not addressed by IFRS 4, remains inconsistent. Four groups, or 40 % of the sample, present deferred acquisition costs "DAC" as an asset under a separate heading; 4 groups (40 % of the sample) present DAC as an asset within "other assets" ; 2 groups (20 % of the sample) present DAC as a deduction from their mathematical or technical reserves.

Diversity also prevails as to the presentation of reinsurance costs on the income statement; however one solution appears to be the most frequent practice. Eight groups (80 % of the sample) present reinsurance costs as a deduction from gross premiums whilst 2 groups (20 % of the sample) present these costs as an expense after gross premiums earned.

Under IFRS 4, insurers are permitted but not required to apply "shadow accounting"; six groups (60 % of the sample) have been found to do so.

The option offered by IFRS 4.24 to re-measure certain insurance liabilities at current market rates and assumptions is not so widely used. One only group (or 10 % of the sample) has been found to use this option.

Though the standard requires that insurers perform impairment tests on reinsurance assets, most groups do not disclose their policy in this respect. Two groups only (or 20 % of the sample) disclose a policy on testing reinsurance assets for impairment.

IFRS 4 has specific requirements on risk disclosures. In particular, insurers must present loss reserves development tables at least for their non-life activities. All groups that are concerned comply with this requirement.

Disclosures on concentrations of insurance risk are provided by all large and medium-sized groups of our sample, either in the notes or in a specific section of the management discussion and analysis. All these groups disclose how they mitigate insurance risk; reinsurance is the primary technique they use.

Though it is not an IFRS requirement, two groups (or 20 % of the sample) provide a full embedded value disclosure; another one mentions that it will publish the embedded value of its portfolio at a later date. Several other groups indicate they use this indicator for the management of their performance and for risk management purposes.

Our overall conclusion is that IFRS 4 is well applied by the insurance groups in the sample. We assume that significant discrepancies, other than those discussed in this survey, most likely remain between the financial statements of the groups included in the sample. This assumption is made in relation with the fact that the accounting treatment for insurance contracts, in particular the measurement of insurance liabilities, is not yet addressed by IFRSs. However, based on an analysis of disclosures, it is impossible to identify the detailed nature and effect of those discrepancies. Real harmonization of European Insurance companies reporting practices will hopefully come with the future standard on Insurance contracts.

18.1. Definition of the sample under review

The sample as set out in the following table includes 10 listed insurance groups of which 5 major players in the industry, 3 medium size groups and 2 small size entities. Our sample of non-listed entities does not include any insurance company.

Table 147 : Sample for detailed analysis of Insurance contracts

Company	Country	Market Capitalisation (EUR millions)	Total assets (EUR millions)	Liabilities arising from insurance and investment contracts (EUR millions)	% of total assets
ING	Netherlands	74 022	1 226 307	268 683	22%
Allianz	Germany	66 696	1 053 226	415 025	39%
AXA	France	63 944	727 555	560 443	77%
Generali	Italy	42 409	377 641	312 325	83%
Munich Re	Germany	29 653	215 874	160 371	74%
Alleanza Assicurazioni	Italy	8 553	62 007	48 919	79%
Unipol Assicurazioni	Italy	3 985	41 650	27 059	65%
Wiener Stäedtische	Austria	5 583	22 483	16 867	75%
Foyer	Luxemburg	468	2 842	2 166	76%
Cosmos Insurance	Cyprus	8	23	11	50%
Total of sample of 10 companies		**295 321**	**3 729 607**	**1 811 869**	**49%**

Amongst these insurance companies, **Allianz** [Germany, Insurance] and **ING** [Netherlands, Insurance] have also a large non-insurance activity. **Munich Re** [Germany, Insurance] and **Allianz** [Germany, Insurance] presented IFRS financial statements prior to 2005.

18.2. Disclosure of the definition of an insurance contract and related classification

IFRS 4 defines an insurance contract as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder. IFRS 4 applies to insurance contracts (subject to some exceptions) and to investment contracts with discretionary participation features.

IFRS 4 *Insurance Contracts* allows insurers to maintain their pre-IFRS accounting policies for insurance contracts, provided that certain minimum requirements defined by the standard are complied with. Additionally, IFRS 4 permits insurers not to change their accounting policies for investment contracts that include discretionary participation features. Thus, issuers of insurance contracts and investment contracts with discretionary participation features may continue to recognize premiums written as revenue and corresponding increases in liabilities. On the contrary, investment contracts without discretionary participation features are accounted for under IAS 39 *Financial Instruments: Recognition and Measurement.*

In addition, specific methodologies for the measurement of insurance provisions may differ between business units or subsidiaries within a same group as they may reflect local regulatory requirements and local practices. For the sample of our survey, this implies that around 45% of their cumulative balance sheet total are not yet governed by IFRSs as far as accounting and measurement are concerned (this proportion increases to 78 % when **Allianz** [Germany] and **ING** [Netherlands] which both have large non-insurance activities are not taken into account).

The main impacts resulting from the adoption of IFRS on the financial statements of insurance companies stem from the classification of contracts. In the IFRS study 2005, the ICAEW had noticed that IFRS 4 had led to the reclassification of many life assurance contracts as investment contracts under IAS 39 because they did not contain significant insurance risk.

Out of 10 companies, 8 either disclosed the difference between insurance contracts and investment contracts together with its implications for the accounting treatment or, alternatively, explained the classification of their products along this line.

Table 148 : Disclosure of the difference between insurance contracts and investment contracts

Company	Yes	No
ING	x	
Allianz	x	
AXA	x	
Generali	x	
Munich Re		x
Alleanza Assicurazioni	x	
Unipol Assicurazioni	x	
Wiener Städtische	x	
Foyer	x	
Cosmos Insurance		x
Total	**8**	**2**

18.3. Fair Value option

Under IAS39, the Fair Value option (FVO) allows an entity to designate a financial instrument -that would otherwise be measured either at amortised cost or at fair value through equity -or at fair value through profit or loss. An amendment to IAS 39, which became effective for annual periods beginning on 1 January 2006 or after, restricts the fair value option to 3 specific circumstances:

- it eliminates, or significantly reduces, an “accounting mismatch”
- it reconciles the accounting treatment of “group of financial assets or financial liabilities managed on a Fair Value basis” with their treatment under internal management and monitoring policies ; or
- the instrument contains one or more separable embedded derivatives

Out of 10 companies, 8 used the Fair Value option; this particularly high proportion is likely explained by the fact that all insurers in our sample have life insurance activities. All these groups indicated that the restriction brought in 2006 to the designation of financial assets or liabilities as at Fair Value through profit or loss has had no impact for them.

Table 149 : Use of the Fair Value option

Company	Yes	No
ING	x	
Allianz	x	
AXA	x	
Generali	x	
Munich Re		x
Alleanza Assicurazioni	x	
Unipol Assicurazioni	x	
Wiener Städtische	x	
Foyer	x	
Cosmos Insurance		x
Total	**8**	**2**

All companies, except one, using the Fair Value option disclosed the reason of this choice.

Given the activities of the group and since its segment information shows that the option is also used in its insurance activities, the entity that does not disclose the reason of its choice can be considered take advantage of the option for all the three possible reasons. The main reasons disclosed for using the Fair Value option are the following:

- 8 companies avoid an accounting mismatch on assets backing unit-linked or index-linked contracts
- 6 companies reconciled the accounting treatment of certain groups of assets, in investment funds, with their internal monitoring practices
- 4 groups simplified the treatment of complex contracts with embedded derivatives

Table 150 : Reasons for using the fair value option and types of products

Company	Reasons			Types of products		
	Accounting mismatch	Embedded derivatives	Groups of A&L on a fair value basis	Unit-linked insurance contracts, and similar	Investment or entrusted funds	Others or N/A
ING	x		x			
Allianz	nd	nd	nd			x
AXA	x		x	x	x	x
Generali	x	x	x	x	x	
Munich Re	na	na	na	na	na	na
Alleanza Assicurazioni	x	x	x	x	x	
Unipol Assicurazioni	x		x	x	x	
Wiener Städtische	x	x		x		
Foyer	x			x		
Cosmos Insurance	na	na	na	na	na	na
Total (including nd)	**8**	**4**	**6**	**6**	**4**	**2**

The financial statement items so designated generally are:

- *Financial assets*, such as portfolios of debt securities, equity securities, structured products, investment fund units, non-controlled investment funds. **AXA** [France, Insurance] also mentioned in broad terms “assets included in non-qualifying economic hedges”
- And *financial liabilities*, such as debt securities issued, investment funds.

Within the sample, two different policies have been adopted for investment contracts where the risk is born by policyholders (primarily unit-linked or index-linked contracts).

The three Italian groups elected to use the fair value option for liabilities arising from those contracts. They accordingly presented those liabilities as “Financial liabilities at fair value through profit or loss”.

Other companies, as **AXA** [France, Insurance], explained[141] that they measured those liabilities at “current unit value” (i.e. reserves measurement is determined on the basis of held assets units fair value) and classified them within “insurance and investment liabilities”.

[141] Axa [France, Insurance] Annual report 2006, page 354

14.5. Liabilities arising from investment contracts by accounting method

(in Euro million)

	Carrying value		
	December 31, 2006	December 31, 2005	December 31, 2004
(Non Unit-Linked) – Liabilities arising from:			
Investment contracts with Discretionnary Participation Features (DPF) measured according to existing accounting policies (a) (d)	32,599	33,267	31,832
Investment contracts with Discretionnary Participation Features (DPF) – measured with current assumptions (b)	–	–	–
Investment contract with no Discretionnary Participation Features (DPF) measured at amortized cost	510	219	140
Investment contract with no Discretionnary Participation Features (DPF) measured at fair value	611	707	730
(Unit-Linked) – Liabilities arising from contracts where financial risk is borne by policyholders:			
Investment contract with Discretionnary Participation Features (DPF) measured according to existing accounting policies (a) & (c)	11,007	9,712	8,436
Features in investment contracts with Discretionnary Participation Features (DPF) measured with current assumptions (b)	–	–	–
Investment contract with no Discretionnary Participation Features (DPF) measured at current unit value (d)	56,665	38,836	30,691
TOTAL LIABILITIES ARISING FROM INVESTMENT CONTRACTS	101,393	82,742	71,828

The latter presentation is possibly developing into an industry practice.

Prior to 2006**, Allianz** [Germany, Insurance] had adopted the same method as the Italian groups but from 2006 the German group presents unit-linked and index-linked investment contracts under the separate caption *"Financial liabilities for unit-linked contracts"*. The group disclosed that this change was implemented as part of a comprehensive revision of financial statements which aimed at improving the transparency of financial reporting and enhancing the comparability with its peers.

18.4. Election of presentation options

Deferred acquisition costs

Pre-IFRS practice in the insurance industry was either to capitalize acquisition costs and amortize them over the life of the according liability or to deduct those costs when initially recognizing mathematical or technical reserves.

IFRS 4 allows the continuation of prior accounting treatment and does not mandate a specific presentation on the face of the balance sheet.

Diversity prevails among the sample. Out of 10 companies, 4 groups (**Allianz**, **AXA**, **ING**, **Munich Re**), corresponding to 40 % of the sample, presented deferred acquisition costs as a separate line item. Four other groups classified deferred acquisition costs among "Other assets"; this is noticeably the case of the 3 Italian groups.

Two groups (**Cosmos Insurance Group** [Cyprus, Insurance] and **Wiener Städtische** [Austria, Insurance]), corresponding to 20 % of the sample, did not present them as an asset but as a deduction from insurance reserves.

Table 151 : Classification of deferred acquisition costs

Company	Separate asset	Other assets	Other
ING	x		
Allianz	x		
AXA	x		
Generali		x	
Munich Re	x		
Alleanza Assicurazioni		x	
Unipol Assicurazioni		x	
Wiener Städtische			x
Foyer		x	
Cosmos Insurance			x
Total	**4**	**4**	**2**

Interestingly, **Allianz** [Germany, Insurance] changed its prior accounting policy to separately present deferred acquisition costs, as part of the above mentioned comprehensive change in financial statement format, for greater transparency and comparability. This presentation is possibly becoming an industry best practice.

Reinsurance costs

Pre-IFRS practice in the insurance industry was either to present reinsurance costs as a deduction from gross premium revenue or to present them as an expense. In the former case, premium revenue is presented on a net basis, in the latter case, premium revenue is presented on a gross basis.

IFRS 4 does not mandate a specific presentation of reinsurance costs on the income statement.

Among the sample, both presentations are observed. However, presentation of premiums earned on a net basis is retained by 80 % of the sample. Two groups only (**ING** and **AXA**), or 20 % of the sample, presented premiums earned on a gross basis.

Table 152 : Presentation of reinsurance costs

Company	Deduction from revenue	Expense
ING		x
Allianz	x	
AXA		x
Generali	x	
Munich Re	x	
Alleanza Assicurazioni	x	
Unipol Assicurazioni	x	
Wiener Städtische	x	
Foyer	x	
Cosmos Insurance	x	
Total	**8**	**2**

18.5. Insurance liabilities

Liability adequacy test

IFRS 4 requires an insurer to assess at each reporting date whether the amount of insurance liabilities recognised are adequate, using current estimates of future cash flows under its insurance contracts. Where the assessment shows that the carrying amount of insurance liabilities is inadequate, the entity must recognise the entire deficiency as an increase in the liability and an expense in profit or loss.

All groups except one commented on carrying out liability adequacy tests.

Table 153 : Performance of liability adequacy tests

Company	Yes	No	N/A
ING	x		
Allianz	x		
AXA	x		
Generali	x		
Munich Re	x		
Alleanza Assicurazioni	x		
Unipol Assicurazioni	x		
Wiener Städtische	x		
Foyer	x		
Cosmos Insurance			x
Total	**9**	**0**	**1**

ING [Netherlands, Insurance] disclosed[142] its policies in deeper detail than the rest of the sample:" *If, for any business unit, it is determined using a best estimate (50%) confidence level that a shortfall exists, it is immediately recorded in the profit and loss account. If, for any business unit, the provisions are not adequate using a prudent (90%) confidence level, but offsetting amounts within other Group business units exist, then the business unit is allowed to take measures to strengthen the provisions over a period no longer than the expected life of the policies. If no offsetting amounts within other Group business units exist, then any shortfall at the 90% confidence level is immediately recorded in the profit and loss account. If the reserves are determined to be adequate at above the 90% confidence level, no reduction in the provision is recorded."*

No overall inadequacy appeared to be reported. Several groups mentioned either in the notes or in a separate section of their annual reports that management believes the level of provisions to be adequate.

[142] ING [Netherlands, Insurance]

While reporting an overall adequacy, **ING** [Netherlands] disclosed[143] "*The segment Insurance Asia/Pacific has a net reserve inadequacy using a prudent (90%) confidence level, and, in line with Group Policy, is taking measures to improve adequacy in that region. This inadequacy was offset by reserve adequacies in other segments, such that at the Group level there is a net adequacy at the prudent (90%) confidence level.*"

Measurement on a discounted or undiscounted basis

IFRS 4 allows an insurer to continue using some existing practices. In particular, it allows an insurer to measure insurance liabilities on an undiscounted basis. IFRS 4 permits an insurer to change its accounting policies for insurance contracts only if, as a result, its financial statements present information that is more relevant and no less reliable, or more reliable and no less relevant. Consequently, an insurer cannot adopt an undiscounted basis if it previously used a discounted basis, but it may change from an undiscounted basis to a discounted basis.

All large insurance groups measured their life insurance liabilities on a discounted basis (as they did under their local or previous GAAP). The measurement basis was not always disclosed however it can be identified because the group disclosed either discounting rates or in reference to national requirements or in reference to prior years' practice.

Conversely, because of their predominantly short-term nature, non-life insurance liabilities are generally measured on an undiscounted basis. Several groups however selectively discounted certain insurance liabilities for certain long-term commitments (asbestos, environmental, disability) when a suitable claims payment pattern exists from which to calculate the discount. Among them are **AXA** [France], **Allianz** [Germany] and **Munich Re [**Germany].

Munich Re [Germany] disclosed[144] that "*The major part of the provision is measured at face value. However, exceptions are for some provisions for occupational disability pensions and annuities in workers' compensation and other lines of property-casualty business*".

No group mentioned a change from its 2005 accounting policy regarding the measurement of insurance liabilities.

Users of financial statements are interested to understand at first glance whether an insurer measures insurance liabilities on an undiscounted basis and to what extent.

As an example **AXA** [France], which indicates[145] *"93 % of Life & Savings reserves (excluding unit-linked contracts) are discounted. […] By convention, contracts with zero guaranteed rates are deemed not-discounted, except for products offering guaranteed rates updated annually and for one year; these contracts are presented in discounted reserves." [….]"In Property & Casualty Business, most reserves (95 %) are not discounted*", *except for incapacity and disability contracts and annuity motor mathematical reserves, where the discount rate is revised regularly.*

However such comprehensive disclosure is not frequent amongst the sample. The measurement basis is disclosed in 4 instances out of 10 for life insurance, and 6 instances for non-life insurance.

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[143] **ING** [Netherlands, Insurance]

[144] **Munich RE** [Germany]

[145] **AXA** [France]

Shadow accounting

IFRS 4.30 provides that "*In some accounting models, realised gains or losses on an insurer's assets have a direct effect on the measurement of some or all of (a) its insurance liabilities, (b) related deferred acquisition costs and (c) related intangible assets. An insurer is permitted, but not required, to change its accounting policies so that a recognised but unrealised gain or loss on an asset affects those measurements in the same way that a realised gain or loss does. The related adjustment to the insurance liability (or deferred acquisition costs or intangible assets) shall be recognised in equity if, and only if, the unrealised gains or losses are recognised directly in equity. This practice is sometimes described as 'shadow accounting'*."

As disclosed in their accounting policies, 6 companies (**Alleanza Assicurazioni** [Italy, Insurance], **AXA** [France, Insurance], **Generali** [Italy, Insurance], **ING** [Netherlands, Insurance], **Unipol Assicurazioni** [Italy, Insurance] and **Wiener Städtische** [Austria, Insurance]) used shadow accounting. The two German groups did not use shadow accounting in prior years and did not disclose any change in 2006.

Table 154 : Use of shadow accounting (amounts in EUR Million)

Company	Yes	No	N/A	Transfer to liabilities (EUR Millions)
ING	x			2 961
Allianz		x		
AXA	x			7 951
Generali	x			7 944
Munich Re		x		
Alleanza Assicurazioni	x			1 128
Unipol Assicurazioni	x			N/A
Wiener Städtische	x			503
Foyer			x	
Cosmos Insurance			x	
Total	**6**	**2**	**2**	

AXA [France] presented[146] a full reconciliation between gross unrealized gains and losses on available for sale financial assets and the corresponding reserve recognized in shareholders' equity, thereby disclosing the deferred participating liability:

The following table shows a reconciliation between gross unrealized gains and losses on available for sale financial assets and the corresponding reserve recognized in shareholders' equity:

(in Euro million)

	December 31, 2006	December 31, 2005	December 31, 2004
Gross unrealized gains and losses	17,751	22,424	16,614
Less unrealized gains and losses attributable to:			
Shadow accounting on policyholders' participation (a)	(7,242)	(10,342)	(7,528)
Shadow accounting on Deferred Acquisition Costs (b)	(315)	(458)	(467)
Shadow accounting on Value of purchased Business in force	(394)	(694)	(530)
Unallocated unrealized gains and losses (before tax)	9,800	10,930	8,088
Deferred tax	(1,833)	(2,565)	(2,257)
Unrealized gains and losses (net of tax) – 100%	7,966	8,365	5,832
Minority interests share in unrealized gains and losses (c)	(273)	(220)	(205)
Translation reserves (d)	71	(34)	94
Unrealized gains and losses (Net group share)	7,763	8,111	5,720

(a) Including shadow accounting impact on premium deficiency liabilities, after reevaluation of available for sale assets.
(b) Net of Shadow accounting on unearned revenues and fees reserves.
(c) Including currency impact attributable to minority interests.
(d) Group share.

Remeasurement at current market rates

IFRS 4.24 permits the selective introduction of an accounting policy that involves re-measuring designated insurance liabilities consistently in each period to reflect current market interest rates (and, if the insurer so elects, other current estimates and assumptions) and recording any adjustment in the income statement. Without this permission, an insurer would be required to apply the change in accounting policies consistently to all similar liabilities.

With the exception of **AXA** [France] all the companies in the sample elected not to use the IFRS 4.24 provision.

AXA [France] used[147] it to solve an accounting mismatch. *"Some guaranteed benefits such as Guaranteed Minimum Death or Income Benefits (GMDB or GMIB), or certain guarantees on return proposed by reinsurance treaties, are covered by a risk management program using derivative instruments. In order to minimize the accounting mismatch between liabilities and hedging derivatives, AXA has chosen to use the option allowed under IFRS 4.24 to re-measure its provisions".* Further details on liabilities measured at current market rates and assumptions are provided in the notes.

18.6. Impairment of reinsurance assets

IFRS 4.20 requires a reduction in the carrying amount of reinsurance assets when there is objective evidence that a company may not receive all the amounts due to it under the terms of the reinsurance contract and the event that gives rise to the evidence has a reliably measurable impact on the amounts that can be recovered from the reinsurer.

Two groups only (**ING** and **Foyer)**, corresponding to 20 % of the sample, specifically stated they carry out impairment tests on reinsurance assets.

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[146] **AXA** [France] Annual report 2006, page 343

[147] **AXA** [France]

Foyer [Luxemburg, Insurance] indicated[148]: "*The reinsurance assets are subject to regular impairment tests and losses in value are recorded when necessary. The Group gathers objective evidence of impairment and records the reduced values according to the same procedures as those used for the financial assets and liabilities recognised at amortised cost*".

However in their risk reports, all groups placed an emphasis on their procedures for monitoring credit risk and concentration risk on reinsurers.

For instance, **ING** [Netherlands, Insurance] added[149] *"The life reinsurance market is highly concentrated and, therefore, diversification of exposure is inherently difficult. To minimise its exposure to significant losses from reinsurer insolvencies, the Group evaluates the financial condition of its reinsurers and monitors concentrations of credit risk arising from similar geographical regions, activities or economic characteristics of the reinsurer.*"

18.7. Segment reporting

Amongst the sample of 10 companies, nine groups provided segment information and one did not appear to have reportable segments. All the groups that disclosed segment data have defined business segmentation as their primary segment reporting format.

Business segmentation differentiated insurance activities from banking activities. Within insurance activities, the most frequent pattern (**AXA, Allianz, Generali,**) separates life insurance (sometimes associated with health insurance) and property-casualty insurance.

Munich Re [Germany] firstly distinguished primary insurance from reinsurance and furthers segregates the life and health business from the non-life business.

ING [Netherlands] presented the various segments of its non Insurance activities and its 3 insurance segments on a geographical basis: "Insurance Europe", Insurance America", "and Insurance Asia-Pacific". This example illustrates how the segmentation of financial conglomerates involved in significant insurance activities may lead to a loss of comparative business segment information with other European Insurance companies.

Amongst the 9 groups that presented segment data for their business segments, 2 explained that they need not present segment information for geographical areas since they only address their domestic market (**Unipol Assicurazioni** and **Alleanza Assicurazioni**).

The 7 other ones provided geographic segment data, either in the notes or in the "Management Discussion and Analysis" with a cross-reference to the notes (**AXA**).

The definition of geographical areas is often indicative of the history of insurance groups in their international operations.

Seven groups mostly involved in primary insurance, presented the home country of the parent as their first segment and thereafter identify either neighbour countries or "Rest of Europe" whilst Munich Re's five geographical areas broadly coincided with continents.

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[148] **Foyer** [Luxemburg, Insurance]

[149] **ING** [Netherlands, Insurance]

Table 155 : Number of business segments and geographical areas

Company	Business segments	of which Insurance business segments	Geographical areas
ING	7	1	7
Allianz	5	2	12
AXA	5	3	8
Generali	3	2	9
Munich Re	5	4	5
Alleanza Assicurazioni	2	1	N/A
Unipol Assicurazioni	3	2	N/A
Wiener Städtische	3	3	5
Foyer	3	2	3
Cosmos Insurance	N/A	N/A	N/A

NB: ING's Insurance Europe, Insurance America, Insurance Asia-Pacific are counted for a single insurance segment. Alleanza Assicurazioni is only involved in life insurance.

18.8. Classification and presentation of non-consolidated financial investments

IFRS requirements

IAS 39 requires non-derivative financial assets to be classified in one of the following categories: [IAS 39.45]

- Available-for-sale financial assets;
- Loans and receivables;
- Held-to-maturity investments; and
- Financial assets at Fair Value through profit and loss.

Categories are used to determine how a particular financial asset is recognised and measured in the financial statements.

To comply with IAS 32.66, an entity must disclose all its significant accounting policies, including the general principles adopted and the method of applying those principles to transactions. In the case of financial instruments, such disclosure includes:

- the criteria applied in determining when to recognize a financial asset or a financial liability;
- the basis of measurement applied to financial assets and financial liabilities on initial recognition and subsequently; and
- The basis on which income and expense arising from financial assets and financial liabilities are recognized and measured.

Observed practices

We have checked the disclosures on classification and accounting policies related to non-derivative and non-operating financial assets ("non-consolidated financial investments"). All large and medium-sized groups carry non-trading securities and non-current loans and receivables on their balance sheet; this is also the case of 1 small group (50 %).

Generally speaking, insurance groups provide the classification by IAS 39 categories on the face of the balance sheet, whereas non financial entities mostly provide this information in the notes.

Non-trading securities are most often (9 cases) classified as available for sale; classification in the held-to-maturity category (7 cases) is more frequent in the insurance industry than in non-financial activities [Section 7 – Financial Instruments – non financial activities], even if the amount booked in this latter category remain marginal compared to those booked in other categories of non-derivative non-operating financial assets.

Table 156 : Classification of "non-consolidated financial investments"

	Number of groups	with AFS portfolio	%	with HTM portfolio	%	with Loans and receivables	%
Large groups	5	5	100%	5	100%	5	100%
Medium-sized groups	3	3	100%	2	66%	3	100%
Small groups	2	1	50%	0	-	1	50%
Total	**10**	**9**	**90%**	**7**	**70%**	**9**	**90%**

100% of the insurance entities disclose their accounting policies (the comprehensiveness of which varies) regarding the classification and treatment of non-consolidated financial investments, as shown in the table below:

Table 157 : Disclosure of accounting policies on the classification and treatment of "non-consolidated financial investments"

	Number of groups	of which having "financial investments"	of which disclose accounting policies	%
Large groups	5	5	5	100%
Medium-sized groups	3	3	3	100%
Small groups	2	1	1	100%
Total	**10**	**9**	**9**	**100%**

NB: percentages are calculated in relation to the number of groups that carry such financial assets on their balance sheets

One group discloses accounting policies for categories of financial assets that it does not present as such on its balance sheet.

18.8.1. Other comment

We have checked the relative importance of IAS 39 categories related to non-derivative non-operating financial assets on the balance sheets of large groups and small groups. Cash and cash equivalents have been excluded from this analysis.

The proportion of financial assets with fair value risk flowing through the income statement (24%) is not as limited as it is for non-financial entities (6%). Financial assets are the main assets of insurance entities.

Table 158 : Analysis of non-derivative non-operating financial assets other than cash and cash equivalents

	Large groups	% of such assets	% of total assets	Small groups	% of such assets	% of total assets
Held-to-Maturity	23 786	1 %	1 %	0	-	-
Loans and Receivables	992 776	33 %	28 %	89	8 %	3 %
Available-for-Sale	1 177 674	39 %	33 %	999	88 %	35 %
At fair value through P&L	859 561	28 %	24 %	49	4 %	2 %
Total	**3 053 797**	**100%**	**84%**	**1 137**	**100%**	**40%**

(Amounts in EUR million)

18.9. Impairment of non-consolidated financial investments

IFRS requirements

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognised. [IAS 39.58]

For assets measured at amortized cost, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate [IAS 39.63]. For available-for-sale, the recoverable value of the investment is measured under current market conditions.

If, in a subsequent period, the amount of the impairment loss relating to a financial asset carried at amortised cost or a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit and loss. Impairments relating to investments in available-for-sale equity instruments are not reversed. [IAS 39.65]

Observed practices

Accounting policies for the impairment of non-consolidated financial investments are disclosed by nearly all large groups. A significant number of medium and small groups do not disclose specific policies for the impairment of their financial assets.

Table 159 : Disclosure of accounting policies on impairment of non-consolidated financial investments

	Number of groups	with non-consolidated financial investments	of which accounting policies disclosed	%
Large groups	5	5	4	80%
Medium-sized groups	3	3	0	-
Small groups	2	1	1	100%
Total	**10**	**9**	**5**	**56%**

18.10. Issues related to debt/equity classification

IFRS requirements

The fundamental principle of IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. The reporting entity must make the decision at the time the instrument is initially recognised.

A financial instrument is an equity instrument only if the instrument includes no contractual obligation to deliver cash or another financial asset to another entity. As a consequence, if an enterprise issues preference (preferred) shares that pay a fixed rate of dividend and that have a mandatory redemption feature at a future date, the substance is that they are a contractual obligation to deliver cash and, therefore, should be recognised as a liability. In contrast, normal preference shares do not have a fixed maturity, and the issuer does not have a contractual obligation to make any payment. They are shown in equity. [IAS 32.18]

Compound financial instruments, such as convertible bonds, have both a liability and an equity component from the issuer's perspective. In that case, IAS 32 requires that the component parts be accounted for and presented separately according to their substance based on the definitions of liability and equity. The split is made at issuance and not subsequently revised.

Observed practices

A significant portion of insurance groups uses hybrid financing instruments such as preference shares, subordinated debt and compound instruments.

Table 160 : Use and classification of hybrid instruments

	Number of groups	of which have issued hybrid instruments	%	Preference shares	Subordinated debt	Convertible debt and similar
Large groups	5	4	80 %	1	4	2
Medium-sized groups	3	0	-	-	-	-
Small groups	2	0	-	-	-	-
Total	**10**	**4**	**40%**	**2**	**4**	**2**

No improper classification between equity and liabilities has been observed. Preference shares described as cumulative and/or redeemable preference shares entitling their holders to a fixed-rate or cumulative dividends have been classified as debt. As explained[150] by **ING** [Netherlands, Insurance] "*Preference shares rank before ordinary shares in entitlement to dividends and distributions*".

[150] **Nutreco** [Netherlands]

18.11. Use of derivative instruments and of hedge accounting

Use of derivative instruments

The use of derivative instruments is spread over the whole sample under review.

All groups indicate that their primary motivation for entering into derivative transactions is risk management, in other words hedging certain risk exposures. The fact that speculative transactions are prohibited in not as explicitly mentioned as it is the case in the non-financial activities sample.

18.12. Use of hedge accounting

IFRS requirements

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is: [IAS 39.88]

- formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness; and
- Expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured. Hedge effectiveness must be assessed both prospectively and retrospectively.

