REVISED EDITION

PRICEWATERHOUSECOOPERS

Adopting IFRS

IFRS 1 – First-time Adoption of International Financial Reporting Standards

A step-by-step illustration of the transition to IFRS

June 2004

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[1] Comperio IFRS can be purchased from the website – www.pwc.com/ifrs

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Please contact your local PricewaterhouseCoopers office to discuss how we can help you make the change to International Financial Reporting Standards or with technical queries. See inside back cover of this publication for further details of our IFRS products and services.

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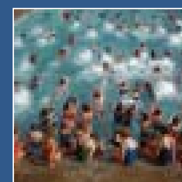
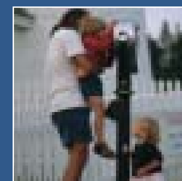
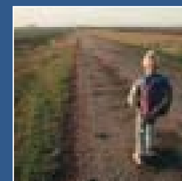
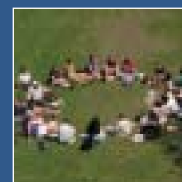

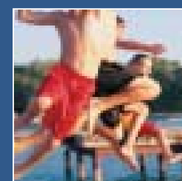
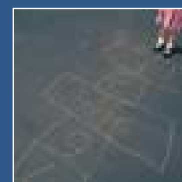

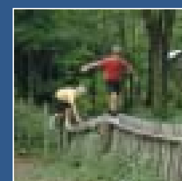

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Preface

Adopting International Financial Reporting Standards (IFRS) presents challenges that many people underestimate. The purpose of this book is to help those preparing IFRS financial statements for the first time to address those challenges.

The publication of IFRS 1, First-time Adoption of International Financial Reporting Standards, in June 2003 and as amended by the publication of new and revised standards between December 2003 and March 2004 means that companies can now avoid some of the burden of reconstructing old records that were not required for previous national reporting. But let's not be fooled into thinking the simplifications turn transition into a five-minute job – far from it. Even with the new standard, the transition process remains complex and time-consuming for many companies. The standard presents management with some tough decisions – which of the 10 optional exemptions, for example, make sense for your specific set of circumstances?

It is essential for everyone involved in this change process to understand the issues they face and to know how they can go about resolving them. I hope you will find this step-by-step approach to IFRS 1 useful as you apply the new reporting requirements.

Ian Wright
Global Corporate Reporting Leader
PricewaterhouseCoopers

Introduction

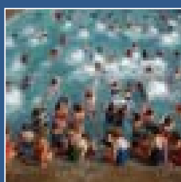
This publication explains when and how IFRS 1, First-time Adoption of International Financial Reporting Standards, is applied in preparing an entity's first IFRS financial statements.

The overview of IFRS 1 requirements explains the selection of accounting policies, the implications of the optional exemptions and the mandatory exceptions.

A comprehensive worked example, including model financial statements, accounting policies and disclosures, is provided to demonstrate the practical challenges of first-time adoption.

The overview also provides guidance on interim reports during an entity's first year of IFRS. Chapter 2 contains answers to some common questions that arise when applying IFRS 1.

The worked example is based on a fictional company, Wayne Holdings Inc., and its first application of IFRS for the year ended 31 December 2005. The example illustrates the changes that are required to present Wayne Holdings' financial statements under IFRS using the guidance in IFRS 1. The example is therefore of a company applying the standards in force at 31 December 2005. The standards published as at 31 March 2004, the IASB's 'stable platform', have been used in preparing the model IFRS financial statements. The IASB may make further amendments to the standards after 31 March 2004, which might be applicable to an entity preparing its first IFRS financial statements to 31 December 2005.



What is IFRS 1?

The International Accounting Standards Board published its first International Financial Reporting Standard, IFRS 1*, First-time Adoption of International Financial Reporting Standards, in June 2003. IFRS 1 replaces SIC-8. The new standard provides guidance in difficult areas such as the use of hindsight and the application of successive versions of the same standards.

The key principle of IFRS 1 is full retrospective application of all IFRS in force at the closing balance sheet date for the first IFRS financial statements. There are 10 optional exemptions that reduce the burden of retrospective application. There are four mandatory exceptions where retrospective application is not permitted.

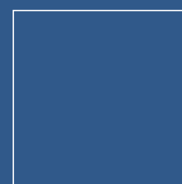
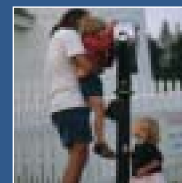
The exemptions provide limited relief for first-time adopters, mainly in areas where the information needed to apply IFRS retrospectively might not be available. Most companies will be required to make significant changes to existing accounting policies in order to comply with IFRS, including financial instruments, pensions, deferred tax, provisions, special purpose entities and employee-share options. There are no exemptions from the demanding disclosure requirements of IFRS, and many companies will need to collect and publish additional information.

IFRS 1 requires companies to:

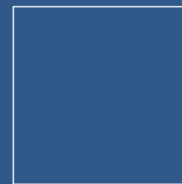
- identify the first IFRS financial statements;
- prepare an opening balance sheet at the date of transition to IFRS;
- select accounting policies that comply, and apply those policies retrospectively to all of the periods presented in the first IFRS financial statements;
- consider whether to apply any of the 10 exemptions from retrospective application;
- apply the four mandatory exceptions from retrospective application; and
- make extensive disclosures to explain the transition to IFRS.

The IASB published a number of revised and new standards in the period December 2003 to March 2004, several of which were amended by the introduction of additional exemptions and exceptions. The impact of the changes arising from the new and revised standards is reflected in this publication, where relevant.

* All references to IFRS 1 include amendments made by the revisions to existing standards and the new standards issued between December 2003 and March 2004.

When to apply IFRS 1



IFRS 1 is applied by any company that prepares its first IFRS financial statements for a period beginning on or after 1 January 2004.

Entities preparing their first IFRS financial statements for periods beginning before 1 January 2004 are encouraged to apply IFRS 1. Thus a company preparing its first IFRS financial statements for the year ended 31 December 2002, for example, is encouraged to apply IFRS 1 rather than SIC-8. An entity applying IFRS 1 early must explain that it has done so.

A company should apply IFRS 1 when it prepares an IFRS interim report for any period that is part of the year covered by the first IFRS financial statements.

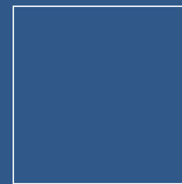
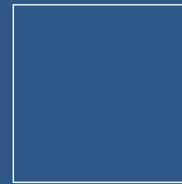
When must IFRS be applied?

IFRS 1 is applied when a company prepares its first IFRS financial statements. These are the first financial statements to contain an explicit and unreserved statement of compliance with IFRS. Most companies will apply IFRS 1 when they move from local GAAP to IFRS. For example, IFRS 1 must be applied when a company's previous financial statements:

- included a reconciliation of some items from a previous GAAP to IFRS;
- complied with some, but not all, IFRS in addition to a previous GAAP – for example, in areas where there is no previous GAAP guidance; or
- complied with IFRS in all respects in addition to a previous GAAP, but did not include an explicit and unreserved statement of compliance.

IFRS 1 is also applied when a company previously:

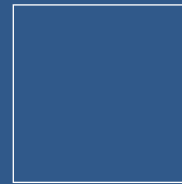
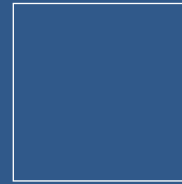
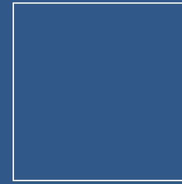
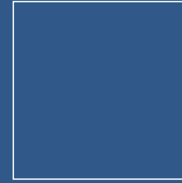
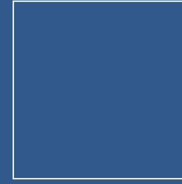
- prepared IFRS financial statements for internal purposes, but did not make them available to any external users;
- prepared a consolidation return under IFRS but did not prepare full financial statements; or
- did not prepare financial statements.

When is IFRS 1 not used?

IFRS 1 cannot be applied if a company previously prepared financial statements that contained an explicit and unreserved statement of compliance with IFRS. It also cannot be applied when a company prepared financial statements that included an unreserved statement of compliance with IFRS and:

- decided to stop presenting separate financial statements in accordance with a previous GAAP;
- decided to delete an additional reference to compliance with a previous GAAP; or
- the auditors' report on the previous IFRS financial statements was qualified.

The opening IFRS balance sheet

The opening IFRS balance sheet is the starting point for all subsequent accounting under IFRS. Companies should prepare an opening IFRS balance sheet at 'the date of transition to IFRS'. This is the beginning of the earliest period for which full comparative information is presented in accordance with IFRS. The opening balance sheet need not be published in the first IFRS financial statements.

When a company prepares its first IFRS financial statements for the year ending 31 December 2005 with one year of comparatives, the date of transition to IFRS will be 1 January 2004 and the opening IFRS balance sheet will be prepared at that date. A company required to present two years of full comparative information should prepare an opening balance sheet at 1 January 2003.

The opening IFRS balance sheet:

- includes all the assets and liabilities that IFRS requires;
- excludes any assets and liabilities that IFRS does not permit;
- classifies all assets, liabilities and equity in accordance with IFRS; and
- measures all items in accordance with IFRS.

The exception to this is where one of the optional exemptions or mandatory exceptions does not require or permit recognition, classification and measurement in accordance with IFRS.

A company's date of adoption is the beginning of the financial year for which IFRS financial statements are first prepared. A company that prepares its first IFRS financial statements for the year ended 31 December 2005 therefore has an adoption date of 1 January 2005.

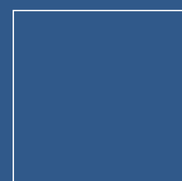
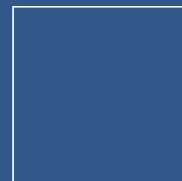
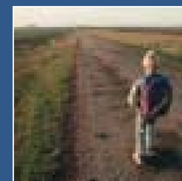
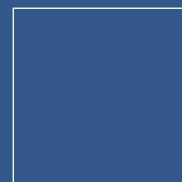
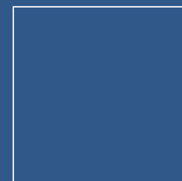
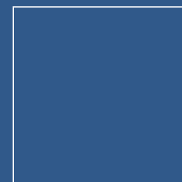
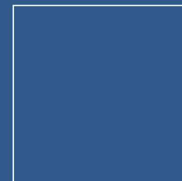
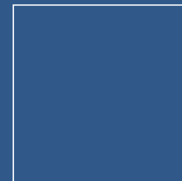
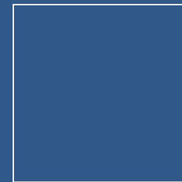
The adjustments as a result of applying IFRS for the first time are recorded in retained earnings or another equity category. For example, a company that is required to remeasure available-for-sale investments to fair value should recognise the adjustment in the fair value reserve, and a company that elects to adopt the allowed alternative treatment in IAS 16 should recognise the difference between the cost and fair value of property, plant and equipment in the revaluation reserve.

The implications for the opening IFRS balance sheet of these IFRS 1 requirements are presented in the table opposite.

Companies might also be required to consolidate entities that were not consolidated under their previous GAAP. There are no exemptions from the requirements of IAS 27 and SIC-12. Companies will be required to consolidate any entity over which it is able to exercise control. Subsidiaries that were previously excluded from the group financial statements are consolidated as if they were first-time adopters on the same date as the parent. The difference between the cost of the parent's investment in the subsidiary and the subsidiary's net assets under IFRS is treated as goodwill.

The deferred tax and the minority interest balance included in the opening IFRS balance sheet will be dependent on the other adjustments made. These balances should therefore calculated after all the other adjustments have been processed.

The preparation of the opening IFRS balance sheet may require the calculation or collection of information that was not calculated or collected under a company's previous GAAP. Companies should plan their transition and identify the differences between IFRS and their previous GAAP early so that all of the information required can be collected.

What are the implications of the opening IFRS balance sheet?

Accounting requirement	Implications
Recognise assets and liabilities that IFRS requires	Many companies will recognise additional assets and liabilities, for example: • defined benefit pension plans • deferred taxation • assets and liabilities under finance leases • provisions where there is a legal or constructive obligation • derivative financial instruments • acquired intangible assets • share-based payments (IFRS 2)
Derecognise assets and liabilities that IFRS does not permit	Some assets and liabilities recognised under a company's previous GAAP will have to be derecognised, for example: • provisions where there is no legal or constructive obligation • general reserves • internally generated intangible assets • deferred tax assets where recovery is not probable
Classify all assets and liabilities in accordance with IFRS	Assets and liabilities that might be reclassified include: • investments in accordance with IAS 39* • some financial instruments previously classified as equity* • any assets and liabilities that have been offset where the criteria for offsetting in IFRS are not met – for example, the offset of an insurance recovery against a provision • non-current assets held for sale (IFRS 5)
Measure all assets and liabilities in accordance with IFRS	Assets and liabilities that might be measured differently include: • receivables (IAS 18) • employee benefit obligations (IAS 19) • deferred taxation (IAS 12) • financial instruments (IAS 39)* • provisions (IAS 37) • impairments of property, plant and equipment and intangible assets (IAS 36) • assets held for disposal (IFRS 5) • share-based payments (IFRS 2)

* An entity that adopts IFRS before 1 January 2006 may defer the application of IAS 32 and IAS 39 to 1 January 2005 subject to the exercise of the optional exemption.

Accounting policies

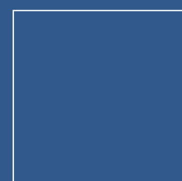
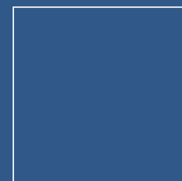
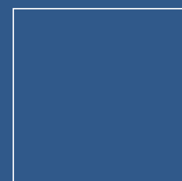
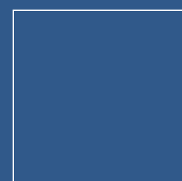
The first IFRS financial statements are prepared using accounting policies that comply with IFRS in force at the 'reporting date'.

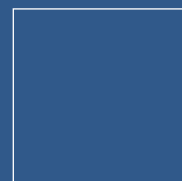
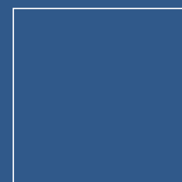
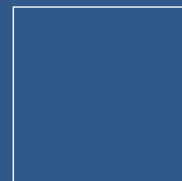
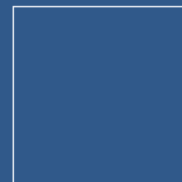
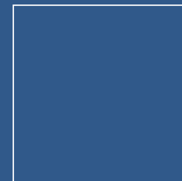
The reporting date is the closing balance sheet date for the first IFRS financial statements. These polices should be applied retrospectively to the opening IFRS balance sheet and for all periods presented in the first IFRS financial statements. Certain exemptions or exceptions apply to this requirement, the principal one being that the application of IAS 32 and IAS 39 may be deferred to 1 January 2005. Earlier versions of the same standard should not be applied.

A company may apply a standard that has been issued at the reporting date, even if that standard is not mandatory, as long as the standard permits early adoption.

The transition guidance in individual standards, and the guidance in IAS 8 for changes in accounting policies, apply to existing IFRS users and are not used by first-time adopters unless the standard or IFRS 1 requires otherwise. The IASB has stated that it will provide specific guidance for first-time adopters in all new standards.

A number of standards allow companies to choose between alternative policies. Companies should select the accounting policies to be applied to the opening IFRS balance sheet carefully, with a full understanding of the implications on both the opening IFRS balance sheet and the financial statements of future periods.

Optional exemptions from retrospective application

First-time adopters can elect to apply all, some or none of the 10 optional exemptions.

The exemptions are designed to allow companies some relief from full retrospective application. This will simplify the task for many companies, but the application of the exemptions is unlikely to be straightforward. Some exemptions allow for alternative ways of applying the relief and others have conditions attached.

Business combinations and scope of consolidation

Business combinations that were recognised before the date of the transition need not be restated. The exemption means that companies are not required to recreate information that was not collected at the date of the business combination. However, application of the exemption is complex and certain adjustments must be made.

When the exemption is applied:

- the classification of the combination as an acquisition or a uniting of interests does not change;
- the assets and liabilities acquired or assumed in the business combination are recognised in the acquirer's opening IFRS balance sheet unless IFRS does not permit recognition;
- the deemed cost for IFRS of assets and liabilities acquired or assumed is the carrying value under previous GAAP immediately after the business combination; and
- assets and liabilities that are measured at fair value under IFRS are restated to fair value on the opening IFRS balance sheet – for example, available-for-sale financial assets or investment properties (when the fair value alternative is chosen for the latter).