IAS 39 defines three categories of hedges: fair value hedges, cash flow hedges, net investment hedges.

A **fair value hedge (FVH)** is a hedge of the exposure to changes in fair value of a recognised asset or liability. The gain or loss from the change in fair value of the hedging instrument is recognised immediately in profit or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss.

A **cash flow hedge (CFH)** is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. [IAS 39.86]

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and recycled to the income statement when the hedged cash transaction affects profit or loss. [IAS 39.95]

A **hedge of a net investment in a foreign operation (NIH)** as defined in IAS 21 is accounted for similarly to a cash flow hedge. [IAS 39.86]

IAS 32.58 requires the disclosure of the following information, by category of hedge:

- a description of the hedge
- a description of the financial instruments designated as hedging instruments and their fair value at the balance sheet date
- the nature of the risk being hedged
- for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur

The following disclosures about gains and losses on hedging instruments in cash flow hedges are also required:

- the amount that was recognized in equity during the period
- the amount that was removed from equity and included in profit or loss during the period
- The amount that was removed from equity during the period and included in the initial measurement of a non-financial asset or a non-financial liability in a hedged highly probable transaction.

Observed practices

Our analysis shows that the use of hedge accounting depends on the size of the group:

- 100 % of large groups use at least one hedge category as defined by IAS 39
- 100 % of the medium-sized groups explicitly use at least one hedge category.
- 0 % of the small groups that enter into derivative transactions actually use hedge accounting. Remaining ones manage their risk exposures through economic hedging.

Table 161 : Use of hedging and of hedge accounting

	Number of groups	o/w use derivatives	o/w use hedge accounting	FVH	CFH	NIH
Large groups	5	5	5	4	5	4
Medium-sized groups	3	3	3	3	-	-
Small groups	2	2	0	-	-	-
Total	**10**	**10**	**8**	**7**	**5**	**4**
			in % of groups using derivatives			
Large groups			100%	80%	100%	80%
Medium-sized groups			100%	100%	-	-
Small groups			0%	-	-	-
			80%	**70%**	**50%**	**40%**

NB: FVH stands for Fair Value Hedge, CFH for Cash Flow Hedge and NIH for Net Investment Hedge

There are no early-adopters of IFRS 7 amongst the insurance entities under review. Nevertheless, the information disclosed appears to be sufficiently specific as to the hedge categories actually used, the nature of hedged items and the risks that are hedged.

Hedging instruments are mostly interest rate swaps, currency swaps, forward/future contracts and options.

Table 162 : Disclosure of hedged risk in fair value hedges and cash flow hedges

	Groups using hedge accounting	o/w using FVH	o/w disclosing the hedged risk	o/w using CFH	o/w disclosing the hedged risk
Large groups	5	4	100%	5	100%
Medium-sized groups	3	3	100%	0	-
Small groups	0	0	-	0	-
Total	**8**	**7**	**100%**	**5**	**100%**

NB: FVH stands for Fair Value Hedge, CFH for Cash Flow Hedge and NIH for Net Investment Hedge

There are numerous instances of groups failing to provide the other disclosures required for cash flow hedges (i.e., periods in which hedged cash flows are expected to occur, the gain or loss recognized in equity and the gain and loss removed from equity).

Table 163 : Disclosure on cash flow hedges

	Groups using CFH	o/w disclosing the maturity of hedged cash flows	o/w disclosing the amounts recognized in and removed from equity
Large groups	5	4	5
Medium-sized groups	0	-	-
Small groups	0	-	-
Total	**5**	**4**	**5**
%	**100 %**	**80 %**	**100 %**

18.13. Debt disclosures

IFRS requirements

Under IAS 32.62, an entity must disclose the terms and conditions of financial instruments that are individually significant. If no single instrument is individually significant to the future cash-flows of the entity, the essential characteristics of the instruments are described for homogeneous groupings.

The standard also states that "in the case of an instrument for which cash flows are denominated in a currency other than the entity's functional currency, [an entity must disclose] the currency in which receipts or payments are required.

Observed practices

Most groups provide information about the characteristics of their financial liabilities with various levels of details.

All groups describe significant transactions in the notes and/or they detail classes of financial liabilities in the notes (bonds, medium-term notes, commercial paper, other long-term loans,). The maturity profile of financial debt is provided by most groups that carry such liabilities on their balance sheets. For the remaining groups, users of their financial statements would usually be able to analyse the run-off of debt, though not necessarily easily. These are the two requirements of IAS 32 regarding debt disclosures that are rather well complied with.

Table 164 : Debt disclosures – maturity profile

	Number of groups	of which have outstanding debts	of which disclosed debt details	%	of which disclosed a maturity profile	%
Large groups	5	5	5	100%	5	100%
Medium-sized groups	3	3	3	100%	2	66%
Small groups	2	1	1	100%	1	100%
TOTAL	**10**	**9**	**9**	**100%**	**8**	**89%**

Other IAS 32 requirements on financial debt are not so often met. IAS 32.64 requires effective interest rate information. Such information (IAS 32.64c) may be disclosed for individual financial instruments or, alternatively, weighted average rates or a range of rates may be presented for classes of financial instruments.

In fact, a number of groups do not disclose any interest rate or disclose the contractual interest rate of their financial liabilities and not the effective interest rate. Certain groups disclose the index to which their floating rate debts are pegged and do not disclose the spread over the index. Others do not qualify the interest rates that they disclose; hence users are not able to easily understand whether or not such interest rates actually are effective interest rates after hedge (when the group hedges interest rate risk).

Altogether, 1 large group (11 %) actually presents the weighted average effective interest rate after hedge (where applicable) of their indebtedness or of significant classes of liabilities. The statistic for insurance entities is lower than the one for non-financial entities.

Table 165 : Debt disclosures – effective interest rates after hedge

	Groups with outstanding debts	of which disclose effective interest rate after hedge	%
Large groups	5	1	20%
Medium-sized groups	3	0	-
Small groups	1	0	-
Total	**9**	**1**	**11%**

Adequate disclosure of the currency in which classes of financial liabilities are denominated or individual transactions are denominated has not been found for all large groups. Furthermore, the information disclosed is sometimes incomplete.

Table 166 : Debt disclosures – analysis by currency for large groups

	Groups with outstanding debts	Direct analysis by currency	%	Other disclosure of currency	%
Large groups	5	2	40%	2	40%

18.14. Disclosures on financial risks and financial risk management

IFRS requirements

IAS 32.56 requires that entities describe their financial risk management objectives and policies including their policies for hedging each main type of forecast transaction of which hedge accounting is used. The discussion of management's policies for controlling the risks associated with financial instruments should include policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risk.

For each class of financial assets and financial liabilities, an entity must disclose information about its exposure to interest rate risk including contractual repricing of maturity dates, whichever dates are earlier and effective interest rates when applicable. If this entity has a variety of instruments, it may present a maturity profile of the carrying amounts of financial instruments exposed to interest rate risk. The effect of hedging transactions on effective interest rates and on interest rate risk of hedging transactions must be disclosed. Interest rate information may be disclosed for individual financial instruments or for relevant groupings. [IAS 32.67]

For each class of financial assets and other credit exposures, an entity must disclose information about the exposure to credit risk, including the amount that best represents its maximum credit risk exposure and significant concentrations of credit risk. [IAS 32. 76]

The standard has no explicit disclosure requirement as to the presentation of liquidity risk, currency risk and other price risks.

Observed practices

Financial risk factors

All insurance groups have included a presentation of their risk factors and of their financial risk management policies either in the notes to their financial statements or in a "Risk management" section of their annual reports, with or without a cross-reference to the notes. As for non-financial entities, financial risk factors primarily relate to credit risk, liquidity risk, interest-rate risk and currency risk with variations depending on size and scope of operations. The risks linked to the insurance industry are more precisely studied in the following chapter.

Table 167 : Type of financial risks disclosed or discussed

	Number of groups	of which disclose or discuss	Credit	Liquidity	Interest rate	Currency	Equity	Other price risk
Large groups	5	5	3	3	4	3	2	4
Medium-sized groups	3	3	3	3	3	2	2	2
Small groups	2	2	2	1	2	1	0	0
Total	**10**	**10**	8	7	9	6	4	6
			% of groups which discussed or disclosed					
Large groups			60%	60%	80%	60%	40%	80%
Medium-sized groups			100%	100%	100%	66%	66%	66%
Small groups			100%	50%	100%	50%	-	-
			80%	70%	90%	60%	40%	60%

18.15. Disclosures on risks and risk management

IFRS 4 requires disclosure of information that helps users understand the amount, timing and uncertainty of future cash flows from insurance contracts, among which information about insurance risk and credit risk.

Comparison between actual claims and previous estimates

IFRS 4 requires an insurer to disclose actual claims compared with previous estimates. These disclosures are primarily required for non-life insurance contracts where uncertainty about the amount and timing of claim payments may extend over several years from the period when a claim arises.

The standard does not mandate a specific format but provides some guidance by presenting an illustrative claim development table.

Amongst the sample, all 8 groups that are concerned present loss reserve development tables as required by IFRS 4, for their non-life business.

Table 168 : Presentation of loss reserve development tables

Company	Yes	No	N/A	Number of years
ING	x			2
Allianz	x			5
AXA	x			10
Generali	x			5
Munich Re	x			10
Alleanza Assicurazioni			x	
Unipol Assicurazioni	x			8
Wiener Städtische	x			5
Foyer	x			5
Cosmos Insurance		x		
Total	**8**	**1**	**1**	

Diversity can be observed in respect to the format of the table. Some groups (for instance, **Allianz**) presented their statistics by year of underwriting.

Thus, **Allianz** [Germany, Insurance] disclosed[151] the following table:

	2001 € mn	2002 € mn	2003 € mn	2004 € mn	2005 € mn	2006 € mn
Loss and loss adjustment expenses						
Net	45,327	45,061	44,683	45,479	49,655	49,331
Ceded	16,156	14,588	12,067	10,049	10,604	9,333
Gross	61,483	59,649	56,750	55,528	60,259	58,664
Paid (cumulative) as of						
One year later	15,945	16,357	14,383	13,282	14,696	
Two years later	24,567	24,093	21,155	20,051		
Three years later	29,984	29,007	26,148			
Four years later	33,586	32,838				
Five years later	36,430					
Liability re-estimated as of						
One year later	58,570	56,550	54,102	56,237	57,932	
Two years later	56,554	55,704	55,363	53,374		
Three years later	56,056	57,386	53,906			
Four years later	57,640	56,802				
Five years later	57,005					
Cumulative surplus (deficiency)						
Gross surplus	4,478	2,847	2,844	2,154	2,327	
Gross surplus after changes in the consolidated subsidiaries of the Allianz Group	4,571	2,847	2,305	2,154	2,327	
Net surplus	3,517	428	1,522	1,772	1,931	
Net surplus after changes in the consolidated subsidiaries of the Allianz Group	3,606	428	1,070	1,772	1,931	
Percent	8.0%	1.0%	2.4%	3.9%	3.9%	

[151] **Allianz** [Germany] Annual Report 2006, page 172

Other companies presented them by year in which claims occurred. Thus, AXA [France, Insurance] disclosed the following presentation:

(in Euro million except percentages)

	1996	1997 (b)	1998	1999 (c)	2000	2001	2002	2003	2004 (d)	2005	2006 (e)
Gross reserves for unpaid claims and claim expenses developed initially at the booking date (d)	5,847	20,371	20,941	26,656	26,916	28,636	28,465	27,825	29,128	31,168	41,193
Gross reserves for unpaid claim and claim expenses developed in 2006 adjusted for changes in exchange rates and scope of consolidation (d)	18,232	21,548	22,167	24,708	25,712	27,236	28,023	28,962	29,843	31,253	41,193
Cumulative payments at:											
One year later	1,388	4,737	4,745	7,727	6,807	6,715	6,371	6,075	6,180	6,084	
Two years later	5,759	6,632	6,818	11,184	10,302	9,900	9,554	9,233	8,871		
Three years later	7,327	8,087	9,361	13,474	12,378	12,440	11,846	11,332			
Four years later	8,351	10,338	10,632	14,798	14,220	14,140	13,411				
Five years later	10,619	11,218	11,384	16,239	15,297	15,410					
Six years later	11,187	11,512	12,435	16,554	16,420						
Seven years later	11,387	12,508	12,889	17,667							
Eight years later	12,143	12,970	13,557								
Nine years later	12,473	13,756									
Ten years later	12,398										
Reserve re-estimated at:											
One year later	5,537	19,425	19,040	23,041	27,069	27,425	26,856	27,527	29,179	29,878	
Two years later	13,881	17,510	19,407	26,294	25,919	25,718	26,219	26,791	27,833		
Three years later	13,864	17,971	22,048	25,542	24,864	25,610	25,835	26,920			
Four years later	14,214	20,162	21,485	24,409	24,665	25,542	25,783				
Five years later	16,742	19,873	20,804	24,304	24,658	25,756					
Six years later	16,439	19,052	20,820	24,174	25,093						
Seven years later	16,024	19,293	20,671	24,720							
Eight years later	16,272	19,267	21,049								
Nine years later	16,188	19,864									
Ten years later	15,825										
Cumulative redundancy (deficiency) from the initial gross reserves in excess of re-estimated gross reserves:											
Amount (f)	2,408	1,684	1,118	(12)	619	1,481	2,241	2,043	2,010	1,375	na
Percentages (a)	13.2%	7.8%	5.0%	0.0%	2.4%	5.4%	8.0%	7.1%	6.7%	4.4%	na

Moreover, the length of the loss experience statistics varies from one insurer to the other: **Allianz** [Germany] presented a 5 years' statistics, whilst **AXA** [France] presented a 10 years' statistics. Amongst the sample, the length of the claim development table ranges from 2 to 10 years.

ING [Netherlands], which presented a table for 2 years, explains[152]: "*The Group applies the exemption in IFRS-EU not to present Gross claims development for annual periods beginning before 1 January 2004 (the date of transition to IFRS-EU) as it is impracticable to obtain such information.*"

Concentrations of insurance risks

IFRS 4.39 (c) states that an insurer shall disclose information about concentrations of insurance risk. IFRS 4.IG 55 explains the circumstances when such concentrations could arise:

- a single insurance contract or a small number of related contracts that cover low-frequency, high severity risks such as earthquakes
- single incidents that expose an insurer to risk under several different types of insurance contracts such as terrorism

[152] **ING** [Netherlands]

- unexpected changes in trends, such as unexpected changes in human behaviour or policyholder behaviour

Practices vary widely amongst the sample. When disclosed, the insurance risk is presented in a risk report that is either a section of the "Management Discussion and Analysis" or a section of the notes to the financial statements.

Risks disclosed as "concentrations of insurance risks" differ in nature between large size companies such as **AXA** [France] or **Munich Re** [Germany] and smaller ones such as **Foyer** [Luxemburg]**.** The former two addressed exceptional events such as natural disasters and pandemics, the latter only mentioned claims that would be excessive relative to its size and financial position.

Table 169 : Nature of the disclosure related to concentrations of insurance risk

Company	Place of the risk report				Content of disclosure	
	Notes	MD&A with cross reference	MD&A w/ partial reference	No disclosure	Generic	Specific
ING	x					x
Allianz			x			x
AXA		x				x
Generali	x				x	
Munich Re		x				x
Alleanza Assicurazioni	x				x	
Unipol Assicurazioni	x				x	
Wiener Städtische	x					x
Foyer	x					x
Cosmos Insurance				x	N/A	N/A
Total	**6**	**2**	**1**	**1**	**3**	**6**

ING, Allianz, Munich Re, Wiener Städtische and **Foyer** further disclosed the Probable Maximum Losses they have set by class of risk, either in euro value or with reference to an occurrence probability. Three groups (**Allianz**, **ING**, **Munich Re**) indicated the occurrence probability of the triggering event that they use to set risk limits on their exposures to natural disasters.

Table 170 : Disclosure of the Probable Maximum Loss (PML)

Company	Quantified information	
	PML (€)	PML (frequency)
ING		x
Allianz		x
AXA		
Generali		
Munich Re		x
Alleanza Assicurazioni		
Unipol Assicurazioni		
Wiener Städtische	x	
Foyer	x	x
Cosmos Insurance	N/A	N/A
Total	**2**	**4**

PML: Probable Maximum Loss

Generally groups stated that they manage risk tolerance levels in terms of earnings volatility or equity sensitivity limits. **Allianz** [Germany] explained[153] "*In order to manage exposures due to natural catastrophes, the Management Board of Allianz SE has defined an earnings volatility limit for these exposures. These limitations […] define the amount Allianz is willing to lose in any such event with an occurrence probability of once in 250 years*."

ING [Netherlands] presented[154] detailed disclosures on risk tolerance: *"Profit and losses stemming from adverse claims in ING's insurance portfolios are managed by setting insurance risk tolerance levels which are reviewed annually by the Executive Board. ING Group has established actuarial and underwriting risk tolerance levels in specific areas of its insurance operations.*

For non-life insurance, risk tolerance levels are set by line of business (in terms of maximum sums insured per individual risk) and for fire business also in terms of probable maximum loss limits. The losses considered to measure this probable maximum loss are those which are attributable to specific events (e.g. natural perils such as storms, earthquakes and floods). For the main non-life units (in The Netherlands, Belgium, Canada, and Mexico) the risk tolerance is generally set at 2.5% of the Group's after tax earnings. […]. The risk tolerance refers to the maximum allowable loss for catastrophic events. The probable maximum loss risk tolerance levels are set at a 1 in 250 return period for Canada, Mexico and the Netherlands-Belgium combined which is in line with industry practice. With respect to the Fire line of business this assessment is based on risk assessment models that are widely accepted in the industry. […]

With respect to life business, ING Group's (pre-tax) risk tolerance level is set at EUR 22 million (2005: EUR 22 million) per insured life for mortality risk. While life insurance risks are considered to be naturally diversifiable by virtue of each life being a separate risk, group contracts may result in significant exposures. For life insurance contracts involving multiple lives, ING has made its own assessment and believes that the potential loss from a significant mortality event occurring in the normal course of business will not exceed an amount higher than the (pre-tax) risk tolerance level for 2006 of EUR 750 million (2005: EUR 750 million). Such an amount could result from a pandemic as observed during the Spanish flu pandemic in 1918, without taking into account medical improvements since that time".

All the groups that disclosed and discussed concentrations of insurance risk use reinsurance or retrocession (**Munich Re**) as their primary risk mitigation technique. The structure of reinsurance (proportionate, excess of loss …) was disclosed in 1 out of 2 instances.

Munich Re [Germany] mentioned[155] "*Particularly important is an accumulated excess-of-loss cover which provides protection against losses from natural catastrophes*".

AXA [France] and **ING** [Netherlands] also mentioned that they participate in industry pools to manage natural disasters or risks related to terrorism.

Lastly, **AXA** [France] and **Munich Re** [Germany] indicated having transferred risks to the financial markets, the former through catastrophe bonds and mortality bonds, and the latter through catastrophe bonds.

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[153] **Allianz** [Germany]

[154] **ING** [Netherlands] Annual Report 2006, page 201

[155] **Munich Re** [Germany]

Table 171 : Risk mitigation techniques

Company	Risk mitigation techniques				
	Reinsurance	Pooling	Transfer to financial markets	Diversification	Product treaty design
ING	x	x			x
Allianz	x				
AXA	x	x	x		x
Generali	x				x
Munich Re	x		x		x
Alleanza Assicurazioni	x				
Unipol Assicurazioni	x				
Wiener Städtische	x			x	
Foyer	x				
Cosmos Insurance	N/A	N/A	N/A	N/A	N/A
Total	**9**	**2**	**2**	**1**	**4**

Insurers are required to disclose information about the sensitivity of profit or loss and of equity to changes in variables that have a material effect on them [IFRS 4. 39(c)].

Five groups (**ING, AXA, Munich Re, Wiener Städtische** and **Foyer**), disclosed this information. Three other ones (**Allianz, Generali, Unipol Assicurazioni**), made references to sensitivity of earnings (or of equity or of the embedded value) or Value-at-Risk being used as an internal risk monitoring tool but they did not disclose their metrics. **Alleanza Assicurazioni** did not disclose similar data.

Table 172 : Sensitivity to insurance risk factors

Company	Sensitivity of profit or equity to insurance risk	
	Yes	No
ING	x	
Allianz		x
AXA	x	
Generali		x
Munich Re	x	
Alleanza Assicurazioni		x
Unipol Assicurazioni		x
Wiener Städtische	x	
Foyer	x	
Cosmos Insurance	N/A	N/A
Total	**5**	**4**

ING [Netherlands] disclosed[156] the following information about the sensitivity:

Through scenario analyses, ING Insurance measured the potential changes in the realised after tax earnings of the insurance operations from an increase/decrease of the insurance risk factors over the year 2006. These changes to net profit can relate to realised claims or any other net profit item that would be affected by the change of these factors. In addition, ING has estimated the impact on the 31 December 2006 shareholders' equity of ING Insurance from the same change in insurance risk factors. The differentiation of sensitivities before and after risk mitigation typically refers to mitigation of the risks by reinsurance. ING assumes that not all these shifts presented below will happen everywhere at the same time.

Insurance risks sensitivity

		Effect on ING Insurance				Effect on ING Insurance			
		Net profit		Shareholders' equity		Net profit		Shareholders' equity	
		Before risk mitigation	After risk mitigation	Before risk mitigation	After risk mitigation 2006	Before risk mitigation	After risk mitigation	Before risk mitigation	After risk mitigation 2005
Mortality	+10%	–91	–70	–87	–67	–82	–61	–85	–63
	–10%	80	70	78	67	80	61	83	64
Morbidity	+10%	–114	–106	–111	–103	–70	–66	–70	–67
	–10%	114	105	111	102	70	66	71	67
P&C	+10%	–196	–185	–188	–178	–125	–98	–130	–101
	–10%	196	185	188	178	125	98	130	101

The sensitivities represent a one-time increase/decrease of the realised claims of P&C and morbidity and an increase/decrease of the mortality rates over 2006.

Wiener Städtische [Austria] elected[157] a different reference as the group provided the sensitivity of its embedded value to risk factors, an option addressed by IFRS 7:

Sensitivities of the European Embedded Value of the life insurance and health insurance as of 31 December 2006	Change in % of the base value
European Embedded Value, Austria	
Decrease in level of equity and property values –10%	–3.8%
Interest rate curve shift +1%	–1.0%
Interest rate curve shift –1%	–4.1%
Maintainance expenses +10%	–2.2%
Maintainance expenses –10%	2.2%
Lapse rate improvement 10%	0.6%
Lapse rate deterioration 10%	–0.6%
Improvement in mortality and morbidity rates for assurances +5%	0.2%
Improvement in mortality, rates for annuities +5%	–0.1%

Embedded value

Insurers are not required to disclose the embedded value of their portfolios but this indicator is increasingly becoming the reference for the management of performance, as well as risk measurement and monitoring.

[156] **ING** [Netherlands] Annual Report 2006, page 202

[157] **Wiener Städtische** [Austria] Annual report, page136

Not surprisingly, all the major insurance groups made some reference to the embedded value of their portfolios. Two of them, **AXA** [France] and **ING** [Netherlands], (or 20 % of the sample), provided a full embedded value disclosure, with the scope and methodology, the result and its sensitivity.

AXA [France] further provided[158] a reconciliation of the embedded value to shareholders' equity.

Euro million, Group share

	2006		
	Life & Savings	Other than Life & Savings	Total
IFRS Shareholders' equity at December 31, 2006	35,497	11,729	47,226
Net URCG not included in Shareholders' equity	576	1,359	1,935
Excluded TSS/TSDI		(7,253)	(7,253)
Mark to Market debt		616	616
Excluded Intangibles	(18,013)	(8,589)	(26,602)
UCG projected in PVFP & other Stat-GAAP adjustments	(2,497)		(2,497)
Life & Savings Adjusted Net Asset Value (ANAV) and Other Business Tangible Net Asset Value (TNAV)	15,562	(2,138)	13,424
Life & Savings VIF	22,828		22,828
AXA Life & Savings EEV + Other business TNAV at December 31, 2006	38,390	(2,138)	36,252

After disclosing the sensitivity of its embedded value, **Wiener Städtische** [Austria] indicated that full publication of the embedded value would occur at a later date.

Allianz, Munich Re [Germany] and **Generali** made several references to the calculation of an embedded value and its use in the management of performance but they did not disclose the embedded value of their portfolios in their annual reports.

[158] **AXA** [France] Annual report 2006, page 455

19. Investment entities

Key points

Investment entities are entities whose main activity is based on the direct private or public equity investment and on the investment in private equity funds, as a majority or minority stockholder. 11 companies out of our sample of 270 entities have been identified as investment entities.

The consolidation methods observed within the dedicated sample are consistent with the guidance for the consolidation of investments held by investment entities provided by IAS27 *Consolidated and Separate Financial Statements* and IAS28 *Investments in Associates*:

- Shares held above 50% are indeed always fully consolidated
- Shares held below 20% are never consolidated but classified either as financial assets at fair value through the profit or loss, or as available-for-sale.

The option offered by IAS28 to account for investments with significant influence but no control as under IAS39 at fair value through P&L (in lieu of equity accounting) is used by 45% of the sample under review.

The classification and valuation of non consolidated investments is covered by IAS39 *Financial Instruments: Recognition and Measurement*. For quoted investments, we observed that the bid price is declared to be the reference value. For unquoted investments, no consensus appeared within the sample under review as the valuation is determined either at cost, or in reference to an arms length transaction or on the basis of valuation techniques.

19.1. Definition of the sample under review

Eleven entities out of the sample of 250 listed entities have been identified as investment entities. Key figures and information relating to the eleven entities are as follows:

Table 173 : Sample for detailed analysis of investment entities

Company	Country	Reporting currency	Non consolidated investments (LT & ST) (EUR Millions)	Total Assets (EUR Millions)	Non consolidated invest in % of Total Assets	Shareholder's Equity (inc. Minority int.) (EUR Millions)	Non consolidated invest in % of Total Equity
Minority stockholdings							
Brederode	Belgium	EUR	1 243	1 305	95%	1 219	102%
CapMan	Finland	EUR	36	80	45%	57	63%
Norvestia	Finland	EUR	111	173	64%	164	68%
BIP Investment Partners	Luxemburg	EUR	453	511	89%	502	90%
Investor	Sweden	SEK	18 466	20 032	92%	17 638	105%
Caledonia Investments	United Kingdom	GBP	1 672	2 144	78%	1 954	86%
SVG Capital	United Kingdom	GBP	1 369	1 902	72%	1 714	80%
Witan Investment Trust	United Kingdom	GBP	2 053	2 233	92%	2 003	103%
Majority stockholdings							
RHJ International	Belgium	JPY	117	4 858	2%	1 673	7%
Wendel Investissement	France	EUR	764	10 165	8%	1 927	40%
Corporacion Financiera Alba	Spain	EUR	355	2 596	14%	2 382	15%

19.2. Classification and valuation of investments held by investment entities

Classification of investments

Three standards provide guidance relating to the accounting treatment of investments held by investment entities depending on the level of control.

According to IAS 27 *Consolidated and Separate Financial Statements*, the general principles of consolidation apply to all investments that are controlled by an investment entity.

Investment entities must consolidate all the investments they control. Control is defined as the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Investment entities should consolidate their controlled investments, even though they are often passive shareholders with no intention to govern.

IAS 28 *Investments in Associates* applies to all investments in which an investor has significant influence but not control or joint control except for investments held by a venture capital organisation, mutual fund, unit trust, and similar entity that (by election or requirement) are accounted for as under IAS 39 *Financial Instruments: Recognition and Measurement* at fair value with fair value changes recognised in profit or loss. [IAS 28.1]

The consolidation methods observed in this "industry specific" sample are the following:

Table 174 : Consolidation method

Consolidation method	Full	Propor-tionate	Under equity	Not consolidated			
				Held to maturity	Available for sale	Fair value through P&L	
Shares held						Design.	HfT
above 50%	11						
between 20%< >50%	1	1	8			5	
below 20%					6	8	10

- All companies reporting investments for which the percentage of holding is above 50%, integrated these investments under the fully consolidation method, as required by IAS 27.
- No investment held with a participating interest below 20% were consolidated. All investments are classified either as financial assets at fair value through the profit or loss, or as available-for-sale.

  Financial assets at fair value through the profit or loss contains held for trading financial assets and financial assets designated at fair value through the profit or loss.

  - Held for trading investments are financial assets acquired or held for the purpose of selling in the short term or for which there is a recent pattern of short-term profit taking.
  - The category “designated at fair value” includes any financial asset that is designated on initial recognition as one to be measured at fair value with fair value changes recorded through the profit and loss statement. This option defined in IAS 39.9 to designate a financial asset at fair value through profit and loss is offered when doing so results in more relevant information because either:
    - It eliminates or significantly reduces a measurement or recognition inconsistency (“accounting mismatch”); or
    - A group of financial assets is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about this group of financial assets is provided internally on that basis to the entity’s key management personnel.

    Available-for-sale financial assets (AFS) are any non-derivative financial assets designated on initial recognition as available for sale. AFS assets are measured at fair value in the balance sheet. Fair value changes on AFS assets are recognised directly in equity.

The different classifications used within the sample for shares held below 20% can be summarized as follows:

Table 175 : Classification of shares with ownership interest below 20 %

Company	Country	Reporting currency	Non-current assets	Current assets
Minority stockholdings				
Brederode	Belgium	EUR	Design.	HfT
CapMan	Finland	EUR	Design.	HfT
Norvestia	Finland	EUR	-	AFS / HfT / Design.
BIP Investment Partners	Luxemburg	EUR	AFS / Design.	HfT
Investor	Sweden	SEK	Design.	HfT
Caledonia Investments	United Kingdom	GBP	AFS / Design.	HfT
SVG Capital	United Kingdom	GBP	Design.	HfT
Witan Investment Trust	United Kingdom	GBP	Design.	-
Majority stockholdings				
RHJ International	Belgium	JPY	AFS	HfT
Wendel Investissement	France	EUR	AFS	HfT
Corporacion Financiera Alba	Spain	EUR	AFS	AFS / HfT

AFS: Available for sale
Design.: Designated at fair value through P&L
HfT: Held for trading

BIP Investment Partners [Luxemburg, Financial services] disclosed[159] in its accounting policies the different accounting treatments relating to long term non consolidated investments:

Financial assets designated at fair value through profit or loss upon initial recognition

Financial assets may be designated at fair value through profit or loss upon initial recognition if one of the following criteria is met:

- the use of the fair value option eliminates or significantly reduces a measurement or recognition inconsistency (accounting mismatch) that would otherwise arise from measuring assets or liabilities and the related gains and losses on different bases
- the assets belong to a group of financial assets that is managed and evaluated on a fair value basis in accordance with a documented risk management strategy
- the financial asset contains an embedded derivative that must be accounted for separately.

Financial assets designated at fair value through profit or loss upon initial recognition include direct private equity investments and investments in private equity funds.

Direct private equity investments in unlisted securities are measured at fair value as determined by the Board of Directors. Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

[159] BIP Investment Partners [Luxemburg, Financial services] Annual report 2006, page 60

Available-for-sale financial assets

Available-for-sale financial assets are non-derivative financial assets that are designated as available for sale or are not classified in any of the three preceding categories. After initial recognition, available-for sale financial assets are measured at fair value, with the related gains and losses due to changes in the fair value recognised directly in equity in a special reserve account. When the Group disposes of an available-for-sale financial asset, the cumulative gain or loss previously recognised in equity is transferred to profit or loss. Dividends received on these investments are recognised in profit or loss under "Dividends and other income on available-for-sale financial assets" as soon as the Group's right to receive payment has been established.

Available-for-sale financial assets include the Company's investments in listed companies.

- Investments with ownership interests between 20% and 50% are accounted for and presented with a variety of possibilities:

Table 176 : Classification of shares held with ownership interest between 20% and 50%

Company	Country	Reporting currency	Consolidation method for shares held between 20% < > 50%
Minority stockholdings			
Brederode	Belgium	EUR	Equity method
CapMan	Finland	EUR	Equity method
Norvestia	Finland	EUR	Equity method
BIP Investment Partners	Luxemburg	EUR	Equity method / Not consolidated
Investor	Sweden	SEK	Equity method / Not consolidated
Caledonia Investments	United Kingdom	GBP	Not consolidated
SVG Capital	United Kingdom	GBP	Not consolidated
Witan Investment Trust	United Kingdom	GBP	Not consolidated
Majority stockholdings			
RHJ International	Belgium	JPY	Full consolidation / Equity method
Wendel Investissement	France	EUR	Proportionate / Equity method
Corporacion Financiera Alba	Spain	EUR	Equity method

RHJ International [Belgium, Financial services] fully consolidated its interests in 2 businesses owned between 20% an 50% on the basis of established power to control.

Jointly controlled companies owned by **Wendel Investissement** [France, Financial services] are consolidated using the proportionate method.

Out of the 11 entities that compose the specific sample under review, 5 entities (45%) use the option offered by IAS28 to account for investments with significant influence but no control as under IAS 39 at fair value through profit and loss, in lieu of equity accounting.

Investor [Sweden, Financial services] declared[160] account for associates under either at fair value or under the equity method:

Associates
Associates are companies in which Investor has significant influence. Investor's main rule is that investments in associates are recognized as financial instruments at fair value in accordance with IAS 39 and IAS 28.1. Investments in associates within Operating Investments are reported using the equity method because Investor is involved in the business operations of these holdings to a greater extent than in other business areas.

Valuation methods of investments at Fair Value

The valuation methods used within this specific sample reach a consensus.

For quoted investments, the bid price is declared to be the reference value. For unquoted investments, the valuation is determined either at cost, or in reference to an arms length transaction or on the basis of valuation techniques.

Witan Investment Trust [United Kingdom, Financial services] described [161]the measurement of the Fair Value of their investments:

(g) Investments held at fair value through profit or loss
When a purchase or sale is made under a contract, the terms of which require delivery within the timeframe of the relevant market, the investments concerned are recognised or derecognised on the trade date.

All the Group's investments are defined by IFRS as investments held at fair value through profit or loss.

All investments are designated upon initial recognition as held at fair value through profit or loss, and are measured at subsequent reporting dates at fair value, which is either the bid price or the last traded price, depending on the convention of the exchange on which the investment is quoted. Investments in unit trusts or OEICs are valued at the closing price, the bid price or the single price as appropriate, released by the relevant investment manager. Fair values for unquoted investments, or for investments for which there is only an inactive market, are established by using various valuation techniques. These may include recent arm's length market transactions, the current fair value of another instrument that is substantially the same, discounted cash flow analysis, option pricing models and reference to similar quoted companies. Where there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, that technique is utilised. Where no reliable fair value can be estimated for such instruments, they are carried at cost, subject to any provision for impairment.

19.3. Issues related to debt/equity classification

IFRS requirements

The fundamental principle of IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. The reporting entity must make the decision at the time the instrument is initially recognised.

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[160] **Investor** [Sweden, Financial services] Annual Report 2006, page 60

[161] **Witan Investment Trust** [United Kingdom, Financial services], Reports and accounts 2006, page 38

A financial instrument is an equity instrument only if the instrument includes no contractual obligation to deliver cash or another financial asset to another entity. As a consequence, if an enterprise issues preference (preferred) shares that pay a fixed rate of dividend and that have a mandatory redemption feature at a future date, the substance is that they are a contractual obligation to deliver cash and, therefore, should be recognised as a liability. In contrast, normal preference shares do not have a fixed maturity, and the issuer does not have a contractual obligation to make any payment. They are shown in equity. [IAS 32.18]

Compound financial instruments, such as convertible bonds, have both a liability and an equity component from the issuer's perspective. In that case, IAS 32 requires that the component parts be accounted for and presented separately according to their substance based on the definitions of liability and equity. The split is made at issuance and not subsequently revised.

Observed practices

A little number of investment entities use hybrid financing instruments such as preference shares, subordinated debt and compound instruments.

Table 177 : Use and classification of hybrid instruments

Company Size	Number of groups	of which have issued hybrid instruments	%	Preference shares	Subordinated debt	Convertible debt and similar
Large groups	0	-	-	-	-	-
Medium sized groups	8	3	38 %	1	0	2
Small groups	3	0	-	-	-	-
Total	**11**	**3**	**27%**	**1**	**0**	**2**

No improper classification between equity and liabilities has been observed. Preference shares classified as equity are generally described as non-voting shares entitling their holders to a preferred dividend. All preference shares described as cumulative and/or redeemable preference shares entitling their holders to a fixed-rate or cumulative dividends have been classified as debt, as stated by **Witan Trust** [UK, Financial services]:

17 Preference shares (continued)

The 3.4 per cent. and 2.7 per cent. cumulative preference shares constitute a single class and confer the right, in priority to any other class of shares:

(i) to receive a fixed cumulative preferential dividend at the respective rates (exclusive of tax credit thereon) of 3.4 per cent. and 2.7 per cent. per annum, such dividend being payable half-yearly on 15 January and 15 July in each year, in respect of the 3.4 per cent. cumulative preference shares, and on 1 February and 1 August in each year, in respect of the 2.7 per cent. cumulative preference shares; and

(ii) to receive repayment of capital at par in a winding up of the Company (but do not confer any further right to participate in profits or assets).

19.4. Embedded derivatives

IFRS requirements

Some contracts that themselves are not financial instruments may nonetheless have financial instruments embedded in them. For example, a contract to purchase a commodity at a fixed price for delivery at a future date has embedded in it a derivative that is indexed to the price of the commodity.

An embedded derivative is a feature within a contract, such that the cash flows associated with that feature behave in a similar fashion to a stand-alone derivative. In the same way that derivatives must be accounted for at fair value on the balance sheet with changes recognised in the income statement, so must some embedded derivatives. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when: [IAS 39.11]

- the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- The entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

If IAS 39 requires that an embedded derivative be separated from its host contract, but the entity is unable to measure the embedded derivative separately, the entire combined contract must be treated as a financial asset or financial liability that is held for trading (and, therefore, remeasured to fair value at each reporting date, with value changes in profit or loss). [IAS 39.12]

Observed practices

No investment entities have been found to disclose the existence of embedded derivatives.

Considering the fact that no large group is included in the sample of investment entities, this observation is consistent with those made in the non-financial entities sample, where only 10% of medium-sized groups and 5% of small groups disclose the existence of embedded derivatives.

19.5. Use of derivative instruments

The use of derivative instruments is widespread among the sample; it increases with the size of the group.

- 100 % of the large groups use derivative instruments
- 95 % of the medium-sized groups mention they use derivatives and one (5%) indicates that it occasionally uses them
- 75 % of the small groups either have derivatives on their balance sheet or may have had derivatives in a recent past

All groups indicate that their primary motivation for entering into derivative transactions is risk management, in other words hedging certain risk exposures. A vast majority mentions that their policies prohibit speculative transactions.

19.6. Use of hedge accounting

IFRS requirements

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is: [IAS 39.88]

- formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness; and
- Expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured. Hedge effectiveness must be assessed both prospectively and retrospectively.

IAS 39 defines three categories of hedges: fair value hedges, cash flow hedges, net investment hedges.

A **fair value hedge (FVH)** is a hedge of the exposure to changes in fair value of a recognised asset or liability. The gain or loss from the change in fair value of the hedging instrument is recognised immediately in profit or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss.

A **cash flow hedge (CFH)** is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. [IAS 39.86]

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised directly in equity and recycled to the income statement when the hedged cash transaction affects profit or loss. [IAS 39.95]

A **hedge of a net investment in a foreign operation (NIH)** as defined in IAS 21 is accounted for similarly to a cash flow hedge. [IAS 39.86]

IAS 32.58 requires the disclosure of the following information, by category of hedge:

- a description of the hedge
- a description of the financial instruments designated as hedging instruments and their fair value at the balance sheet date
- the nature of the risk being hedged
- for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur

The following disclosures about gains and losses on hedging instruments in cash flow hedges are also required:

- the amount that was recognized in equity during the period
- the amount that was removed from equity and included in profit or loss during the period
- The amount that was removed from equity during the period and included in the initial measurement of a non-financial asset or a non-financial liability in a hedged highly probable transaction.

Observed practices

Despite the fact that all groups use derivatives for risk management purposes and generally prohibit any speculative transaction, a fair number of them does not use or makes a limited use of hedge accounting. Our analysis shows that the use of hedge accounting depends on the size of the group:

- 75 % of the medium-sized groups explicitly use at least one hedge category.
- 33 % of the small groups that enter into derivative transactions actually use hedge accounting.

Table 178 : Use of hedging and of hedge accounting

	Number of groups	of which using derivatives	of which using hedge accounting	FVH	CFH	NIH
Large groups	0	-	-	-	-	-
Medium-sized groups	8	8	6	4	6	-
Small groups	3	2	1	1	-	-
Total	**11**	**10**	**7**	**5**	**6**	**0**
Large groups			-	-	-	-
Medium-sized groups			75%	50%	75%	-
Small groups			50%	50%	-	-
			70%	50%	60%	-

Note: FVH stands for Fair Value Hedge, CFH for Cash Flow Hedge and NIH for Net Investment Hedge

No early-adopters of IFRS 7 have been identified within the sample of investment entities.

Hedging instruments are mostly interest rate swaps for hedges of interest rate risk, forward contracts and cross-currency swaps for hedges of currency risk.

All groups in the sample have disclosed the hedged item and/or the nature of the hedged risk; not necessarily the precise risk factor that is hedged. Nearly all groups provide the other disclosures required for cash flow hedges (i.e., periods in which hedged cash flows are expected to occur, the gain or loss recognized in equity and the gain and loss removed from equity).

Table 179 : Disclosure on cash flow hedges

	Number of groups using Cash Flow Hedge	of which disclosing the maturity of hedged cash flows	of which disclosing the amounts recognized in and removed from equity
Large groups	0	-	-
Medium-sized groups	6	4	5
Small groups	0	-	-
Total	**6**	**4**	**5**
%	**100 %**	**66 %**	**83 %**

19.7. Debt disclosures

IFRS requirements

Under IAS 32.62, an entity must disclose the terms and conditions of financial instruments that are individually significant. If no single instrument is individually significant to the future cash-flows of the entity, the essential characteristics of the instruments are described for homogeneous groupings.

The standard also states that “in the case of an instrument for which cash flows are denominated in a currency other than the entity’s functional currency, [an entity must disclose] the currency in which receipts or payments are required.

Observed practices

Most groups provide information about the characteristics of their financial liabilities with various levels of details.

All groups describe significant transactions in the notes and/or they detail classes of financial liabilities in the notes (bonds, medium-term notes, commercial paper, other long-term loans,). The maturity profile of financial debt is provided by most groups that carry such liabilities on their balance sheets. For the remaining groups, users of their financial statements would usually be able to analyse the run-off of debt, though not necessarily easily. These are the two requirements of IAS 32 regarding debt disclosures that are rather well complied with.

Table 180 : Debt disclosures – maturity profile

	Number of groups	of which have outstanding debts	of which disclosed debt details	%	of which disclosed a maturity profile	%
Large groups	0	-	-	-	-	-
Medium-sized groups	8	6	5	83%	5	38%
Small groups	3	1	0	-	0	-
Total	**11**	**7**	**5**	**71%**	**62**	**71%**

Other IAS 32 requirements on financial debt are not so often met. IAS 32.64 requires effective interest rate information. Such information (IAS 32.64c) may be disclosed for individual financial instruments or, alternatively, weighted average rates or a range of rates may be presented for classes of financial instruments.

In fact, a number of groups do not disclose any interest rate or disclose the contractual interest rate of their financial liabilities and not the effective interest rate. Certain groups disclose the index to which their floating rate debts are pegged and do not disclose the spread over the index. Others do not qualify the interest rates that they disclose; hence users are not able to easily understand whether or not such interest rates actually are effective interest rates after hedge (when the group hedges interest rate risk).

Table 181 : Debt disclosures – effective interest rates after hedge

	Number of groups	of which have outstanding debts	of which disclosed effective interest rate after hedge	%
Large groups	0	-	-	-
Medium-sized groups	8	6	3	50%
Small groups	3	1	0	-
Total	**11**	**7**	**3**	**43%**

19.8. Disclosures on financial risks and financial risk management

IFRS requirements

IAS 32.56 requires that entities describe their financial risk management objectives and policies including their policies for hedging each main type of forecast transaction of which hedge accounting is used. The discussion of management's policies for controlling the risks associated with financial instruments should include policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risk.

For each class of financial assets and financial liabilities, an entity must disclose information about its exposure to interest rate risk including contractual repricing of maturity dates, whichever dates are earlier and effective interest rates when applicable. If this entity has a variety of instruments, it may present a maturity profile of the carrying amounts of financial instruments exposed to interest rate risk. The effect of hedging transactions on effective interest rates and on interest rate risk of hedging transactions must be disclosed. Interest rate information may be disclosed for individual financial instruments or for relevant groupings. [IAS 32.67]

For each class of financial assets and other credit exposures, an entity must disclose information about the exposure to credit risk, including the amount that best represents its maximum credit risk exposure and significant concentrations of credit risk. [IAS 32. 76]

The standard has no explicit disclosure requirement as to the presentation of liquidity risk, currency risk and other price risks.

Observed practices

Financial risk factors

All investment entities under review have included a presentation of their risk factors and of their financial risk management policies either in their financial statements or in a "Risk management" section of their annual reports with a cross-reference to the notes. Not surprisingly, financial risk factors primarily relate to credit risk, liquidity risk, interest-rate risk and currency risk with variations depending on size and scope of operations.

Table 182 : Type of financial risks disclosed or discussed

	Number of groups	of which disclose or discuss	Credit	Liquidity	Interest rate	Currency	Equity	Other price risk
Large groups	0	-	-	-	-	-	-	-
Medium-sized groups	8	8	7	7	8	8	1	6
Small groups	3	3	2	1	2	3	-	1
Total	**11**	**11**	**9**	**8**	**10**	**11**	**1**	**7**
% of groups which discussed or disclosed								
Large groups			-	-	-	-	-	-
Medium-sized groups			88%	88%	100%	100%	13%	75%
Small groups			66%	33%	66%	100%	-	33%
			82%	73%	91%	100%	13%	64%

The detailed disclosures on credit risk, liquidity risk, interest rate risk, currency risk, shows no pattern compared to the observations made for non-financial entities.

The risk linked to the change in market price is often described as managed through the spread of investments in the portfolio in order to reduce the risk arising from factors specific to a particular country or sector.

20. Banks

Key points

We have analysed the consolidated financial statements of a balanced sample of 28 banking groups, 24 of them listed and 4 of them non-listed, from 18 different countries. Classified by their total assets, those groups range from the major players in the industry to small entities. Non-listed groups are evenly distributed among the sample. Four groups are early-adopter of IFRS *7 Financial Instruments: Disclosures*.

Application of IFRS by banks reduces prior diversity of practice and enhances transparency in a number of areas such as revenue recognition and measurement of interest income on loans, impairment of loans, conditions under which hedging relationships qualify for hedge accounting or disclosures on financial instruments and financial risks. Our analysis shows that altogether financial statements under review have followed IFRS recognition and measurement requirements but not necessarily all disclosure requirements, where exceptions, limited in number and scope, were found.

Widely different options are taken as to the presentation of the Income Statement. Our observations lead us to consider that pan-European industry comparisons cannot be carried out directly on the basis of lines and aggregates presented on the face of the income statement but require reclassification and disaggregation after careful reading of the notes.

Nineteen banks (or 68 % of the sample) provide performance indicators that are fully consistent with the aggregates presented on the face of the income statement and do not present additional indicators in their financial highlights. The remaining nine banks (32 %), all large or medium-sized banks, use non-IFRS measures as at 2006 year end, either in place of or in addition to IFRS figures. Three main reasons are provided for the presentation of non-IFRS figures: eliminating the effect of non-recurring events, presenting an underlying or economic performance, segregating non-homogenous activities.

All banks in our sample comply with IAS 14 requirements, either providing segmental information in the two required formats or explaining why they are not required to provide this information. Twenty-two groups, or 85 % of those that are required to report segment information, have defined business segmentation as their primary segment information format. Business segments usually differentiate: retail banking, corporate and investment banking, insurance, asset management, treasury and funding. The number of business segments per group varies from 2 to 10. The number of geographical areas per group varies from 2 to 11. Large groups present a relatively small number of large geographical areas whereas groups from Northern or Central Europe tend to provide a detailed country-by-country breakdown.

Banks have extensively taken advantage of the Fair Value option. Twenty-two groups (nearly 80 % of the sample) use it for varied purposes and in particular to avoid or reduce accounting mismatches. Consequently, the relative weight of fair value measurements on the cumulative balance sheet of our sample reaches 38 % of total assets.

Twelve groups in our sample have been found to use macro-hedging. Out of these, five use macro fair value hedges under the carved-out version of IAS 39. Altogether, out of the forty-three banks comprised in our survey, in prior year's survey by the ICAEW, or in the survey carried out by Ernst & Young in 2007, eleven European banks **(25%)** appear to have used the carve-out in 2005 and/or 2006.

Loans and receivables are the largest asset in banks' balance sheet and represent nearly 50 % of the total assets of the sample. As required by IAS 39, all banks have determined impairment allowances based on objective evidence of incurred losses. Complying with IAS 39 requirements, twenty-three banks (82 %) have - explicitly or not - firstly tested loans that are individually impaired and then performed a collective impairment test on groups of unimpaired loans so as to capture losses incurred but not yet reported. Twelve banks only (less than 50 % of the sample) disclose that interest accrual stops, and recognition on a cash basis will subsequently occur, for loans that are impaired or past due by a given number of days, a non-mandatory but useful information. In this respect, practices may well be dissimilar across Europe. Since IFRS 7 does not address this issue, a more in-depth study might be desirable to assess potential inconsistencies throughout the European and global banking industry.

Twenty-eight groups present non-consolidated non-trading financial investments on their balance sheet. Twenty-six groups (93 %) comply with IAS 30 requirements since they entirely classify such investments in IAS 39 categories and disclose an accounting policy for each category. All but one bank classify (explicitly or not) whole or part of those financial investments as available-for-sale. Out of those, twenty-four banks (89 %) disclose an accounting policy dealing with the impairment of those assets. Nineteen groups (or 68 % of the sample) have classified certain debt securities as held-to-maturity, a category less frequently used given the stringent requirements of IAS 39.

A financial instrument in issue must be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. Our research did not identify any misclassification between equity and liabilities. Incidentally, we have noted that classification according to the substance of the instrument has led a mutual building society in the United Kingdom into presenting its share capital among current liabilities. Though it was not yet a requirement of IFRSs at the end of 2006, 21 groups, among which all large banks and 84 % of the medium-sized ones, disclose their regulatory capital and/or their solvency ratios.

All banks but the smallest in the sample regularly use derivative instruments. Twenty-three groups disclose accounting policies on hedge accounting; the remaining banks using economic hedging only. Fair Value hedges are used by all banks that practice hedge accounting whereas cash flow hedges are used by 15 groups. Economic hedging is frequent; several groups indicate they do so for hedging relationships consistent with their risk management policies but that do not qualify under IAS 39 provisions.

All 28 banks have provided financial risk disclosures that are broadly consistent with the flexible requirements of IAS 30 and IAS 32. 93 % include disclosures on credit risk; 75 % of large banks and 50 % of medium-sized ones enhance the usefulness of such disclosures with an analysis of their exposures by credit rating or a similar measure of the credit worthiness of the counterparty. 100 % present the maturity profile of their liquidity gap. In varied ways, 100 % present their exposure to interest rate risk on their banking book. All those that are involved in trading activities disclose their exposure to market risks. Altogether, most of these disclosures (82 %) can be considered as entirely clear. We have nevertheless observed that the content of disclosures on risk exposures is not always up to current industry standards on financial risk measurement and reporting; also disclosures sometimes provide information that is not fully relevant whereas some relevant information is not disclosed.

Hopefully IFRS 7 will bring improvements in this respect as the standard has better defined and more prescriptive requirements than IAS 30 and IAS 32. In particular, the standard adopts a management view approach which implies that users will be provided with information that management considers relevant. We have indeed noted that financial risk disclosures of all early IFRS 7 adopters are fully comprehensive, clear and relevant.

20.1. Presentation of the sample

The sample is comprised of 28 banking groups, 24 of them listed and 4 of them non-listed, from 18 different countries.

Ranked by their total assets, those groups range from the major players in the industry to small entities. Non-listed groups are evenly distributed among the sample, since they respectively rank 8th, 13th, 16th and 28th.

Four groups, all of them listed, are subsidiaries of large international banking groups:

- **Komerční Banka** [Czech Republic], a subsidiary of Société Générale
- **Bank Handlowy** [Poland], a subsidiary of Citibank
- **Všeobecná Úverová Banka** [Slovakia], a subsidiary of Sanpaolo
- **L'udová Banka** [Slovakia]**,** a subsidiary of Österreicher Volksbank

Four groups have early adopted IFRS 7:

- **HSBC** [UK]
- **Danske Bank** [Denmark]
- **Nordea** [Sweden]
- **Nationwide Building Society** [UK]

Table 183 : Sample for detailed analysis of Banks – breakdown by size

Total assets (EUR Billions)		**Number of groups**	**Total assets** (cumulative) (EUR Billions)	% Total assets
> 500	Listed	7	8 270	73,9 %
	Non-listed	1	556	5,0 %
	Sub total	**8**	**8 826**	**78,9 %**
25 - 500	Listed	10	1 964	17,6 %
	Non-listed	2	300	2,7 %
	Sub total	**12**	**2 264**	**20,2 %**
< 25	Listed	7	92	0,8 %
	Non-listed	1	1	0,0 %
	Sub total	**8**	**93**	**-**
	Total	**28**	**11 183**	**100,0 %**

20.2. Presentation of the income statement

Aggregates presented on the face of the income statement

IFRSs have no prescriptive requirements as to the presentation of the income statement. As a consequence, even though comparability at the national level is enhanced in jurisdictions where a mandatory format exists (France, Italy, Spain), cross-border comparisons remain difficult. A few examples are provided below to show the diversity of income statement formats currently prevailing throughout Europe and in particular the different ways to classify cost of risk on the face of the income statement.

Presentation of the cost of risk on the income statement – *Erste Bank*

Impairment charges are presented after net interest income, before fee and commission income

I. Consolidated Income Statement of Erste Bank for the year endec
31 December 2006

in EUR thousand	Notes	2006
Interest and similar income		7,089,295
Interest and similar expenses		(3,928,679)
Income from associates accounted for at equity		28,709
Net interest income	**1**	**3,189,325**
Risk provisions for loans and advances	2	(439,097)
Fee and commission income		1,805,098
Fee and commission expenses		(359,192)
Net fee and commission income	**3**	**1,445,906**
Net trading result	4	277,867
General administrative expenses	5	(2,945,330)
Income from insurance business	6	35,849
Other operating result	7	(144,043)
Result from financial assets - at fair value through profit or loss	8	(4,487)
Result from financial assets - available for sale	9	100,011
Result from financial assets - held to maturity	10	6,243
Pre-tax profit		**1,522,244**
Taxes on income	11	(339,843)
Net profit before minority interests		**1,182,401**
Minority interests		(250,155)
Net profit after minority interests	**12**	**932,246**

Presentation of the cost of risk on the income statement – *Unicredito Italiano*

Impairment charges are presented after total revenues

Consolidated profit and loss account

Items		2006
10.	Interest income and similar revenues	34,294,958
20.	Interest expense and similar charges	(22,140,073)
30.	**Net interest margin**	**12,154,885**
40.	Fee and commission income	9,966,526
50.	Fee and commission expense	(1,618,851)
60.	**Net fees and commissions**	**8,347,675**
70.	Dividend income and similar revenue	823,730
80.	Gains and losses on financial assets and liabilities held for trading	1,470,347
90.	Fair value adjustments in hedge accounting	29,729
100.	Gains and losses on disposal of:	493,457
	a) loans	*16,486*
	b) available-for-sale financial assets	*479,030*
	c) held to maturity investments	*3,493*
	d) financial liabilities	*(5,552)*
110.	Gains and losses on financial assets/liabilities at fair value through profit and loss	41,347
120.	**Total revenues**	**23,361,170**
130.	Impairment losses on:	(2,296,038)
	a) loans	*(2,196,408)*
	b) available for sale financial assets	*(47,440)*
	c) held-to-maturity investments	*1,110*
	d) other financial assets	*(53,300)*
140.	**Net profit from financial activities**	**21,065,132**
150.	Premiums earned (net)	89,058
160.	Other income (net) from insurance activities	(67,817)
170.	**Net profit from financial and insurance activities**	**21,086,373**
180.	Administrative costs:	(12,409,029)
	a) staff expenses	*(7,860,299)*
	b) other administrative expenses	*(4,548,730)*
190.	Provisions for risks and charges	(765,131)
200.	Impairment/write-backs on property, plant and equipment	(812,104)
210.	Impairment/Write-backs on intangible assets	(556,664)
220.	Other net operating income	597,109
230.	**Operating costs**	**(13,945,819)**
240.	Profit (loss) of associates	283,443
260.	Impairment of goodwill	(356,880)
270.	Gains and losses on disposal of investments	794,685
280.	**Total profit or loss before tax from continuing operations**	**7,861,802**
290.	Tax expense (income) related to profit or loss from continuing operations	(1,790,119)
295.	HVB Group Profit (loss) after tax	-
300.	**Total profit or loss after tax from continuing operations**	**6,071,683**
310.	Gains (losses) on non-current assets or disposal groups classified as held for sale	56,174
320.	**Net Profit or Loss for the year**	**6,127,857**
330.	Minorities	(680,116)
340.	**Net Profit or Loss attributable to the Parent Company**	**5,447,741**
	Earnings per share (€)	0.527
	Diluted earnings per share (€)	0.525

Presentation of the cost of risk on the income statement – *Barclays*

Impairment charges are presented after Total income net of insurance claims

Consolidated income statement

For the year ended 31st December

	Notes	2006 £m
Continuing operations		
Interest income	2	21,805
Interest expense	2	(12,662)
Net interest income		9,143
Fee and commission income	3	8,005
Fee and commission expense	3	(828)
Net fee and commission income		7,177
Net trading income	4	3,614
Net investment income	4	962
Principal transactions		4,576
Net premiums from insurance contracts	5	1,060
Other income	6	214
Total income		22,170
Net claims and benefits incurred on insurance contracts	5	(575)
Total income net of insurance claims		21,595
Impairment charges	7	(2,154)
Net income		19,441
Staff costs	8	(8,169)
Administration and general expenses	9	(3,914)
Depreciation of property, plant and equipment	25	(455)
Amortisation of intangible assets	24	(136)
Operating expenses		(12,674)
Share of post-tax results of associates and joint ventures	22	46
Profit on disposal of subsidiaries, associates and joint ventures		323
Profit before tax		7,136
Tax	10	(1,941)
Profit after tax		5,195
Profit attributable to minority interests	38	624
Profit attributable to equity holders of the parent		4,571
		5,195
		p
Earnings per share		
Basic earnings per share	11	71.9
Diluted earnings per share	11	69.8
Interim dividend per ordinary share		10.50
Proposed final dividend per ordinary share	1	20.50
		£m
Interim dividend		666
Proposed final dividend	1	1,307

Presentation of the cost of risk on the income statement – *BNP Paribas*

Impairment charges are presented after operating expenses

In millions of euros	Note	Year to 31 Dec. 2006
Interest income	2.a	44,582
Interest expense	2.a	(35,458)
Commission income		10,395
Commission expense		(4,291)
Net gain/loss on financial instruments at fair value through profit or loss	2.b	7,573
Net gain/loss on available-for-sale financial assets	2.c	1,367
Income from other activities	2.d	23,130
Expense on other activities	2.d	(19,355)
NET BANKING INCOME		**27,943**
Operating expense		(16,137)
Depreciation, amortisation and impairment of property, plant and equipment and intangible assets	5.k	(928)
GROSS OPERATING INCOME		**10,878**
Cost of risk	2.e	(783)
OPERATING INCOME		**10,095**
Share of earnings of associates		293
Net gain on non-current assets		195
Change in value of goodwill		(13)
PRE-TAX NET INCOME		**10,570**
Corporate income tax	2.f	(2,762)
NET INCOME		**7,808**
Net income attributable to minority interests		500
NET INCOME ATTRIBUTABLE TO EQUITY HOLDERS		**7,308**
Basic earnings per share	8.a	8.03
Diluted earnings per share	8.a	7.95

The number of aggregates on the income statement ranges from 3 to 11. **Danske Bank** [Denmark] has adopted a very condensed presentation where 3 aggregates only are presented: net interest income, pre-tax profit, consolidated net income. **BBVA** [Spain] presents 11 aggregates: the first 3 cover the main components of gross income (net interest income, insurance activity income, gains and losses on financial assets and liabilities); the remaining aggregates include: net operating income, impairment losses, other gains, other losses, Income before tax, income from ordinary activities and net income. On average, groups present 7 aggregates.

Widely different options are taken as to the presentation of revenues, banking income or cost of risk. The following list, which is not all-inclusive, illustrates some of the discrepancies. Certain groups report interest on transactions at fair value through profit or loss as a component of interest income whereas others report it among gains and losses on financial assets. Some groups present equity income within total income whilst others present it immediately above pre-tax income. Impairment losses on financial assets other than loans and advances are presented either within gains and losses on financial assets or within the cost of risk. For groups that have also insurance activities, total income has been found to include either premiums from insurance activities (gross of claim expense) or net income from insurance activities. We have also noted that the cost of risk is presented in at least 4 different ways on the face of the Income Statement.