Assets and liabilities that were not recognised under a company's previous GAAP immediately after the business combination are recognised on the opening IFRS balance sheet only if they would be recognised in the acquired entity's separate IFRS balance sheet. For example, a first-time adopter should recognise a subsidiary's finance leases and intangible assets separately acquired by a subsidiary, but should not recognise a subsidiary's internally generated intangible assets. Adjustments to goodwill may be required despite the exemption. Goodwill is adjusted for any:

- intangible assets that are recognised for the first time in accordance with IFRS;
- intangible assets that were recognised under previous GAAP, but that do not satisfy the IFRS recognition criteria; and
- adjustments to contingent consideration required by IFRS.

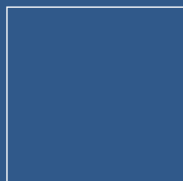
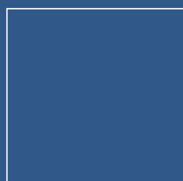
Goodwill must be tested for impairment at the date of transition to IFRS. However, goodwill is not adjusted for the previous amortisation of goodwill. Goodwill written off directly to equity is not reinstated on transition to IFRS. The business combinations exemption is also applied to associates or joint ventures.

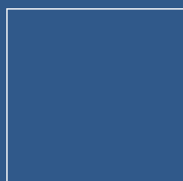
Fair value as deemed cost

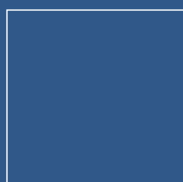
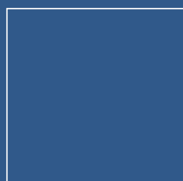
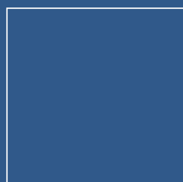
A company is not required to recreate cost information for fixed assets, a significant simplification for many companies. When the exemption is applied, deemed cost is the basis for subsequent depreciation and impairment tests. A company that applies the fair-value-as-deemed-cost exemption is not required to apply the revaluation model in IAS 16 in future periods.

Employee benefits

Retrospective application of the corridor approach permitted by IAS 19 requires a company to determine actuarial gains and losses from the date pension plans were established. The exemption allows a company to adopt the corridor approach prospectively from the date of transition.



Cumulative translation differences

Retrospective application of IAS 21 would require a company to determine the translation differences in accordance with IFRS since the date on which a subsidiary was formed or acquired. The exemption allows a company to apply IAS 21 prospectively. All cumulative translation gains and losses are reset to zero.

Comparatives for financial instruments

Companies that have an IFRS adoption date before 1 January 2006 may choose not to restate their comparatives for IAS 32 and IAS 39. A company preparing its first IFRS financial statements for the year ended 31 December 2005 may choose to apply IAS 32 and IAS 39 from 1 January 2005. The date from which IAS 32 and IAS 39 are applied is its 'IAS 32/39 transition date'. A company that takes this exemption should apply its previous GAAP recognition, classification and measurement rules for financial instruments to its comparatives.

Designation of financial assets and financial liabilities

IAS 39 allows a company to classify a financial instrument as a financial asset or financial liability 'at fair value through profit or loss' or as available for sale at the inception of the financial instrument. This exemption allows that classification to be made at the IAS 32/39 transition date.

Share-based payments

IFRS 2, Share-based Payment, is applicable to equity instruments granted after 7 November 2002 that were not vested by the later of transition date and 1 January 2005. Liabilities arising from cash-settled share-based payments settled after 1 January 2005 are subject to IFRS 2. A first-time adopter may choose to apply IFRS 2 to other instruments but only if the company has previously disclosed publicly the fair value of the instruments, determined at the measurement date.

Insurance contracts

Companies that issue insurance contracts need not restate comparatives for IFRS 4, Insurance Contracts. This exemption is only available to companies with an adoption date before 1 January 2006.

Compound financial instruments

Compound financial instruments are analysed into debt and equity components based on the circumstances at the inception of the instrument. Companies are not required to identify separately the two elements of the equity component if the liability component is not outstanding at the IAS 32/39 transition date.

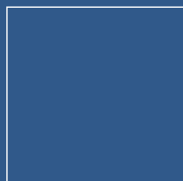
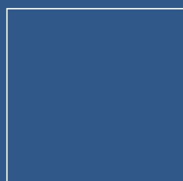
Assets and liabilities of subsidiaries, associates and joint ventures

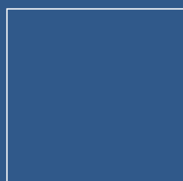
A parent and its subsidiaries might adopt IFRS at different dates. For example, a parent company in the UK might prepare its first IFRS financial statements at 31 December 2005, while its subsidiary in Australia might not be required to adopt IFRS until 30 June 2006.

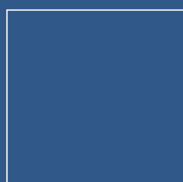
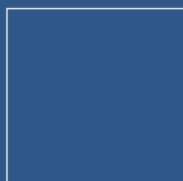
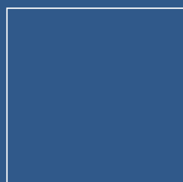
The exemption allows the subsidiary to measure its assets and liabilities either at the carrying amounts included in the parent's consolidated financial statements or on the basis of IFRS 1 applied at its date of transition. When the subsidiary elects to use the carrying amounts in the parent's consolidated financial statements, those carrying amounts are adjusted, where relevant, to exclude consolidation and acquisition adjustments.

When a parent adopts IFRS later than its subsidiary, the parent must measure the subsidiary's assets and liabilities in the consolidated financial statements using the subsidiary's carrying values. There are no exemptions. Those carrying values are adjusted, where relevant, to include consolidation and acquisition adjustments.

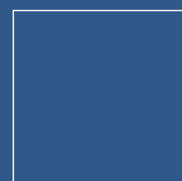
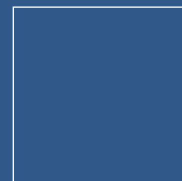
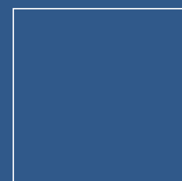
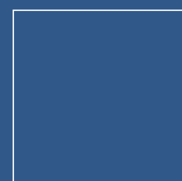
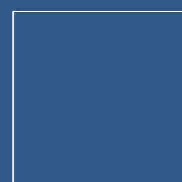
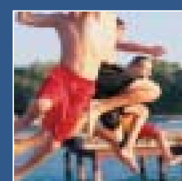
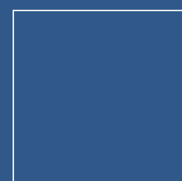
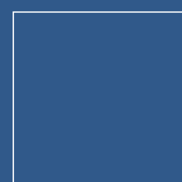
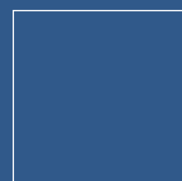
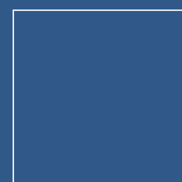
Exemption	Choice
Business combinations	For all transactions accounted for as business combinations under previous GAAP: • do not restate business combinations before the date of transition; • restate all business combinations before the date of transition; or • restate a particular business combination, in which case all subsequent business combinations must also be restated.
Fair value as deemed cost	For property, plant and equipment: • use cost in accordance with IFRS; • use fair value at the date of transition as deemed cost; or • use a revaluation carried out at a previous date as deemed cost, subject to certain conditions. A previous revaluation may be used as deemed cost only if it resulted in a carrying amount that was broadly comparable to fair value or was based on a price index that was applied to cost. The exemption may be applied to any individual item of property, plant and equipment. This exemption can also be applied to intangible assets that meet the criteria for revaluation in IAS 38 and to investment properties where the cost method in IAS 40 is applied. The exemption may not be used for any other assets. A company may also choose a revaluation to fair value in connection with a specific event, such as an IPO, as deemed cost for any individual asset or liability.
Employee benefits	Deferral of the recognition of actuarial gains and losses using the corridor approach in IAS 19 may be applied prospectively. If elected, the exemption must be applied to all benefit plans.
Cumulative translation adjustment	The cumulative translation adjustment may be set to zero. If elected, the exemption must be applied to all subsidiaries.
Compound financial instruments	The two equity elements of a compound financial instrument do not need to be identified if the liability component is not outstanding at the IAS 32/39 transition date.
Date of adoption for subsidiaries	A subsidiary that adopts IFRS later than its parent can elect to apply IFRS 1 or to use the carrying amounts of its assets and liabilities included in the consolidated financial statements, subject to eliminating any consolidation adjustments.



Exemption	Choice
Comparatives for financial instruments	A company with an adoption date before 1 January 2006 may choose not to restate its comparatives for IAS 32 and IAS 39. The company should apply its previous GAAP to financial instruments and hedging transactions for its comparatives.
Designation of financial assets and financial liabilities	A company may choose to classify a financial instrument as a financial asset or financial liability 'at fair value through profit or loss' or as available for sale at its IAS 32/39 transition date.
Share-based payments	A company may choose to apply IFRS 2, Share-based Payment, to any equity instruments that were granted before 7 November 2002 or that vested before the later of date of transition and 1 January 2005 but only if the company has previously disclosed publicly the fair value of the instruments, determined at the measurement date.
Insurance contracts	A company that issues insurance contracts and has a date of adoption before 1 January 2006 may choose not to restate comparatives for IFRS 4, Insurance Contracts. The company applies its previous GAAP to insurance contracts for its comparatives.

Mandatory exceptions from retrospective application

There are four mandatory exceptions to full retrospective application.

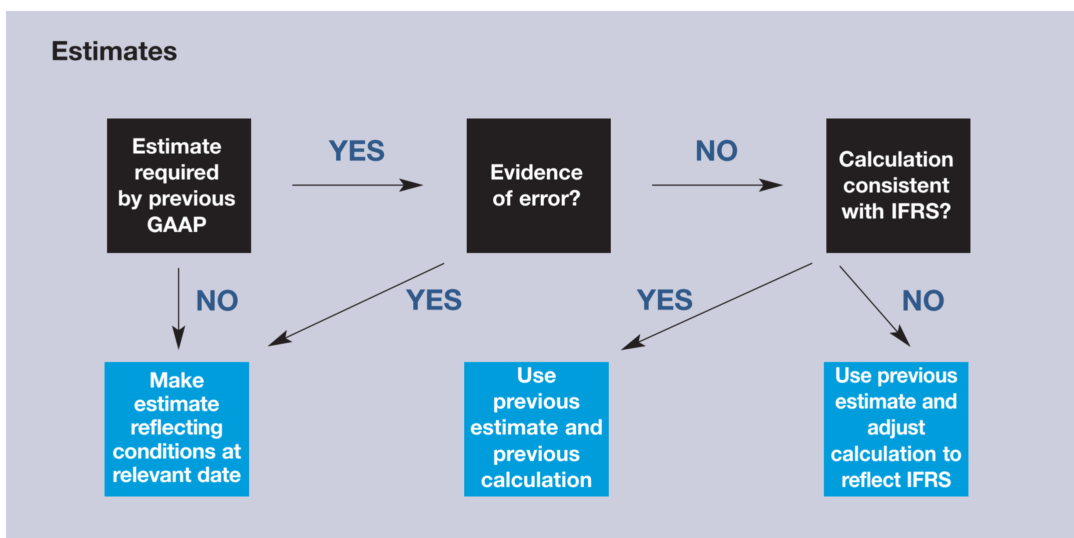
Estimates

IFRS 1 prohibits the use of hindsight to correct estimates made under previous GAAP unless there is objective evidence of error. A company should only adjust the estimates made under previous GAAP when the basis of calculation does not comply with IFRS.

IFRS 1 requires:

- Estimates made at the same date under the previous GAAP to be used for the opening IFRS balance sheet, unless there is objective evidence of an error. For example, a provision for the settlement of litigation made under the previous GAAP would not be revised for the opening IFRS balance sheet because a company subsequently became aware of the outcome of the case.
- Estimates made under previous GAAP to be revised if necessary to comply with IFRS, but they should reflect conditions at the date of transition. For example, a decommissioning liability that was not discounted under the previous GAAP should be restated to net present value on the opening IFRS balance sheet.
- Estimates that were not required under the previous GAAP to reflect conditions at the date of transition. For example, the provision on the opening balance sheet for an onerous rental contract in a foreign operation should be calculated using rental rates, interest rates and exchange rates current at the date of transition.

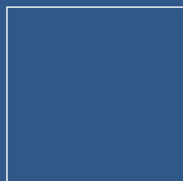
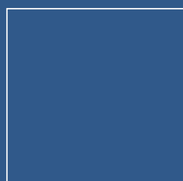
The requirements of IFRS 1 in connection with estimates are summarised in the chart below.

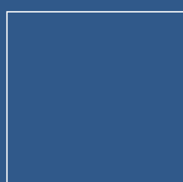


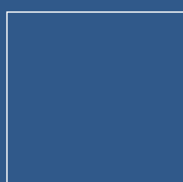
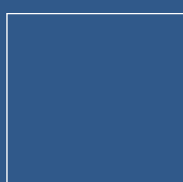
Assets held for sale and discontinued operations

IFRS 5 applies for first-time adopters from 1 January 2005. Companies with an adoption date before 1 January 2006 should not restate comparatives for non-current assets that met the criteria to be classified as held for sale at an earlier date. However, comparatives in the income statement should be re-classified for the results of discontinued questions that meet the criteria after 1 January 2005. Earlier application is only permitted if the necessary information was obtained at the earlier dates.

A company with an adoption date after 31 December 2005 should restate its comparatives for IFRS 5.



Derecognition of financial assets and financial liabilities

The IAS 39 guidance dealing with the recognition of financial assets and financial liabilities should be applied to transactions from 1 January 2004. The guidance may only be applied to transactions occurring before this date if the information required by IAS 39 was obtained at the date of the transactions. However, exercise of the optional exemption not to restate comparatives for IAS 32 and IAS 39 will result in previous GAAP rules for derecognition being applied in preparing comparatives.

Hedge accounting

Hedge accounting after the IAS 32/39 transition date may only be applied if all the IAS 39 hedge accounting criteria are met. Previous GAAP guidance should be followed for any period before the IAS 32/39 transition date. At the date of IAS 32/39 transition, a company should consider whether its hedges under previous GAAP are of a type that qualify for hedge accounting under IFRS. If they are, it should follow the detailed guidance in IFRS 1 to recognise the hedging instrument and the hedging relationship. The company should then apply IAS 39 guidance for discontinuing hedge accounting unless or until all IAS 39 hedge accounting criteria are met; it may then apply IAS 39 hedge accounting from that date onwards. This process is illustrated in the decision tree on the opposite page.

Did the entity identify hedges under previous GAAP?

No → Recognise all derivatives at fair value with corresponding adjustment to retained earnings

Yes → Is the hedge relationship of a type that qualifies for hedge accounting under IAS 39?

Yes → Is the hedge a hedge of the variability in fair value or cash flows?

No → Is it the hedge of a net position?

No → The hedging relationship must not be reflected in the opening balance sheet[(1)] at the IAS 32/39 transition date

Yes → Entity may designate an individual item within that net position as a hedged item under IFRS provided it does so no later than the IAS 32/39 transition date

→ Does the entity want to/is the entity able to designate an individual item within the net position as the hedged item?

No → The hedging relationship must not be reflected in the opening balance sheet[(1)] at the IAS 32/39 transition date

Yes → Is the hedge a hedge of the variability in fair value or cash flows?

Fair value hedge → Recognise the hedging instrument at fair value, adjust the carrying amount of a hedged item that is not measured at fair value, and recognise the corresponding entry to opening retained earnings at the IAS 32/39 transition date[(2)]

→ Are the IAS 39 hedge accounting criteria met?

No → Follow the rules for discontinuation of hedge accounting under IAS 39[(3)]

Yes → Follow the IAS 39 hedge accounting rules from the later of the date from which the IAS 39 hedge accounting criteria are met and the IAS 32/39 transition date

Cash flow hedge → Is the forecast transaction still expected to occur as at the IAS 32/39 transition date?

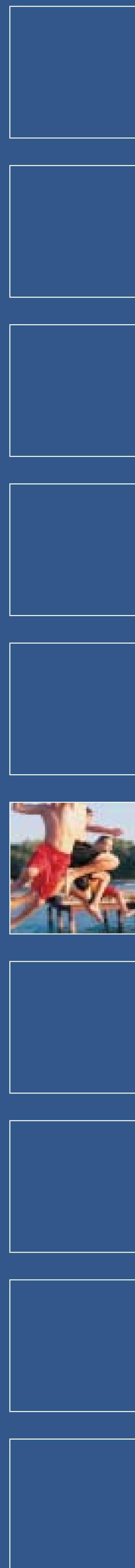
No → Recognise the hedging instrument at fair value and derecognise the deferred gain/loss (if any) against opening retained earnings at the IAS 32/39 transition date

Yes → Recognise the hedging instrument at fair value, with the corresponding entry to the cash flow hedging reserve in equity

→ Are the IAS 39 hedge accounting criteria met?

Yes → Follow the IAS 39 hedge accounting rules from the later of the date from which the IAS 39 hedge accounting criteria are met and the IAS 32/39 transition date

No → Follow the rules for discontinuation of hedge accounting under IAS 39[(4)]

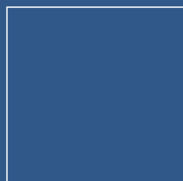
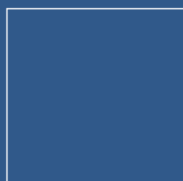


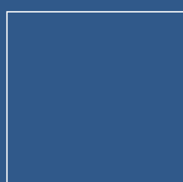
(1) The only entries recognised in the opening balance sheet at the IAS 32/39 transition date should be the derivative at fair value and the hedged item measured in accordance with the normal IFRS measurement rules for that type of asset/liability. Any adjustments are recognised against opening retained earnings.

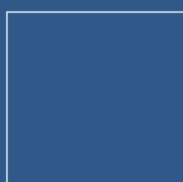
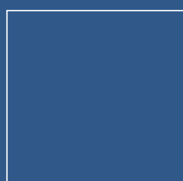
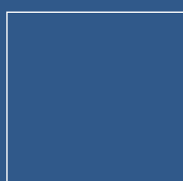
(2) The carrying amount of the hedged item is adjusted by the lesser of a) that portion of the cumulative change in the fair value of the hedged item that reflects the designated hedged risk and was not recognised under previous GAAP, and b) that portion of the cumulative change in the fair value of the hedging instrument that reflects the designated hedged risk and, under previous GAAP, was either i) not recognised or ii) deferred in the balance sheet as an asset or liability.

(3) For example, for a financial asset the adjustment made to the carrying value of the hedged item is amortised to profit or loss. The amortisation is based on a recalculated effective interest rate at the date amortisation begins and should be amortised fully by maturity.

(4) The net cumulative gain/loss included in equity remains in equity until a) the forecast transaction subsequently results in the recognition of a non-financial asset or liability, b) the forecast transaction affects profit and loss, or c) subsequently circumstances change and the forecast transaction is no longer expected to occur, in which case, any related net cumulative gain/loss that had been recognised directly in equity is recognised in profit or loss.



Topic	Exception
Estimates	Hindsight should not be used to create or revise estimates. The estimates made under a company's previous GAAP are revised only to correct errors and for changes in accounting policies.
Assets held for sale and discontinued operations	The IFRS 5 requirements are applied from 1 January 2005. Companies with an adoption date before 1 January 2006 do not restate comparatives for non-current assets that met the criteria to be classified as held for sale at an earlier date. However, comparatives in the income statement are reclassified for discontinued operations that meet the criteria after 1 January 2005. Earlier application is only permitted if the necessary information was obtained at the earlier dates.
Derecognition of financial assets and financial liabilities	The IAS 39 derecognition requirements should be applied from 1 January 2004. Assets and liabilities derecognised before this date should not be recognised in the first IFRS financial statements unless: • the company chooses to do so; and • the information necessary to apply the IAS 39 derecognition criteria was gathered when the transactions were initially accounted for.
Hedge accounting	Hedge accounting can be applied to transactions that satisfy the hedge accounting criteria in IAS 39 prospectively from the company's IAS 32/39 transition date. Hedging relationships cannot be designated retrospectively, and the supporting documentation cannot be created retrospectively.

Disclosures

There are no exemptions from the disclosure requirements of any other standards. The first IFRS financial statements should provide all of the disclosures IFRS require in addition to the specific disclosures required by IFRS 1.

IFRS 1 requires specific disclosures to explain the impact of the transition to IFRS.

Reconciliations in the first IFRS financial statements

The first IFRS financial statements should include a reconciliation of:

- equity from previous GAAP to IFRS at the transition date and at the end of the last period presented in the company's most recent financial statements under previous GAAP; and
- net profit from previous GAAP to IFRS for the last period in the company's most recent financial statements under previous GAAP.

The reconciliations should give sufficient detail to enable users to understand the material adjustments to the balance sheet and income statement, and to distinguish changes in accounting policies from the correction of errors identified during transition.

Other disclosures in the first IFRS financial statements

The disclosures that IAS 36 requires should be given when impairment losses are recognised in the opening IFRS balance sheet. When fair value is used as deemed cost, the aggregate fair values and the aggregate adjustment to the previous carrying amounts should be disclosed for each line item. A company should also explain material adjustments to the cash flow statement.

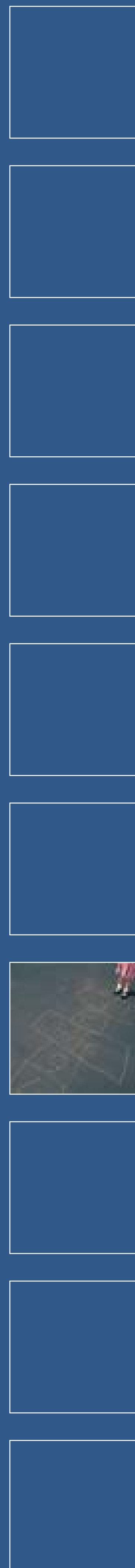
A company that applies the optional exemption to classify a financial asset or financial liability as 'at fair value through profit or loss' must disclose:

- the fair values of the item;
- the carrying amount under previous GAAP; and
- the classification under previous GAAP.

Comparative information and historical summaries

The first IFRS financial statements should include at least one year of comparative information prepared in accordance with IFRS, subject to the exemptions and exceptions that allow or require non-restatement of comparatives. A company can elect to present additional years of comparative information in accordance with IFRS, and this information might be required for regulatory purposes.

A company may elect to present a summary of historical data for earlier periods. IFRS 1 does not require such information to be presented in accordance with IFRS. A company can also elect to present additional comparative information under the previous GAAP. When historical summaries or comparative information under a previous GAAP are presented, the information should be labelled clearly as not complying with IFRS, and the nature of the main adjustments to comply with IFRS should be described.



IFRS 1 and the publication of interim financial information

IFRS, including IFRS 1, does not require interim reporting but provides guidance on what a company should report when it publishes interim financial information.

IAS 34 allows companies preparing interim reports the option of presenting either full IFRS financial statements or condensed interim financial information. IAS 34 sets out the minimum contents of condensed reporting.

A company that publishes interim financial information for a period covered by the first IFRS financial statements must also follow the additional requirements of IFRS 1 if that interim financial information is prepared in accordance with IFRS. The additional requirements set out in IFRS 1 are the publication of two additional reconciliations of previous GAAP results to IFRS results.

Publication of condensed interim financial information

A company may find that the first published financial information under IFRS is in the form of interim financial statements. The interaction of the reconciliation requirements of IFRS 1, and the requirement of IAS 34 to present all information 'material to an understanding of the current interim period', may require the production of extensive interim financial statements.

IFRS 1 requires the reconciliation of equity and the profit and loss under previous GAAP at the end of the comparable interim period, as well as some of the reconciliations expected for the first full IFRS financial statements. It does not require the company to publish a full set of financial statements as a first interim financial statement.

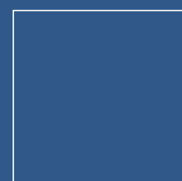
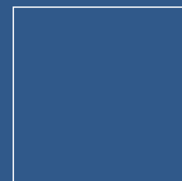
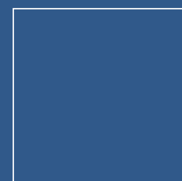
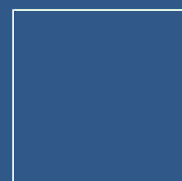
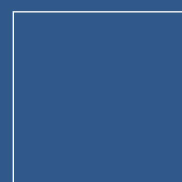
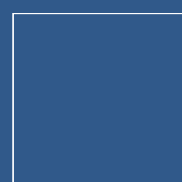
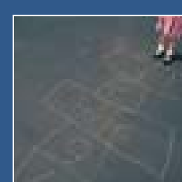
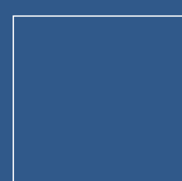
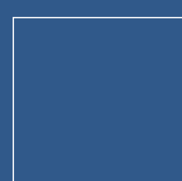
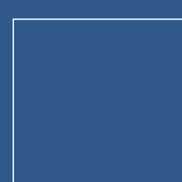
IAS 34 sets out the concept of an 'interim financial report', which allows the primary financial statements to be condensed and keeps accounting policies and disclosures to a minimum. Entities are permitted to reduce disclosures and condense line items in an interim financial report because they would have made 'full disclosures' in their previously published annual financial statements. Traditional interim financial statements focus on the operational and financial changes of the reporting entity since the last full set of financial statements. The requirements of IAS 34 could therefore be more burdensome than companies realise.

What happens if the detailed information implied by 'full disclosures' is not available? The financial statements published under local GAAP may use recognition and measurement criteria that are different from IFRS, or may not provide all the information that must be disclosed in full IFRS financial statements or all of the same line items.

The interim financial report must bridge the gap between the information published under previous GAAP and the information that will appear in the first complete set of IFRS financial statements. A company must either include all necessary information in the interim financial report, or cross-references to another document that includes the necessary information.

Neither IFRS 1 nor IAS 34 includes a checklist of required information. Disclosure depends on the company's specific circumstances. Companies making the transition to IFRS for the year ended 31 December 2005 that have published annual financial statements under previous GAAP for year-end 2004 may have to report a great deal of additional information to avoid misleading users of financial statements.

International businesses with diverse operations are more likely to have significant differences between local GAAP and IFRS on both measurement and presentation issues.

Also, the more complex the business or the organisation, the more disclosures are required. Companies may have to include additional line items or subtotals to the financial statements in order to communicate significant changes in the figures.

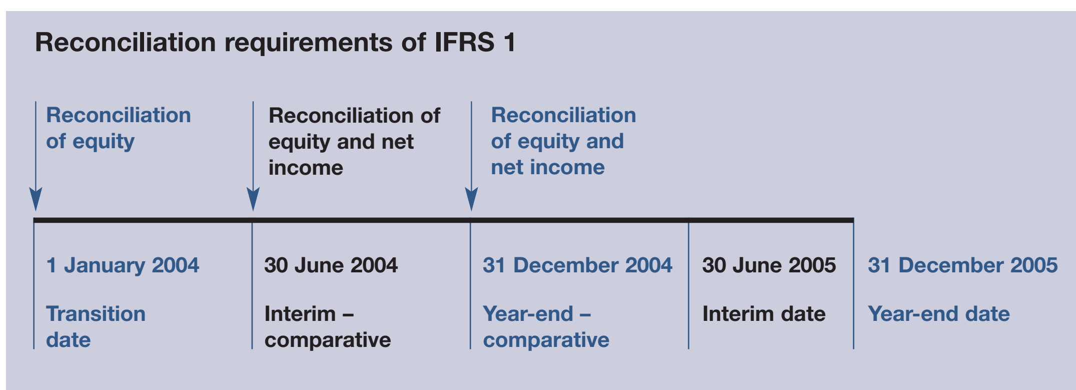
Reconciliation requirements of IFRS 1

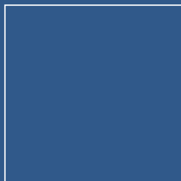
IFRS financial reports published for interim periods covered by the first IFRS financial statements should include two additional reconciliations. The reconciliations are of the net profit for the comparative interim period and of the equity at the end of that period.

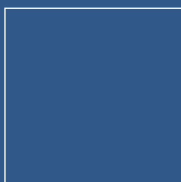
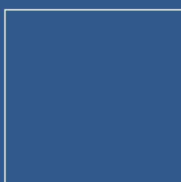
Interim financial reports should include additional disclosures beyond those usually required by IAS 34 to explain the transition to IFRS.

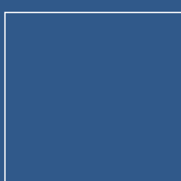
The first IFRS interim report published for interim periods covered by the first IFRS financial statements must also include the same reconciliations as will be included in the first annual IFRS financial statements.

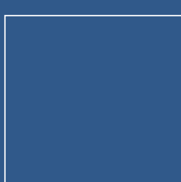
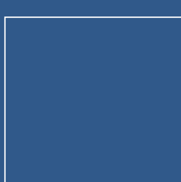
The diagram below illustrates the disclosures that must be made by an entity adopting IFRS for its 31 December 2005 financial statements in its half-yearly interim IFRS financial report for the six months ended 30 June 2005.







Questions and answers

1. Can IFRS 1 be applied when a company previously prepared its financial statements in accordance with some, but not all, IFRS?

The answer depends on how the previous financial statements were presented. A company that previously presented financial statements that included an unreserved statement of compliance with IFRS, but consequently received a qualified audit report due to non-compliance with certain IFRS, would not be able to apply the provisions of IFRS 1. However, a company may have previously presented financial statements in compliance with previous GAAP where, for example, previous GAAP was largely consistent with IFRS except for certain standards. Such an entity can apply the provisions of IFRS 1 provided that its previous GAAP financial statements did not contain an unreserved statement of compliance with IFRS.

2. Can an existing IFRS reporter create a new parent company in order to apply the provisions of IFRS 1?

No. The creation of a new parent entity just to hold the group is a transaction that has no substance. The transaction should be ignored, and the first financial statements of the new parent entity should be prepared on the basis that the original parent continues as the preparer of the group financial statements.

3. Can a first-time adopter apply the transitional provisions of other IFRS?

No. A first-time adopter of IFRS should not apply the transitional provisions included in other IFRS unless IFRS 1 specifically requires otherwise. Guidance for first-time adopters is provided by IFRS 1.

4. What requirements should an entity apply if it does not elect to apply the business combinations exemption? That is, how should it restate its past business combinations?

A first-time adopter should apply the IFRS guidance in force at the closing balance sheet date of its first IFRS financial statements. Consequently, an entity preparing its first IFRS financial statements for the year ended 31 December 2005 should apply the requirements of IFRS 3 to any business combinations that it chooses to restate.

5. When should a first-time adopter consolidate additional subsidiaries?

A first-time adopter must consolidate all entities that it has the power to control. This includes entities that carry on businesses that are different from those of the group, even if the entities were not consolidated under previous GAAP. The only exception is where control is intended to be temporary and the subsidiary was acquired and held with the exclusive intention of disposing of it within 12 months from the date of acquisition and management is actively seeking a buyer.

6. Can the employee benefits exemption be applied to selected retirement benefit plans?

No. An entity must apply the employee benefits exemption to all post-employment benefit plans or none of them. The only exception is in respect of schemes operated by subsidiaries that have already converted to IFRS. IFRS 1 requires the assets and liabilities of a subsidiary that already prepares IFRS financial statements to be included in the parent's consolidated IFRS balance sheet at the values used for the subsidiary's own IFRS financial statements, after adjusting for consolidation adjustments and for the effects of the business combination in which the parent acquired the subsidiary. A first-time adopter should, therefore, apply the exemption to all post-employment benefit plans other than those operated by subsidiaries that are already IFRS reporters.

7. Can a first-time adopter apply hindsight in making estimates for inclusion in the comparative balance sheet of the first IFRS financial statements?

No. A first-time adopter should use the estimates that it prepared under its previous GAAP as the basis for amounts to be included in the IFRS financial statements. Where an estimate was not required under previous GAAP, it should develop an estimate based on the information that would have been available at the time. For example, a provision for a legal case that was settled in the current period but was outstanding at the comparative balance sheet dates should be based on the information that was known at the relevant balance sheet date. This may mean volatility in the income statement if a provision is recognised in one period and then partially released in another.

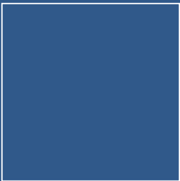
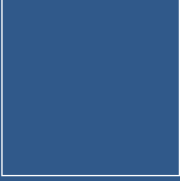
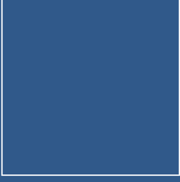
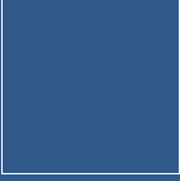
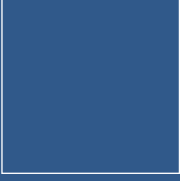
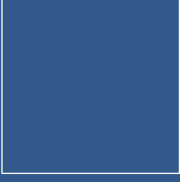
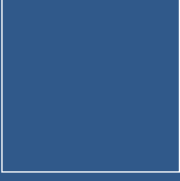
8. Can the fair-value-as-deemed-cost exemption be applied selectively?

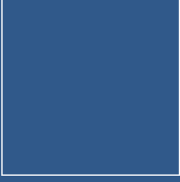
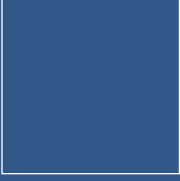
Yes. A first-time adopter may choose the individual items of property, plant and equipment to which it applies the fair-value-as-deemed-cost exemption. The application of the component approach to items of property, plant and equipment also means that an asset's individual components can be selected in applying the exemption.