It follows from the foregoing observations that pan-European industry comparisons cannot be carried out directly on the basis of lines and aggregates presented on the face of the income statement but require reclassification and disaggregation after careful reading of the notes.

Consistency of the performance indicators with the aggregates presented on the income statement

The use of non-IFRS measures in financial highlights is not rare among the large and medium-sized banks in the sample. Nineteen banks (or 68 % of the sample) provide performance indicators that are fully consistent with the aggregates presented on the face of the income statement and do not present additional indicators in their Financial Highlights. The remaining nine banks (or 32 % of the sample), all large or medium-sized banks, use non-IFRS measures as at 2006 year end, either in place of or in addition to IFRS figures.

Three main reasons are provided for the presentation of non-IFRS figures:

- eliminating the effect of non-recurring events
- presenting an underlying or economic performance
- segregating non-homogenous activities

Five groups (Barclays, Royal Bank of Scotland, BBVA, Unicredito Italiano, KBC Group, Raiffaisen International Bank) use non-IFRS figures to eliminate the effect of one-off events such as the sale of a strategic investment or a subsidiary that is not large enough to qualify as a discontinued operation.

Four groups (Danske Bank, KBC Group, Nationwide Building Society) present performance measures in line with their pre-IFRS track record and eliminate IFRS effects that in their view obscure the presentation of their underlying performance.

One group, **Barclays** [United Kingdom], factors a capital charge in the determination of "economic profit", a key performance measure[162]: "*In addition, economic profit (EP) is used to support the pursuit of the top quartile TSR goal. The strategies we follow and the actions we take are aligned to value creation for all stakeholders. Barclays uses EP, a non-IFRS measure, as a key indicator of performance because it believes that it provides important discipline in decision making. Barclays believes that EP encourages both profitable growth and the efficient use of capital.*"

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[162] **Barclays** [United Kingdom],

One group **ABN AMRO** [Netherlands] presents[163] non-IFRS figures to segregate its finance activities from the non-finance activities it is required to consolidate under IFRS. The group explains: "*IFRS requires the consolidation of private equity investments over which we have control, including non financial investments managed as private equity investments. However, as a practical matter, our private equity business is managed separately from the rest of our banking business and management does not measure the performance of our banking business based on our consolidated results of operations. Our private equity business involves buying equity stakes in unlisted companies over which we can establish influence or control, and managing these shareholdings as an investor for a number of years with a view to selling these with a profit. The companies in which we have these temporary holdings are active in business outside the financial industry. We believe that combining these temporary holdings with our core banking business does not provide a meaningful basis for discussion of our financial condition and results of operations. Therefore, in the presentation of our 'Group results', we have removed the effects of a line-by-line consolidation in the income statement of the private equity holdings of Private Equity and BU Global Clients.*"

All those groups present a reconciliation of the non-GAAP measures with IFRS-measures. Hereunder[164] is Barclays's reconciliation of its "economic profit" with reported figures.

Reconciliation of economic profit

	2006 £m	2005 £m	2004 £m
Profit attributable to equity holders of the parent	4,571	3,447	3,254
Addback of amortisation charged on acquired intangible assets[(a)]	83	29	6
Profit for economic profit purposes	4,654	3,476	3,260
Average shareholders' equity for economic profit purposes[(b)] (rounded to nearest £50m)	20,500	18,150	17,800
Post-tax cost of equity	9.5%	9.5%	9.5%
Capital charge[(c)]	(1,950)	(1,724)	(1,692)
Economic profit	2,704	1,752	1,568

20.3. Segment reporting

IFRS requirements

As more fully detailed in section 8 of this report, IAS 14 requires that a listed entity, or an entity that is in the process of being listed, reports segmental information according to business segmentation and to a geographical segmentation of its operations. The extent of disclosures is larger in the primary segment reporting format.

All banks in our sample comply with IAS 14 requirements, either providing segmental information in the two required formats or explaining why they are not required to provide this information. Two small banks (7% of the sample) explain that they are not concerned by IAS 14 since they operate a single business in a single economic environment.

[163] **ABN AMRO** [Netherlands]

[164] Barclays [United Kingdom] Annual Report 2006, page 51

Primary segment information format

Twenty-two groups, or 85 % of those that are required to report segment information, have defined business segmentation as their primary segment information format.

Four banks have determined that risks and returns are primarily influenced by the geographical environments in which they operate: **Banco Santander** [Spain], **Erste Bank AG** [Austria]**, HSBC** [United Kingdom]**, OTP** [Hungary]**.**

Business segments

Business segments usually differentiate: retail banking, corporate and investment banking, insurance, asset management, treasury and funding, Retail Banking, mostly a "local business" is often further divided in Retail Banking in the home country of the parent and Retail Banking in foreign countries with sometimes two International Retail Banking segments identified. Corporate and Investment Banking on the contrary is presented as a global business and not further divided. This is also the case of Asset Management or Wealth Management.

The number of business segments per group varies from 2 to 10. As the following table shows, this figure is related to the size of the group and to the fact that the primary segmentation is on a business basis or on a geographical basis.

Table 184 : Number of business segments – Breakdown by size

Total Assets in EUR Billion	Primary Format	Number of groups	Number of segments	
			Minimum	Maximum
> 500	Geographical	2	3	5
	Business	6	6	10
25 – 500	Geographical	2	2	4
	Business	10	3	7
< 25	Geographical	0	-	-
	Business	6	2	3
	N/A	2	n/a	n/a
Total		**28**		

Among the "large banks" category, **Banco Santander** [Spain] has defined 3 business segments only: *Commercial Banking, Asset Management, Global Wholesale Banking*; this is the smallest number of business segments in the category. At the same time, **ABN AMRO** [Netherlands] which has adopted a matrix organisation, has retained 10 business segments: *Netherlands, Rest of Europe, North America, Latin America, Asia, Global clients, Private clients, Asset Management, Private Equity, Group functions.*

Segment information by geographical areas concerns 20 groups only (or 70 % of the sample) since the other 8 banks address a single economic environment. These 8 banks are **Nationwide Building Society** [United Kingdom], the **National Bank of Greece** [Greece] and the six smallest groups in the sample.

The number of geographical areas per group varies from 2 to 11 in relation with the two foregoing factors (size and type of primary influence on risks and returns) as well as with the primary market of the parent.

Table 185 : Number of geographical segment – Breakdown by size

Total Assets in EUR Billion	Primary Format	Number of groups	of which operating in several areas	Number of areas	
				Minimum	Maximum
> 500	Geographical	2	2	4	5
	Business	6	6	4	8
25 – 500	Geographical	2	2	4	9
	Business	10	10	2	11
< 25	Geographical	0	-	-	-
	Business	6	2	2	3
	N/A	2	-	-	-
Total		**28**	**20**		

Large groups present a relatively small number of large geographical areas. For instance, **Barclays** [United Kingdom] has defined 5 segments: UK, Other European Union, US, Africa, Rest of the World. This is also the case for **HSBC** [United Kingdom]: Europe, Hong-Kong, Rest of Asia-Pacific, North America and Latin America.

Groups from Northern or Central Europe tend to provide a detailed country/country breakdown:

- **Danske Bank** [Denmark] which reports 11 geographical areas : Denmark, Finland, Sweden, Norway, Poland, Germany, Luxemburg, UK, Ireland, US, Rest of the world
- **OTP** [Hungary] which has identified 9 areas**:** Hungary, UK, Slovakia, Romania, Ukraine, Bulgaria, Croatia, Serbia, Russia
- **Rabobank** [the Netherlands] which reports 8 areas: Netherlands, Rest of EU, Rest of Europe, North America, Latin America, Asia, Australia, Rest of the world

In addition, we have noted that **Nordea** [Sweden] discloses segmental information on its 5 geographical areas (Sweden, Denmark, Finland, Norway and Poland (including Baltic countries)) whilst indicating "*The geographical segment reporting does not reflect Nordea´s operational structure and management principles*." It remains to be seen which information this groups will provide once *IFRS 8, Operating segments* is effective.

20.4. Fair Value option

IFRS requirements

As more fully explained in sections 12 and 20, the Fair Value option (FVO) in IAS 39 allows an entity to designate a financial instrument - that would otherwise be measured at amortised cost or at fair value through equity - as at Fair Value through profit or loss. An amendment to IAS 39, which became effective for annual periods beginning on 1 January 2006 or after, restricts the fair value option to 3 specific circumstances:

- it eliminates, or significantly reduces, an "accounting mismatch",
- it reconciles the accounting treatment of "group of financial assets or financial liabilities managed on a fair value basis" with their treatment under internal management policies and monitoring ; or,
- The instrument contains one or more separable embedded derivatives.

Use of the Fair Value option

The Fair Value option is widely used by banks; overall, 22 groups (i.e. nearly 80 % of the sample) take or have previously taken advantage of it. No group but **Caixa Geral de Depósitos** indicates that the restriction brought in 2006 to the designation of financial assets or liabilities at Fair Value through profit or loss has had an impact. **Caixa Geral de Depósitos** states[165] "*As a result of this alteration, CGD Group reclassified its commercial paper with a book value of 1 218 958 thousand at 31 December 2005 from Financial assets at fair value through profit or loss to Loans and advances to customers.*

Altogether, the proportion of Fair Value measurements on the balance sheet is brought to 38 % of total assets. As far as liabilities are concerned, this proportion may be slightly understated; this is the case when liabilities arising from unit-linked contracts in the insurance business are not presented as designated items (refer to section 20 of this report).

Table 186 : Proportion of financial assets and of financial liabilities at Fair Value

Financial assets	
At fair value through profit or loss	
Held for trading	24%
Designated	7
At fair value through equity	
Available for sale	7%
Total at fair value	**38%**
Financial liabilities	
Held for trading	16%
Designated	3%
Total at fair value	**19%**

The use of the fair value option appears to be positively correlated with size and diversity of banks' portfolios.

Table 187 : Use of the Fair Value Option – Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	of which using the Fair Value Option	%
> 500	Listed	7	7	100 %
	Non-listed	1	1	100 %
	Sub total	**8**	**8**	**100 %**
25 – 500	Listed	10	8	80 %
	Non-listed	2	2	100 %
	Sub total	**12**	**10**	**83 %**
< 25	Listed	7	4	57 %
	Non-listed	1	0	0 %
	Sub total	**8**	**4**	**50 %**
	Total	**28**	**22**	**79 %**

[165] **Caixa General de Depósitos [Portugal]**

Banks use the Fair Value option for financial assets as well as financial liabilities:

- *financial assets* include loans, portfolios of debt securities, equity securities, structured products, assets backing insurance liabilities and
- *financial liabilities* include deposits, debt securities issued, liabilities arising from unit-linked contracts.

Large groups designate both assets and liabilities as at Fair Value whilst smaller ones designate only assets.

Table 188 : Balance sheet items designated as at fair value through profit or loss

Total Assets in EUR Billion	Status	Number of groups	of which Fair Value Option for Assets & Liablilities	of which Fair Value Option for Assets only	of which No Fair Value Option
> 500	Listed	7	7	-	-
	Non-listed	1	1	-	-
	Sub total	**8**	**8**	**-**	**-**
25 - 500	Listed	10	5	3	2
	Non-listed	2	-	2	0
	Sub total	**12**	**5**	**5**	**2**
< 25	Listed	7	-	4	3
	Non-listed	1	-	-	1
	Sub total	**8**	**-**	**4**	**4**
	Total	**28**	**13**	**9**	**6**

Though the reasons for using the Fair Value option are not always stated, our analysis indicates that it is primarily used to reduce accounting mismatches stemming either from insurance business or from the mixed measurement model applied in hedge accounting. In the latter case, designation at fair value through profit and loss appears to be an effective way to build economic hedges for a variety of micro- or macro- risk exposures.

Also commonly encountered is the use of the fair value option to reconcile the accounting treatment of certain groups of assets and/or liabilities with the group's management and monitoring policies.

Danske Bank [Denmark] explains[166] "*Mortgage loans granted under Danish mortgage finance law are funded by issuing listed mortgage bonds on identical terms. Borrowers may repay such mortgage loans by delivering the underlying bonds. The Group buys and sells own mortgage bonds on an ongoing basis because such securities play an important role in the Danish financial market. If mortgage loans and issued mortgage bonds were valued at amortised cost, the purchase and sale of own mortgage bonds would mean that timing differences in profit and loss recognition would occur: The purchase price of the mortgage bond portfolio would not equal the amortised cost of the issued bonds. Moreover, elimination would result in recognition of an arbitrary effect on profit and loss, which would require an excessive amount of resources to calculate. If the Group subsequently decided to sell its holding of own mortgage bonds, the new amortised cost of this "new issue" would not equal the amortised cost of the matching mortgage loans, and the difference would be amortised over the remaining term to maturity. Consequently, the Group has chosen to recognise both mortgage loans and issued mortgage bonds at fair value in accordance with the option offered by IAS 39 to ensure that neither profit nor loss will occur on the purchase of own mortgage bonds.*"

[166] **Danske Bank** [Denmark]

To a lower extent the option is also used to simplify the accounting treatment of assets and/ or liabilities with embedded derivatives.

Large banks have taken advantage of the fair value option for 2 reasons at least; small ones generally for one reason only.

Table 189 : Reasons for using the Fair Value Option

Total Assets in EUR Billion	Status	Number of groups using Fair Value Option	of which for Accounting mismatch	of which for Embedded derivatives	of which for Groups of A and/or L	of which for undisclosed reason
> 500	Listed	7	7	6	5	0
	Non-listed	1	-	-	-	1
	Sub total	**8**	**7**	**6**	**5**	**1**
25 - 500	Listed	8	4	3	6	2
	Non-listed	2	2	-	1	0
	Sub total	**10**	**6**	**3**	**7**	**2**
< 25	Listed	4	2	1	2	1
	Non-listed	0	-	-	-	0
	Sub total	**4**	**2**	**1**	**2**	**1**
	Total	**22**	**15**	**10**	**14**	**4**

Note: A: Assets; L: Liabilities

20.5. Macro hedges and the European carve-out

IFRS requirements

Macro hedging refers to hedging portfolios of assets and/or liabilities on the basis of their overall characteristics as opposed to hedging specific assets or specific liabilities. Since macro cash flow hedging, a technique developed by German, Swiss and UK banks, was deemed inadequate by some European countries, macro fair value hedging has been brought into IAS 39 through the March 2004 amendment “Fair Value “. The requirements of the amendment subsequently appeared too stringent in certain circumstances, which resulted in the European carve-out of IAS 39. The carve-out allows an entity to include demand deposits in a Fair Value hedge; it further relaxes the conditions under which effectiveness must be tested.

Use of macro-hedges

Identification of macro-hedging on the basis of financial statements is not a straightforward exercise. The reasons are twofold: firstly, groups do not necessarily disclose the hedging techniques they use in relation with specific exposures and secondly, they do not necessarily explain in sufficient detail why they use the fair value option.

Altogether, we have identified 12 groups which declare using macro-hedges or whose financial statements indicate that they most likely macro-hedge certain exposures. We remain undecided about 2 other groups - the **Royal Bank of Scotland** [United Kingdom] and the **National Bank of Greece** [Greece]. We have checked our observations with the comments made by E&Y in its 2007 survey: they had also considered that **Royal Bank of Scotland**’s use, or absence of use, of macro-hedges could not be determined on the basis of published financial statements. As for the 14 other banks, our review has led us to consider that they probably do not use macro-hedges. On this basis, macro-hedging appears to be an issue that mostly concerns large groups: in our sample, at least 87 % of large banks macro-hedge certain exposures; 42 % of medium-sized banks do so; no small bank uses macro-hedging.

Out of 12 groups that use macro-hedging, 7 use macro fair value hedges and 5 others use macro cash flow hedges or macro economic hedges. Five banks using macro fair value hedges indicate that they have taken advantage of the carve-out; the other 2 disclose compliance with the IFRS as endorsed by the European Union but do not go any further to explicitly state whether or not they have used the carve-out option. Though we remain undecided about **Royal Bank of Scotland**’s and **National Bank of Greece**’s use of macro-hedging, it is apparent that none of them uses the carve-out option: the **Royal Bank of Scotland** declares “*The Group has not taken advantage of this relaxation and has adopted IAS 39 as issued by the IASB”* and **National Bank of Greece** declares that its financial statements comply with “*IFRS as adopted by the IASB*”.

Table 190 : Use of macro-hedges and of the European carve-out

Company	Country	Total Assets in EUR Billion	Macro hedge	FVH	CFH	Economic	Carve-out
Barclays	United Kingdom	1 480	x			x	
BNP Paribas	France	1 440	x	x	x		x
HSBC Holdings	United Kingdom	1 410	x		x		
ABN AMRO	Netherlands	987	x		x		
Banco Santander	Spain	834	x	x		x	nd
Unicredito Italiano	Italy	823	x	x	x	x	x
Rabobank	Netherlands	556	x	x			x
BBVA	Spain	412	x			x	
Danske Bank	Denmark	367	x			x	
Nordea Bank	Sweden	347	x	x			x
KBC Group	Belgium	325	x	x			x
Nationwide Building Society	United Kingdom	204	x	x			nd
Subtotal		**9 185**	**12**	**7**	**4**	**5**	**5**
Subtotal (%)		**82,1%**	**42,9%**				
Royal Bank of Scotland	United Kingdom	1 294	nd	nd	nd	nd	
National Bank of Greece	Greece	61	nd	nd	nd	nd	
Subtotal		**1355**	**2**	**2**	**2**	**2**	**0**
Subtotal (%)		**12,1%**	**7,1%**				
Others		643	14				
Others (%)		5,7%	50%				
Total		**11 183**					

Nd: not determined

When brought together, ICAEW's prior year survey, the survey carried out by Ernst & Young in 2007 and INEUM's survey cover a total 43 banks. Among these:

- 11 banks appear to have used the European carve-out in 2005 or 2006,
- 29 banks appear not to have taken advantage of that provision,
- For 3 banks it is unclear whether or not they use macro hedges.

Table 191 : Banks using the European carve-out (enlarged scope)

Country	Company	Source
Belgium	KBC	ICAEW, E&Y, INEUM
	Dexia	ICAEW, E&Y
	Fortis	ICAEW, E&Y
France	BNP Paribas	ICAEW, E&Y, INEUM
	Crédit Agricole	ICAEW, E&Y
	Société Générale	ICAEW, E&Y
Germany	Commerzbank	ICAEW
Italy	Unicredito	INEUM
Netherlands	ING Bank Rabobank	E & Y INEUM
Sweden	Nordea Bank	ICAEW, INEUM
Total	**11**	

Table 192 : Banks not using the European carve-out (enlarged scope)

Country	Company	Source
Austria	Erste Bank Raiffaisen International Bank	ICAEW, INEUM ICAEW, INEUM
Cyprus	Bank of Cyprus Marfin Popular Bank	INEUM ICAEW, INEUM
Czech Republic	Komerční Banka	INEUM
Denmark	Danske Bank	ICAEW, INEUM
Finland	Sampo	ICAEW
Germany	Hypo Real Estate	ICAEW
Greece	National Bank of Greece	ICAEW, INEUM
Hungary	OTP Bank	ICAEW, INEUM
Ireland	Allied Irish Bank	ICAEW, INEUM
Latvia	DnB Bank	ICAEW
Lithuania	Ukios Bankas	ICAEW
Malta	APS Bank Bank of Valetta	INEUM INEUM
Netherlands	ABN AMRO	E & Y, ICAEW, INEUM
Poland	Bank BPH Bank Handlowy PKO	ICAEW INEUM INEUM
Portugal	Banco Comercial Portugues Caixa Geral de Depósitos	ICAEW ICAEW, INEUM
Slovakia	L'udová Banka Všeobecná Úverová Banka	INEUM INEUM
Spain	Banco Pastor Banco Santander BBVA	ICAEW ICAEW E&Y
United Kingdom	HSBC Royal Bank of Scotland	E&Y, INEUM E&Y, ICAEW, INEUM
Total	**29**	

Table 193 : Banks for which the use of the European Carve-out cannot be identified on the basis of financial statements (enlarged scope)

Country	Company	Source
Italy	Banca Intesa	E&Y
United Kingdom	Barclays Nationwide Building Society	E&Y, INEUM INEUM
Total	**3**	

20.6. Loans and advances

Loans and receivables are non-derivative financial assets with fixed or determinable payments, originated or acquired, that are not quoted in an active market, not held for trading, and not designated on initial recognition as assets at fair value through profit or loss or as available-for-sale. Loans and receivables are measured at amortised cost [IAS 39.46(a)]. Such loans are the largest asset in banks' balance sheet and represent nearly 50 % of the total assets of the sample.

Our work was primarily directed at the disclosure of accounting policies regarding the impairment of loans and receivables, the reclassification into a "non-accrual" category and the write-off of loans.

Impairment of loans

IFRS requirements

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more unfavourable events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to perform a detailed impairment calculation to determine whether an impairment loss should be recognised. [IAS 39.58]

The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate. [IAS 39.63] The measurement of the loss is performed individually for loans that are significant or collectively for loans that are not individually significant.

Assets that are individually assessed and for which no impairment exists are grouped with financial assets with similar credit risk statistics and collectively assessed for impairment. [IAS 39.64]

If, in a subsequent period, the amount of the impairment loss decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit and loss [IAS 39.65].

In other words, paragraph IAS 39.58 provides that impairment losses are to be recognized only for losses that are incurred at the balance sheet date (as opposed to expected losses). Paragraph IAS 39.58 combined with IAS 39.65 require that banks follow a two-step approach: firstly determining allowances for loans that have been found to be individually impaired, secondly determining allowances on homogeneous groups of individually unimpaired loans for which evidence exists that they have incurred losses that are not yet reported at the balance sheet date.

Observed practices

All banks have determined impairment allowances based on objective evidence of incurred losses. **KBC Group** [Belgium] discloses[167] its policies and practice as follows: "*Impairment losses are recognised for loans and advances for which there is evidence – either on an individual or portfolio basis – of impairment at balance sheet date. Whether or not evidence exists is determined on the basis of the probability of default (PD). Loans and advances with a probability of default of 12 (problem loans with the highest probability of default) are individually tested for impairment (and written down on an individual basis if necessary). Loans and advances with a PD of 10 or 11 (also considered to be problem loans) are tested either individually (significant loans) or on a statistical basis (non-significant loans). Impairment losses are posted on these loans and advances on an individual and a statistical basis, respectively. For loans with a PD lower than 10, lastly, impairment losses are recognised on a portfolio basis.*

Interest on loans written down as a result of impairment is recognised using the rate of interest used to measure the impairment loss.

Most banks (twenty-one) have explicitly applied the "two-step approach" in 2006. We have noticed that this is the first year in which **L'udová Banka** [Slovakia] has done so: this bank indicates[168] that "*collective testing of unimpaired loans began in 2006*". Remaining banks have followed various approaches. We have considered that **Rabobank** [Netherlands] is also compliant even though the wording of the disclosure is rather imprecise[169]: "*The value adjustments for loans includes losses if there is objective evidence that losses are attributable to some portions of the loan portfolio at the balance sheet date. These are estimated based on the historical pattern of losses for each separate portion, the credit ratings of the borrowers, and taken into account the actual economic conditions under which the borrowers conduct their activities*". **Komerční Banka** [Czech Republic] has also likely followed the "two-step approach" to conclude that it needs not recognize a collective impairment loss. The related disclosures of the 5 remaining banks are not clear enough to allow us to determine whether they have or not carried out the required tests to identify incurred but not yet reported losses.

Table 194 : Application of the "two-step approach" in assessing impairment losses

Total Assets in EUR Billion	Status	Number of groups	of which Explicit 2- steps	of which Likely 2-steps	Other
> 500	Listed	7	7	0	0
	Non-listed	1	0	1	0
	Sub total	**8**	**7**	**1**	**0**
25 - 500	Listed	10	7	0	3
	Non-listed	2	2	0	0
	Sub total	**12**	**9**	**0**	**3**
< 25	Listed	7	4	1	2
	Non-listed	1	1	0	0
	Sub total	**8**	**5**	**1**	**2**
	Total	**28**	**21**	**2**	**5**

[167] **KBC Groupe** [Belgium]

[168] **L'udová Banka** [Slovakia]

[169] **Rabobank**

A limited number of banks provide information as to what is considered to be "significant" for individual assessment. The **National Bank of Greece** [Greece] does so, stating that loans above EUR 1 million are significant.

Altogether, we have observed a lack of value added disclosures in relation to loan loss impairment methodology since the majority of the sample simply repeats the wording of IAS 39.

Presentation of loan impairment losses

The loan impairment expense is disclosed by 27 banks. Sixteen banks present loan impairment losses on a separate line of the income statement; the other 11 present them among other impairment losses with an analysis in the notes. The disclosure provided by one bank is not clear enough to identify the amount of its loan impairment losses.

As already mentioned, the cost of risk is reported in varying places on the income statement:

- The two Austrian banks and **OTP** [Hungary] report impairment losses immediately after net interest income, before fee income;
- **Unicredito Italiano** [Italy] report them immediately after total revenues;
- **HSBC** and **Barclays** [UK] report them after total income before operating expenses;
- **BNP Paribas** [France] reports them after operating expenses;

Reclassification of loans from accrual to non-accrual status

IFRS requirements

IAS 18 requires that interest income be recognized on a loan when it is probable that the interest will flow to the bank and the interest can be measured reliably. Hence, a bank needs to consider whether to recognize interest income on a loan which is in arrears in respect of payment of interest or principal because the first condition may not be met. The point is generally addressed at the national level by banking authorities. Should the bank decide to put the loan on a "non-accrual" basis, interest shall be recognized only when actually paid by the borrower. IAS 30 does not provide specific guidance on this issue. Neither IAS 30 nor IAS 32 mandate the disclosure of the rules related to the reclassification of loans from accrual to non-accrual status.

Observed practices

Sixteen banks, both large and small ones, do not disclose the rules along which they transfer problem loans on a non-accrual basis. The 12 other ones mention that interest accrual stops, and recognition on a cash basis will subsequently occur, for loans that are impaired or past due by a given number of days.

As an illustration of general disclosure without precise rules, **Banco Santander** [Spain] indicates[170] "*Balances are deemed to be impaired, and the interest accrual is suspended, when there are reasonable doubts as to their full recovery and/or the collection of the related interest for the amounts and on the dates initially agreed upon ...*"

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[170] **Banco Santander** [Spain]

Our research indicates that practices may well be dissimilar across Europe. Since IFRS 7 does not address this issue, a specific consistency study might be envisaged within the European and global banking industry to ensure that bank practices are reasonably consistent on this point.

Write-off of loans

IFRS requirements

IAS 30.43 (a) requires that banks disclose their accounting policy for the write-off of uncollectible loans and advances.

Observed practices

Eleven groups, both large and small ones, do not disclose their rules for writing-off loans. For the 17 other banks, loans are written off when either and/or:

- they are not collectible;
- the borrower is unable to fulfil obligations;
- they are unrecoverable;
- recovery is remote;
- there is no real prospect of recovery;
- the allowance is 100%; and
- Recovery is considered unlikely.

HSBC [United Kingdom] uses[171] specific language :*"Loans (and the related impairment allowance accounts) are normally written off, either partially or in full, when there is no realistic prospect of recovery of these amounts and, for collateralised loans, when the proceeds from realising the security have been received. Unsecured consumer facilities are normally written off between 150 and 210 days overdue. In HSBC Finance, this period is generally extended to 300 days overdue (240 days for real estate secured products). Instances of write-off periods exceeding 360 days overdue are few, but can arise where certain consumer finance accounts are deemed collectible beyond this point or where, in a few countries, regulation or legislation constrain earlier write-off. In the event of bankruptcy, […], write-off can occur earlier.*

So does[172] **ABN AMRO** [Netherlands]: *"For consumer loans, our write-off rules are time-based and vary by type of product. For example, unsecured facilities, such as credit cards and personal loans, are generally written off at 180 days past due and cash-backed and debt and/or equity-backed facilities are generally written off at 90 days past due".*

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[171] **HSBC** [United Kingdom]

[172] **ABN AMRO** [Netherlands]

20.7. Non-consolidated financial investments

Classification of non-consolidated financial investments

IFRS requirements

IAS 39 allows an entity to classify its non-trading debt investments as held-to-maturity if its management has the ability and the positive intent to hold those securities to maturity. Investments that are intended to be held for an indefinite period of time and may be sold in response to needs for liquidity, or any other reason, should be classified as available-for-sale. All non-trading equity investments should be classified within that category.

IFRSs do not mandate that the IAS 39 categories be reflected on the face of the balance sheet. Reconciliation between the headings on the balance sheet and IAS 39 categories was not required prior to IFRS 7 (which 4 groups of our sample have early adopted by 2006 year end).

Observed practices

Twenty-eight groups present non-consolidated financial investments on their balance sheet.

Twenty-six groups (or 93 % of the sample) explicitly classify whole or part of those investments as available-for-sale. In addition, we have assumed that another bank accounts for its unclassified "non-trading other current financial assets" as available-for-sale.

Nineteen groups (or 68 % of the sample) have classified certain debt securities as held-to-maturity. In this count, we have assumed that one bank which does not disclose the IAS 39 category of its "unquoted corporate bonds and debentures at amortized cost[173]" accounts for them as loans and advances.

Table 195 : Classification of non-consolidated financial investments

Total Assets in EUR Billion	Status	Number of groups	W/ AFS Portfolios (*)	AFS Portfolios in EUR Billion	AFS Portfolios (%)	W/ HTM Portfolios (**)	HTM Portfolios in EUR Billion	HTM Portfolios (%)
> 500	Listed	7	7	559	6,8%	4	37	0,4%
	Non-listed	1	1	49	8,8%	1	1	0,3%
	Sub total	**8**	**8**	**608**	**6,9%**	**5**	**38**	**0,4%**
25 - 500	Listed	10	9	134	6,9%	8	42	2,1%
	Non-listed	2	2	36	11,9%	-	-	-
	Sub total	**12**	**11**	**170**	**7,5%**	**8**	**42**	**2,1%**
< 25	Listed	7	7	11	12,0%	5	3	3,6%
	Non-listed	1	1	ns	23,8%	1	ns	20,5%
	Sub total	**8**	**8**	**11**	**12,1%**	**6**	**3**	**3,7%**
	Total	**28**	**27**	**789**	**7,1%**	**19**	**84**	**0,8%**

Note: in this table, % means % of total assets for the line item. For instance, 6,8 % (first line) is 559 (AFS portfolios in EUR billion) divided by EUR 8 270 billion (cumulative total assets of the large listed banking groups)
(*) Including Raiffaisen International Bank's "non-trading non current financial assets"
(**) excluding Bank of Valetta's "non-listed corporate bonds and debentures"

[173] The amount was immaterial

Though its use is not rare, the "Held-To-Maturity" category is not as frequently chosen as the "Available-For Sale" category, due to the stringent conditions that prohibit any sale of held-to-maturity securities. For instance, **Nordea** Bank [Sweden] states: "*Investments classified as held-to-maturity are entirely related to Life. This category is, from a Nordea perspective, only used to a limited extent due to the restrictions regarding disposals of instruments that once have been classified into this category.*

Nine groups that classify debt securities as available-for-sale do not use the held-to-maturity category. Those are **AIB** [Ireland], **PKO Bank** [Poland], **Bank Handlowy** [Poland], **Caixa Geral de Depósitos** [Portugal], **L'udová Banka** [Slovakia], **Banco Santander** [Spain], **Barclays** [United Kingdom], **Nationwide Building Society** [United Kingdom], **Royal Bank of Scotland** [United Kingdom]. Conversely, one group that classify debt securities as held-to-maturity does not use the available-for-sale category and designates all other non-trading financial assets as at fair value through profit or loss; this is **Danske Bank** [Denmark].