9. What adjustments are required to a business combination that was treated as a pooling of interests under previous GAAP but would have been classified as an acquisition under IFRS, where the business combinations exemption is applied?

The following adjustments may be required:

- Any assets and liabilities that the acquired entity would have recognised had it changed to IFRS on the same date as the parent should be recognised and measured at its fair value at the date of acquisition, adjusted for depreciation and amortisation for the period from acquisition to transition;
- Any assets and liabilities that were recognised under previous GAAP but are not permitted by IFRS must be excluded; and
- The depreciation and amortisation charged against the acquired assets since the acquisition must be revised if the amortisation method or period is inappropriate under IFRS. The first-time adopter should not, however, remeasure the remaining assets and liabilities acquired through the acquisition.

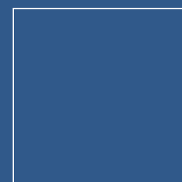
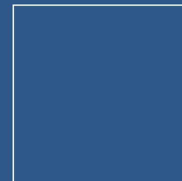








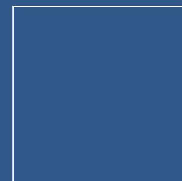
10. Is a first-time adopter required to re-recognise receivables in the first IFRS balance sheet that were derecognised under a securitisation arrangement that was set up before 1 January 2004 when the exemption from restating comparatives for IAS 32 and IAS 39 is applied?

All receivables that were derecognised from the entity's balance sheet under previous GAAP before 1 January 2004 can remain derecognised in the IFRS financial statements. Receivables that were derecognised after 1 January 2004 do not qualify automatically for derecognition in the first IFRS financial statements. The IAS 39 criteria for derecognition should be met.

However, the exemption from restating comparatives for IAS 32 and IAS 39 means that previous GAAP rules for derecognition should be applied when presenting the comparatives. Consequently, a securitisation that occurs in February 2004, for example, and that meets the previous GAAP derecognition criteria but not the IAS 39 criteria should be de-recognised in the 2004 comparative balance sheet and should be re-recognised in the opening balance sheet at 1 January 2005.

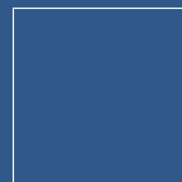



Step-by-step application of IFRS 1 – illustrative example



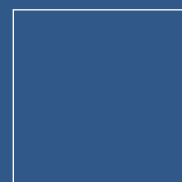
This section provides a detailed example illustrating the application of IFRS 1 for a fictional company, Wayne Holdings Inc.

Wayne Holdings Inc. is the parent company of a multinational group operating in several different business segments. The Group's consolidated financial statements have been prepared in accordance with the GAAP in Wayne Holdings' home country. Consolidated financial statements were last prepared in accordance with GAAP for the year ended 31 December 2004. Local legislation requires Wayne Holdings to apply IFRS in the consolidated financial statements for the year ending 31 December 2005.



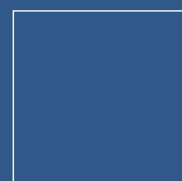
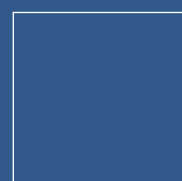
This section is structured as follows:

A Extracts from Wayne Holdings' first IFRS consolidated financial statements for the year ending 31 December 2005.

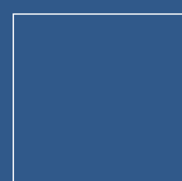
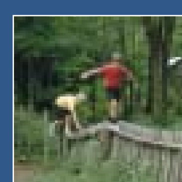
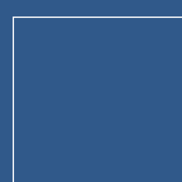


B Step-by-step application of IFRS 1:

- Step 1 – Identify the key dates and the first IFRS financial statements.
- Step 2 – Identify the differences between the accounting policies applied under GAAP and those that IFRS requires, and select the accounting policies to be applied under IFRS.
- Step 3 – Consider whether to apply any of the 10 exemptions from mandatory retrospective application.
- Step 4 – Apply the four mandatory exceptions to retrospective application and determine whether the information exists to apply these to an earlier date.
- Step 5 – Prepare an opening balance sheet at the date of transition to IFRS.
- Step 6 – Identify disclosures that IFRS 1 requires.

C Extracts from Wayne Holdings' consolidated financial statements for the year ended 31 December 2004, prepared in accordance with GAAP.

A – First IFRS consolidated financial statements of Wayne Holdings. Year ended 31 December 2005

Consolidated income statement

(all amounts in € thousands)

	Year ended 31 December	
	2005	**2004**
Sales	49,275	47,820
Cost of sales	(36,437)	(34,742)
Gross profit	12,838	13,078
Other operating income	3,460	1,114
Distribution costs	(6,325)	(4,547)
Administrative expenses	(4,919)	(4,907)
Other operating expenses	(5,492)	(5,386)
Loss from operations	(438)	(648)
Finance costs – net	(377)	(482)
Share of profit of associates	2,068	2,200
Profit before tax	1,253	1,070
Income tax expense	(412)	(299)
Profit for the period	841	771
Attributable to:		
Equity holders of the Company	590	474
Minority interest	251	297
	841	771
Earnings per share for profit attributable to the equity holders of the Group during the year (expressed in € per share)		
– basic	0.15	0.12
– diluted	0.09	0.07

Consolidated balance sheet

(all amounts in € thousands)

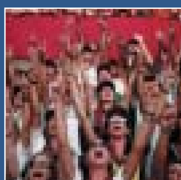
	Year ended 31 December	
	2005	**2004**
ASSETS		
Non-current assets		
Property, plant and equipment	23,862	23,402
Goodwill	2,483	2,745
Intangible assets	5,207	5,241
Investments in associates	6,001	3,958
Available-for-sale investments	16,643	
Receivables	16,609	18,762
Investments in other companies		14,377
Deferred income tax assets	946	522
	71,751	69,007
Current assets		
Inventories	15,204	17,665
Trade and other receivables	3,943	3,519
Other accrued income and prepaid expenses	2,787	1,350
Available-for-sale investments	4,501	
Financial assets at fair value through profit or loss	7,629	
Financial receivables	10,758	10,894
Short-term securities		8,480
Cash and cash equivalents	3,519	2,233
	48,341	44,141
Total assets	120,092	113,148
EQUITY		
Capital and reserves attributable to the Company's equity holders		
Share capital	4,018	5,018
Treasury shares	(200)	
Fair value and other reserves	2,417	200
Cumulative translation adjustment	(457)	(279)
Retained earnings	9,154	9,902
	14,932	14,841
MINORITY INTEREST	2,046	1,993
Total equity	16,978	16,834
LIABILITIES		
Non-current liabilities		
Borrowings	23,704	18,362
Deferred income tax liabilities	5,806	5,477
Retirement benefit obligations	15,002	15,131
Provisions	6,870	4,848
Other liabilities	10,580	9,194
	61,962	53,012
Current liabilities		
Trade and other payables	29,239	32,275
Current income tax liabilities	510	442
Borrowings	11,403	10,585
	41,152	43,302
Total liabilities	103,114	96,314
Total equity and liabilities	120,092	113,148

These financial statements have been approved for issue by the Board of Directors on 31 March 2006

Consolidated statement of changes in shareholders' equity

(all amounts in € thousands)

	Share capital	Treasury shares	Fair value and other reserves	Cumulative translation adjustments	Retained earnings	Minority interest	Total
Balance at 1 January 2004	5,018		120	–	10,506	2,044	17,688
Employee share option scheme:							
– value of services provided			80				80
Currency translation adjustments				(279)			(279)
Net income (expense) recognised directly in equity			80	(279)			(199)
Dividend relating to 2003					(1,078)	(348)	(1,426)
Profit for the period					474	297	771
Balance at 31 December 2004	5,018		200	(279)	9,902	1,993	16,834
Adoption of IAS 32 and IAS 39	(1,000)	(200)	1,920		(460)	85	345
Balance at 1 January 2005	4,018	(200)	2,120	(279)	9,442	2,078	17,179
Fair value gains/(losses), net of tax:							
– available-for-sale investments			288				288
– cash flow hedges			(21)				(21)
Employee share option scheme:							
– value of services provided			30				30
Currency translation adjustments				(178)			(178)
Net income (expenses) recognised directly in equity			297	(178)			119
Dividend relating to 2004					(878)	(283)	(1,161)
Profit for the period					590	251	841
Balance at 31 December 2005	4,018	(200)	2,417	(457)	9,154	2,046	16,978



Consolidated cash flow statement

(all amounts in € thousands)

	Year ended 31 December	
	2005	**2004**
Cash flows from operating activities		
Cash generated from operations	1,361	949
Interest paid	(3,479)	(3,162)
Tax paid	(451)	(306)
Net cash outflow from operating activities	(2,569)	(2,519)
Cash flows from investing activities		
Purchase of property, plant and equipment	(3,958)	(3,093)
Purchase of intangible assets	(442)	(2,480)
Purchase of available-for-sale investments	(3,410)	–
Purchase of investments in other companies	–	(1,434)
Disposal of available-for-sale investments	801	–
Disposal of investments in other companies	–	1,191
Proceeds from sale of PPE	622	809
Finance lease repayments received	5,719	5,501
Interest received	690	445
Dividends received	205	58
Net cash from investing activities	227	997
Cash flows from financing activities		
Proceeds from borrowings	11,539	10,275
Repayments of borrowings	(6,066)	(6,713)
Finance lease principal payments	(623)	(507)
Dividends paid to group shareholders	(878)	(1,078)
Dividends paid to minority interests	(283)	(348)
Net cash from financing activities	3,689	1,629
Effects of exchange rate changes	(123)	(326)
Net increase/(decrease) in cash and cash equivalent	1,224	(219)
Cash and cash equivalents at beginning of year	1,792	2,011
Cash and cash equivalents at end of year	3,016	1,792
Reconciliation of cash and cash equivalents		
Cash and cash equivalents for balance sheet purposes	3,519	2,233
Overdraft bank accounts included in borrowings	(503)	(441)
Cash and cash equivalents for cash flow statement purposes	3,016	1,792

Accounting policies

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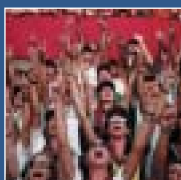


Accounting policies (continued)

The principal accounting policies adopted in the preparation of these consolidated financial statements are set out below.

A Basis of preparation

These consolidated financial statements of Wayne Holdings Inc. ('Wayne Holdings' or 'the Group') have been prepared in accordance with International Financial Reporting Standards (IFRS). IFRS 1, First-time Adoption of International Financial Reporting Standards, has been applied in preparing these financial statements. These consolidated financial statements are the first Wayne Holdings financial statements to be prepared in accordance with IFRS.

The policies set out below have been consistently applied to all the years presented except for those set out below relating to the classification and measurement of financial instruments. The Group has taken the exemption available under IFRS 1 to only apply IAS 32 and IAS 39 from 1 January 2005.

Consolidated financial statements of Wayne Holdings until 31 December 2004 had been prepared in accordance with Generally Accepted Accounting Principles (GAAP). GAAP differs in certain respects from IFRS. When preparing Wayne Holdings' 2005 consolidated financial statements, management has amended certain accounting, valuation and consolidation methods applied in the GAAP financial statements to comply with IFRS. The comparative figures in respect of 2004 were restated to reflect these adjustments.

Reconciliations and descriptions of the effect of the transition from GAAP to IFRS on the Group's equity and its net income are given in notes 1(a) to 1(c) (pp45-47).

These consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available-for-sale financial assets and financial assets and financial liabilities (including derivative instruments) at fair value through profit or loss.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Company's accounting policies. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements, are disclosed in Note 4 (Critical accounting estimates and judgements)*.

B Consolidation

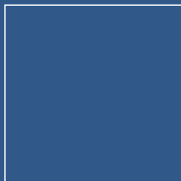
(1) Subsidiaries

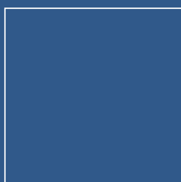
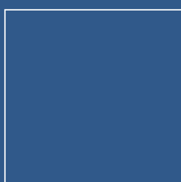
Subsidiaries are all entities (including special purpose entities) over which the Group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity.

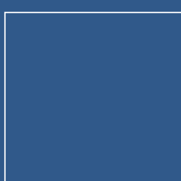
Subsidiaries are fully consolidated from the date on which control is transferred to the Group. They are de-consolidated from the date that control ceases.

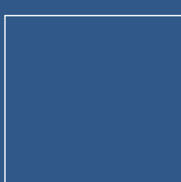
The purchase method of accounting is used to account for the acquisition of subsidiaries by the Group.

* For the purposes of this publication, Note 4 has not been presented. Refer to PricewaterhouseCoopers publication 'Illustrative Corporate Financial Statements' for an example.







Accounting policies (continued)

The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the Group's share of the identifiable net assets acquired is recorded as goodwill. If the cost of acquisition is less than the fair value of the Group's share of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement (see Note E.)

Intercompany transactions, balances and unrealised gains on transactions between group companies are eliminated. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the Group.

(2) Associates

Associates are all entities over which the Group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The Group's investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition (see Note E).

The Group's share of its associates' post-acquisition profits or losses is recognised in the income statement, and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

When the Group's share of losses in an associate equals or exceeds its interest in the associate, including any other unsecured receivables, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

Unrealised gains on transactions between the Group and its associates are eliminated to the extent of the Group's interest in the associates. Unrealised losses are also eliminated unless the transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates have been changed where necessary to ensure consistency with the policies adopted by the Group.

(3) Joint ventures

The Group's interests in jointly controlled entities are accounted for by proportionate consolidation.

The Group combines its share of the joint ventures' individual income and expenses, assets and liabilities and cash flows on a line-by-line basis with similar items in the Group's financial statements.

The Group recognises the portion of gains or losses on the sale of assets by the Group to the joint venture that is attributable to the other venturers. The Group does not recognise its share of profits or losses from the joint venture that result from the Group's purchase of assets from the joint venture until it resells the assets to an independent party. However, a loss on the transaction is recognised immediately if the loss provides evidence of a reduction in the net realisable value of current assets, or an impairment loss. Accounting policies of joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

Accounting policies (continued)

C Foreign currency translation

(1) Functional and presentation currency

Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates ('the functional currency'). The consolidated financial statements are presented in euros, which is the Company's functional and presentation currency.

(2) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges and qualifying net investment hedges.

Translation differences on non-monetary items, such as equities held at fair value through profit or loss, are reported as part of the fair value gain or loss. Translation differences on non-monetary items, such as equities classified as available-for-sale financial assets, are included in the fair value reserve in equity.

(3) Group companies

The results and financial position of all the group entities (none of which has the currency of a hyperinflationary economy) that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

(a) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each income statement are translated at average exchange rates (unless this average is not a reasonable approximation of the cumulative effect of the rates prevailing on the transaction dates, in which case income and expenses are translated at the dates of the transactions); and

(c) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders' equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

D Property, plant and equipment

Land and buildings comprise mainly factories and offices. All property, plant and equipment is shown at cost, less subsequent depreciation and impairment, except for land, which is shown at cost less impairment. Cost includes expenditure that is directly attributable to the acquisition of the items. Cost may also include transfers from equity of any gains/losses on qualifying cash flow hedges of foreign currency purchases of property, plant and equipment. Subsequent costs are included in the asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to

Accounting policies (continued)

the Group and the cost of the item can be measured reliably. All other repairs and maintenance expenditures are charged to the income statement during the financial period in which they are incurred.

Depreciation is calculated using the straight-line method to allocate the cost of each asset to its residual value over its estimated useful life as follows:

- Buildings 25-40 years
- Plant and machinery 10-15 years
- Equipment and motor vehicles 3-8 years
- Land is not depreciated

Major renovations are depreciated over the remaining useful life of the related asset or to the date of the next major renovation, whichever is sooner.

The assets' residual values and useful lives are reviewed, and adjusted if appropriate, at each balance sheet date. An asset's carrying amount is written down immediately to its recoverable amount if the asset's carrying amount is greater than its estimated recoverable amount (see Note F).

Gains and losses on disposals are determined by comparing the disposal proceeds with the carrying amount and are included in the income statement.

Borrowing costs incurred for the construction of any qualifying asset are capitalised during the period of time that is required to complete and prepare the asset for its intended use. Other borrowing costs are expensed.

E Intangible assets

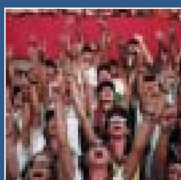
(1) Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the Group's share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill on acquisitions of subsidiaries is included in intangible assets. Goodwill on acquisitions of associates is included in investments in associates. Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Goodwill is allocated to cash-generating units for the purpose of impairment testing. Each of those cash-generating units represents the Group's investment in each country of operation by each primary reporting segment (see Note F).

(2) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success, considering its commercial and technological feasibility, and costs can be measured reliably. Other development expenditures are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have a finite useful life that have been capitalised are amortised from the commencement of the commercial production of the product on a straight-line basis over the period of its expected benefit, not exceeding five years.



Accounting policies (continued)

(3) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. These costs are amortised using the straight-line method over their estimated useful lives (three to five years).

Costs associated with developing or maintaining computer software programmes are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the Group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised using the straight-line method over their estimated useful lives (not exceeding three years).

(4) Trademarks and licences

Trademarks and licences are shown at historical cost. Trademarks and licences have a definite useful life and are carried at cost less accumulated amortisation. Amortisation is calculated using the straight-line method to allocate the cost of trademarks and licences over their estimated useful lives (15-20 years).

F Impairment of assets

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment. Assets that are subject to amortisation or depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. For the purposes of assessing impairment, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units).

G Investments

From 1 January 2004 to 31 December 2004:

Financial fixed assets include investments in companies other than subsidiaries and associates, financial receivables held for investment purposes, treasury stock and other securities. Financial fixed assets are recorded at cost, including additional direct charges. A permanent impairment is provided as a direct reduction of the securities account.

Current assets also include investments and securities acquired as a temporary investment, which are valued at the lower of cost and market, cost being determined on a last-in-first-out (LIFO) basis.

From 1 January 2005:

The Group classifies its investments in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date.

Accounting policies (continued)

(1) Financial assets at fair value through profit or loss

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss at inception. A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management. Derivatives are also categorised as held for trading unless they are designated as hedges. Assets in this category are classified as current assets if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

(2) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the Group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months after the balance sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet (see Note K).

(3) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Group's management has the positive intention and ability to hold to maturity. During the year, the Group did not hold any investments in this category.

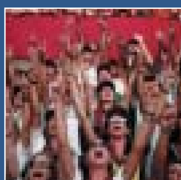
(4) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Purchases and sales of investments are recognised on trade-date – the date on which the Group commits to purchase or sell the asset. Investments are initially recognised at fair value plus transaction costs for all financial assets not carried at fair value through profit or loss. Investments are derecognised when the rights to receive cash flows from the investments have expired or have been transferred and the Group has transferred substantially all risks and rewards of ownership. Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Loans and receivables and held-to-maturity investments are carried at amortised cost using the effective interest method. Realised and unrealised gains and losses arising from changes in the fair value of the 'financial assets at fair value through profit or loss' category are included in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of non-monetary securities classified as available-for-sale are recognised in equity. When securities classified as available-for-sale are sold or impaired, the accumulated fair value adjustments are included in the income statement as gains and losses from investment securities.

The fair values of quoted investments are based on current bid prices. If the market for a financial asset is not active (and for unlisted securities), the Group establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, reference to other instruments that are substantially the same, discounted cash flow analysis, and option pricing models refined to reflect the issuer's specific circumstances.

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security



Accounting policies (continued)

below its cost is considered in determining whether the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement.

H Leases

(1) A Group company is the lessee

Leases of property, plant and equipment where the Group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding. The corresponding rental obligations, net of finance charges, are included in other long-term payables. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases is depreciated over the shorter of the asset's useful life and the lease term.

Leases where the lessor retains a significant portion of the risks and rewards of ownership are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

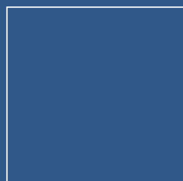
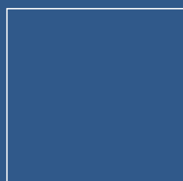
(2) A Group company is the lessor

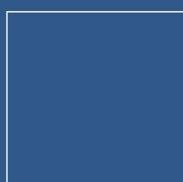
When assets are leased out under a finance lease, the present value of the lease payments is recognised as a receivable. The difference between the gross receivable and the present value of the receivable is recognised as unearned finance income. Lease income is recognised over the term of the lease using the net investment method, which reflects a constant periodic rate of return.

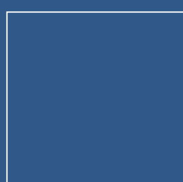
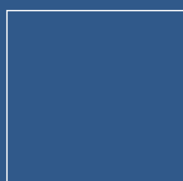
Assets leased to third parties under operating leases are included in property, plant and equipment in the balance sheet. They are depreciated over their expected useful lives on a basis consistent with similar owned property, plant and equipment. Rental income (net of any incentives given to lessees) is recognised on a straight-line basis over the lease term.

I Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in-first-out (FIFO) method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses. Costs of inventories include the transfer from equity of gains/losses on qualifying cash flow hedges relating to inventory purchases.



Accounting policies (continued)

J Construction contracts

Contract costs are recognised when incurred. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised only to the extent of contract costs incurred that are likely to be recoverable. When the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, contract revenue is recognised over the period of the contract. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

The Group uses the 'percentage of completion method' to determine the appropriate amount to recognise in a given period. The stage of completion is measured by reference to the contract costs incurred up to the balance sheet date as a percentage of total estimated costs for each contract. Costs incurred in the year in connection with future activity on a contract are excluded from contract costs in determining the stage of completion. They are presented as inventories, pre-payments or other assets, depending on their nature.

The Group presents as an asset the gross amount due from customers for contract work for all contracts in progress for which costs incurred plus recognised profits (less recognised losses) exceeds progress billings. Progress billings not yet paid by customers and retentions are included within 'trade and other receivables'.

The Group presents as a liability the gross amount due to customers for contract work for all contracts in progress for which progress billings exceed costs incurred plus recognised profits (less recognised losses).

K Trade receivables

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the effective interest rate. The amount of the provision is recognised in the income statement.

L Cash and cash equivalents

Cash and cash equivalents are carried in the balance sheet at cost. Cash and cash equivalents comprise cash on hand, deposits held at call with banks, other short-term, highly liquid investments with original maturities of three months or less, and bank overdrafts. Bank overdrafts are included within borrowings in current liabilities on the balance sheet.

M Share capital

Ordinary shares are classified as equity. Mandatorily redeemable preference shares are classified as liabilities (see Note N).

Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds. Incremental costs directly attributable to the issue of new shares or options, or for the acquisition of a business, are included in the cost of acquisition as part of the purchase consideration.

Accounting policies (continued)

Where any Group company purchases the Company's equity share capital (treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the Company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the Company's equity holders.

N Borrowings

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost; any difference between proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Preference shares, which are mandatorily redeemable on a specific date, are classified as liabilities. The dividends on these preference shares are recognised in the income statement as interest expense.

The fair value of the liability portion of a convertible bond is determined using a market interest rate for an equivalent non-convertible bond. This amount is recorded as a liability on an amortised cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option. This is recognised and included in shareholders' equity, net of income tax effects.

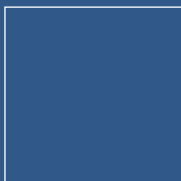
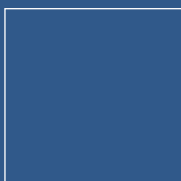
Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the balance sheet date.

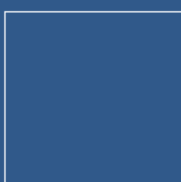
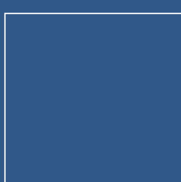
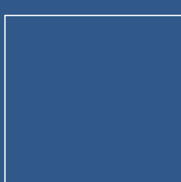
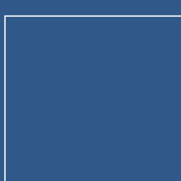
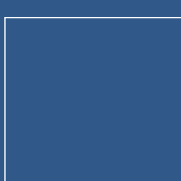
O Deferred income taxes

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Accounting policies (continued)

P Employee benefits

(1) Pension obligations

Group companies operate various pension schemes. The schemes are generally funded through payments to insurance companies or trustee-administered funds, determined by periodic actuarial calculations. The Group has both defined benefit and defined contribution plans. A defined benefit plan is a pension plan that defines the amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the Group pays fixed contributions into a separate entity. The Group has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets, together with adjustments for unrecognised actuarial gains or losses and past service costs. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability.

Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to income over the employees' expected average remaining working lives.

Past-service costs are recognised immediately in income, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

(2) Other post-employment obligations

Some Group companies provide post-retirement healthcare benefits to their retirees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments, and changes in actuarial assumptions, are charged or credited to income over the expected average remaining working lives of the related employees. These obligations are valued annually by independent qualified actuaries.

(3) Share-based compensation

Share options are granted before 7 November 2002 and vested before 1 January 2005.

No expense is recognised in respect of these options. The shares are recognised when the options are exercised and the proceeds received allocated between share capital and share premium.

Share options granted after 7 November 2002 and vested after January 2005.

The Group operates an equity-settled, share-based compensation plan. The fair value of the employee services received in exchange for the grant of the options is recognised as an expense.

Accounting policies (continued)

The total amount to be expensed over the vesting period is determined by reference to the fair value of the options granted, excluding the impact of any non-market vesting conditions (for example, profitability and sales growth targets). Non-market vesting conditions are included in assumptions about the number of options that are expected to become exercisable. At each balance sheet date, the entity revises its estimates of the number of options that are expected to become exercisable.

It recognises the impact of the revision of original estimates, if any, in the income statement, and a corresponding adjustment to equity.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

(4) Termination benefits

Termination benefits are payable when employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The Group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after balance sheet date are discounted to present value.

(5) Profit-sharing and bonus plans

The Group recognises a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a provision where contractually obliged or where there is a past practice that has created a constructive obligation.

Q Provisions

Provisions for environmental restoration, restructuring costs and legal claims are recognised when:

- the Group has a present legal or constructive obligation as a result of past events;
- it is more likely than not that an outflow of resources will be required to settle the obligation; and
- the amount has been reliably estimated.

Restructuring provisions comprise lease termination penalties and employee termination payments. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations – for example, in the case of product warranties – the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole. A provision is recognised even if the likelihood of an outflow with respect to any one item included in the same class of obligations may be small.

R Revenue recognition

Revenue comprises the fair value for the sale of goods and services, net of value-added tax, rebates and discounts and after eliminated sales within the Group. Revenue is recognised as follows:

(1) Sales of goods

Sales of goods are recognised when a Group entity has delivered products to the customer, the customer has accepted the products and collectibility of the related receivables is reasonably assured.

Accounting policies (continued)

(2) Sales of services

Sales of services are recognised in the accounting period in which the services are rendered, by reference to completion of the specific transaction assessed on the basis of the actual service provided as a proportion of the total services to be provided.

(3) Interest income

Interest income is recognised on a time-proportion basis using the effective interest method. When a receivable is impaired, the Group reduces the carrying amount to its recoverable amount – being the estimated future cash flow discounted at original effective interest rate of the instrument – and continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

(4) Royalty income

Royalty income is recognised on an accruals basis in accordance with the substance of the relevant agreements.

(5) Dividend income

Dividend income is recognised when the right to receive payment is established.

S Dividend distribution

Dividend distribution to the Company's shareholders is recognised as a liability in the Group's financial statements in the period in which the dividends are approved by the Company's shareholders.

T Segment reporting

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments.

A geographical segment is engaged in providing products or services within a particular economic environment that are subject to risks and returns that are different from those of components operating in other economic environments.

U Financial risk management

(1) Financial risk factors

The Group's activities expose it to a variety of financial risks:

a) market risk (including foreign exchange risk and price risk),

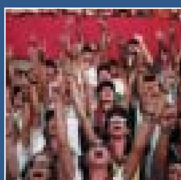
b) cash flow and fair value interest rate risk,

c) credit risk, and

d) liquidity risk.

The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential adverse effects on the Group's financial performance. The Group uses derivative financial instruments to hedge certain risk exposures.

Risk management is carried out by a central treasury department (Group treasury) under policies approved by the Board of Directors. Group treasury identifies, evaluates and hedges financial risks in close co-operation with the Group's operating units. The Board provides written



Accounting policies (continued)

principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest-rate risk, credit risk, use of derivative financial instruments and non-derivative financial instruments, and investing excess liquidity.

(a) Market risk

(i) Foreign exchange risk

The Group operates internationally and is exposed to foreign exchange risk arising from various currency exposures, primarily with respect to the US dollar, the UK pound, the Russian rouble and the Japanese yen.

Foreign exchange risk arises from future commercial transactions, recognised assets and liabilities and net investments in foreign operations. To manage their foreign exchange risk arising from future commercial transactions, recognised assets and liabilities, entities in the Group use forward contracts, transacted with Group treasury. Foreign exchange risk arises when future commercial transactions, recognised assets and liabilities are denominated in a currency that is not the entity's functional currency. Group treasury is responsible for managing the net position in each foreign currency by using external forward currency contracts.

For segment reporting purposes, each subsidiary designates contracts with Group treasury as fair value hedges or cash flow hedges, as appropriate. External foreign exchange contracts are designated at Group level as hedges of foreign exchange risk on specific assets, liabilities or future transactions, on a gross basis.

The Group's risk management policy is to hedge between 60% and 75% of anticipated transactions (mainly export sales) in each major currency for the subsequent 12 months. Approximately 72% (2004: 68%) of projected sales in each major currency qualifies as 'highly probable' forecast transactions, for hedge accounting purposes.

The Group has certain investments in foreign operations whose net assets are exposed to foreign currency translation risk. Currency exposure arising from the net assets of the Group's foreign operations in the US, UK, Russia and Japan is managed primarily through borrowings denominated in the relevant foreign currencies.

(ii) Price risk

The Group is exposed to equity securities price risk because of investments held by the Group and classified on the consolidated balance sheet either as available-for-sale or at fair value through profit or loss. The Group is not exposed to commodity price risk.

(b) Cash flow and fair value interest rate risk

The Group's income and operating cash flows are substantially independent of changes in market interest rates. The interest rates of finance leases to which the Group is lessor are fixed at inception of the lease. These leases expose the Group to fair value interest rate risk.

The Group's cash flow interest rate risk arises from long-term borrowings. Borrowings issued at variable rates expose the Group to cash flow interest rate risk. Borrowings issued at fixed rates expose the Group to fair value interest rate risk. Group policy is to maintain approximately 60% of its borrowings in fixed rate instruments. At the year end, 65% of borrowings were at fixed rates.

The Group manages its cash flow interest rate risk by using floating-to-fixed interest rate swaps. Such interest rate swaps have the economic effect of converting borrowings from floating rates to fixed rates. Generally, the Group raises long-term borrowings at floating rates and swaps them into fixed rates that are lower than those available if the Group borrowed at fixed rates directly. Under the interest rate swaps, the Group agrees with other parties to exchange, at

Accounting policies (continued)

specified intervals (mainly quarterly), the difference between fixed contract rates and floating-rate interest amounts calculated by reference to the agreed notional principal amounts.

Occasionally, the Group also enters into fixed-to-floating interest rate swaps to hedge the fair value interest rate risk arising where it has borrowed at fixed rates in excess of the 60% target.

(c) Credit risk

The Group has no significant concentrations of credit risk. It has policies in place to ensure that sales of products are made to customers with an appropriate credit history. Derivative counterparties and cash transactions are limited to high-credit-quality financial institutions. The Group has policies that limit the amount of credit exposure to any financial institution.

(d) Liquidity risk

Prudent liquidity risk management implies maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Due to the dynamic nature of the underlying businesses, Group treasury aims to maintain flexibility in funding by keeping committed credit lines available.

(2) Accounting for derivative financial instruments and hedging activities

From 1 January 2004 to 31 December 2004:

Derivative financial instruments are designated ‘hedging’ or ‘non-hedging instruments’. The transactions which, according to the Group’s policy for risk management, are able to meet the conditions for hedge accounting are classified as hedging transactions; the others, although set up for the purpose of managing risk (since the Group’s policy does not permit speculative transactions), have been designated as ‘trading’. The Group records derivative financial instruments at cost. The gains and losses on derivative financial instruments are included in the income statement on maturity to match the underlying hedged transactions where relevant.

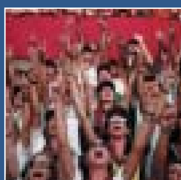
For foreign exchange instruments designated as hedges, the premium (or discount) representing the difference between the spot exchange rate at the inception of the contract and the forward exchange rate is included in the income statement, in financial income and expenses, in accordance with the accrual method.

For interest rate instruments designated as hedges, the interest rate differential is included in the income statement, in financial income and expenses, in accordance with the accrual method, offsetting the effects of the hedged transaction. Derivative financial instruments designated as trading instruments are valued at year-end market value, and the difference between the nominal contract value and fair value is recorded in the income statement under financial income and expenses.