Use of those categories, and particularly of the "held-to-maturity" category, does not appear to be related to size. To some extent, it seems related to the country of incorporation: we have observed that the classification of securities as held-to-maturity is infrequent in the UK, in Ireland and in Poland. But altogether we consider it to be mostly group specific.

As the following table shows, **Danske Bank** [Denmark] and **Nordea** [Sweden] present no or insignificant amounts as available-for-sale but both selectively classify certain financial investments as "held-to-maturity".

Conversely, **Banco Santander** [Spain] and **BBVA** [Spain] both carry non-consolidated financial investments on their balance sheets. **Banco Santander** [Spain] classifies all of them as available-for-sale whereas **BBVA** [Spain] classifies part of its portfolio as held-to-maturity.

Table 196 : Classification of investments

Company	Country	Total Assets in EUR Billion	AFS (% of Total Assets)	HTM (% of Total Assets)
Danske Bank	Denmark	367	0,0%	0,1%
Nordea	Sweden	347	0,0%	0,4%
BBVA	Spain	412	10,3%	1,4%
Banco Santader	Spain	834	4,6%	0,0%

Impairment of non-consolidated financial investments

IFRS requirements

Financial assets that are not measured at Fair Value through profit or loss must be tested for impairment at each balance sheet date. If there is objective evidence that an asset is impaired, it should be written down to its recoverable amount with the related impairment loss charged to the income statement.

A significant or prolonged decline in value is objective evidence of impairment of listed shares.

For available-for-sale securities, impairment means that any amount previously recorded in equity should be removed and transferred to the income statement. Impairment losses on equity securities are not reversed through the income statement.

Observed practices

Our analysis covers two questions: does the group disclose accounting policies regarding the impairment of available-for-sale financial investments? Where are impairment losses on available-for-sale securities presented on the income statement?

24 banks out of 27 having an available-for-sale portfolio, disclose an accounting policy dealing with the impairment of those assets. Those groups indicate they review their portfolios at each balance sheet date and individually test them for impairment if there is objective evidence that their cost might not be fully recoverable. For equity investments, evidence of impairment is tied to "a prolonged and significant decline in value"; no group uses more specific language in this respect.

ABN AMRO [Netherlands] indicates[174]: "*In the case of equity instruments classified as available-for-sale, a significant or prolonged decline in the fair value of the security below its cost is also considered in determining whether impairment exists. Where such evidence exists, the cumulative net loss that has been previously recognised directly in equity is removed from equity and recognised in the income statement within results on financial transactions. Held to maturity and available-for-sale debt investments are assessed and any impairment is measured on an individual basis, consistent with the methodology applied to loans and receivables.*"

Disclosures about where impairment losses on available-for-sale financial assets are reported in the income statement are as follows:

Table 197 : Presentation of impairment losses on available-for-sale financial assets

	Net G/L	Cost of risk	Not Disclose	No AFS Portfolio	Total
Equity securities	6	16	5	1	28
Debt securities	5	17	5	1	28

Net G/L: net gains or losses on financial instruments

Impairment losses on available-for-sale financial assets are actually reported in the income statement either:

- as a separate line on the face of the income statement;
- within loan loss impairment (with analysis in a note);
- Within goodwill and intangible asset impairment (with analysis in a note).

[174] **ABN AMRO** [Netherlands]

20.8. Matters related to debt/equity classification and capital

Debt / equity classification

IFRS requirements

The fundamental principle of IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form. The classification must be made at the time the instrument is initially recognised. [IAS 32.15] A financial instrument is an equity instrument only if the instrument includes no contractual obligation to deliver cash or another financial asset to another entity. [IAS 32.16] No hybrid instruments should be presented between debt and equity.

Observed practices

Classification according to the substance of the instrument has led **Nationwide Building Society** [175][United Kingdom], a mutual building society specializing in mortgage lending, banking and savings personal financial services and commercial property lending in the United Kingdom, whose shares are redeemable at the option of the holder, into presenting its share capital (GBP 86,795 million or 63 % of its total assets) among current liabilities.

	Notes	Group 2007 £m	Group 2006 £m	Society 2007 £m	Society 2006 £m
Total assets		137,378.5	120,586.0	138,637.6	118,228.3
Liabilities					
Shares	31	86,795.4	80,918.6	86,795.4	80,918.6
Deposits from banks	32	3,288.7	2,697.4	2,767.4	1,805.2
Other deposits	33	3,406.7	3,161.4	11,749.2	7,225.1
Due to customers	34	2,926.1	2,608.3	945.0	941.1
Debt securities in issue	35	28,871.7	20,767.6	27,568.1	19,571.7
Fair value adjustment for portfolio hedged risk	20	(30.2)	53.9	(19.9)	53.9
Derivative financial instruments	19	703.2	714.7	564.6	641.3
Insurance contract liabilities	36	-	1,190.5	-	-
Other liabilities	37	516.5	515.8	438.6	350.1
Provisions for liabilities and charges	38	50.3	40.3	37.3	29.0
Accruals and deferred income	39	367.0	230.1	328.4	192.6
Subordinated liabilities	40	1,617.0	1,446.3	1,617.0	1,446.3
Subscribed capital	41	1,045.4	741.2	1,045.4	741.2
Current tax liabilities		93.2	174.3	73.8	141.0
Retirement benefit obligations	42	172.4	294.2	172.1	293.6
Liabilities directly associated with assets classified as held for sale	16	2,090.7	-	-	-
Total liabilities		131,914.1	115,554.6	134,082.4	114,350.7
General reserve	43	5,295.8	4,825.6	4,413.1	3,714.5
Revaluation reserve	44	128.2	117.0	127.9	116.8
Available for sale reserve	45	40.4	88.8	14.2	46.3
Total reserves & liabilities		137,378.5	120,586.0	138,637.6	118,228.3

Subordinated debt and preference shares are widely used among the sample. This is hardly surprising since those instruments are partly or in full included in the determination of regulatory capital.

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[175] **Nationwide Building Society**, Annual Report 2006-2007, page 49

Most banks (23 out of 28) have subordinated debts in issue on their balance sheets and 12 banking groups carry preference shares. Several also have convertible debt in issue but this point is not further investigated since it is not specific to banks.

Table 198 : Use of hybrid instruments - Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	of which Subord. Debt	of which Prefer Shares	of which Neither
> 500	Listed	7	7	6	-
	Non-listed	1	-	1	-
	Sub total	**8**	**7**	**7**	**-**
25 - 500	Listed	10	9	3	1
	Non-listed	2	2	1	-
	Sub total	**12**	**11**	**4**	**1**
< 25	Listed	7	4	1	3
	Non-listed	1	1	-	-
	Sub total	**8**	**5**	**1**	**3**
	Total	**28**	**23**	**12**	**4**

The four banks without hybrids are the **National Bank of Greece** (Greece) and three subsidiaries of larger international banking groups: **Bank Handlowy** (Poland), **L'udová Banka** (Slovakia) and **Všeobecná Úverová Banka** (Slovakia).

Even when they are named shares, financial instruments giving rise to a fixed or cumulative interest are classified as debt. As mentioned[176] by **Banco Santander** [Spain]: "*Equity having the substance of a financial liability (EUR 668 million) is presented on the face of the balance sheet but it is included in the "Total liabilities" amount.*"

[176] **Banco Santander** [Spain] Annual Report 2006, page 274

26. EQUITY HAVING THE SUBSTANCE OF A FINANCIAL LIABILITY

This category includes the financial instruments issued by the consolidated companies which, although equity for legal purposes, do not meet the requirements for classification as equity.

These shares do not carry any voting rights and are non-cumulative. They were subscribed to by non-Group third parties and, except for the shares of Abbey amounting to GBP 325 million, are redeemable at the discretion of the issuer, based on the terms and conditions of each issue.

The changes in the balance of "Equity having the substance of a financial liability" were as follows:

Thousands of Euros	2006	2005	2004
Balance at beginning of year	1,308,847	2,124,222	3,908,084
Inclusion of companies in the Group	-	-	877,477
Redemptions	(472,925)	(944,968)	(2,624,283)
Of which:			
Totta & Açores Financing, Limited	*(118,483)*	-	-
Abbey National, plc	*(354,442)*	-	-
BSCH Finance, Ltd.	-	*(754,774)*	*(2,057,390)*
BCH Capital, Ltd.	-	*(190,194)*	-
Exchange differences and other changes	(167,594)	129,593	(37,056)
Balance at end of year	**668,328**	**1,308,847**	**2,124,222**

The detail of the issuers and of the most significant terms and conditions of the issues at 31 December 2006 is as follows:

	Millions					
	2006		2005			
Issuer and Currency of Issue	Equivalent Euro Value	Foreign Currency	Equivalent Euro Value	Foreign Currency	Annual Interest Rate	Redemption Option (1)
Banesto Holdings Ltd. (US dollars)	59	77	66	77	10.50%	30/06/2012
Totta Açores Financing Limited (US dollars)	-	-	127	150	8.88%	11/10/2006
Pinto Totta International Finance Limited (US dollars)	95	125	212	250	7.77% (2)	1/08/2007
Abbey (US dollars)	-	-	381	450	7.38%	9/11/2006
Abbey (pounds sterling)	484	325	474	325	8.63% to 10.38%	No option
Valuation adjustments	30	-	49	-	-	-
Balance at end of year	668		1,309			

(1) From these dates, the issuer can redeem the shares, subject to prior authorisation by the national supervisor.
(2) Return until 1 August 2007. 6-month US dollar Libor + 2.75% from this date.

Royal Bank of Scotland [United Kingdom] explains[177] "*Those preference shares where the Group has an obligation to pay dividends are classified as debt; those where distributions are discretionary are classified as equity.*

The conversion rights attaching to the convertible preference shares may result in the Group delivering a variable number of equity shares to preference shareholders; these convertible preference shares are treated as debt."

[177] **Royal Bank of Scotland** [United Kingdom] Annual Report 2006, page 175

Non-cumulative preference shares

Non-cumulative preference shares entitle the holders thereof to receive periodic non-cumulative cash dividends at specified fixed rates for each Series payable out of distributable profits of the company.

The non-cumulative preference shares are redeemable at the option of the company, in whole or in part from time to time at the rates detailed below plus dividends otherwise payable for the then current dividend period accrued to the date of redemption.

Class of preference share	Number of shares in issue	Interest rate	Redemption date on or after	Redemption price per share	Debt or equity (1)
Non-cumulative preference shares of US$0.01					
Series E (2)	8 million	8.1%	17 October 2006	US$25	Debt
Series F	8 million	7.65%	31 March 2007	US$25	Debt
Series G (2)	10 million	7.4%	31 March 2003	US$25	Debt
Series H	12 million	7.25%	31 March 2004	US$25	Debt
Series K (2)	16 million	7.875%	30 June 2006	US$25	Debt
Series L	34 million	5.75%	30 September 2009	US$25	Debt
Series M	37 million	6.4%	30 September 2009	US$25	Equity
Series N	40 million	6.35%	30 June 2010	US$25	Equity
Series P	22 million	6.25%	31 December 2010	US$25	Equity
Series Q	27 million	6.75%	30 June 2011	US$25	Equity
Series R	26 million	6.125%	30 December 2011	US$25	Equity
Non-cumulative convertible preference shares of US$0.01					
Series 1	1 million	9.118%	31 March 2010	US$1,000	Debt
Non-cumulative preference shares of €0.01					
Series 1	1.25 million	5.5%	31 December 2009	€1,000	Equity
Series 2	1.25 million	5.25%	30 June 2010	€1,000	Equity
Non-cumulative convertible preference shares of £0.01					
Series 1	0.2 million	7.387%	31 December 2010	£1,000	Debt

Notes:

(1) Those preference shares where the Group has an obligation to pay dividends are classified as debt; those where distributions are discretionary are classified as equity. The conversion rights attaching to the convertible preference shares may result in the Group delivering a variable number of equity shares to preference shareholders; these convertible preference shares are treated as debt.

Altogether, our research did not identify any misclassification between equity and liabilities. Subordinated debt is usually classified within liabilities and appears on a separate line with a "Subordinated debt" heading.

Disclosure of regulatory capital and solvency ratio

Disclosure of regulatory capital and of the solvency ratio was not a requirement of IFRSs at the end of 2006 but it had been considered good practice for a number of years.

Twenty-one groups, among which all large banks and 84 % of the medium-sized ones, disclose their solvency ratios and sometimes their regulatory capital and their risk-weighted assets. Two medium-sized groups do not provide information in this respect: **OTP** [Hungary] and **Caixa Geral de Depósitos** [Portugal]. Such is also the case of five small groups: **Bank of Cyprus** [Cyprus], **Marfin Popular Bank** [Cyprus], **Komerční Banka** [Czech Republic], **L'udová Banka** [Slovakia] and **Všeobecnà Úverová Banka** [Slovakia]; the last three ones being all subsidiaries of larger groups.

Table 199 : Disclosure of regulatory capital and solvency ratio - Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	Disclosure	No Disclosure
> 500	Listed	7	7	-
	Non-listed	1	1	-
	Sub total	**8**	**8**	**-**
25 - 500	Listed	10	9	1
	Non-listed	2	1	1
	Sub total	**12**	**10**	**2**
< 25	Listed	7	2	5
	Non-listed	1	1	-
	Sub total	**8**	**3**	**5**
	Total	**28**	**21**	**7**

Nordea Bank [Sweden], an early adopter of IFRS 7, provides[178] very informative details about the calculation of regulatory capital and risk-weighted assets. A limited extract is presented hereunder:

Note 48:
Capital adequacy

	Group		Parent company	
EURm	31 Dec 2006	31 Dec 2005	31 Dec 2006	31 Dec 2005
Calculation of total capital base				
Equity	**15,322**	**12,960**	**12,009**	**8,284**
Proposed/actual dividend	–1,271	–908	–1,271	–908
Hybrid capital loans	1,458	1,472	1,458	963
Deferred tax assets	–369	–327	–39	–45
Goodwill	–1,770	–1,794	–808	–880
Other items, net	–223	35	–58	–27
Tier 1 capital (net after deduction of goodwill)	**13,147**	**11,438**	**11,291**	**7,387**
– of which hybrid capital	1,458	1,472	1,458	963
Tier 2 capital	**6,726**	**5,862**	**5,133**	**4,202**
– of which perpetual subordinated loans	684	837	–	508
Deduction[2]	–1,714	–1,815	–1,535	–1,535
Total capital base[3]	**18,159**	**15,485**	**14,889**	**10,054**
Risk–weighted assets for credit and market risks				
Credit risks as specified below	176,329	153,483	28,686	24,180
Market risks as specified below	9,069	15,545	720	505
Total risk–weighted assets	**185,398**	**169,028**	**29,406**	**24,685**
Tier 1 capital ratio, %	7.1	6.8	38.4	29.9
Total capital ratio, %	9.8	9.2	50.6	40.7

[1] 72% of untaxed reserves included in Equity.
[2] Deduction for investments in insurance companies including goodwill related to insurance acquisitions and deductions for investments in other financial institutes outside the financial group of undertakings.
[3] See Note 40; Hybrid capital loans are included in Tier 1 capital and supplementary capital includes the undated subordinated loans and the dated subordinated loans after deduction for short remaining maturities. Relating currency swaps have been taken into account when including subordinated loans in capital base.

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[178] **Nordea Bank** [Sweden] Annual Report 2006, note 48, Page 130.

20.9. Day one profit

IFRS requirements

A day one profit is the positive difference between the amount paid upon acquiring (or received upon issuing) a financial instrument and the fair value of that instrument at the date the transaction occurs. When the Fair Value is based on valuation models using unobservable market data, the entire initial difference should not recognised immediately in the income statement. Instead, it should be recognised over the life of the transaction on an appropriate basis or be recognised in the income statement when the inputs become observable, or when the transaction matures or is closed out. Neither IAS 30 nor IAS 32 mandate that banks disclose on their "day one profits"; this will be a new requirement of IFRS 7 from 1 January 2007 onwards.

Observed practices

10 banks, among which 6 large listed ones (75 % of sub-sample) and 4 medium-sized listed ones (or 33 % of the sub-sample), either disclose an accounting policy for the recognition of their "day one profit" or explain why they are not concerned by this issue. We tend to think that the remaining 18 banks do not generate material "day one profits".

Table 200 : Disclosures related to Day One Profit recognition - Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	Disclose a policy	Provide an explanation	Other
> 500	Listed	7	3	3	1
	Non-listed	1	-	-	1
	Sub total	**8**	**3**	**3**	**2**
25 - 500	Listed	10	1	3	6
	Non-listed	2	-	-	2
	Sub total	**12**	**1**	**3**	**8**
< 25	Listed	7	-	-	7
	Non-listed	1	-	-	1
	Sub total	**8**	**-**	**-**	**8**
	Total	**28**	**4**	**6**	**18**

HSBC [United Kingdom] and **Nordea** [Sweden] both early-adopters of IFRS 7, provide informative details.

In particular, **HSBC** [United Kingdom] discloses[179] a full reconciliation of the deferred amount.

Derivatives valued using models with unobservable inputs

The amount that has yet to be recognised in the consolidated income statement relating to the difference between the fair value at initial recognition (the transaction price) and the amount that would have arisen had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

	2006 US$m	2005 US$m
Unamortised balance at 1 January	252	73
Deferral on new transactions	283	340
Recognised in the income statement during the period:		
– amortisation	(59)	(56)
– subsequent to unobservable inputs becoming observable	(226)	(64)
– maturity or termination	(53)	(25)
Exchange differences	17	(16)
Unamortised balance at 31 December	214	252

Nordea [Sweden] indicates[180] "*The total effect on the income statement from financial assets and financial liabilities that are measured using valuation techniques based on assumptions not fully supported by observable market data amounted to EUR 27m (EUR 7m) in Nordea. The effect in the parent company was EUR 0m (EUR 0m).*"

20.10. Hedging and hedge accounting

Use of hedge categories

IFRS requirements

Hedging refers to a series of techniques and instruments aiming at mitigating risk on separate transactions or on portfolios. IAS 39 permits hedge accounting, under strict conditions, for three types of hedging relationships:

- **Fair Value Hedges** (FVH) of the exposure to changes in the fair value of all or a portion of a recognised asset or liability or an unrecognised firm commitment;
- **Cash Flow Hedges** (CFH) of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction; and
- **Hedges of Net Investments** (NIH) in foreign operations in relation to the exposure to changes in the entity's share of the net assets of a foreign operation.

Hedging strategies that do not qualify for hedge accounting are often named economic hedges.

[179] **HSBC** [United Kingdom], Annual Report 2006, page 354

[180] **Nordea** [Sweden]

Observed practices

Twenty-three groups disclose accounting policies about hedging and/or hedge accounting. Several of those that use economic hedges indicate they do so since consistent with their risk management policies. The following table analyzes the number of groups disclosing a policy on hedging and hedge accounting per type of hedge category.

Table 201 : Disclosure of policies related to hedge accounting - Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	FVH	CFH	NIH	Economic Hedges
> 500	Listed	7	7	7	6	4
	Non-listed	1	1	-	1	1
	Sub total	**8**	**8**	**7**	**7**	**5**
25 - 500	Listed	10	8	6	5	3
	Non-listed	2	2	-	-	2
	Sub total	**12**	**10**	**6**	**5**	**5**
< 25	Listed	7	5	4	3	4
	Non-listed	1	-	-	-	0
	Sub total	**8**	**5**	**4**	**3**	**4**
	Total	**28**	**23**	**17**	**15**	**14**

We have tried to identify whether groups actually use hedge accounting, when they disclose an accounting policy in this respect. Up until 2006 year end this was not an easy task since reporting entities were not yet required to analyze their derivative portfolios by intent and by hedge category. Here follows the very informative analysis provided[181] by **Barclays** [United Kingdom] such analysis will become mandatory from 2007.

[181] **Barclays** [United Kingdom] Annual Report 2006, Page 177

14 Derivative financial instruments (continued)

The fair values and notional amounts of derivative instruments held for risk management are set out in the following table:

Year ended 31st December Derivatives held for risk management	2006 Notional contract amount £m	2006 Fair value Assets £m	2006 Fair value Liabilities £m	2005 Notional contract amount £m	2005 Fair value Assets £m	2005 Fair value Liabilities £m
Derivatives designated as cash flow hedges						
Currency swaps	–	–	–	14	1	–
Interest rate swaps	51,614	132	(312)	27,042	230	(290)
OTC interest rate options bought	–	–	–	782	1	–
Exchange traded interest rate swaps	12,077	–	–	11,899	–	–
Commodity swaps and forwards	204	–	(89)	343	–	(193)
Derivatives designated as cash flow hedges	63,895	132	(401)	40,080	232	(483)
Derivatives designated as fair value hedges						
Currency swaps	1,454	–	(233)	1,686	–	(81)
Interest rate swaps	16,940	240	(152)	29,394	387	(190)
Equity options	1,029	58	(56)	1,084	36	(46)
Forward foreign exchange	66	–	–	28	–	(14)
OTC interest rate options bought	–	–	–	1,287	–	–
Derivatives designated as fair value hedges	19,489	298	(441)	33,479	423	(331)
Derivatives designated as hedges of net investments						
Forward foreign exchange	2,730	–	(78)	–	–	–
Currency swaps	9,320	650	(31)	5,919	2	(254)
Derivatives designated as hedges of net investment	12,050	650	(109)	5,919	2	(254)
Derivative assets/(liabilities) held for risk management	95,434	1,080	(951)	79,478	657	(1,068)

Interest rate derivatives, designated as cash flow hedges, primarily hedge the exposure to cash flow variability from interest rates of variable rate loans to banks and customers, variable rate debt securities held and highly probable forecast financing transactions and reinvestments.

Interest rate derivatives designated as fair value hedges primarily hedge the interest rate risk of fixed rate borrowings in issue, fixed rate loans to banks and customers and investments in fixed rate debt securities held.

Currency derivatives are primarily designated as hedges of the foreign currency risk of net investments in foreign operations.

The Group's total derivative asset and liability position as reported on the balance sheet is as follows:

Year ended 31st December	2006 Notional contract amount £m	2006 Fair value Assets £m	2006 Fair value Liabilities £m	2005 Notional contract amount £m	2005 Fair value Assets £m	2005 Fair value Liabilities £m
Total derivative assets/(liabilities) held for trading	20,886,755	137,273	(139,746)	17,804,964	136,166	(136,903)
Total derivative assets/(liabilities) held for risk management	95,434	1,080	(951)	79,478	657	(1,068)
Recognised derivative assets/(liabilities)	20,982,189	138,353	(140,697)	17,884,442	136,823	(137,971)

Evidence has been sought in the note presenting the breakdown of the portfolio of derivatives and in the statement of change in equity or in the note detailing shareholders' equity. We have considered that there was no practical means to reliably identify the actual use of economic hedges and have not further investigated this point since it is not an issue specific to banks. The following table analyzes the number of groups that actually use hedges and hedge accounting for fair value hedges and cash flow hedges.

Table 202 : Actual use of hedge accounting - Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	FVH	CFH
> 500	Listed	7	7	7
	Non-listed	1	1	-
	Sub total	**8**	**8**	**7**
25 - 500	Listed	10	6	3
	Non-listed	2	2	1
	Sub total	**12**	**8**	**4**
< 25	Listed	7	2	-
	Non-listed	1	-	-
	Sub total	**8**	**2**	**-**
	Total	**28**	**18**	**11**

Disclosure of the impact of hedge ineffectiveness on the income statement

IFRS requirements

Neither IAS 30 nor IAS 32 mandates that banks disclose the effect of hedge ineffectiveness on the income statement. This also will be a new requirement of IFRS 7 from 1 January 2007 onwards.

Observed practices

Out of 24 groups, that use hedge accounting or disclose a policy on this topic, 23 indicate that ineffectiveness is charged to the income statement whatever the category of hedge. The other was **Bank of Cyprus** [Cyprus], which had no open hedges at the end of 2006.

Ten groups (or 35 % of the sample) disclose the impact of ineffectiveness on the income statement; those are the 4 early adopters of IFRS 7 and 6 other groups, among which **Barclays**[182] [United Kingdom]

14 Derivative financial instruments (continued)

	2005						
	Total £m	Up to one year £m	Between one to two years £m	Between two to three years £m	Between three to four years £m	Between four to five years £m	More than five years £m
Forecast receivable cash flows	3,230	779	768	704	458	265	256
Forecast payable cash flows	2,300	358	350	337	287	238	730

The maximum length of time over which the Group is hedging its exposure to the variability in future cash flows for forecasted transactions, excluding those forecasted transactions related to the payment of variable interest on existing financial instruments, is eight years (2005: 29 years).

No gain or loss on forecast transactions accorded hedge accounting in 2006 that are no longer expected to occur remains in equity.

Net gains/(losses) arising on fair value hedges in net interest income during the year were:

	2006 £m	2005 £m
On hedging instruments	(460)	204
On the hedged items attributable to the hedged risk	465	(164)
Ineffectiveness	5	40

Ineffectiveness recognised in relation to cash flow hedges in net interest income was a loss of £23m (2005: loss of £34m). Ineffectiveness recognised in relation to hedge of net investment was a gain of £13m (2005: loss of £5m).

20.11. Loan commitments

IFRS requirements

IAS 30.26 requires that a bank discloses the nature and amount of its contingent liabilities and commitments, among which:

- commitments to extend credit that are irrevocable
- contingent liabilities and commitments arising from off-balance sheet items such as guarantees, standby letters of credit, underwriting facilities,

[182] **Barclays** [United Kingdom] Annual Report 2006, page 144 note 14

Observed practices

All 28 banks disclose the amounts of their loan commitments and other similar contingent liabilities. We have specifically checked the disclosures of 8 groups involved in securitisation programs or mentioning Special Investment Vehicles and multiseller conduits. In respect to the vehicles that are not consolidated, with the exception of **BNP Paribas** [183][France], we have not found much specific information regarding the risks involved.

6.c CUSTOMER SECURITISATION PROGRAMMES

The BNP Paribas Group carries out securitisation programmes involving the creation of special-purpose entities on behalf of its customers. These programmes have liquidity facilities and, where appropriate, guarantee facilities. Special-purpose entities over which the Group does not exercise control are not consolidated.

6.c.1 Short-term refinancing

At 31 December 2006, six non-consolidated multiseller conduits (Eliopée, Thésée, Starbird, J Bird, J Bird 2 and Matchpoint) were managed by the Group on behalf of customers. These entities are refinanced on the local short-term commercial paper market. The Group has issued letters of credit guaranteeing the default risk on securitised receivables managed for customers by these entities up to an amount of EUR 580 million (EUR 629 million at 31 December 2005), and has granted liquidity facilities totalling EUR 12,518 million to these entities (EUR 12,176 million at 31 December 2005).

6.c.2 Medium/long-term bond refinancing

BNP Paribas also acts as arranger for customers, setting up funds that receive securitised customer assets and issuing medium and long-term bonds which are then placed by the Group. However, BNP Paribas does not manage these funds, and they are not consolidated. At 31 December 2006, the BNP Paribas Group had granted liquidity facilities totalling EUR 289 million (EUR 331 million at 31 December 2005) to eleven such funds (Tenzing – Invesco, Master Dolfin, Italfinance – Italease, CR Ferrara, Forest – Immofinanz, Cars – Renault, Tiepolo, Emerald – Ascendas REIT, Cari Firenze, LFE 3 – BNPP and RMF IV), representing a total of EUR 6,480 million in securitised receivables (EUR 2,600 million at 31 December 2005).

20.12. Disclosures related to risk management and risk exposures

IFRS requirements

Until the application of *IFRS 7, Financial instruments: Disclosures*, banks are subject to *IAS 30, Disclosures in the financial statements of Banks and Similar Financial Institutions*.

Among other requirements, IAS 30 requires that banks disclose the maturities of their assets and liabilities into relevant maturity groupings. Maturity can be expressed in terms of repayment date (so as to present liquidity risk) or in terms of repricing date (so as to present interest rate risk).

IAS 30 similarly requires that banks disclose significant concentrations of assets, liabilities, and off-balance sheet items, in terms of geographical areas, customer or industry groups, or other concentrations of risks.

Significant foreign currency exposures are also to be disclosed.

Effective from 1 January 2007, IFRS 7 will supersede IAS 30 and require the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk.

[183] BNP Paribas [France] Annual Report 2006, page 150

Observed practices

All banks report risk disclosures either in the notes or in a separate section of the report with cross-references that bring the section within the scope of the financial statements.

Credit risk

26 have included credit risk disclosures; two groups barely provide any information or any value-added information.

Where applicable, credit risk on the banking book is differentiated from counterparty risk arising from the trading book and from derivative transactions. However the main focus of disclosure relates to credit risk on the banking book. The segmentation and level of detail used varies according to the size of the bank and the diversity of its operations. Large banks use a multi-dimensional approach, segmenting their exposures by geographical area, industry, types of customers.

Using the standard terminology of banking regulations, **Banco Santander** [Spain] explains [184]its segmentation for credit risk management and the breakdown of the carrying amounts on its balance sheet by type of customer.

i. Customer segmentation for credit risk management

The table below details the distribution, by segment, of the credit risk exposure to customers in terms of EAD. Approximately 82% of total risk exposure to customers (excluding sovereign and counterparty risk) relates to the SME and individuals financing segments, which underlines the predictable nature of the Santander Group's credit risk. The expected loss arising from customer exposure is 0.56%, as compared with 0.48% for the Group's total credit risk exposure, and, accordingly, the credit risk assumed can be classified as medium-low.

Segmentation of Credit Risk Exposure

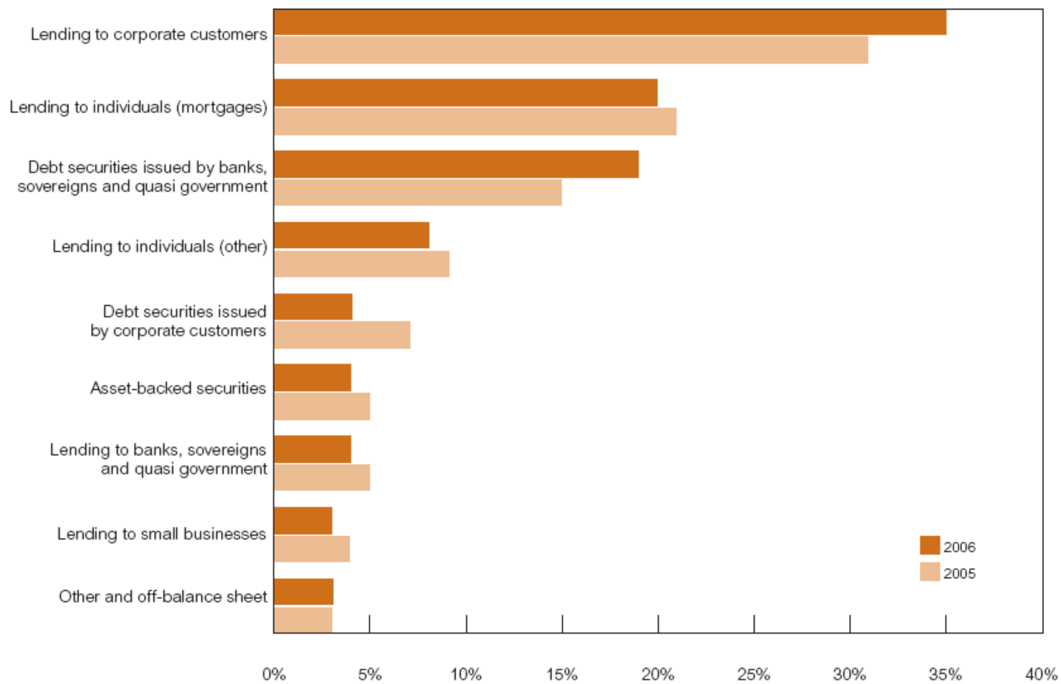
	EAD	%	Average PD	Average LGD	EL
Sovereign	37,163	5.4%	1.10%	22.0%	0.24%
Counterparty	80,863	11.8%	0.22%	33.4%	0.07%
Public sector	4,434	0.6%	0.64%	20.6%	0.13%
Corporate	97,816	14.3%	0.76%	30.4%	0.23%
SMEs	131,313	19.2%	2.33%	32.0 %	0.75%
Mortgages	248,964	36.3%	0.80%	13.8%	0.11%
Consumer loans	72,975	10.7%	5.51%	34.9%	1.92%
Cards	10,605	1.5%	5.27%	43.0%	2.26%
Other	982	0.1%	4.09%	61.8%	2.52%
Memorandum item – customers	*567,089*	*82.8%*	*1.84%*	*30.22%*	*0.56%*
Total	685,115	100.0%	1.61%	30.0%	0.48%

Source: MIR December 2006 - millions de euros

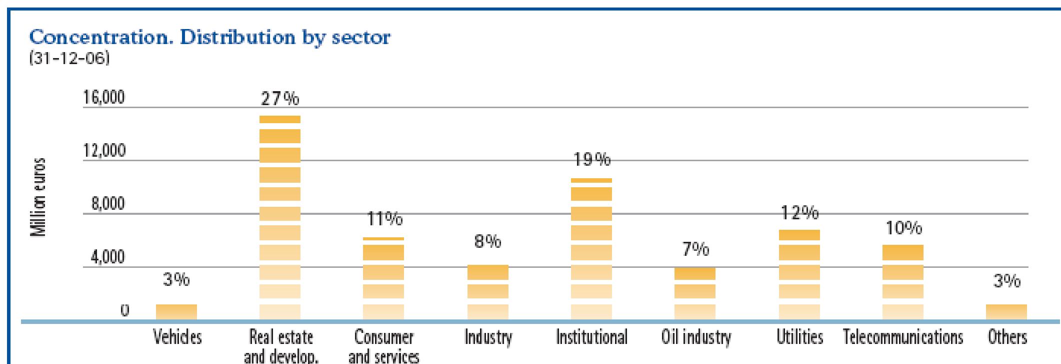
Note:
*EAD stands for Exposure at Default; PD for Probability of Default; LGD for Loss Given Default; EL for Expected Loss; EL = EAD * PD * LGD*

[184] Banco Santander [Spain] Annual Report 2006, page 311

Royal Bank of Scotland [United Kingdom] describes [185]the distribution of its entire credit risk assets by product and customer type, showing among others its exposure on asset-backed securities. **HSBC** [United Kingdom], **Barclays** [United Kingdom] and **Banco Santander** [Spain] also indicate their balances in such securities.



Concentrations of credit risk exist when a number of counterparties are engaged in similar activities, or operate in the same geographical areas or industry sectors and have similar economic characteristics so that their ability to meet contractual obligations is similarly affected by changes in economic, political or other conditions. IAS 30 requires that significant concentrations of assets, liabilities and off-balance sheet items be disclosed with the appropriate analysis. Concentrations of credit risk are addressed by all large banks, 58 % of medium-sized ones and 37,5 % of small ones.



[185] Royal Bank of Scotland [United Kingdom] Annual Report 2006, page 85

BBVA *(continued)*[186], *"Concentration : At the close of the year, the Group has 104 company groups (79 in 2005) with credit risk exposure (investment and guarantees) exceeding €200m, which represents 19% of the Group's overall risk (15% in 2005). 90% of the said company groups has an investment grade loan rating. Viewed from the transaction source perspective, they are spread as follows: 69% in Spain, 22% from the Bank's branches abroad, and 9% in Latin America, of which Mexico accounts for 7%. The breakdown by activity sectors highlights real estate and construction (27%), institutional (19%), electricity and gas (12%), consumption and services (11%) and telecommunications (10%).*

Although not specifically required by the standards, a proper analysis of bank exposures to credit risk is enhanced when they provide an analysis of the credit worthiness of their counterparties with a breakdown of their exposures by credit rating or risk class. This information is provided by twelve groups (six large and six medium-sized). Interestingly also at the end of 2006, only one bank (HSBC) provides information on mortgage lending in the US market.

BNP Paribas, [France] says[187]:

PORTFOLIO QUALITY

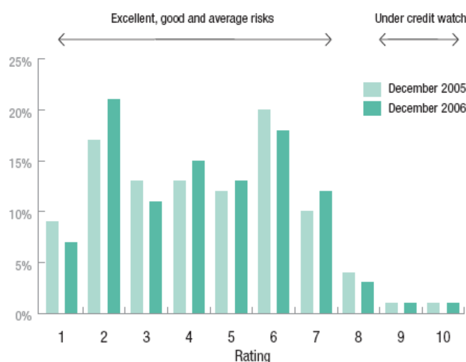
The rating policy that is being progressively but vigourously rolled out across the Group now covers all of the Corporate and Investment Banking and French Retail Banking portfolios, as well as a significant part of other core businesses.

The corporate portfolio (companies, government agencies, banks and institutions) in both CIB and FRB are of a high quality. The vast majority of commitments are towards Investment Grade borrowers, reflecting the Bank's strong presence among large multi-nationals and financial institutions.

A significant proportion of commitments to borrowers with lower credit ratings are highly structured or secured by high quality guarantees implying a higher recovery in the event of default. This includes export financing covered by export credit insurance written by international agencies, project finance, structured finance and transaction financing.

The distribution of the Bank's portfolio by credit quality is fairly stable year on year, with however an improvment of the credit quality on the highest credit ratings (1 to 5).

➤ BREAKDOWN OF SOUND COMMITMENTS OF THE CORPORATE & INVESTMENT BANKING AND FRENCH RETAIL BANKING DIVISIONS (EXCLUDING PRIVATE INDIVIDUALS) BY INTERNAL CREDIT RATING



[186] **BBVA** [Spain] Annual Report 2006, page 63

[187] **BNP Paribas** [France] Annual Report 2006, page 75

It is to be noted that **HSBC** [United Kingdom] provides[188] an analysis of loan delinquency in the US mortgage lending market. It is the only bank to highlight as soon as at 2006 year end, the development of what has since turned into the so-called "sub-prime crisis".

Loan delinquency in the US

(Unaudited)

The following table summarises two-months-and-over contractual delinquency (as a percentage of loans and advances) within Personal Financial Services in the US:

(Unaudited)	Quarter ended							
	31 December 2006 %	30 September 2006 %	30 June 2006 %	31 March 2006 %	31 December 2005 %	30 September 2005 %	30 June 2005 %	31 March 2005 %
Residential mortgages ...	2.59	2.24	1.95	1.86	2.06	1.76	1.67	1.65
Second lien mortgage lending	4.02	2.74	1.88	1.79	1.62	1.38	1.53	1.68
Vehicle finance[1]	3.16	3.21	2.82	2.27	3.28	3.10	3.12	2.76
Credit card[2]	4.48	4.46	4.09	4.28	3.46	4.06	3.67	3.91
Private label	2.83	2.88	2.84	2.60	2.41	2.54	2.52	2.70
Personal non-credit card	9.05	8.23	7.56	7.70	8.58	8.28	7.99	8.18
Total[2]	3.70	3.30	2.91	2.84	2.99	2.81	2.71	2.75

Residential mortgages and second lien mortgage lending two-months-and-over contractual delinquency (as a per cent of loans and advances) for the mortgage services and consumer lending portfolios comprised the following:

(Unaudited)	Quarter ended							
	31 December 2006 %	30 September 2006 %	30 June 2006 %	31 March 2006 %	31 December 2005 %	30 September 2005 %	30 June 2005 %	31 March 2005 %
Mortgage services:								
– first lien.........	4.52	3.76	3.11	2.90	3.20	2.78	2.68	2.60
– second lien	5.71	3.67	2.35	1.83	1.91	1.46	1.66	2.02
Total mortgage services .	4.76	3.74	2.94	2.68	2.97	2.57	2.55	2.54
Consumer lending:								
– first lien.........	2.08	1.92	1.87	1.90	2.31	2.27	2.32	2.41
– second lien	3.08	2.03	1.76	2.61	2.07	2.04	2.37	2.45
Total consumer lending .	2.22	1.93	1.86	2.00	2.28	2.24	2.32	2.42

1 *In December 2006, the vehicle finance business changed its write-off policy to provide that the principal balance of vehicle loans in excess of the estimated net realisable value will be written-off 30 days (previously 90 days) after the financed vehicle has been repossessed if it remains unsold, unless it becomes 150 days contractually delinquent, at which time such excess will be written off. This resulted in a one-time acceleration of write-off which totalled US$24 million in December 2006. In connection with this policy change the vehicle finance business also changed its methodology for reporting two-months-and-over contractual delinquency to include loan balances associated with repossessed vehicles which have not yet been written down to net realisable value. This resulted in an increase of 42 basis points to the vehicle finance delinquency ratio and an increase of 3 basis points to the total consumer delinquency ratio. Prior period amounts have been restated to conform to the current year presentation.*

Liquidity risk

All 28 banks in our sample discuss liquidity risk and its management either in the notes or in the risk management section. All of them disclose the maturities (expressed in repayment dates) either of their financial assets and financial liabilities, or of their whole balance sheet, or of their liquidity gap, into maturity groupings. Below are the maturity profile and liquidity gap of **Barclays** [United Kingdom]. The most frequent time bands are: less than one month, one through three months, three through twelve months, one through five years, over five years. In accordance with their specific activities, certain banks have elected to more fully describe the short-term horizon whilst others detail the long-term horizon. In addition, some banks disclose the regulatory liquidity ratios.

[188] **HSBC** [United Kingdom] Annual Report 2006, Page 209

Barclays [United Kingdom] displays[189] :

56 Liquidity risk

The Group's objectives and policies in managing the liquidity risks that arise in connection with the use of financial instruments are set out in Note 52 under the heading 'Liquidity Risk Management'.

The following table provides detail on the contractual maturity of all financial instruments and other assets and liabilities:

At 31st December 2006	On demand £m	Not more than three months £m	Over three months but not more than six months £m	Over six months but not more than one year £m	Over one year but not more than three years £m	Over three years but not more than five years £m	Over five years but not more than ten years £m	Over ten years £m	Total £m
Assets									
Cash and balances with central banks	7,050	295	–	–	–	–	–	–	7,345
Items in course of collection from other banks	1,782	626	–	–	–	–	–	–	2,408
Trading portfolio assets	1,528	28,433	7,034	10,540	27,738	21,606	28,809	52,179	177,867
Financial assets designated at fair value:									
– held on own account	1,899	1,975	295	942	5,692	5,239	4,018	11,739	31,799
– held in respect of linked liabilities to customers under investment contracts	59,462	1,026	366	999	2,856	1,266	2,994	13,829	82,798
Derivative financial instruments	–	11,991	7,803	12,570	24,072	28,249	30,949	22,719	138,353
Loans and advances to banks	2,887	18,806	800	3,063	1,595	1,130	1,012	1,633	30,926
Loans and advances to customers	32,492	44,424	9,901	15,508	31,986	27,668	38,036	82,285	282,300
Available for sale financial investments	564	9,084	2,516	8,733	13,854	4,621	6,999	5,332	51,703
Reverse repurchase agreements and cash collateral on securities borrowed	32,795	117,077	4,670	11,025	1,375	6,939	168	41	174,090
Total financial assets	140,459	233,737	33, 385	63,380	109,168	96,718	112,985	189,757	979,589
Non-financial assets	–	–	–	–	–	–	–	17,198	17,198
Total assets	140,459	233,737	33,385	63,380	109,168	96,718	112,985	206,955	996,787
Liabilities									
Deposits from banks	19,163	55,534	1,418	891	593	1,406	367	190	79,562
Items in course of collection to other banks	2,154	67	–	–	–	–	–	–	2,221
Customer accounts	153,642	89,079	5,594	3,604	1,655	1,436	807	937	256,754
Trading portfolio liabilities	114	11,578	2,885	1,709	12,242	7,495	17,740	18,111	71,874
Financial liabilities designated at fair value:									
– held on own account	6	13,958	6,297	5,143	7,090	8,447	10,978	2,068	53,987
– liabilities to customers under investment contracts	56, 612	1,481	367	912	2,976	1,446	3,737	17,106	84,637
Derivative financial instruments	59	12,040	7,589	13,143	25,510	30,499	32,010	19,847	140,697
Debt securities in issue	17	70,805	8,669	5,311	10,408	3,798	4,017	8,112	111,137
Repurchase agreements and cash collateral on securities lent	2,230	119,048	6,362	2,659	2,305	–	–	4,352	136,956
Subordinated liabilities	–	–	–	–	236	911	4,623	8,016	13,786
Total financial liabilities	233,997	373,590	39,181	33,372	63,015	55,438	74,279	78,739	951,611
Non-financial liabilities	–	–	–	–	–	–	–	17,786	17,786
Total liabilities	233,997	373,590	39,181	33,372	63,015	55,438	74,279	96,525	969,397
Cumulative liquidity gap	(93,538)	(233,391)	(239,187)	(209,179)	(163,026)	(121,746)	(83,040)	27,390	27,390

Market risks on banking or non-trading activities

Market risks are comprised of interest rate risk, currency risk, equity risk and other price risks. Banks usually segregate the management, measurement and monitoring of market risks tied to "banking" or "non-trading" activities from those tied to trading activities.

[189] **Barclays** [United Kingdom] Annual Report 2006, page 243

Interest rate risk

Interest rate risk on "banking activities" is generally measured through repricing profiles, interest rate gaps, sensitivity of earnings for a given change in interest rates, earnings-at-risk. Certain banks also use, but this less frequent, value-at-risk[190] or the sensitivity of the net present value of their portfolios of financial instruments. All banks in the sample indicate that they use one or several of these techniques to monitor their exposure to interest rate risk. A fair number of them explain that in addition to the measurement of the effect of "normal" shifts in the yield curve they carry out stress test to assess the impact of more extreme conditions.

Twelve banks disclose the sensitivity of their net interest margins or earnings to a change in interest rates. The fluctuation bands considered are distributed as follows:

- 3 banks retain a 0,01% change;
- 1 bank retains a 0,10% change;
- 1 bank retains a gradual 1,00% change over 4 terms;
- 6 banks retain a 1,00 % change;
- 1 bank retains fluctuation bands ranging from 2.00% to 8.00 % in order to reflect the differences in yield curve across markets.

Seven banks elect to present the Value-at-Risk (VaR) of their banking portfolios due to interest rate risk, either aggregated with the trading VaR (4 instances) or separately (3).

Here is an extract of **ABN AMRO** [Netherlands][191] :

"**Interest rate risk (banking book)**

Measurement and control

Several measures are used to monitor and limit banking book interest rate risk. The methods employed include earnings simulation, duration and present value per base point limits. Limits are set on the earnings and market value sensitivity. Model-based scenario analysis is used to monitor the interest rate risk positions denominated in euros, Brazilian reals and US dollars to the extent that these positions are held in Europe, Brazil and the US, which relates to some 85% to 90% (2005: 85% to 90%) of the total exposure of the Group. Interest rate risk positions in other currencies and other countries are controlled by present value per base point limits and/or market value limits, as these positions are typically less complex. […]

Interest rate sensitivity disclosure banking book positions

For assessing interest rate risk in the banking books, Group Asset and Liability Management provides a set of measures – the Earnings-at-Risk and Market Value Risk for the EUR, USD and BRL currencies – and reports these to the Group Asset and Liability Committee. […]

*The Earnings-at-Risk table shows the **cumulative sensitivity of net interest income** [emphasis added] over a time horizon of 6, 12, and 24 months, and under a number of predefined scenarios. Sensitivity is defined as the percentage change in the interest income relative to a base case scenario. The base case scenario assumes continuation of the present yield curve environment. The 'rates rise' and 'rates fall' scenarios assume a gradual parallel shift of the yield curve during 12 months, after which the curve remains unchanged. In order to reflect the differences in yield curve across markets, the scenarios are currency-dependent.*

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[190] VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels.

[191] **ABN AMRO** [Netherlands] annual Report 2006. page 208 (earnings definition)

Due to the low interest environment the EUR 'rates fall' scenario is 150 bp (2005: 100 bp), whereas the 'rates rise' scenario is 200 bp for both years presented. The change in scenario, we applied from the first quarter 2006, reflects the higher EUR yield curve and the subsequent increased downward potential. For USD, the scenarios reflect a gradual change of 200 bp upwards and 200 bp downwards for both years. For BRL, the 'rates rise' scenario is 1,100 bp and the 'Rates Fall' is 800 bp for both years presented In all cases, the volume scenario assumes new business volume in line with the business forecast during the first year, and a constant balance sheet thereafter."

The following table shows the cumulative % change in income over the relevant time horizon:

Earnings-at-Risk

		December 2006			December 2005		
	Horizon	EUR	USD	BRL	EUR	USD	BRL
Rates rise	Six months	**(1.7%)**	**(0.2%)**	**(1.2%)**	(2.4%)	(2.1%)	(4.2%)
	One year	**(2.6%)**	**2.6%**	**(2.2%)**	(2.9%)	(1.6%)	(2.8%)
	Two years	**(1.6%)**	**4.2%**	**1.8%**	0.7%	0.3%	3.1%
Rates fall	Six months	**1.2%**	**(6.9%)**	**1.3%**	1.1%	(2.2%)	2.6%
	One year	**1.6%**	**(4.5%)**	**2.3%**	1.3%	(1.1%)	1.3%
	Two years	**(1.5%)**	**(3.7%)**	**(0.7%)**	(1.1%)	(8.8%)	(3.1%)

The Earnings-at-Risk table below gives the 2006 cumulative change in income over the relevant time horizon as absolute numbers using exchange rates at 31 December 2006.

Earnings-at-Risk

(in millions of euros)		December 2006			December 2005		
	Horizon	EUR	USD	BRL	EUR	USD	BRL
Rates rise	Six months	**(31)**	**(2)**	**(19)**	(30)	(19)	(55)
	One year	**(97)**	**44**	**(71)**	(75)	(30)	(77)
	Two years	**(123)**	**150**	**123**	35	12	179
Rates fall	Six months	**23**	**(58)**	**20**	15	(20)	35
	One year	**59**	**(76)**	**74**	33	(21)	36
	Two years	**(115)**	**(131)**	**(46)**	(58)	(343)	(180)

Currency risk

Generally speaking, banks tend to avoid currency risk on the banking book. We have noticed that 7 out of 8 large banks disclose such policy or fact. In other words, their non-trading exposures arise mainly from their net investment in foreign subsidiaries. Several banks provide a breakdown of their financial assets and financial liabilities by currency.

Other market risks

Two banks mention other risk exposures on their non-trading books: **Banco Santander** [Spain] and **BBVA** [Spain] indicate that they are exposed to equity risk. **Nordea Bank** [Sweden] explains that it is exposed to commodity (paper and pulp) price risk on commodity derivatives but that such exposure though monitored within the trading book is solely related to client-driven activities.

All three disclose a measure of such risk. **BBVA** [Spain] discloses[192]:" *The BBVA Group's exposure to structural equity price risk derives mainly from investments in industrial and financial companies with medium- to long-term investment horizons. It is reduced by the net short positions held in derivative instruments on the same underlyings in order to limit the sensitivity of the portfolio to possible falls in prices.*

As of December 31, 2006 the aggregate sensitivity of the Group's equity positions to a 1% fall in the price of the shares amounted to €75 million, 73% of which is concentrated in highly liquid European Union equities. this figure is determined by considering the exposure on shares measured at market price or, in the absence thereof, at fair value, including the net positions in equity swaps and options on the same."

Market risks on trading activities

Market risks are generally measured and managed using Value-at-Risk (VaR) frequently supplemented by other metrics or analyses. As already mentioned, VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. The longer the time horizon and the higher the confidence level, the more stringent the measurement.

All 8 large banks use VaR. Ten out of 12 medium-sized banks similarly use this methodology; the 2 medium-sized banks that do not use it seemingly have only limited trading activities (at the close of 2006 their held-for-trading assets represent less than 2% of their total assets). Three small banks also use it.

Table 203 : Use of Value-at-Risk for the measurement of risk on trading activities
Breakdown by size

Total Assets in EUR Billion	Status	Number of groups	of which using Value-at-Risk	of which not using Value-at-Risk
> 500	Listed	7	7	-
	Non-listed	1	1	-
	Sub total	**8**	**8**	**-**
25 - 500	Listed	10	8	2
	Non-listed	2	2	-
	Sub total	**12**	**10**	**2**
< 25	Listed	7	3	4
	Non-listed	1	-	1
	Sub total	**8**	**3**	**5**
	Total	**28**	**21**	**7**

The assumptions and scope of value-at-risk are disclosed by all large groups, nine medium-sized groups (90 %) as well as two small groups (66 %) using this methodology. The limitations of value-at-risk are not always presented: one large group, several medium-sized and small groups fail to mention them; a qualitative improvement of disclosures is desirable on this point.

[192] **BBVA** [Spain]

Royal Bank of Scotland [United Kingdom] presents[193] this information as follows:

"VaR is a technique that produces estimates of the potential negative change in the market value of a portfolio over a specified time horizon at given confidence levels. For internal risk management purposes, the Group's VaR assumes a time horizon of one day and a confidence level of 95%. The Group uses historical simulation models in computing VaR. This approach, in common with many other VaR models, assumes that risk factor changes observed in the past are a good estimate of those likely to occur in the future and is, therefore, limited by the relevance of the historical data used. The Group's method, however, does not make any assumption about the nature or type of underlying loss distribution. The Group typically uses the previous 500 trading days market data.

The Group's VaR should be interpreted in light of the limitations of the methodology used. These limitations include:

• Historical data may not provide the best estimate of the joint distribution of risk factor changes in the future and may fail to capture the risk of possible extreme adverse market movements which have not occurred in the historical window used in the calculations.

• VaR using a one-day time horizon does not fully capture the market risk of positions that cannot be liquidated or hedged within one day.

• VaR using a 95% confidence level does not reflect the extent of potential losses beyond that percentile.

The Group largely computes the VaR of trading portfolios at the close of business and positions may change substantially during the course of the trading day. Controls are in place to limit the Group's intra-day exposure; such as the calculation of the VaR for selected portfolios. These limitations and the nature of the VaR measure mean that the Group cannot guarantee that losses will not exceed the VaR amounts indicated."

Out of 21 groups using value-at-risk,

- 1 retains a 99 % confidence level and two holding periods (1 day and more than 1 month)
- 1 retains a 99 % confidence level and a holding period of more than 1 month
- 4 retain a 99 % confidence level and a 10 days' holding period
- 10 retain a 99% or more confidence level and 1 day holding period
- 3 retain a 95 % - 99 % confidence level and a 1 day holding period
- 2 disclose the confidence level but not the assumed holding period

Twenty groups disclose one measure of their value-at-risk.

Barclays [United Kingdom] discloses[194] the minimum, maximum and average amount of VaR during the reporting period and additionally discusses the assessment of the effectiveness of the model: "*Daily value at risk (DVaR) is an estimate of the potential loss which might arise from unfavourable market movements, if the current positions were to be held unchanged for one business day, measured to a confidence level of 98%. Daily losses exceeding the DVaR figure are likely to occur, on average, twice in every 100 business days.*

In Barclays Capital, DVaR is an important market risk measurement tool. DVaR is calculated using the historical simulation method with a historical sample of two years.

[193] **Royal Bank of Scotland** [United Kingdom]

[194] **Barclays** [United Kingdom] Annual Report 2006, page 234

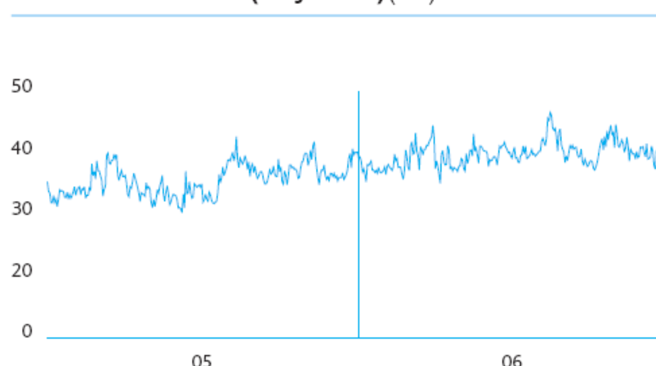
The effectiveness of the DVaR model is assessed principally by backtesting which counts the number of days when trading-related losses are bigger than the estimated DVaR figure. Back-testing results are shown on page 88. Outside Barclays Capital, Barclays uses a simplified approach to calculate DVaR. »

Barclays Capital DVaR: Summary table for 2006 and 2005

	12 months to 31st December 2006		
	Average £m	High(b) £m	Low(b) £m
Interest rate risk	20.1	28.8	12.3
Credit spread risk	24.3	33.1	17.9
Commodities risk	11.3	21.6	5.7
Equities risk	7.8	11.6	5.8
Foreign exchange risk	4.0	7.7	1.8
Diversification effect	(30.4)	n/a	n/a
Total DVaR	37.1	43.2	31.3

The graph below shows the history of total DVaR on a daily basis for 2005 and 2006.

DVaR in 2005 and 2006 (daily values) (£m)



Barclays adds[195] :

« Barclays recognises the importance of assessing the effectiveness of its DVaR model. The main approach employed is the technique known as back-testing, which counts the number of days when trading losses exceed the estimated DVaR figure. The regulatory standard for backtesting is to measure DVaR assuming a one-day holding period with a 99% level of confidence. For Barclays Capital's regulatory trading book, there were no instances in 2006 or 2005, of a daily trading revenue loss exceeding the corresponding back-testing DVaR. »

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[195] **Barclays** [United Kingdom] Annual Report 2006, page 235

20.13. Clarity and relevance of the presentation of risks

Our analysis also included an assessment of the clarity of financial risk disclosures. We have considered these disclosures to be clear when the following criteria were met:

- risk factors are clearly described in relation to the group's activities;
- risk management objectives and policies are expressed for the identified risk factors;
- And finally for each risk exposure a relevant measure is provided.

All banks provide descriptions of risk factors they are exposed to. Additionally, large and medium-sized banks elaborate on their risk management frameworks and present their risk management objectives and policies in this context. Risk limits are referred to as a mean to ensure compliance with the risk appetite of the group. The sophistication of disclosures is higher for large groups than for small ones.

We have found a majority of clear disclosures containing an informative combination of (1) narrative statements explaining the nature of the data presented and commenting on significant figures, changes or trends; (2) selected summary quantitative data allowing users to understand the global risk profile of the group and (3) detailed information where a specific focus is needed. Several groups discuss the effectiveness of their models and techniques and substantiate the discussion with a disclosure of back-testing results or similar information.

Instances where we have considered the disclosures to be unclear are as follows:

- Risk disclosures presented over 100 pages and about as many tables without a word of explanation or comment. This form of disclosure is unlikely to assist users in a proper way;
- apparently similar risk measures presented both in the management commentary and in the notes but figures differ for an unknown reason;
- the component parts of the disclosure in different sections of the annual report and the relationship between the different parts of the report difficult to understand;
- risk exposures presented at instrument level not for the entire group or for the relevant segment;
- A significant risk (namely credit risk) neither analysed nor commented upon (three instances noted).

Apart from these cases, we have observed that for some specific topics the clarity and relevance of the disclosures could be improved. This comment applies for instance to the disclosure of interest rate risk and currency risk on the banking book.

As already mentioned, several groups disclose the potential impact on profit or loss of a given fluctuation in interest rates. The magnitude of the assumption factored in the calculation of sensitivity for interest rate risk exposures in the European environment varies from 0.01 % (a purely calculating means) to 2 % (a stress scenario). In some instances, the sensitivity measure disclosed seems unrelated or loosely related to the indicators that are considered for decision-making purposes. Some groups provide no sensitivity analysis whereas they indicate that sensitivity indicators are reported to management. In the case of groups operating in different economic environments, assumptions are not always differentiated by economic environment.

One can expect that IFRS 7 will bring clarity in this respect as the standard requires that the impact of risk factors on profit or loss be calculated for a reasonably possible change. Similarly the standard mandates that such possible change be adapted to the different economic environments in which risk exposures arise and for which a sensitivity analysis is required. Overall, the new standard adopts a management view approach which implies that users will be provided with information that management considers relevant. We have noted that the disclosures of all early IFRS 7 adopters had such features.

Table 204 : Clarity of financial risk disclosures – Breakdown by size

Total Assets (EUR Billions)		Number of groups	Of which using VAR	%
> 500	Listed	7	6	86%
	Non-listed	1	1	100%
	Sub total	**8**	**7**	**88%**
25 - 500	Listed	10	9	90%
	Non-listed	2	1	50%
	Sub total	**12**	**10**	**83%**
< 25	Listed	7	5	71%
	Non-listed	1	1	100%
	Sub total	**8**	**6**	**75%**
	Total	**28**	**23**	**82%**

Here follows[196] an illustration of IFRS 7 disclosures made by Nordea [Sweden]:

limits are set in relation to the earnings these activities generate.

Reporting and control processes
The CRO receives daily reporting on the Group's consolidated market risk. GEM receives reports on a monthly basis, and the Board of Directors on a quarterly basis.