From 1 January 2005 onwards:

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Group designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or a firm commitment (fair value hedge); (2) hedges of highly probable forecast transactions (cash flow hedges); or (3) hedges of net investments in foreign operations.

The Group documents at the inception of the transaction the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.



Accounting policies (continued)

The fair values of various derivative instruments used for hedging purposes are disclosed in Note 10 ('Derivative financial instruments'). Movements on the hedging reserve in shareholders' equity are shown in Note 16 ('Other reserves').

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

(b) Cash flow hedge

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled in the income statement in the periods when the hedged item will affect profit or loss (for instance when the forecast sale that is hedged takes place). However, when the forecast transaction that is hedged results in the recognition of a non-financial asset (for example, inventory) or a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

(c) Net investment hedge

Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

(d) Derivatives that do not qualify for hedge accounting

Certain derivative instruments do not qualify for hedge accounting. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

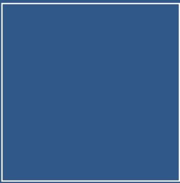
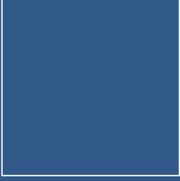
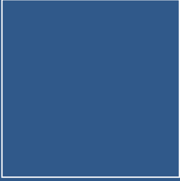
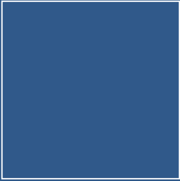
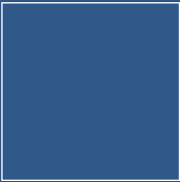
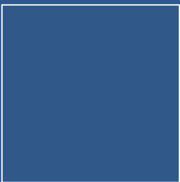
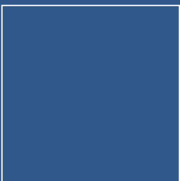
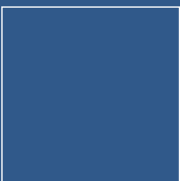
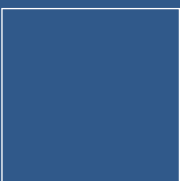
(3) Fair value estimation

The fair value of financial instruments traded in active markets (such as publicly traded derivatives, and trading and available-for-sale securities) is based on quoted market prices at the balance sheet date.

The quoted market price used for financial assets held by the Group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

The fair value of financial instruments that are not traded in an active market (for example, over-the-counter derivatives) is determined by using valuation techniques. The Group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date.

* For the purposes of this publication, Notes 10 and 16 have not been presented. Refer to PricewaterhouseCoopers publication 'Illustrative Corporate Financial Statements' for an example.

Accounting policies (continued)

Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest-rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the Group for similar financial instruments.

Note 1a: Reconciliation of equity at 1 January 2004

(all amounts in € thousands)

	GAAP	Effect of transition to IFRS	IFRS
ASSETS			
Non-current assets			
Property, plant and equipment	40,241	(17,786)	22,455
Goodwill	1,987	853	2,840
Intangible assets	4,470	(1,090)	3,380
Investments in associates	1,778	–	1,778
Receivables	2,114	16,890	19,004
Investments in unconsolidated subsidiaries	758	(758)	–
Investments in other companies	14,124	–	14,124
Deferred income tax assets	–	735	735
	65,472	(1,156)	64,316
Current assets			
Inventories	16,182	505	16,687
Trade and other receivables	4,303	(380)	3,923
Other accrued income and prepaid expenses	3,487	–	3,487
Financial receivables	5,444	5,644	11,088
Short-term securities	6,043	50	6,093
Cash and cash equivalents	2,200	120	2,320
	37,659	5,939	43,598
Total assets	103,131	4,783	107,914
EQUITY			
Capital and reserves attributable to equity holders			
Share capital	5,018	–	5,018
Fair value and other reserves	–	120	120
Cumulative translation adjustment	300	(300)	–
Consolidated reserve	1,050	(1,050)	–
Retained earnings and other reserves	7,190	3,316	10,506
	13,558	2,086	15,644
Minority interest	1,404	640	2,044
Total equity	14,962	2,726	17,688
LIABILITIES			
Non-current liabilities			
Borrowings	13,814	730	14,544
Deferred income tax liabilities	4,000	1,805	5,805
Retirement benefit obligations	13,966	765	14,731
Provisions	4,577	235	4,812
Other liabilities	10,649	(1,850)	8,799
	47,006	1,685	48,691
Current liabilities			
Trade and other payables	30,094	(23)	30,071
Current income tax liabilities	200	45	245
Borrowings	10,869	350	11,219
	41,163	372	41,535
Total liabilities	88,169	2,057	90,226
Total equity and liabilities	103,131	4,783	107,914

Note 1b: Reconciliation of equity at 31 December 2004

(all amounts in € thousands)

	GAAP	Effect of transition to IFRS	IFRS
ASSETS			
Non-current assets			
Property, plant and equipment	41,451	(18,049)	23,402
Goodwill	1,859	886	2,745
Intangible assets	6,021	(780)	5,241
Investments in associates	3,958	–	3,958
Receivables	1,822	16,940	18,762
Investments in unconsolidated subsidiaries	634	(634)	–
Investments in other companies	14,377		14,377
Deferred income tax assets	–	522	522
	70,122	(1,115)	69,007
Current assets			
Inventories	17,257	408	17,665
Trade and other receivables	4,189	(670)	3,519
Other accrued income and prepaid expenses	1,350	–	1,350
Financial receivables	5,215	5,679	10,894
Short-term securities	8,440	40	8,480
Cash and cash equivalents	2,133	100	2,233
	38,584	5,557	44,141
Total assets	108,706	4,442	113,148
EQUITY			
Capital and reserves attributable to equity holders			
Share capital	5,018	–	5,018
Fair value and other reserves	–	200	200
Cumulative translation adjustment	500	(779)	(279)
Consolidated reserve	1,050	(1,050)	–
Retained earnings and other reserves	6,120	3,782	9,902
	12,688	2,153	14,841
Minority interest	1,437	556	1,993
Total equity	14,125	2,709	16,834
LIABILITIES			
Non-current liabilities			
Borrowings	17,830	532	18,362
Deferred income tax liabilities	3,874	1,603	5,477
Retirement benefit obligations	14,021	1,110	15,131
Provisions	4,883	(35)	4,848
Other liabilities	11,243	(2,049)	9,194
	51,851	1,161	53,012
Current liabilities			
Trade and other payables	32,105	170	32,275
Current income tax liabilities	410	32	442
Borrowings	10,215	370	10,585
	42,730	572	43,302
Total liabilities	94,581	1,733	96,314
Total equity and liabilities	108,706	4,442	113,148

Note 1c: Reconciliation of profit and loss for 2004

(all amounts in € thousands)

	GAAP	Effect of transition to IFRS	IFRS
Sales	48,042	(222)	47,820
Cost of sales	(34,993)	251	(34,742)
Gross profit	13,049	29	13,078
Other operating income	3,314	(2,200)	1,114
Distribution costs	(4,560)	13	(4,547)
Administrative expenses	(4,847)	(60)	(4,907)
Other operation expenses	(5,366)	(20)	(5,386)
Profit/(loss) from operations	1,590	(2,238)	(648)
Finance costs – net	(712)	230	(482)
Share of profit of associates	–	2,200	2,200
Profit before tax	878	192	1,070
Income tax expense	(294)	(5)	(299)
Profit from ordinary activities after tax	584	187	771
Extraordinary item	(135)	135	–
Profit for the period	449	322	771
Attributable to:			
Minority interest	346	(49)	297
Group equityholders	103	371	474
	449	–	771

Explanation of adjustments

IFRS 1 paragraphs 39-41 require sufficient detail to be provided to enable the user of the financial statements to understand the changes in the accounting policies that led to the adjustments to the balance sheet, income statement and, if applicable, cash flow statement. The above notes 1(a) to 1(c) should be supplemented with a description of the adjustments made. The explanations are illustrated in IFRS 1 Implementation Guidance paragraph 63. These descriptions have not been presented in this practice aid as full details are provided in Steps 2-5 (pp49-91) of this step-by-step guide.

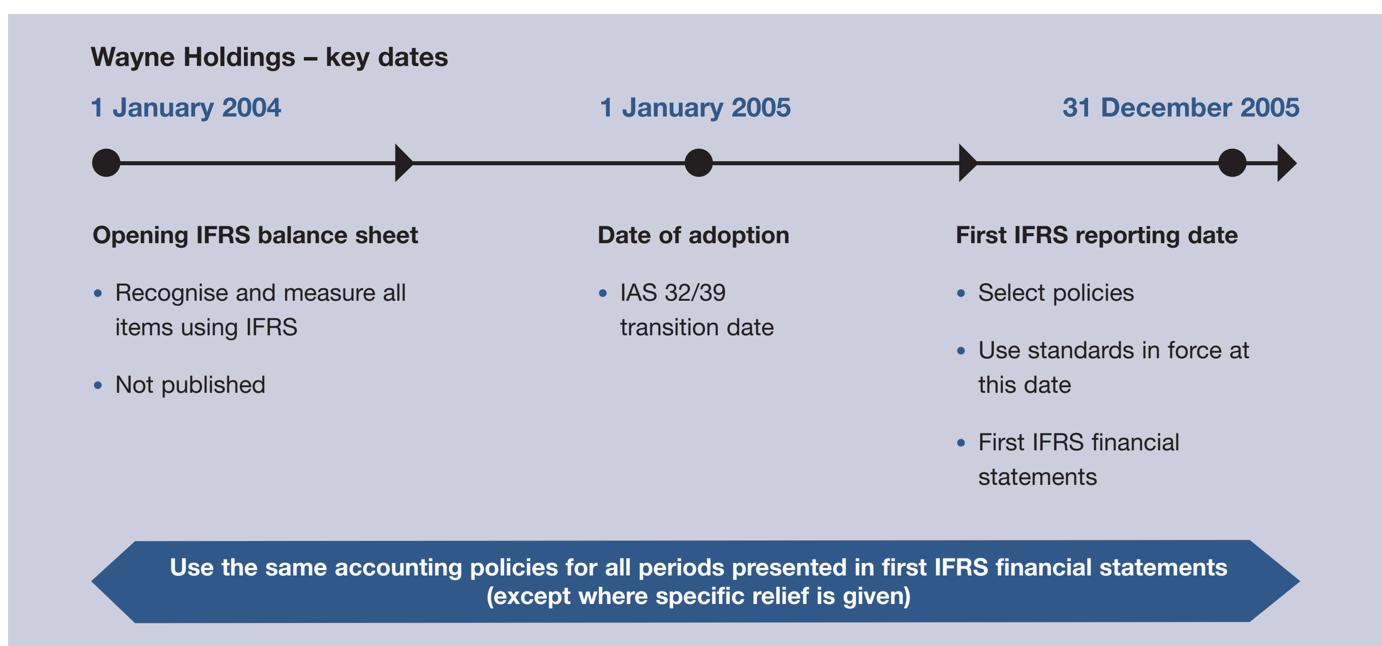
B – IFRS 1 step-by-step

Step 1 – Identify the key dates and the first IFRS financial statements

Management has decided to apply IFRS 1 for the year ending 31 December 2005. The reporting date is the closing balance sheet date of the first IFRS financial statements – 31 December 2005. The date of transition is the beginning of the earliest period for which full comparative information under IFRS is presented in the first IFRS financial statements. IFRS 1 requires at least one year of comparatives. Wayne Holdings' date of transition is 1 January 2004; the Group must prepare its opening IFRS balance sheet at 1 January 2004.

The Group's date of adoption for IFRS is 1 January 2005. This is the beginning of the first annual accounting period for which annual financial statements have been prepared in accordance with IFRS. The Group has elected to apply the exemption from restating comparatives in accordance with IAS 32 and IAS 39. The Group's IAS 32/39 transition date is therefore 1 January 2005.

The Group's accounting policies should comply with the standards in force at the reporting date – 31 December 2005. These policies should be applied in the opening IFRS balance sheet and throughout the first IFRS financial statements except where specific relief is given.



Step 2 – Identify the differences between the existing accounting policies and IFRS

Select IFRS accounting policies

Current presentation and accounting policies should be compared to the IFRS requirements in order to identify differences between the existing policies and IFRS. Management should also select its accounting policies where there is a choice under IFRS.

Index to accounting policies and identification of eventual adjustments

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A Basis of preparation

Current disclosures	Changes required to comply with IFRS
The consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP).	The Group's first IFRS financial statements should include an explicit and unreserved statement of compliance with IFRS.

B Presentation of the primary statements

Primary financial statement	Changes required to comply with IFRS
Balance sheet	The balance sheet should be presented in the format that IAS 1 requires. Minority interests should not be presented in equity. Liabilities should be classified as current or non-current on the face of the balance sheet. The balance sheet should be cross-referenced to the notes. Net income/loss for the year should be presented as part of retained earnings.
Income statement	The income statement should be presented in the format that IAS 1 requires. Expenses should be presented by nature or by function. The investor's share of profits and losses of associates should be presented on the face of the income statement. Extraordinary items do not arise under IFRS. The minority interest's share of profit should be presented below the income statement as an allocation of profit. Earnings per share should be presented on the face of the income statement.
Statement of changes in equity	The statement of changes in shareholders' equity should be presented as a primary statement.
Cash flow statement	The cash flow statement should be presented as a primary statement.

C Group Accounting

Existing accounting policy*	Changes required to comply with IFRS
a. The assets and liabilities, and revenues and expenses, of subsidiaries consolidated on a line-by-line basis are included in the consolidated financial statements, regardless of the percentage of ownership. The carrying values of investments are eliminated against the subsidiaries' stockholders' equity. The portion of stockholders' equity and results of operations attributed to minority interests are disclosed separately in the consolidated financial statements.	No changes are required to the accounting policy. Minority interests are not presented as part of equity.
b. Entities whose operations are not homogeneous with those of the Group have been excluded from the scope of consolidation. Entities for which it would be not practicable to obtain the necessary information on a timely basis or without disproportionate expense have not been consolidated.	IAS 27 does not permit the exclusion of subsidiaries that have non-homogeneous operations or when it is not possible to obtain information on a timely basis or without disproportionate expense. These subsidiaries should be consolidated on the opening IFRS balance sheet using the guidance in IFRS 1.B.2(j) (Adjustment C1).
c. Differences arising from the elimination of investments against the related stockholders' equity of the investment at the date of acquisition are allocated to the fair value of the assets and liabilities of the company being consolidated. The residual value, if positive, is capitalised as goodwill, and is amortised using the straight-line method over the estimated period of recoverability. Negative residual amounts are recorded as a component of stockholders' equity in 'consolidation reserve' (or as a liability in 'consolidation reserve for future risks and charges', when it is attributable to a forecast of future losses).	The accounting policy for the purchase price allocation is appropriate under IFRS. This policy should be applied to business combinations after the date of transition to IFRS in accordance with the detailed requirements of IFRS 3. The application of the policy to business combinations before the date of transition to IFRS is covered by one of the 10 optional exemptions (see Step 3, p75). Positive goodwill should not be amortised but should be tested for impairment at least annually. IFRS 3 requires negative goodwill to be recognised in the income statement. Negative goodwill should not be presented in equity (Adjustment C2). Goodwill recognised directly in equity under previous GAAP is covered by one of the 10 optional exemptions and is not restated on transition (see Step 3, p75).
d. Unrealised intercompany profits and losses are eliminated net of related tax effects, together with all intercompany receivables, payables, revenues and expenses arising on transactions between consolidated companies that have not been realised by transactions outside the Group. The gross margin on intercompany sales of plant and equipment produced and sold at prices in line with market conditions are not eliminated. Guarantees, commitments and risks relating to companies included in the consolidation are also eliminated.	The profit recorded on intercompany sales of plant and equipment produced and sold at prices in line with market conditions should be eliminated on consolidation in accordance with IAS 27 (Adjustment C3).

* The letters assigned to the existing accounting policies correspond to the accounting policies presented in the GAAP financial statements on pp88-91.

Adjustments to the opening IFRS balance sheet in connection with accounting policy changes for Group accounting:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
C1	Investments in unconsolidated subsidiaries		758
C1	Property, plant and equipment	1,350	
C1	Goodwill	350	
C1	Intangible assets	120	
C1	Deferred tax assets	10	
C1	Inventories	430	
C1	Trade and other receivables	520	
C1	Short-term investments	50	
C1	Cash and cash equivalents	120	
C1	Minority interest		50
C1	Borrowings		630
C1	Deferred tax liabilities		70
C1	Retirement benefit obligations		250
C1	Provisions		345
C1	Other liabilities		550
C1	Trade and other payables		252
C1	Current tax liabilities		45

Being the consolidation of subsidiaries previously excluded from consolidation under GAAP, including the elimination of intercompany balances.

C2	Consolidation reserve (negative goodwill)	1,050	
C2	Retained earnings		1,050

Being the reclassification of negative goodwill written off directly to reserves under GAAP from consolidation reserve to retained earnings.

C3	Property, plant and equipment		287
C3	Retained earnings	287	

Being the elimination of unrealised profit on property, plant and equipment purchased from group companies.

D Foreign currency translation

Existing accounting policy*	Changes required to comply with IFRS
f. Foreign subsidiaries' balance sheets are translated into euros by applying year-end exchange rates. Foreign subsidiaries' income statements are translated using average exchange rates.	The accounting policy complies with IFRS but should be expanded to describe how each subsidiary's measurement currency is determined.
f. The financial statements of subsidiaries operating in high-inflation countries (cumulative inflation in excess of 100% in three years) are prepared using accounting principles for hyperinflationary economies.	Wayne Holdings has subsidiaries in Russia, which had a hyperinflationary economy until 1 January 2003. The Group no longer has operations in hyperinflationary economies; however, it will have to consider whether adjustments are required to those Russian assets held since before 1 January 2003. The accounting rules under previous GAAP for hyperinflationary economies permitted the results of entities operating in those economies to be expressed in terms of a hard currency. This approach was applied to the Russian subsidiary for the periods when Russia had a hyperinflationary economy. This is not permitted under IFRS **(Adjustment D1)**.
g. Exchange differences resulting from the translation of opening stockholders' equity at current exchange rates and at the exchange rates used at the end of the previous year, as well as differences between net income expressed at average exchange rates and that expressed at current exchange rates, are reflected in stockholders' equity as 'cumulative translation adjustments'. Such reserves relating to investments in subsidiaries or associated companies are included in the income statement when the investments are sold to third parties.	No changes to the accounting policy are required. The restatement of the cumulative currency translation reserve is addressed by one of the optional exemptions **(see Step 3, p80)**.
v. Receivables denominated in foreign currency are translated at the exchange rate in effect at year-end. Resulting exchange gains and losses are included in the income statement.	No changes to the accounting policy are required.
aa. Accounts payable denominated in foreign currency are translated at the exchange rate in effect at year-end. Resulting exchange gains and losses are included in the income statement.	No changes to the accounting policy are required.

* The letters assigned to the existing accounting policies correspond to the accounting policies presented in the GAAP financial statements on pp49-74.

Existing accounting policy	Changes required to comply with IFRS
ff. For foreign exchange instruments designated as hedges, the premium (or discount) representing the difference between the spot exchange rate at the inception of the contract and the forward exchange rate is included in the income statement, in financial income and expenses, in accordance with the accrual method.	Derivative financial instruments, including foreign exchange contracts, should initially be recognised in the balance sheet at cost and subsequently remeasured at their fair value. The method of recognising the resulting gain or loss is dependent on the nature of the item being hedged. The Group designate certain derivatives as either (1) a hedge of the fair value of a recognised asset or liability or of a firm commitment (fair value hedge), (2) a hedge of a forecasted transaction (cash flow hedge), or (3) a hedge of a net investment in a foreign entity on the date a derivative contract is entered into. Changes in the fair value of derivatives that are designated and qualify as fair value hedges, and that are highly effective, should be recorded in the income statement, along with any changes in the fair value of the hedged asset or liability that is attributable to the hedged risk. Changes in the fair value of derivatives that are designated and qualify as cash flow hedges and that are highly effective should be recognised in equity. Where the forecasted transaction results in the recognition of an asset (for example, property, plant and equipment) or of a liability, the gains and losses previously deferred in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability. Otherwise, amounts deferred in equity should be transferred to the income statement and classified as revenue or expense in the same periods during which the hedged firm commitment or forecasted transaction affects the income statement (for example, when the forecasted sale takes place). Certain derivative transactions, while providing effective economic hedges under the Group's risk management policies, do not qualify for hedge accounting under the specific rules in IAS 39. Changes in the fair value of any derivative instruments that do not qualify for hedge accounting under IAS 39 should be recognised immediately in the income statement. Hedge accounting is addressed by one of the mandatory exceptions (see Step 4, p84).

Adjustments to the opening IFRS balance sheet in connection with accounting policy changes for foreign currency:

Adjustment		Effect of transition to IFRS	
		Dr	Cr
D1	Property plant and equipment	340	
D1	Retained earnings		340

Being the restatement of the results of the Russian subsidiary, in accordance with IAS 29.

E Property, plant and equipment

Existing accounting policy	Changes required to comply with IFRS
j. Property, plant and equipment are recorded at purchase or construction cost. These values are adjusted where the specific laws of the country in which the assets are located allow or require revaluation, in order to reflect, even if only partially, changes in the currency's purchasing power.	The revaluation model in IAS 16 cannot be adopted only for certain assets in certain countries. Management chose the cost model under IAS 16 rather than applying the revaluation model treatment to all items of property, plant and equipment as its ongoing accounting policy. The measurement of property, plant and equipment at the date of transition to IFRS should be covered by one of the 10 optional exemptions (see Step 3, p78).
j. Cost also includes financing expenses incurred during the construction period for specific loans, where significant.	The capitalisation of interest must be applied to all items. Management has chosen to apply the allowed alternative treatment under IAS 23 and capitalise all borrowing costs that are directly attributable to the acquisition, construction or production of qualifying assets (Adjustment E1).
k. Depreciation is provided on a straight-line basis at rates that reflect the estimated useful life of the related assets.	The accounting policy is appropriate under IFRS. However, management should confirm that the depreciation periods actually applied comply with IFRS. One of Wayne Holdings' subsidiaries has used tax depreciation rates that are significantly different from the assets' estimated useful lives. Certain assets were fully depreciated several years before they were retired from service (Adjustment E2).
l. When, at the balance sheet date, property, plant and equipment shows a permanent impairment in value, it is written down to the lower value.	This accounting policy should be reviewed, as there is no concept of 'permanent' impairment in IFRS. The policy should be redrafted to comply with IAS 36. Management has determined that the carrying amounts of property, plant and equipment in certain subsidiaries may not be recoverable. The requirements of IAS 36 should be applied at the date of transition to IFRS, and assets tested for impairment if there are indications that they might be impaired. Assets are written down when recoverable amount is less than carrying amount (Adjustment E3).

Existing accounting policy	Changes required to comply with IFRS
m. Repairs and maintenance expenses related to property, plant and equipment are charged to the statement of operations in the year in which they are incurred, while maintenance expenses that increase the value of property, plant and equipment are capitalised.	Costs should be capitalised only if it is probable that they will increase the economic benefits that property, plant and equipment is expected to generate. All other costs should be charged in the income statement as incurred, even if they increase the asset's value. The accounting policy should be amended to comply with IAS 16. Any amounts previously capitalised that did not meet the capitalisation criteria should be written off **(Adjustment E4).**

Adjustments to the opening IFRS balance sheet in connection with property, plant and equipment:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
E1	Property, plant and equipment	255	
E1	Retained earnings		255

Being the capitalisation of all eligible borrowing costs directly attributable to the acquisition, construction or production of property, plant and equipment.

		Dr	**Cr**
E2	Property, plant and equipment	800	
E2	Retained earnings		800

Being the restatement of accumulated depreciation to reflect assets' useful lives rather than their tax lives.

		Dr	**Cr**
E3	Property, plant and equipment		600
E3	Retained earnings	600	

Being the recognition of impairment provisions against PPE using the guidance set out in IAS 36.

		Dr	**Cr**
E4	Property, plant and equipment		130
E4	Retained earnings	130	

Being the write-off of maintenance costs capitalised under previous GAAP.

F Intangible assets

Existing accounting policy	Changes required to comply with IFRS
h. Intangible assets and deferred charges expected to benefit future periods are recorded at cost, adjusted by amortisation on a straight-line basis over the period to be benefited. Goodwill is amortised over a period of not more than 20 years, taking into account the expected period of recovery.	Charges cannot be deferred because they are expected to benefit future periods. Only costs that meet the definition of an asset can be capitalised. The accounting policy should be revised to conform with IAS 38. The capitalised costs should be reviewed to ensure that they meet the IAS 38 recognition criteria **(Adjustment F1).** Intangible assets with indefinite lives should not be amortised but tested at least annually for impairment. Wayne Holdings does not have any intangible assets with indefinite lives. Goodwill should not be amortised but should be tested for impairment at the date of transition and then at least annually. The accounting policy should be revised. Amortisation charged before date of transition is not restated.
h. The Group periodically and critically ascertains that the carrying value of such assets is not higher than the estimated recoverable value, in relation to their use or realisation determined by reference to the most recent corporate plans.	This accounting policy should be reviewed and revised to comply with IAS 36. The requirements of IAS 36 must be applied at the date of transition to IFRS and assets tested for impairment if there are indications that they might be impaired. Assets are written down when recoverable amount is less than carrying amount. No material adjustment was required.
jj. The costs of researching and developing new products and/or processes are mainly included in the income statement in the period in which such costs are incurred, in line with the principle of conservatism and with international practice in the security sector.	The policy for research and development costs does not comply with IAS 38. The guidance in IAS 38 paragraph 57 should be applied and development costs capitalised where they meet the recognition criteria **(Adjustment F2).**
jj. Advertising and promotion expenses are charged to the income statement in the year incurred.	Advertising and promotion expenses should only be recognised as an asset if they represent a pre-payment for advertising services not yet received. There were no pre-paid advertising expenses at the transition date, so no adjustment was required.

Adjustments to the opening IFRS balance sheet in connection with intangible assets:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
F1	Intangible assets		1,230
F1	Retained earnings	1,230	

Being the write-off of deferred charges that do not meet the IFRS definition of an asset

		Dr	Cr
F2	Intangible assets	130	
F2	Retained earnings		130

Being the capitalisation of development costs that meet the recognition criteria of IAS 38 that were written off under previous GAAP.

G Investments

Existing accounting policy	Changes required to comply with IFRS
n. Financial fixed assets include investments in unconsolidated subsidiaries, associated companies and other companies, financial receivables held for investment purposes, treasury stock and other securities.	Treasury stock should be presented as a deduction from equity as required by IAS 32 rather than as an investment (Adjustment G1).
o. Investments in unconsolidated subsidiaries, in companies in which the Group exercises joint control with other partners and associated companies, are normally accounted for using the equity method. Investments in other companies are valued at cost. A permanent impairment in value is provided as a direct reduction of the investment account.	Unconsolidated subsidiaries should be consolidated (Adjustment C1). Investments in other companies (where the group does not have control, joint control or significant influence) should be measured at fair value as available-for-sale assets under IAS 39 (see Step 3, page 81).
q. Securities are recorded at cost, including additional direct charges. A permanent impairment is provided as a direct reduction of the securities account.	Securities are measured at fair value as available-for-sale or at amortised cost as originated loans, rather than at cost (see Step 3, page 81). A financial asset is impaired if its carrying amount is greater than its recoverable amount. Management should assess at each balance sheet date whether there is any objective evidence that an asset may be impaired. It should estimate the recoverable amount of that asset and recognise any impairment loss in the income statement. The recoverable amount of an asset measured at fair value is the present value of expected future cash flows discounted at the current market rate of interest for a similar financial asset.
w. Current assets also include investments and securities acquired as a temporary investment, which are valued at the lower of cost and market, cost being determined on a last-in-first-out (LIFO) basis.	These securities should be classified as financial assets at fair value through profit or loss; trading assets are measured at fair value rather than the lower of cost and market (see Step 3, page 81).

Adjustments to the opening balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with investments:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
G1	Short-term securities		200
G1	Treasury shares – equity	200	

Being the reclassification of treasury shares from investments to equity.

H Leases

Existing accounting policy	Changes required to comply with IFRS
r. Investment in leased equipment is recorded at cost. The related depreciation is calculated, using the financial method, based on the life of the lease and the related risk in managing such contracts.	Equipment leased out under operating leases should be depreciated over its expected useful life on a basis consistent with similar owned property, plant and equipment. The financial method of depreciation resembles a reverse sum-of-the-digits method and is not permitted under IFRS **(Adjustment H1).**

Adjustments to the opening IFRS balance sheet in connection with leases:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
H1	Property, plant and equipment	130	
H1	Retained earnings		130

Being the restatement of accumulated depreciation on assets leased out under operating leases.

I Inventories

Existing accounting policy	Changes required to comply with IFRS
s. Inventories are valued at the lower of cost and market value, cost being determined on a first-in-first-out (FIFO) basis. The valuation of inventories includes the direct costs of materials and labour and variable indirect costs. Fixed indirect production costs are expensed as incurred.	The valuation of inventories should include an allocation of fixed indirect production costs (for example, depreciation of factory buildings) **(Adjustment I1).**
u. Provision is made for obsolete and slow-moving raw materials, finished goods, spare parts and other supplies, based on their expected future use and realisable value.	Inventory provisions under IFRS are recorded at net realisable value. An item is not impaired just because it is slow moving **(Adjustment I2).**

Adjustments to the opening IFRS balance sheet in connection with inventories:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
I1	Inventory	25	
I1	Retained earnings		25

Being the inclusion of fixed indirect production costs in the valuation of inventory.

		Dr	Cr
I2	Inventory	50	
I2	Retained earnings		50

Being the reversal of the provision for slow-moving raw materials.

J Construction contracts

Existing accounting policy	Changes required to comply with IFRS
t. Work in progress on long-term contracts is valued based on the stage of completion and is recorded gross of advance payments received from customers. Eventual losses on such contracts are fully recorded when they become known.	The accounting policy for recognising income complies with IFRS, but the basis of recognising revenue should be disclosed in more detail. Amounts recoverable on long-term contracts should be presented net of amounts received from customers. An adjustment is required to correct the balance sheet presentation (Adjustment J1).

Adjustments to the opening IFRS balance sheet in connection with construction contracts:

Adjustment		Effect of transition to IFRS	
		Dr	Cr
J1	Amounts recoverable from long-term contracts		2,400
J1	Advances received from customers – long-term contracts	2,400	

Being the presentation of amounts recoverable on long-term contracts net of amounts received from customers.

K Receivables

Existing accounting policy	Changes required to comply with IFRS
p. Financial receivables arising from equipment sales with extended credit periods are recorded at estimated realisable value.	Financial receivables should be recognised at their present value. The discount to reflect the time value of money should be calculated using a discount rate that reflects the risks associated with the customer. It is not clear if the accounting policy that Wayne Holdings followed is consistent with IFRS requirements. If it is consistent, it must be properly described in the accounting policies. The accounting policy description should be revised but no adjustment is required to the transition balance sheet.
v. Receivables are recorded at estimated realisable value. Any unearned interest included in the nominal value of financial receivables is deferred to future periods when it is earned. Receivables sold to third parties with recourse or without recourse (including those sold as part of securitisation transactions) are eliminated from receivables.	Receivables should be stated at amortised cost less provision for impairment, not estimated realisable value. The provision should reflect both the likelihood of being paid and the timing of the cash flows (Adjustment K1). The accounting policy should be revised to reflect this requirement. The derecognition of receivables sold with recourse is unlikely to be appropriate under IAS 39. However, derecognition of financial assets and liabilities is one of the mandatory exceptions from retrospective application (see Step 4, p82).

Adjustments made to the opening balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with receivables:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
K1	Receivables		450
K1	Retained earnings	450	

Being the restatement of the provision for impairment of receivables to reflect the expected timing of receipt.

L Cash and cash equivalents

Existing accounting policy	Changes required to comply with IFRS
There is no accounting policy dealing with cash and cash equivalents.	An accounting policy is required for the measurement and classification of cash balances in connection with the cash flow statement.

M Share capital

Existing accounting policy	Changes required to comply with IFRS
There is no accounting policy for share capital or other transactions within equity.	An accounting policy should be drafted to explain the classification and measurement of share capital and other transactions in equity. The policy should deal with the classification of complex capital instruments, if relevant. The policy should also address share issue costs and transactions in the company's own shares.

N Borrowings

Existing accounting policy	Changes required to comply with IFRS
There is no accounting policy for borrowings.	An accounting policy is required for the initial recognition and subsequent measurement of borrowings. The policy should include, if relevant, an explanation of the treatment of compound instruments and preference shares that are classified as liabilities. Wayne Holdings has issued perpetual preference shares that are redeemable at the option of the Company but not at the option of the holders. The shares pay annual dividends of 10% when there are sufficient distributable profits. The dividends accumulate in years when there are insufficient distributable profits and must be paid before any ordinary dividend. These shares are classified as equity under GAAP. The preference shares are a liability under IFRS. Management does not have the discretion to avoid paying the dividends. The potential or actual absence of distributable profits does not alter this conclusion **(Adjustment N1).**

Adjustment made to the opening balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with preference shares:

	Adjustment	Effect of transition to IFRS	
		Dr	**Cr**
N1	Share capital – preference shares	1,000	
N1	Borrowings due after one year – preference shares		1,000

Being the reclassification of preference shares from equity to liabilities.