Adherence to limits is crucial and if a limit decided by the Board of Directors, ALCO or the CRO were to be violated, the decision-making body would be informed immediately.

Measurement methods
As there is no single risk measure that captures all aspects of market risk, Nordea on a daily basis uses several risk measures including Value-at-Risk (VaR) models, stress testing, Jump-to-Default exposure, scenario simulation and other non-statistical risk measures such as basis point values, net open positions and option key figures.

Normal market conditions
VaR is used by Nordea to measure interest rate, foreign exchange, equity and credit spread risks. A VaR measure across these risk categories, allowing for diversification among them, is also used. For interest rate, foreign exchange and equity risk, the VaR figures include both linear positions and options.

VaR is a statistical risk measure, which in Nordea is based on the last two years' historical changes in market prices and rates, a holding period of 10 banking days and a probability of 99%. Nordea's historical simulation VaR model is based on the expected shortfall approach, which implies using the average of a number of the most adverse simulation results as an estimate of VaR.

The book value of private equity funds and the market risk in structured equity derivatives are limited and monitored in the daily market risk management process, but are not included in the VaR figures.

From the end of 2006, Nordea's VaR model is the basis for calculating risk weighted assets for general market risk from equities, interest rates and foreign exchange in the trading books of all four Nordic countries, as well as for specific market risk from equities and interest rates in the major portfolios. As a consequence, the Group's risk- weighted assets for market risk have been reduced by around EUR 7bn from end of third quarter to EUR 9.1bn at end of 2006.

The risk on commodity positions, both linear and non-linear, is measured using scenario simulation. The scenarios are based on the sensitivity to changes in commodity prices and their volatility.

The market risk on Nordea's account due to a mismatch between the market risk exposure on policy holders' assets and liabilities in Nordea Life and Pensions is measured as the loss sensitivity for two standard market scenarios, which represent normal and stressed market conditions, respectively.

Back-tests of the VaR-model are performed daily in accordance with the guidelines laid down by the Basel Committee on Banking Supervision in order to test the reliability of the VaR and simulation models. The models have shown reliable statistical characteristics throughout 2006.

Stress testing
Stress tests are used to estimate the possible losses that may occur under extreme market conditions. Nordea performs daily stress tests based on the current portfolio and information about the daily financial market developments since the beginning of 1993. In addition, Nordea's portfolios are stress tested for subjective scenarios, which are most often based on selected historical events prior to 1993 or adverse scenarios relevant at the current state of the economic cycle or geopolitical situation. Market risk is also a part of Nordea's comprehensive ICAAP stress testing.

Market risk analysis
The analysis is based on the consolidated risk stemming from both investment and trading activities. Overall, fluctuations in the risk levels for the various categories of risks have been moderate over the year.

Nordea's market risk associated with the mismatch between policyholders' assets and liabilities in Nordea Life and Pension is analysed separately. The scenario for normal market conditions shows a risk of EUR 12m at the end of 2006 (EUR 0.2m). The market risk from the internal pension plans is also measured separately.

Total risk
The total VaR was EUR 34m (EUR 50m) at the end of 2006 recognising a noticeable diversification effect between interest rate, equity and foreign exchange and credit spread risk, as the total VaR is lower than the sum of the risk in the four categories.

Interest rate risk
The total interest rate VaR ended 2006 at EUR 23m (EUR 35m). The total gross sensitivity to a 1-percentage-point parallel shift, which measures the development in the market value of Nordea's interest rate sensitive positions if all interest rates were to

Market risk

EURm	Measure	31 Dec 2006	2006 high	2006 low	2006 average	31 Dec 2005
Total risk	VaR	34.3	61.2	30.8	41.5	49.7
Interest rate risk	VaR	23.0	48.5	17.7	29.2	35.4
Equity risk	VaR	27.1	36.2	13.9	23.6	23.7
Foreign exchange risk	VaR	4.2	7.6	2.1	4.2	2.3
Credit spread risk	VaR	1.7	7.6	1.6	4.0	-
Diversification effect	% of total VaR	39%				
Commodity risk, linear	Simulation	4.0	11.8	2.3	5.0	11.7
option risk, non-linear risk	Simulation	2.9	7.9	1.8	4.9	6.0

[196] **Nordea** [Sweden] Annual Report 2006, page 50-54

m at the end of 2006 (EUR 261m). The largest part of Nordea's interest rate sensitivity stemmed from interest rate positions in Danish Kroner, Euro, Swedish Kronor, US Dollars and Norwegian Kroner.

Equity risk
At the end of 2006, Nordea's equity VaR stood at EUR 27m (EUR 24m) and the net sensitivity to a 10% movement in equity prices was EUR 35m (EUR 28m). The largest equity exposure was to the financial sector.

Foreign exchange risk
Nordea's foreign exchange VaR of EUR 4m (EUR 2m) at year-end is relatively low compared to the interest rate and equity risk exposure. The gross sensitivity to a 5% change in the exchange rate of all currencies vis-à-vis the Euro was EUR 25m (EUR 23m).

Credit spread risk
Credit spread VaR remained fairly stable throughout the year and was EUR 2m at year-end.

Commodity risk
Nordea's exposure to commodity risk, primarily pulp and paper, is solely related to client-driven activities. The linear commodity risk was EUR 4m (EUR 12m) at the end of 2006 and the net sensitivity to a 10% movement in all relevant commodity prices was EUR 0.1m. The commodity option risk was EUR 3m (EUR 6m).

Structural Interest Income Risk
Structural Interest Income Risk (SIIR) is the amount Nordea's accumulated net interest income would change during the next 12 months if all interest rates change by one percentage point.

It reflects the mismatch in the balance sheet items and the off-balance-sheet items when the interest rate re-pricing periods, volumes or reference rates of assets, liabilities and derivatives do not correspond exactly.

Measurement methods
The basic measures for SIIR are the two re-pricing gaps measuring the effect on Nordea's net interest income for a 12 months period of a one percentage point increase, respectively

pricing gaps are calculated under the assumption that no new market transactions are made during the period. Main elements of the customer behaviour and Nordea's decision-making process concerning Nordea's own rates are, however, taken into account. For example in a low interest rate environment, when rates are decreasing further, the total decrease of rates cannot be applied to non-maturity deposits since rates cannot be negative. Similarly in an increasing rate environment Nordea may choose not to increase interest rates on all customer deposits immediately.

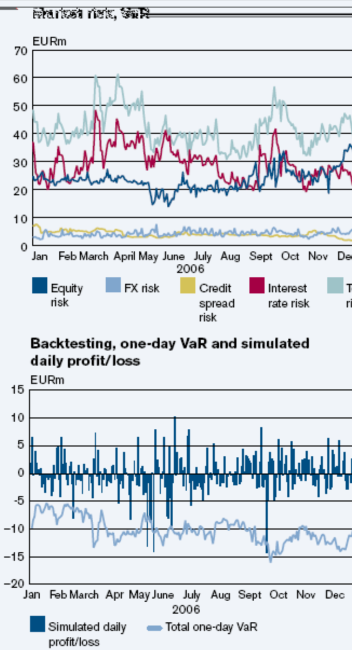
SIIR analysis
At the end of the year, the SIIR for decreasing market rates was EUR –220m (EUR –175m) and the SIIR for increasing rates was EUR 206m (EUR 154m). These figures imply that net interest income would decrease if interest rates fall and increase if interest rates rise.

Liquidity risk
Liquidity risk is the risk of being able to meet liquidity commitments only at increased cost or, ultimately, being unable to meet obligations as they fall due.

Measurement methods
The liquidity risk management focuses on both short-term liquidity risk and long-term structural liquidity risk. Nordea's liquidity risk management includes a business continuity plan and stress testing for liquidity management. In order to measure the exposure on both horizons, a number of liquidity risk measures have been developed.

In order to avoid short-term funding pressures, Nordea measures the funding gap risk, which expresses the expected maximum accumulated need for raising liquidity in the course of the next 14 days. Funding gap risk is measured for each currency and as a total figure for all currencies combined.

To ensure funding in situations where Nordea is in urgent need of cash and the normal funding sources do not suffice, Nordea holds a liquidity buffer. The liquidity buffer consists of high-grade liquid securities that



can be sold or used as collateral in funding operations.

The structural liquidity risk of Nordea is measured by the net balance of stable funding, which is defined as the difference between stable liabilities and stable assets. These liabilities primarily comprise retail deposits, bank deposits and bonds with a term to maturity longer than 6 months, and shareholders' equity, while stable assets primarily comprise retail loans and other loans with a term to maturity longer than 6 months. ALCO has set as a target that the net balance of stable funding should be positive, which means that stable assets must be funded by stable liabilities. The table shows the maturity of financial liabilities. Nordea manages the liquidity risk inherent in financial liabilities with the funding gap risk, the liquidity buffer and the net balance of stable funding, which are presented in the liquidity risk analysis below.

Liquidity risk analysis
The short-term liquidity risk has been held at moderate levels throughout 2006. The average funding gap risk, i e the average expected need for raising liquidity in the course of the next 14 days, has been EUR 2.8bn (EUR 2.3bn).

SIIR, Gap analysis 31 Dec 2006

Re-pricing gap for increasing interest rates

EURm Interest Rate Fixing Period	Group balance sheet	Within 3 months	3–6 months	6–12 months	1–2 years	2–5 years	>5 years	Non Repricing	Total
Assets									
Interest bearing assets	289,121	190,288	16,543	12,957	7,134	9,616	25,128	27,454	289,121
Off-balance sheet items	0	2,639,283	17,380	18,357	19,977	17,278	3,883	0	2,716,158
Non interest bearing assets	57,769	0	0	0	0	0	0	57,769	57,769
Total assets	**346,890**	**2,829,571**	**33,924**	**31,314**	**27,111**	**26,894**	**29,011**	**85,223**	**3,063,048**
Liabilities and equity									
Interest bearing liabilities	250,333	153,729	11,168	20,026	18,627	18,728	24,048	4,007	250,333
Off-balance sheet items	0	2,656,646	19,045	16,025	11,458	9,568	3,415	0	2,716,158
Non interest bearing	96,557	0	0	0	0	0	0	96,557	96,557
Total liabilities and equity	**346,890**	**2,810,375**	**30,214**	**36,051**	**30,085**	**28,296**	**27,463**	**100,564**	**3,063,048**
Exposure		**19,196**	**3,710**	**–4,737**	**–2,974**	**–1,402**	**1 549**	**–15,342**	
Cumulative exposure			**22,906**	**18,169**	**15,195**	**13,793**	**15,342**	**0**	

Liquidity risk, contractual maturity analysis for financial liabilities

Contractual cash flows EURm Remaining contractual maturity	31 dec 2006 Payable on demand	Other within 1 year	1–5 year	>5 year	Total
Liabilities	105,723	89,092	38,843	35,442	269,099

EURm Remaining contractual maturity	31 dec 2005 Payable on demand	Other within 1 year	1–5 year	>5 year	Total
Liabilities	86,917	103,252	25,697	38,966	254,832

Nordea's liquidity buffer has been in the range EUR 13.9–27.0bn (EUR 13.7–26.3bn) throughout 2006 with an average of EUR 18.5bn (EUR 19.1bn). Nordea considers this a high level and it reflects the Group's conservative attitude towards liquidity risk in general and towards unexpected liquidity events in particular.

The aim of always maintaining a positive net balance of stable funding has been comfortably achieved throughout 2006. The yearly average for the net balance of stable funding was EUR 9.7bn (EUR 7.4bn).

Operational risk

In the Group's Policy for Internal Control and Risk Management, operational risk is defined as the risk of direct or indirect loss, or damaged reputation resulting from inadequate or failed internal processes, from people and systems, or from external events. Legal and Compliance risks as well as Crime risk and Process risks, including IT risk, constitute the main sub-categories to Operational risk.

Operational risks are inherent in all activities within the organisation, in outsourced activities and in all interaction with external parties.

Solid internal control and quality management, consisting of a risk-management framework, leadership and skilled personnel, is the key to successful operational risk management. An annual report on the quality of Internal Control in the Group is submitted to the Board, incorporating all main issues on financial and operational risks.

Each business area is primarily responsible for managing its own operational risks. Group Credit and Risk Control develops and maintains a framework for identifying, assessing, monitoring and controlling operational risks and supports the line organisation in implementing the framework.

Information security, physical security and crime prevention are important components when managing operational risks. To cover this broad scope, the Group security function is included in Group Credit and Risk Control, and close cooperation is maintained with Group IT as well as Group Legal and Group Compliance.

The main processes for managing operational risks are an ongoing monitoring through self-assessment and the documenting and registering of incidents and quality deficiencies. The analysis of operational risk-related events, potential risk indicators and other early-warning signals are in focus when developing the processes.

The mitigating techniques consist of business continuity plans together with crisis management preparedness and a broad insurance cover for handling major incidents. Mitigation efforts target reliability and continuity in the value chains rather than focusing on single units in the organisation. Special emphasis is put on quality and risk analysis in change management and product development.

The techniques and processes for managing operational risks are structured around the risk sources as described in the definition of operational risk. This approach improves the comparability of risk profiles in different business areas and globally throughout the organisation. It also supports the focus on limiting and mitigating measures in relation to the sources, rather than the symptoms.

21. Overall evolution from 2005 to 2006

The overall evolution of disclosure content and presentation between 2005 and 2006 was very limited. On many instances, preparers maintained financial statements templates and accompanying notes barely unchanged. Once having met the challenge of transition to IFRS and gone through the threshold of auditors and regulators reviews, many preparers likely felt unproductive to further enhance their disclosures in 2006.

This being said, and while it is difficult to assess evolution on the basis of a quantitative analysis, we consider that 2006 financial statements showed improvement in this respect over 2005.

Despite renewed advice from regulators and observers to avoid boilerplate presentation of accounting principles, there were still instances to be found in 2006 financial statements. Two main patterns emerge:

- The use of wording stated in the standards, without further explanations relating to the specificities of the preparer.

  As an example, regarding the impairment of intangibles assets, a majority of companies used the wording of IAS 36 without further relevant information relating to the methodology applied by the Group to calculate the recoverable value (fair value less costs to sell, value in use or the higher of the previous methods).

- The irrelevant disclosure of accounting policies, as they appear to deal with issues that are non-material for the preparer.

  As example, regarding the disclosure of financial instruments, 20% to 25% of small and medium sized groups disclose accounting policies for categories of financial assets that they do not present as such on their balance sheet:

  As another example, one small group discloses that it has retained the Held-for-Trading and the Available-for-Sale categories whereas it classifies financial investments in the Held-to-Maturity category for which no accounting policy is provided.

As it could be expected, tendency to disclose boilerplate presentation appears more frequent on complex, technically challenging standards, and with small or even medium sized companies.

However, boilerplating is not a widespread feature, and many preparers and reviewers demonstrated successful efforts in tailoring the wording of their accounting principles to ensure straightforward understanding.

The reference made to IFRS-EU as accounting standards improved significantly from 2005 to 2006. It reached 99% of financial statements for the 250 listed companies, under the combined effect of two possible causes:

- Continuing IFRS reporters that had previously adhered to IFRS choose to adopt IFRS-EU in 2006 onwards.
- First time applicants that had overlooked in 2005 the importance of precisely defining their set of accounting standards (either IRFS or IFRS-EU or both) clarified in 2006 their reference to IFRS-EU.

Table 205 : Reference to IFRS-EU as the set of accounting principles

	2005		2006	
	Number of companies	%	Number of companies	%
Compliance with IFRS-EU	158	72 %	219	88%
Compliance with both IFRS & IFRS-EU	32	15%	28	11%
Total IFRS-EU	**190**	**87%**	**247**	**99%**
Compliance with IFRS only	28	13%	3	1%
Total	**218**	**100%**	**250**	**100%**

Sources: 2005 Table 8.2 p 76 & Table 9.3 p 83, ICAEW

With the notable exception of amendments to IAS 19 & 39 that took effect in 2006, an average of 3 to 5% of companies disclose the early adoption of future IFRS standards or IFRIC interpretations.

In 2005, the first year of application of IFRS for all listed companies, as much as 30% of companies early adopted the amendment to IAS 19 *Actuarial Gains and Losses, Group Plan and Disclosures*, and 18% the amendment to IAS 39 on Fair Value Option. It is likely that numerous First Time applicants took the opportunity to adopt an all inclusive set of standards at the same time, including forthcoming changes that they deemed relevant for them.

Amendments and interpretations early adopted in 2005 all became effective for all companies in 2006. It is therefore not possible to track progression over time of early adoption of these regulations.

Also, new standards and interpretations early adopted in 2006 had not been used as early as 2005. It is therefore not possible to track progression over time of early adoption of these regulations.

Early adoption rates in 2005 and 2006 appear however comparable, in the range of 1% to 5% of companies.

Table 206 : Early adoption of IFRS

	2005		2006	
	Number of companies	**%**	**Number of companies**	**%**
Amendment to IAS 19 : Actuarial Gains and Losses, Group Plan and Disclosures	60	30%	effective in 2006 for all companies	
Amendment to IAS 39 : Cash Flow Hedge Accounting of Forecast Intragroup Transactions	19	10%		
Amendment to IAS 39 The Fair Value Option	36	18%		
Amendment to IAS 39 Financial Guarantee Contracts	5	3%		
IFRIC 4 Determining whether an Arrangement contains a lease	8	4%		
IFRIC 5 Rights to Interests arising from Decommissioning, Restoration, and Environmental Rehabilitation Funds	3	2%		
IFRIC 6 Liabilities arising from Participating in a Specific Market – Waste Electrical and Electronic Equipment	0	0%		
IRFS 7 Financial Instruments : Disclosures	No early application in 2005		12	5%
Amendment to IAS1 : Capital Disclosures			5	2%
IFRS 8 : Operating Segments			2	1%
IFRIC 7 Applying the Restatement Approach under IAS 29 Financial Reporting in Hyperinflationary Economies			9	4%
IFRIC 8 Scope of IFRS2			10	4%
IFRIC 9 Reassessment of Embedded Derivatives			13	5%
IFRIC 10 Interim Financial Reporting and Impairment			11	4%
IFRIC 11 IFRS 2 Group and Treasury Share Transactions			2	1%
IFRIC 12 Service Concession Arrangements			2	1%

Sources: 2005 Table 8.2 p 76 & Table 9.3 p 83, ICAEW

As already observed, a relatively low number of companies opted for Fair Value accounting, whenever offered the option to do otherwise. 2006 statistics largely confirm the findings of 2005 study, however with a larger proportion of preparers using Fair Value for financial instruments, and a lesser proportion of preparers using Fair Value for PPE and Investment property revaluation.

Table 207 : Use of Fair Value for financial assets

	2005			2006		
	Number of companies		%	Number of companies		%
	Using FVO	Total	using FVO	Using FVO	Total	using FVO
Banks	21	29	72%	22	28	79%
Insurance companies	8	13	62%	8	10	80%
Other companies	7	159	4%	8	80	10 %
Total	**36**	**200**	**18%**	**38**	**118**	**32%**

Sources: 2005 Table 14.1, p 118, ICAEW

Table 208 : Use of Fair Value for PPE

	2005		2006	
	Number of companies	%	Number of companies	%
Cost model for all property, plant and equipment	191	96%	73	97%
Revaluation model for all property, plant and equipment			1	1%
Revaluation model for all properties; cost model for all plant and equipment	5	3%		
Revaluation model for some properties; cost model for other properties and all plant and equipment	3	2%		
Cost model for all properties and plants, and revaluation models for some equipments			1	1%
No own use property, plant and equipment	1	1%		
Total	**200**	**100%**	**75**	**100%**

Sources: 2005 Table 14.2, p 119, ICAEW

Table 209 : Use of Fair Value for Investment Property

	2005		2006	
	Number of companies	%	Number of companies	%
Fair Value Model	23	12%	6	8%
Cost Model	58	29%	27	36%
No investment property	119	60%	42	56%
Total	**200**	**100%**	**75**	**100%**

Sources: 2005 Table 14.4, p 121, ICAEW

The proportion of companies disclosing impairment charges on goodwill and other intangible assets rose slightly from 2005 to 2006. 42% of companies disclosed such a charge in 2005 and 49% in 2006. 39% of companies disclosed neither in 2005 nor in 2006 any impairment charge on goodwill and other intangible assets. For two companies, the information was not clearly disclosed or not separately displayed from impairments linked to the tangible assets.

Table 210 : Impairment on goodwill and other intangible assets

	2005		2006	
	Number of companies	%	Number of companies	%
Impairment charges	31	42%	36	49%
No impairment charges	42	55%	37	48%
No disclosure	2	3%	2	3%
Total	**75**	**100%**	**75**	**100%**

Analysis of other IFRS option in 2006 mostly confirmed the observations made in 2005. The presentation of income statement remained quite well balanced between function and nature classifications. It is noteworthy that one preparer disclosed a change in accounting policy, relative to a change of presentation as it switched from nature classification to function classification.

Table 211 : Disclosure of expenses in the income statement

	2005		2006	
	Number of companies	%	Number of companies	%
Function classification	81	41%	108	40%
Nature classification	73	37%	91	34%
Combination of both classification	1	1%	3	1%
Banks, insurance and other financial institutions	45	23%	68	25%
Total	**200**	**100%**	**270**	**100%**

Sources: 2005 Table 13.1, p 110, ICAEW

The choice of accounting method for borrowing costs appears remarkably stable between the 2005 and 2006 samples. It is noteworthy that for the three companies out of four not disclosing capitalised borrowing costs, it is virtually impossible to conclude whether they expensed significant amounts of such costs or not.

Table 212 : Choice of method of accounting of borrowing costs

	2005		2006	
	Number of companies	%	Number of companies	%
Capitalised	51	26%	64	26%
Expensed	149	74%	186	74%
Total	**200**	**100%**	**250**	**100%**

Sources: 2005 Table 15.6 p 131, ICAEW

The choice of method for the consolidation of interests in jointly controlled entities remained somewhat stable between the 2005 and 2006 samples. However a slightly higher proportion of companies disclosed in 2006 the existence of such interests, resulting in a higher proportion of proportionate consolidations.

Table 213 : Choice of method of consolidation for interests in jointly controlled entities

	2005		2006	
	Number of companies	%	Number of companies	%
Proportionate consolidation	60	30%	89	36%
Equity method	41	21%	53	21%
No jointly controlled entities	99	50%	108	43%
Total	**200**	**100%**	**250**	**100%**

Sources: 2005 Table 15.7 p 132, ICAEW

The choice of method for the recognition of actuarial gains and losses on post-employment benefits plans shows some differences between the 2005 and 2006 samples. While the corridor approach was the most frequent in 2005, immediate recognition in balance sheet and equity appears favoured in 2006.

Table 214 : Choice of method of actuarial gains and losses

	2005		2006	
	Number of companies	%	Number of companies	%
All gains and losses recognised immediately in the balance sheet and in the income statement	19	12%	4	6%
All actuarial gains and losses recognized immediately in the balance sheet and in equity	54	33%	37	53%
Companies recognizing all actuarial gains and losses immediately	**73**	**45%**	**41**	**59%**
All actuarial gains and losses deferred and amortized in both balance sheet and income statement	1	1%		
Actuarial gains and losses recognised using corridor approaches	88	54%	29	41%
Total	**200**	**100%**	**70**	**100%**

Sources: 2005 Table 15.1 p 128, ICAEW

22. Sampling Methods for 2006 Financial Statements selection

Sampling criteria

The study relies on a sampling of 270 EU companies reporting in IFRS, including 250 listed companies, selected by a sampling approach designed to ensure that the sample is representative of the overall population of companies according to three criteria:

- Member State: the companies sampled are registered in one of the twenty-five Member States of the European Union subject to the IFRS regulation as of 31 December 2006. The sampling comprises :
  - at least three listed companies from each Member State
  - at least one unlisted company from eleven of the twenty-five Member State

  In all but one of the twenty-five Member States, the capitalization of listed companies in the sampling exceeds 20%[197] of the market capitalization of domestic shares. Globally, the capitalization of the 250 listed companies in the sampling exceeds EUR 4 200 billion or 40% of the total European market capitalization.
- Industry sector: the companies sampled are classified according to the ICB eighteen “Super-sectors”. The sampling comprises :
  - at least eight listed companies from each sector
  - at least one unlisted company from twelve of the eighteen sectors

  In each of the eighteen sectors, the capitalization of listed companies in the sampling exceeds 20% of the market capitalization of the sector at a European level.
- Company Size : the companies sampled comprise :
  - 76 listed companies with a market capitalization in excess of EUR 15 billion: “**large cap**”
  - 87 listed companies with a market capitalization between EUR 500 million and EUR 15 billion: “**medium cap**”
  - 87 companies with a market capitalization below EUR 500 million : “**small cap**”, of which 9 companies are eligible for SME criteria: two small[198] and seven medium[199]
  - 20 unlisted companies.

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[197] and 15% of market capitalization of domestic shares on the Bratislava Stock Exchange (Slovenia)

198 meeting two criterion : Net turnover < EUR 8.8 million, Total balance sheet < EUR 4.4 million, workforce < 50 employees

[199] meeting two criterion : Net turnover < EUR 35 million, Total balance sheet < EUR 17.5 million, workforce < 250 employees

Sampling method

In each regulated market place of the twenty-five Member States, we selected - on the basis of the market capitalization as of 31 December 2006 - the top two companies (50 companies), and within each of the eighteen industry sectors, we selected the top four EU25 companies (64 companies). After double counting elimination, we had a list of 107 companies.

At this stage, we cross checked the list of 107 companies with the list of European companies registered with the U.S. SEC for ADR (American Depositary Receipt) listing either on the NYSE or the NASDAQ. We found 18 out of the 20 largest companies, ranked by market capitalization as of 31st December 2006, already in our sample and therefore added the two missing companies (one bank from United Kingdom and one bank from Spain), bringing the sample from 107 to 109.

The sample was completed by 115 other companies, randomly selected to ensure a proper balance between Member States and industry sectors, and 26 companies, mostly involved in financial services, insurance, concession business and extractive industries chosen for the purpose of analyzing specific standards.

Finally, we identified 20 unlisted groups, of various size and type of business, whose financial statements for year 2006 have been prepared in accordance with IFRS.

Whenever the case arose, we excluded from the sample companies not registered in one of the twenty-five Member States, and companies controlled (subsidiaries) by another company already included in the sample.

Table 215 : Presentation of the sample breakdown by Member States

Number of companies	Listed companies			Unlisted companies	Total
	Top Market Cap	Other Companies	Specific Sectors		
Austria	2	4	1		**7**
Belgium	2	8	4		**14**
Cyprus	2	1		1	**4**
Czech Republic	2	1			**3**
Denmark	3	4	1	1	**9**
Estonia	2	1			**3**
Finland	2	4	3	2	**11**
France	19	12	1	1	**33**
Germany	12	12	1	4	**29**
Greece	3	4	1		**8**
Hungary	2	1			**3**
Ireland	2	4			**6**
Italy	4	8	3	2	**17**
Latvia	2	1			**3**
Lithuania	2	1			**3**
Luxemburg	2	1	1		**4**
Malta	2	1		1	**3**
Netherlands	7	8	1	1	**17**
Poland	2	4			**6**
Portugal	2	1	1	2	**6**
Slovakia	2	1			**3**
Slovenia	2	1			**2**
Spain	4	12	3		**19**
Sweden	5	8	1	3	**17**
United Kingdom	20	12	4	2	**38**
Total	**109**	**115**	**26**	**20**	**270**

Market capitalisation in EUR million as of 29 December 2006

Sources: Federation of European Securities Exchange; OMX Nordic Exchange, Euronext, FTSE International

Table 216 : Presentation of the sample breakdown by industry

Number of companies *market cap in EUR million*	Listed companies			Unlisted	Total	Total market	% market sampled
	Large cap	Medium cap	Small cap	companies	sampling		
Automobiles & Parts	4 *123 239*	2 *4 128*	3 *993*	1	**10** ***128 360***	***266 400***	***48%***
Banks	15 *824 438*	7 *38 506*	2 *505*	5	**29** ***863 449***	***2 261 555***	***38%***
Basic Resources	5 *194 632*	3 *8 162*	3 *899*	1	**12** ***203 693***	***389 631***	***52%***
Chemicals	3 *88 439*	4 *20 453*	1 *42*	1	**9** ***108 934***	***215 723***	***50%***
Construction & Materials	4 *82 079*	3 *6 139*	1 *42*	1	**9** ***88 260***	***297 533***	***30%***
Financial services	1 *16 026*	16 *76 055*	11 *1 785*		**28** ***93 866***	***348 673***	***27%***
Food & Beverage	4 *136 651*	5 *10 827*	5 *785*	2	**16** ***148 263***	***412 396***	***36%***
Health Care	4 *289 618*	5 *10 164*	8 *1 411*	1	**18** ***301 192***	***505 750***	***60%***
Industrial goods & services	5 *167 518*	5 *34 931*	20 *4 964*	2	**32** ***207 414***	***713 567***	***29%***
Insurance	5 *276 723*	3 *18 121*	2 *476*		**10** ***295 321***	***666 123***	***44%***
Media	1 *34 053*	6 *42 006*	1 *217*		**8** ***76 276***	***312 001***	***24%***
Oil & Gas	4 *564 011*	4 *19 785*	3 *894*		**10** ***452 231***	***962 564***	***61%***
Personal & Household Goods	4 *162 861*	3 *8 858*	11 *1 551*	1	**19** ***173 270***	***465 479***	***37%***
Retail	4 *133 502*	3 *7 513*	1 *268*	2	**10** ***141 282***	***391 406***	***36%***
Technology	2 *87 658*	2 *10 058*	9 *912*		**13** ***98 628***	***324 807***	***30%***
Telecommunications	5 *351 531*	4 *25 441*	1 *352*		**10** ***377 324***	***700 696***	***54%***
Travel & Leisure		6 *42 528*	2 *165*	2	**10** ***42 693***	***170 971***	***25%***
Utilities	6 *282 292*	6 *22 135*	3 *567*	1	**16** ***304 993***	***910 603***	***33%***
TOTAL	**76** ***3 815 270***	**87** ***405 811***	**87** ***16 827***	**20**	**270** ***4 237 908***	***10 315 877***	***41%***

Market capitalisation in EUR million as of 29 December 2006

Sources: FTSE International, Ineum consulting analysis

Appendix 1: Sampled companies

Listed companies

Company	Country of incorporation	Industry Sector
A.P. Moller-Maersk	DENMARK	Industrial goods & services
Aalberts Industries	NETHERLANDS	Industrial goods & services
Abbeycrest	UK	Personal & Household Goods
Abbot Group	UK	Oil & Gas
Abertis Infraestructuras	SPAIN	Industrial goods & services
ABN AMRO	NETHERLANDS	Banks
Accor	FRANCE	Travel & Leisure
Agora	POLAND	Media
AIB	IRELAND	Banks
AIG International Real Estates	GERMANY	Financial services
Akzo Nobel	NETHERLANDS	Chemicals
Alcatel-Lucent	FRANCE	Technology
Alitalia	ITALY	Travel & Leisure
Alleanza Assicurazioni	ITALY	Insurance
Allianz	GERMANY	Insurance
Amsterdam Commodities (Acomo)	NETHERLANDS	Food & Beverage
Anglo American	UK	Basic Resources
Arcelor	LUXEMBURG	Basic Resources
Areva	FRANCE	Utilities
ASML Holding	NETHERLANDS	Technology
AstraZeneca	UK	Health Care
Atlantia (Autostrade)	ITALY	Industrial goods & services
AWD Group	GERMANY	Financial services
AXA	FRANCE	Insurance
Azkoyen	SPAIN	Industrial goods & services
Banco Santander Central Hispano	SPAIN	Banks
Bang & Olufsen	DENMARK	Personal & Household Goods
Bank Handlowy	POLAND	Banks
Bank of Cyprus Public Company	CYPRUS	Banks
Bank of Valletta	MALTA	Banks
Barclays	UK	Banks

Baron de Ley	SPAIN	Food & Beverage
BASF	GERMANY	Chemicals
Bayer	GERMANY	Chemicals
BBVA	SPAIN	Banks
Beijer Alma (BEIAB)	SWEDEN	Industrial goods & services
Betanet Group	GREECE	Construction & Materials
BHP Billiton	UK	Basic Resources
Biesse Group	ITALY	Industrial goods & services
Biomérieux	FRANCE	Health Care
Bioquell	UK	Health Care
BIP Investment Partners	LUXEMBURG	Financial services
Blue Fox Enterprises	NETHERLANDS	Technology
BMW	GERMANY	Automobiles & Parts
BNP Paribas	FRANCE	Banks
Boiron	FRANCE	Health Care
BP	UK	Oil & Gas
Brain Force Holding	AUSTRIA	Technology
Brederode	BELGIUM	Financial services
British American Tobacco	UK	Personal & Household Goods
British Sky Broadcasting Group	UK	Media
Bulgari	ITALY	Personal & Household Goods
BWT AG	AUSTRIA	Utilities
C&C Group	IRELAND	Food & Beverage
Caledonia Investments	UK	Financial services
CapMan	FINLAND	Financial services
Cardo	SWEDEN	Construction & Materials
Carrefour	FRANCE	Retail
Cash Life	GERMANY	Financial services
CEZ	CZ REPUBLIC	Utilities
Chargeurs	FRANCE	Personal & Household Goods
Cimpor (Cimentos de Portugal)	PORTUGAL	Construction & Materials
Cintra Concesiones	SPAIN	Industrial goods & services
Colruyt	BELGIUM	Retail
Compagnie Immobilière de Belgique	BELGIUM	Financial services
Compass Group	UK	Travel & Leisure
Concordia Maritime	SWEDEN	Industrial goods & services
Conergy	GERMANY	Utilities
Construccion y Auxiliar de Ferrocariles	SPAIN	Industrial goods & services
Corin Group	UK	Health Care
Corporacion Dermoestetica	SPAIN	Health Care

Corporacion Financiera Alba	SPAIN	Financial services
Cosmos Insurance Public Company	CYPRUS	Insurance
CRH	IRELAND	Construction & Materials
CS Communication & Systèmes	FRANCE	Technology
D.Carnegie & Co	SWEDEN	Financial services
D+S Europe	GERMANY	Media
DaimlerChrysler	GERMANY	Automobiles & Parts
Danisco	DENMARK	Food & Beverage
Danone	FRANCE	Food & Beverage
Danske Bank	DENMARK	Banks
Datalex	IRELAND	Technology
Deutsche Boerse	GERMANY	Financial services
Deutsche Post	GERMANY	Industrial goods & services
Deutsche Telekom	GERMANY	Telecommunications
Diageo	UK	Food & Beverage
DO & CO Restaurants & Catering	AUSTRIA	Travel & Leisure
Dogi International Fabrics	SPAIN	Personal & Household Goods
EADS	NETHERLANDS	Industrial goods & services
Eesti Telekom	ESTONIA	Telecommunications
Electricité de France	FRANCE	Utilities
Electrolux	SWEDEN	Personal & Household Goods
Elia System	BELGIUM	Utilities
Emak Spa	ITALY	Personal & Household Goods
ENEL	ITALY	Utilities
Energias De Portugal	PORTUGAL	Utilities
Enil	ITALY	Oil & Gas
Ericsson	SWEDEN	Telecommunications
Ersol Solar Energy	GERMANY	Utilities
Erste Bank	AUSTRIA	Banks
Eurofly	ITALY	Travel & Leisure
Fabege	SWEDEN	Financial services
FG Europe	GREECE	Personal & Household Goods
Fleury Michon	FRANCE	Food & Beverage
Fortum	FINLAND	Utilities
Foseco	UK	Industrial goods & services
Foyer	LUXEMBURG	Insurance
France Telecom	FRANCE	Telecommunications
Gamma Holding	NETHERLANDS	Industrial goods & services
Generali	ITALY	Insurance
Géodis Group	FRANCE	Industrial goods & services

GKN	UK	Automobiles & Parts
Glanbia	IRELAND	Food & Beverage
GlaxoSmithKline	UK	Health Care
Global Capital	MALTA	Financial services
Gorenje	SLOVENIA	Personal & Household Goods
Grammer	GERMANY	Automobiles & Parts
Graphisoft Park	HUNGARY	Technology
Greentech Energy Systems	DENMARK	Utilities
Grigiskes	LITHUANIA	Personal & Household Goods
Grindeks	LATVIA	Health Care
H.Lundbeck	DENMARK	Health Care
Haldex	SWEDEN	Automobiles & Parts
Haulotte Group	FRANCE	Industrial goods & services
Hellenic Duty Free Shops	GREECE	Retail
Hellenic Telecom (OTE)	GREECE	Telecommunications
Hennes & Mauritz	SWEDEN	Retail
Hornbach	GERMANY	Retail
HSBC	UK	Banks
Huhtamaki	FINLAND	Industrial goods & services
Impel	POLAND	Industrial goods & services
InBev	BELGIUM	Food & Beverage
Inditex	SPAIN	Retail
Indo Internacional	SPAIN	Health Care
ING	NETHERLANDS	Insurance
Investor	SWEDEN	Financial services
Irish Continental Group	IRELAND	Industrial goods & services
JC Decaux	FRANCE	Media
K+S AG	GERMANY	Chemicals
KBC Groupe	BELGIUM	Banks
Komercni Banka	CZ REPUBLIC	Banks
Krka Novo Mesto	SLOVENIA	Health Care
La Doria	ITALY	Food & Beverage
Lafarge	FRANCE	Construction & Materials
L'Air Liquide	FRANCE	Chemicals
Land Securities Group	UK	Financial services
Latvijas Kugnieciba	LATVIA	Industrial goods & services
Ledstiernan	SWEDEN	Financial services
Lietuvos Energija	LITHUANIA	Utilities
L'Oreal	FRANCE	Personal & Household Goods
LPP	POLAND	Personal & Household Goods
Ludova Banka Volksbank	SLOVAKIA	Banks

Lufthansa	GERMANY	Travel & Leisure
LVMH	FRANCE	Personal & Household Goods
Maltacom / GO	MALTA	Telecommunications
Man Group	UK	Financial services
Mania Technologie	GERMANY	Industrial goods & services
Marfin Popular Bank Public Co.	CYPRUS	Banks
Mazeikiu Nafta	LITHUANIA	Oil & Gas
Miquel y Costas	SPAIN	Basic Resources
MOL	HUNGARY	Oil & Gas
M-Real	FINLAND	Basic Resources
Munich Re	GERMANY	Insurance
Mytilenos Holdings	GREECE	Basic Resources
National Bank of Greece	GREECE	Banks
Natraceutical	SPAIN	Health Care
Nokia	FINLAND	Technology
Nordea Bank	SWEDEN	Banks
Norvestia	FINLAND	Financial services
Novo Nordisk	DENMARK	Health Care
Nutreco	NETHERLANDS	Food & Beverage
Okmetic	FINLAND	Technology
Omega Pharma	BELGIUM	Health Care
OPAP	GREECE	Travel & Leisure
OTP	HUNGARY	Banks
Outokumpu	FINLAND	Basic Resources
Papeles y Cartones de Europa (Europac)	SPAIN	Basic Resources
Paramo	CZ REPUBLIC	Oil & Gas
Pendragon	UK	Retail
PGNIG (Polskie Gornictwo Naftowe I Gazownictwo)	POLAND	Oil & Gas
Philips Electronics	NETHERLANDS	Personal & Household Goods
Piaggio	ITALY	Automobiles & Parts
PKO Bank Polski S.A.	POLAND	Banks
Plastic Omnium	FRANCE	Automobiles & Parts
Portugal Telecom	PORTUGAL	Telecommunications
Protherics	UK	Health Care
Public Power Corporation of Greece	GREECE	Utilities
Puleva Biotech	SPAIN	Health Care
PVA Tepla	GERMANY	Industrial goods & services
Raiffeisen International Bank	AUSTRIA	Banks
Recticel	BELGIUM	Basic Resources

Reditus	PORTUGAL	Technology
Renault	FRANCE	Automobiles & Parts
Renta Corporacion Real Estate	SPAIN	Financial services
Resilux	BELGIUM	Industrial goods & services
RHJ International	BELGIUM	Financial services
Rio Tinto	UK	Basic Resources
Rodamco Europe	NETHERLANDS	Financial services
Royal Bank of Scotland Group	UK	Banks
Royal Dutch Shell	UK	Oil & Gas
RPC Group	UK	Industrial goods & services
RTL Group	LUXEMBURG	Media
RWE	GERMANY	Utilities
Saint-Gobain	FRANCE	Construction & Materials
Sanofi-Aventis	FRANCE	Health Care
Savills	UK	Financial services
Shires Income	UK	Financial services
Siemens	GERMANY	Industrial goods & services
Sipef	BELGIUM	Food & Beverage
Socotherm	ITALY	Oil & Gas
SP Group	DENMARK	Chemicals
Spector Photo Group	BELGIUM	Personal & Household Goods
Suez	FRANCE	Utilities
SVG Capital	UK	Financial services
Tallink Grupp	ESTONIA	Travel & Leisure
Technopolis	FINLAND	Industrial goods & services
Technotrans	GERMANY	Industrial goods & services
Telefonica	SPAIN	Telecommunications
Telegraaf Media Groep	NETHERLANDS	Media
Telekom Slovenije	SLOVENIA	Telecommunications
Tesco	UK	Retail
Tessenderlo Chemie	BELGIUM	Chemicals
Total	FRANCE	Oil & Gas
Ubisoft Entertainment	FRANCE	Technology
Umbro	UK	Personal & Household Goods
Umicore	BELGIUM	Chemicals
Unicredito Italiano	ITALY	Banks
Unilever	NETHERLANDS	Food & Beverage
Unipol Assicurazioni	ITALY	Insurance
Unit 4 Agresso	NETHERLANDS	Technology
Van Der Moolen	NETHERLANDS	Financial services
Ventspils Nafta	LATVIA	Oil & Gas

Viel et Cie	FRANCE	Financial services
Viisnurk (Trigon Property Dvpt)	ESTONIA	Personal & Household Goods
Vinci	FRANCE	Construction & Materials
Viscofan	SPAIN	Food & Beverage
Vivendi	FRANCE	Media
Vodafone	UK	Telecommunications
Volkswagen	GERMANY	Automobiles & Parts
Volvo	SWEDEN	Industrial goods & services
Vseobecna Uverova Banka, a.s.	SLOVAKIA	Banks
Wendel Investissement	FRANCE	Financial services
Wiener Städtische	AUSTRIA	Insurance
Witan Investment Trust	UK	Financial services
WPP Group	UK	Media
Xano Industri	SWEDEN	Industrial goods & services
Xstrata	UK	Basic Resources
Zeleziarne Podbrezova	SLOVAKIA	Industrial goods & services
Zetex	UK	Technology
Zumtobel AG	AUSTRIA	Construction & Materials

Non-listed companies

Company	Country of incorporation	Sector
Air Malta	MALTA	Travel & Leisure
Altia	FINLAND	Food & Beverage
ANA	PORTUGAL	Industrial Goods & Services
APS Bank	MALTA	Banks
Caixa Geral de Depósitos	PORTUGAL	Banks
Danfoss	DENMARK	Construction & Materials
Efacec	PORTUGAL	Basic Resources
Freudenberg Group	GERMANY	Chemicals
Groupe Auchan	FRANCE	Retail
Itelia Group	FINLAND	Industrial Goods & Services
John Lewis	UK	Retail
Nationwide Building Society	UK	Banks
Octapharma	SWEDEN	Healthcare
Otto Group	GERMANY	Personal & Household Goods
Patrizia	GERMANY	Financial Services
Rabobank	NETHERLANDS	Banks
Robert Bosch	GERMANY	Automobiles & Parts
SJ	SWEDEN	Travel & Leisure
Tchibo Holding	GERMANY	Food & Beverage
Vattenfall	SWEDEN	Utilities

Appendix 2: On-line survey results

Country of residence:

	Nb	% cit.
Austria	1	5.0%
Belgium	1	5.0%
Cyprus	0	0.0%
Czech Republic	2	10.0%
Denmark	2	10.0%
Estonia	0	0.0%
Finland	1	5.0%
France	5	25.0%
Germany	1	5.0%
Greece	1	5.0%
Hungary	0	0.0%
Ireland	1	5.0%
Italy	0	0.0%
Latvia	0	0.0%
Lithuania	1	5.0%
Luxembourg	0	0.0%
Malta	0	0.0%
Netherlands	0	0.0%
Poland	0	0.0%
Portugal	1	5.0%
Slovakia	0	0.0%
Slovenia	0	0.0%
Spain	0	0.0%
Sweden	3	15.0%
United Kingdom	0	0.0%
Other	0	0.0%
Total	**20**	**100.0%**

Did your group adopt IFRS in its consolidated financial statements for the first time…

	Nb	% cit.
Earlier than 2005.	**7**	**35.0%**
For 2005 reporting (or 2005/2006 reporting if closing date differs from Dec 31).	**13**	**65.0%**
Later.	**0**	**0.0%**
Total	**20**	**100.0**

Thinking about Consolidated Financial Statements, and in comparison with previous application of non-IFRS GAAP, the application of IFRS has made them…

	Nb	% obs.
easier to compare across countries.	13	59.1%
easier to compare across competitors within same industry sector.	10	45.5%
easier to compare across industry sectors.	7	31.8%
more relevant through enhanced quality of disclosure.	5	22.7%
easier for analysts and investors to understand.	5	22.7%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

IFRS has...

	Nb	% obs.
improved the efficiency of EU capital markets.	5	22.7%
made financial statements easier for regulators/supervisors to use.	9	40.9%
changed the way our business is run.	1	4.5%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

Do you consider that the application of IFRS has had an impact on the international investment profile of your group ?

	Nb	% obs.
More coverage by foreign analysts.	5	22.7%
More cross border investment by foreign investors.	6	27.3%
More challenge coming from the comparison of your company to similar companies in other countries	4	18.2%
Other (please specify in the text box below)	1	4.5%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

Comment on the impact of IFRS on the international investment profile of your group

	Nb	% cit.
IFRS hasn't really made any difference or impact. Just more information for the financial market which lacks the knowledge to apply and understand it. For small private investors it's a complete waste. That is the brutal reality. Anyone saying something else is lying.	1	25.0%
It had very little impact in this way	1	25.0%
No	1	25.0%
no change	1	25.0%
Total	**4**	**100.0%**

What feedback from fund managers and analysts did you get on the extent your IFRS consolidated financial statements meet their needs?

	Nb	% cit.
Positive feedback	8	40.0%
Neutral feedback	6	30.0%
Negative feedback	2	10.0%
No feedback	4	20.0%
Total	**20**	**100.0%**

How confident are you that fund managers and analysts fully understand the impact of IFRS on your group's consolidated financial statements?

	Nb	% cit.
Not at all confident	2	10.0%
Not very confident	5	25.0%
Fairly confident	8	40.0%
Very confident	4	20.0%
Extremely confident	0	0.0%
Don't know	1	5.0%
Total	**20**	**100.0%**

To your knowledge, for which standards has the application of IFRS in your group NOT SATISFIED or not met the expectations of analysts and fund managers in terms of quality of disclosure and usefulness of information:

	Nb	% obs.
Revenue recognition	1	4.5%
Business combinations	3	13.6%
Financial instruments	5	22.7%
Leases	0	0.0%
Consolidation	1	4.5%
Employee pensions	1	4.5%
Employee share options	1	4.5%
Impairments	0	0.0%
Deferred tax	2	9.1%
Intangible assets	1	4.5%
Derivatives	2	9.1%
Debt / equity	0	0.0%
Foreign currency	1	4.5%
Joint Ventures	2	9.1%
Associates	0	0.0%
Off balance sheet items	0	0.0%
Other	1	4.5%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

Comment on expectations from analysts and fund manager not met by the application of IFRS by your company

	Nb	% cit.
Earnings show a greater volatility and less predictability. As a result, analyst job has become more difficult. Stockprice volatility around results announcement has also increased. While this is helping the brokerage community, it is neither helping the investors community, nor the issuers.	1	50.0%
We are a company applying IAS 41 Agriculture. This standard is not suited for our business (fair value accounting for an asset that is productive for some 25 years and changes have to be recorded through the income statement). The analysts and fund managers are all reversing the impact of this standard.	1	50.0%
Total	**2**	**100.0%**

Do you use IFRS accounting for your internal reporting ?

	Nb	% cit.
Yes	14	73.7%
No	4	21.1%
Don't know	1	5.3%
Total	**19**	**100.0%**

If yes, please give the main reason for your answer :

	Nb	% cit.
consistency between public and internal reports	1	14.3%
Consistency of internal and external reporting.	1	14.3%
Important for us to communicate internally in the same financial language as we use externally.	1	14.3%
We break the p&l down in a different way then in our reporting simply because it fit us better.	1	14.3%
We use both IFRS accounting and FAS (Finnish Accounting Standards) on our internal reporting. The internal reporting is made mainly based on IFRS numbers.	1	14.3%
We use IFRS for internal reporting with the exception of standard IAS 41 which we believe is not relevant for our business. We still record our biological assets at amortized cost whereas according to IAS 41 we can not depreciate any more and acquisitions are recorded directly in the income statement.	1	14.3%
We use recognition and measurement IFRS requirements for internal reporting to avoid two sets of accounts	1	14.3%
Total	**7**	**100.0%**

If yes, has it been beneficial for management purpose ?

	Nb	% cit.
Yes	8	57.1%
No	5	35.7%
Don't know	1	7.1%
Total	**14**	**100.0%**

Comments:

	Nb	% cit.
Figures are not polluted by various countries' different accounting rules/standards.	1	20.0%
IFRS accounting is internally used to appraise the performance of units managers	1	20.0%
No discernable change	1	20.0%
Some IFRS rules are against business sense	1	20.0%
there is no difference between internal reporting and IFRS consolidated financial statements	1	20.0%
Total	**5**	**100.0%**

Some European countries have implemented IFRS beyond the scope of consolidated financial statements of listed companies. Please select the other cases which you consider relevant for providing IFRS information:

	Nb	% obs.
consolidated financial statements of all groups, whether listed or non-listed	7	31.8%
individual accounts of subsidiaries of groups disclosing their consolidated statements in IFRS	5	22.7%
individual accounts of all companies	4	18.2%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

Which stakeholders should be in the position to provide IASB with the most interesting input for continued enhancements of quality and relevance of financial reporting?

	Nb	% obs.
Preparers	12	54.5%
Reviewers	8	36.4%
National level bodies including standard setters and enforcement authorities	3	13.6%
European level bodies	2	9.1%
Financial analysts and investors	12	54.5%
Total	**22**	

The sum of percentages is not equal to 100 due to multiple responses and deletions.

Comments on future inputs for continued enhancements of financial reporting

	Nb	% cit.
From the preparers viewpoint certain standards are unduly complex, designed from the position of a certain industry sector or multi national scenario but then compulsory applied to less complex organisations yielding no benefit. The cross referencing between standards is poor and the IASB in addition to producing standards should produce comprehensive application notes.	1	25.0%
I have the feeling that financial statements are getting so complicated that only the preparers are really analysing the financial reporting of other companies in order to prepare their own financial statements. In the meantime a lot of time and energy is lost in drafting these financial statements (financial instruments disclosure 'IFRS 7, tax disclosure, pension disclosure...)	1	25.0%
One needs to have a really good look at what the small private investor really understands. IFRS is way too complicated.	1	25.0%
We would very much like to be part of the process, provided we feel we have any influence.	1	25.0%
Total	**4**	**100.0%**

If you have any further comments you would like us to take into account, please use this text box

	Nb	% cit.
IAS 39 is just a nonsense	1	20.0%
The ways IFRS are applied are neither consistent from one country to another, nor from one company to another.	1	20.0%
Some of the IFRS initiatives that appear to be in the pipeline seem very theoretical and technical, and can lead to financial statements being far from the normal business persons understanding of the business performance, meaning that the "IFRS language" cannot longer be used for internal performance measurement. If that is going to be the case IFRS will lose importance in both the internal and external financial communication.	1	20.0%
The introduction of IFRS had a big impact on auditors and consultants. The people doing analysis and providing the financial data to investors do it the same way as before. For them IFRS is simply the same as it used to be. One really has to understand that. The introduction of IFRS has made no impact what so ever on how you evaluate companies or read financial statement. For the private small investors it's just too complicate. Why didn't anyone spot that?	1	20.0%
The tendency for extension of fair value promoted by IASB does not provide better information for financial market, and wouldn't give better information or the long term performances of the companies.	1	20.0%
Total	**5**	**100.0%**

Indexes

Standards & Interpretations

IFRS 1 *First-time Adoption of International Financial Reporting Standards*: 52
IFRS 2 *Share-based payments*: 14, 17, 25, 56, 59, 161, 163, 164, 165, 166, 169, 170, 313
IFRS 4 *Insurance contracts*: 15, 47, 55, 219, 220, 221, 224, 225, 226, 227, 228, 229, 239, 241, 244
IFRS 6 *Exploration for and Evaluation of Mineral Resources*: 44, 48, 49, 215, 216, 217
IFRS 7 *Financial Instruments: Disclosures*: 14, 29, 44, 52, 56, 57, 58, 61, 124, 135, 143, 144, 150, 236, 245, 256, 261, 262, 263, 281, 282, 289, 290, 294, 295, 296, 306, 307, 335
IFRS 8 *Operating Segments*: 13, 41, 56, 58, 59, 61, 77, 91, 92, 96, 271, 313

IAS 1 *Presentation of Financial Statements:* 20, 21, 42, 44, 56, 58, 62, 65, 66, 71, 104, 171, 178
IAS 8 *Accounting Policies: Changes in Accounting Estimates and Errors*: 44, 48, 116, 215
IAS 14 *Segment Reporting:* 13, 22, 58, 77, 81, 83, 84, 85, 91, 261, 269
IAS 16 *Property, Plant and Equipment:* 13, 113, 114, 116, 217
IAS 17 *Leases:* 22, 48
IAS 19 *Employee Benefits:* 9, 10, 14, 23, 41, 44, 45, 46, 173, 178, 179, 187, 189, 313
IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*: 197, 198, 199
IAS 21 *The Effects of Changes in Foreign Exchange Rates*: 44, 48, 133, 235, 255
IAS 23 *Borrowing Costs:* 12, 153, 156
IAS 27 *Consolidated and Separate Financial Statements*: 17, 25, 53, 93, 94, 248, 249, 250
IAS 28 *Investments in Associates:* 25, 93, 95, 248, 249, 251
IAS 31 *Interest in Joint Ventures*: 93, 95
IAS 32 *Financial Instruments : Presentation* : 13, 17, 52, 57, 124, 127, 134, 135, 137, 138, 140, 141, 145, 146, 149, 150, 231, 234, 235, 237, 238, 252, 253, 255, 256, 257, 258, 262, 280, 285, 290, 294
IAS 34 *Interim Financial Reporting*: 60
IAS 36 *Impairment of Assets*: 10, 23, 27, 60, 99, 100, 108, 109, 110, 112, 311
IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*: 12, 201
IAS 38 *Intangible Assets*: 99, 106, 107, 217
IAS 39 *Financial Instruments : Recognition and Measurement* : 9, 13, 17, 24, 29, 41, 44, 46, 47, 52, 60, 124, 126, 129, 130, 131, 133, 134, 136, 219, 221, 222, 231, 232, 233, 235, 236, 247, 248, 249, 251, 254, 255, 261, 262, 271, 274, 275, 278, 280, 282, 291, 313, 335
IAS 40 *Investment Property*: 113, 118

IFRIC 4 *Determining whether an Arrangement contains a Lease*: 44, 48, 51, 313
IFRIC 5 *Rights to Interest arising from Decommissioning, Restoration and Environmental Rehabilitation Funds*: 44, 201, 313
IFRIC 6 *Liabilities arising from Participating in a Specific Market – Waste Electrical & Electronic Equipment*: 201, 313
IFRIC 7 *Applying the Restatement Approach under IAS 29*: 41, 56, 59, 313
IFRIC 8 *Scope of IFRS 2: Share-based payments*: 41, 56, 59, 313
IFRIC 9 *Reassessment of Embedded Derivatives*: 41, 56, 60, 313
IFRIC 10 *Interim Financial Reporting & Impairment:* 56, 60, 313

IFRIC 11 *IFRS 2: Group and Treasury Share Transactions:* 44, 49, 50, 56, 60, 61, 212, 313
IFRIC 12 *Service Concession Arrangements*: 14, 41, 56, 61, 209, 210, 211, 212, 213, 214, 313

Companies

Abbeycrest, 81
ABN AMRO, 106, 269, 270, 277, 281, 284, 301
Acea, 209
Agora, 171
AIB, 192, 283
Alcatel, 169, 187
Alleanza Assicurazioni, 228, 230, 231, 244
Allianz, 106, 220, 221, 224, 225, 227, 230, 240, 241, 242, 243, 244, 246
Anglo American, 60, 159, 204, 216
Arcelor, 206
ASML Holding, 128, 143
Atlantia Autostrade, 79, 212, 213
Atlantia-Autostrade, 79
AWD Group, 81
AXA, 171, 223, 224, 225, 227, 228, 229, 230, 241, 242, 243, 244, 246
Banco Santander, 67, 270, 277, 280, 283, 286, 296, 297, 302
Bank Handlowy, 263, 277, 283, 286
Bank of Cyprus, 277, 288
Barclays, 192, 266, 268, 269, 271, 277, 280, 283, 292, 294, 297, 299, 300, 304, 305
BASF, 140, 179
Bayer, 60, 61, 195
BBVA, 67, 69, 267, 268, 277, 283, 298, 302, 303
Bioquell, 67
BIP Investment Partners, 250
BNP Paribas, 267, 277, 280, 295, 298
Bouygues, 94, 209, 210
BP, 59, 179, 195, 217
Brisa, 209
British American Tobacco, 192
C&C Group, 67
Caixa General de Depositos, 272
Caixa Geral de Depósitos, 272, 277, 283, 288
Caledonia Investments, 50, 61
CEZ, 118, 216
Cimentos de Portugal, 106
Cintra Concesiones, 71, 213
Cosmos Insurance, 224
DaimlerChrysler, 92, 124, 144, 167, 181
DaimlerCrysler, 59
Danisco, 172
Danske Bank, 55, 192, 263, 267, 268, 271, 274, 277, 283
Danske Bank Group, 55
Datalex, 67, 143
Deutsche Börse, 81
Deutsche Post, 51
Deutsche Telekom, 106, 124
Diageo, 52, 97, 192
EADS, 129, 131
Eesti Telekom, 51
Electricité de France, 129, 131, 213
Electrolux, 71, 104
Elia System, 78
ELIA SYSTEM, 78
Enel, 213
Eni, 94
ENI, 216
Erste Bank, 264, 270, 277
Erste Bank AG, 270
Fabege, 118, 119
Fortum, 154
Foyer, 229, 230, 242, 244
France Telecom, 53, 61, 132
Gas Natural, 209
Gaz de France, 209, 212
Generali, 228, 230, 244, 246
GKN, 192, 195
GlaxoSmithKline, 111, 131, 143, 145
Hornbach, 61
HSBC, 118, 119, 192, 193, 263, 270, 271, 277, 280, 281, 290, 291, 297, 298, 299
HSBC Holdings, 118
Huhtamaki, 124, 150
InBev, 105, 111
ING, 220, 221, 224, 225, 226, 227, 228, 229, 230, 231, 241, 242, 243, 244, 245, 246, 277
Investor, 252
JC Decaux, 58
KBC Groupe, 170, 268, 279
Klepierre, 94, 95
Komerční Banka, 263, 277, 279, 288
L'udová Banka, 263, 277, 279, 283, 286, 288
Lafarge, 105, 110, 170
Land Securities Group, 118

Latvijas Kugnieciba, 81
LVMH, 94
Marfin Popular Bank, 277, 288
MOL, 159
Munich Re, 220, 224, 227, 230, 242, 243, 244, 246
National Bank of Greece, 270, 275, 277, 280, 286
Nationwide Building Society, 263, 268, 270, 277, 283, 285
Nordea, 263, 271, 277, 283, 289, 290, 291, 302, 308
Norvestia, 67
Nutreco, 128, 234
OPAP, 106
OTP, 270, 271, 277, 280, 288
Paramo, 117
Pendragon, 111, 142, 192
Philips Electronics, 179
PKO Bank, 283
Public Power Corporation, 115
Rabobank, 271, 277, 279
Raiffaisen International Bank, 268, 277
Renault, 129, 131
RHJ International, 251
Rio Tinto, 217
Royal Bank of Scotland, 268, 275, 277, 283, 287, 297, 304
RPC Group, 192
RWE, 47, 49, 52, 58, 143
Sanofi-Aventis, 46, 108
Shell, 217, 218
Siemens, 54, 59, 92, 124, 131, 135, 147
SP Group, 118
Suez, 129, 131, 146, 147, 148, 211
Tallink Grupp, 118
Telefonica, 144
Telegraaf Media Groep, 110
Telekom Slovenije, 115
Tesco, 192
Total, 84, 100, 114, 217, 218
Umicore, 131, 154
Unicredito Italiano, 106, 265, 268, 280
Unilever, 105, 106, 192
Unipol Assicurazioni, 228, 230, 244
Veolia, 209, 210
Vinci, 212
Vivendi, 166, 170
Vodafone, 97, 109, 112, 124
Volvo, 47, 64, 182
Všeobecná Úverová Ban, 286
Všeobecná Úverová Banka, 263, 277
Všeobecnà Úverová Banka, 288
Wendel Investissement, 106, 251
Wiener Städtische, 224, 228, 242, 244, 245, 246
Witan Investment Trust, 67, 69, 252
WPP Group, 168
Xstrata, 110, 207
Zetex, 192
Zumtobel AG, 50