O Deferred income taxes

Existing accounting policy	Changes required to comply with IFRS
nn. Income taxes currently payable are provided for in accordance with the existing legislation of the various countries in which the Group operates.	This accounting policy is acceptable under IFRS.
oo. Deferred tax liabilities or deferred tax assets are determined on all the timing differences between the consolidated assets and liabilities and the corresponding amounts for purposes of taxation, including those deriving from the most significant consolidation adjustments. GAAP allows the recognition of deferred taxes to account for the tax benefit of tax loss carry-forwards whenever the specific conditions for future recoverability are met.	This accounting policy might not comply with IFRS. IAS 12 requires deferred tax to be calculated on temporary differences, not timing differences. IFRS has detailed rules in specific areas that may result in differences in the tax assets and liabilities that are recognised (see Step 5, p86).
pp. Deferred tax assets are only recorded if there is a reasonable certainty of their future recovery.	This accounting policy might not comply with IFRS. Deferred tax assets are recognised under IFRS if it is probable that sufficient future taxable profit will be available. No adjustments to the amounts recognised were necessary.
qq. Deferred tax liabilities are not recorded if it is unlikely that a future liability will arise.	Deferred tax liabilities are recorded regardless of the probability that a future tax payment may be required. A deferred tax provision calculated on the basis of probability does not comply with IAS 12 (see Step 5, p86).
rr. Deferred tax assets and liabilities are offset if they refer to the same company. The balance from offsetting the amounts is recorded in other receivables in current assets, if a deferred tax asset, and in the deferred tax reserve, if a deferred tax liability.	Deferred tax assets and liabilities should be offset if they relate to the same tax jurisdiction. Assets and liabilities that arise in the same legal entity are not sufficient (see Step 5, p86). Deferred tax assets should not be classified as current assets. They should be disclosed as a non-current separate item on the face of the balance sheet.

P Employee benefits

Existing accounting policy	Changes required to comply with IFRS
y. The reserve for pensions and similar obligations includes provisions for long-service or other bonuses (including pension funds required by some countries in which the Group operates), payable to employees and former employees under contractual agreements or by law, determined on an actuarial or legal basis, where applicable.	Provisions for long-term employee benefits and other awards should be calculated in accordance with IAS 19, which may be different from local law. The Group has issued share options to senior management. Wayne Holdings will need to include an accounting policy that complies with IFRS 2 and recognise an adjustment at the date of transition. The adjustment is addressed by one of the optional exemptions (see Step 3, p81).

Q Provisions

Existing accounting policy	Changes required to comply with IFRS
x. Reserves for risks and charges include provisions to cover losses or liabilities that are likely to be incurred, but where the amount or the date on which they will arise are uncertain.	The reserve for risks and charges includes 'losses' likely to be incurred. IAS 37 does not permit the recognition of a provision for future operating losses **(Adjustment Q1).** Wayne Holdings operates a plant in country X. There are no legal requirements in country X that obligate the Group to clean up contamination, nor are there any environmental regulations that would result in penalties to be paid. However, Wayne Holdings has published corporate responsibility policies stating that it will rectify all environmental damage it causes anywhere in the world. The Group has carried out environmental remediation work elsewhere in the past when it has not been legally obliged to do so. Although there is no legal requirement for Wayne Holdings to provide for the clean-up costs, it has created a constructive obligation as a result of its published policies and past practices. The Group must therefore recognise the present value of the costs expected to be incurred in connection with the clean-up **(Adjustment Q2).** The unamortised cost of the provision will be included in the cost of the plant. Wayne Holdings should include an accounting policy for environmental provisions in its IFRS financial statements.
z. Restructuring reserves include the costs to carry out corporate reorganisation and restructuring plans; they are provided in the year in which the company formally decides to implement such plans, where such costs can be reasonably estimated.	The provision for restructuring costs should be recognised only when there is a legal or constructive obligation. Management's decision is not sufficient on its own. The accounting policy will need to be revised. However, although the GAAP accounting policy does not comply with IFRS, a detailed review of provisions revealed that no adjustments to the amounts were necessary.
jj. Estimated product warranty costs are charged to the income statement at the time the sale is recorded.	No adjustments are required with regard to the accounting policy for product warranty costs.

Adjustments to the opening IFRS balance sheet in connection with provisions:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
Q1	Provision	240	
Q1	Retained earnings		240

Being the reversal of the provision for future operating losses.

		Dr	Cr
Q2	Property, plant and equipment	100	
Q2	Environmental provision		130
Q2	Retained earnings	30	

Being the recognition of a provision for environmental costs relating to a constructive obligation.

R Revenue recognition

Existing accounting policy	Changes required to comply with IFRS
ii. Revenues from sales and services are recognised on the accrual basis net of returns, discounts, allowances and rebates. Revenues from sales of products are recognised at the moment title passes to the customer, which is generally at the time of shipment. Revenues from services are recorded when they are performed. Revenues from long-term contracts are recognised using the percentage of completion method.	The transfer of the legal title is not necessarily sufficient to recognise revenue under IAS 18. Management has reviewed the revenue policies adopted in connection with each type of revenue. Despite the need to amend the accounting policy, no material adjustments were required. The group sells security equipment and provides services. Management analysed the related revenue recognition policies in detail, particularly the analysis between product sale and maintenance service income. No material adjustment was required.
ii. Revenues also include amounts received from financing leases, net of depreciation, and income from company assets on operating leases.	The accounting policy does not comply with IFRS. When assets are leased out under a finance lease, the asset should be treated as sold and derecognised. Wayne Holdings leases assets that it has manufactured. IAS 17 requires a manufacturer to recognise a profit equivalent to the profit on an outright sale at normal selling prices at the start of the lease and the finance income over the lease term using the net investment method. The present value of the lease payments should be recognised as a receivable. The difference between the gross receivable and the present value of the receivable should be recognised as unearned finance income **(Adjustment R1)**. The accounting policy will need to be revised. The change in accounting policy will result in the revenue for the sale of the asset being recognised at the start of the lease and the asset's carrying value being recognised as cost of sales. Consequently there should be no depreciation charge recognised in respect of the asset. The finance income over the life of the lease should be recognised using the net investment method.

Adjustments to the opening IFRS balance sheet in connection with revenue recognition:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
R1	Property, plant and equipment		24,014
R1	Receivables (finance lease)	24,034	
R1	Retained earnings		20

Being the derecognition of assets leased out under finance leases and the recognition of the finance lease receivable.

S Dividends

Existing accounting policy	Changes required to comply with IFRS
The accounting policy was not included in the financial statements. Dividends proposed after the balance sheet date, but before the financial statements are finalised, are treated as an adjusting post-balance sheet event under GAAP and accrued in the financial statements.	The Accounting policies note should include an accounting policy for dividends. Dividends proposed after balance sheet date should not be accrued. At the opening balance sheet date, Wayne Holdings had accrued a final dividend for the year ended 31 December 2003 of €275. This must be reversed in the opening IFRS balance sheet (Adjustment S1).

Adjustments to the opening IFRS balance sheet in connection with dividends:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
S1	Dividends payable (within other payables due within one year)	275	
S1	Retained earnings		275

Being the reversal of proposed ordinary dividends payable.

T Segment reporting

Existing accounting policy	Changes required to comply with IFRS
GAAP does not require presentation of segment information.	The Group operates in three business segments: equipment, residential services and corporate services. Also, the Group operates in four main geographical segments: North America, Europe, South America and Asia. Segment information should be disclosed.

U Financial risk management

Existing accounting policy	Changes required to comply with IFRS
dd. Derivative financial instruments are designated as 'hedging instruments' or 'non-hedging instruments'. The transactions that, according to the Group's risk management policy, are able to meet the conditions for hedge accounting are classified as hedging transactions; the others, although set up for the purpose of managing risk (as the Group's policy does not permit speculative transactions) have been designated as 'trading'. **ee.** The Group records derivative financial instruments at cost. The gains and losses on derivative financial statements are included in the income statement on maturity to match the underlying hedged transactions, where relevant. **hh.** For interest-rate instruments designated as hedges, the interest-rate differential is included in income, in financial income and expenses, in accordance with the accrual method, offsetting the effects of the hedged transaction. **gg.** Derivative financial instruments designated as trading instruments are valued at year-end market value, and the difference between the nominal contract value and fair value is recorded in the income statement under financial income and expenses.	Wayne Holdings will need to recognise all derivatives at fair value when it adopts IAS 39. It will also have to recognise its previous GAAP hedging relationships at the IAS 32/39 transition date if they are of the type allowable under IAS 39. The accounting policies related to financial instruments should be expanded to include financial risk management policies. The accounting policies also do not include classification of financial assets, initial and subsequent measurement and valuation methods to determine fair value. The policies for hedging should be clearer – for example, in relation to what risks they are hedging and what hedging instruments they are using.

Step 3 – Applying the optional exemptions

Section 1 of this publication provides an explanation of the optional exemptions from retrospective application. Management has considered which of the 10 optional exemptions it wants to apply. Some of the exemptions must be applied to all similar items, while others can be applied separately. The summary of management's decisions is presented below.

Business combinations exemption

Wayne Holdings has made a number of acquisitions in recent years. Management has decided that Wayne Holdings will use the business combinations exemption in IFRS 1 and will not restate business combinations that took place prior to the IFRS transition date. The exemption has been applied as described below.

Acquisition	Application of the exemption
Acquisition 1 Wayne Holdings merged with TDB Limited, a smaller business, using a share-for-share exchange. The transaction was recorded using the pooling-of-interests method. TDB's assets and liabilities were recorded in the consolidated financial statements, using the book values in TDB's financial statements.	There is no requirement to restate the transaction as an acquisition. The exemption in IFRS 1 allows Wayne Holdings to keep the same classification for this transaction. The carrying amount of TDB's assets and liabilities in the consolidated financial statements immediately after the transaction should be deemed cost under IFRS. Any assets and liabilities normally measured at fair value under IFRS should be restated to fair value for the opening IFRS balance sheet. No adjustment is required in respect of this acquisition.
Acquisition 2 Wayne Holdings acquired a competitor, MJS Pty, in 1998. Purchase accounting was applied, but certain of MJS's internally generated trademarks were not recognised as intangible assets. The goodwill arising from the application of purchase accounting was charged against equity in accordance with GAAP.	There is no requirement to restate intangible assets or goodwill. IFRS 1 does not permit goodwill previously charged against equity to be reinstated. IAS 38 would not permit MJS to recognise the internally generated trademarks, so Wayne Holdings should not recognise the assets at the date of transition. No adjustment is required in respect of this acquisition.

Acquisition	Application of the exemption
Acquisition 3 Wayne Holdings acquired a research business, Ardito SA, in 2000. Purchase accounting was applied, and all of Ardito's assets and liabilities were restated to fair value. The research team was included in the identifiable assets at a fair value determined by independent experts. The fair value of certain development work in progress was determined by independent experts and written off in the income statement immediately, although at the date of acquisition it met the criteria in IAS 38 for recognition as an asset. Ardito SA leased its research facility under an arrangement that is accounted for as if it were an operating lease, although title to the factory passes to Ardito SA at the end of the lease.	The fair value attributed to the assembled workforce does not meet the criteria in IAS 38 for recognition as an asset. The asset should be excluded from the opening IFRS balance sheet with a corresponding adjustment to goodwill (Adjustment C4a). Consequential adjustments will also be required to minority interest and deferred tax (see Step 5, p86). The development work in progress was recognised at fair value at the time of the acquisition and written off over a period inconsistent with IFRS. The development work in progress should be recognised as an asset in the opening IFRS balance sheet, after allowing for appropriate amortisation, with a corresponding adjustment to retained earnings (Adjustment C4b). Goodwill is not affected by this adjustment because the intangible asset was properly recognised as an asset under GAAP at the time of the acquisition; however, the useful life applied for amortisation purposes was not compatible with IFRS. The lease on the research facility is a finance lease. The asset and liability should be recognised on the opening balance sheet, based on the circumstances at the inception of the lease (Adjustment C4c).
Acquisition 4 Wayne Holdings acquired some short-term contracts, internally generated brand names, tangible assets and related staff from a competitor, Ferreria GmbH, in January 2001. The transaction was not accounted for as a business combination under GAAP but treated as the purchase of a collection of assets. The purchase price was allocated across the tangible assets acquired.	The business combinations exemption can be applied because although the transaction was not classified as a business combination under GAAP, it qualifies as one under IFRS. The intangible assets under GAAP were ones that were internally generated by Ferreria GmbH. Ferreria GmbH would not recognise these assets in its separate IFRS balance sheet under IAS 38 so no adjustment is required.

Adjustments to the opening IFRS balance sheet in connection with the business combinations exemption:

Adjustment	Effect of transition to IFRS	
	Dr	**Cr**
C4a Intangible assets		350
C4a Goodwill	350	

Being the derecognition of the assembled workforce, which was recorded as an intangible asset under GAAP. A consequential adjustment is also required to deferred tax and minority interest (see Step 5, p84).

Adjustment	Dr	Cr
C4b Intangible assets	240	
C4b Retained earnings		240

Being the restatement of accumulated depreciation charged against development work in progress on a basis compatible with IFRS.

Adjustment	Dr	Cr
C4c Property, plant and equipment	550	
C4c Borrowings (finance lease)		450
C4c Retained earnings		100

Being the recognition of a finance lease that had been treated as an operating lease under GAAP.

Fair value as deemed cost exemption

Management has decided to elect to measure certain items of property, plant and equipment at the date of transition to IFRS at fair value, and use that fair value as the deemed cost of those assets at that date. The exemption has been applied as described below.

Assets to be revalued	Application of exemption
Major components Wayne Holdings owns a number of ships. The ships' engines are replaced on average five times during the useful life of the ship. The ships are depreciated over their average life and the cost of engine renewals are charged as repairs and maintenance when incurred. Wayne Holdings does not maintain details of the cost of each renewal.	The component approach that IAS 16 requires should be adopted. Management was not able to obtain the historical cost information required. Management has therefore applied the fair value as deemed cost exemption, with sufficient detail to apply the component approach prospectively. The components of each ship are restated to fair value in the opening IFRS balance sheet. Management assesses the useful life of the components of each ship, making reference to the date of the next scheduled replacement. The deemed cost of the components is depreciated over the assessed useful lives **(Adjustment E5).**
Selective revaluation The subsidiary in Poland has restated property, plant and equipment each year in accordance with a local asset price index. That index has resulted in a carrying value that is a reasonable approximation of fair value.	IAS 16 does not permit selective revaluation of property, plant and equipment. However, IFRS 1 permits a revaluation made under previous GAAP using a local price index to be used as deemed cost for any item of property, plant and equipment. Applying the exemption results in no adjustment in respect of the Polish assets.
Revaluation of property, plant and equipment Wayne Holdings' office building in central New York was bought for €6,500 (€5,000 – building; €1,500 – land) in 1991. The useful life of this asset is 50 years and the carrying amount under GAAP at the transition date is €5,300. A valuation performed at 1 January 2004 assessed the fair value of the property as €8,900.	Management has applied the fair value as deemed cost exemption in respect of the New York office building and land. The corresponding adjustment is to retained earnings **(Adjustment E6).**

Adjustments to the opening IFRS balance sheet in connection with the fair value as deemed cost exemption:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
E5	Property, plant and equipment	120	
E5	Retained earnings		120

Being the componentisation of the ships and their engines and restatement to fair value at the date of transition.

Adjustment		Dr	Cr
E6	Property, plant and equipment	3,600	
E6	Retained earnings		3,600

Being the restatement of the New York office to fair value at the date of transition.

Employee benefits exemption

Management has elected to recognise all cumulative actuarial gains and losses at the date of transition to IFRS and to apply the corridor approach for later actuarial gains and losses. The exemption has been applied as described below.

Employee benefit arrangement	Application of exemption
Termination benefit All of the employees in Wayne Holdings' home country are entitled to receive a termination indemnity benefit regardless of the reason for their termination. Each employee is entitled to receive 10% of their annual salary for each year of service, increased annually for the movement in the retail price index. The gross accumulated obligation at the end of the year has been recorded as a liability in accordance with GAAP.	The termination benefits are classified as a post-employment defined benefit plan. The projected unit credit method should be used to value the obligation at the date of transition to IFRS. Management has decided to apply the corridor approach permitted by IAS 19 prospectively and apply the IFRS 1 employee benefits exemption. All cumulative actuarial gains and losses at the transition date will be recognised **(Adjustment P1).**
Pension plans Wayne Holdings' subsidiaries in a number of countries operate defined benefit pension plans. IAS 19 has been applied to recognise and measure the defined benefit obligation in these countries. IAS 19 is an allowed alternative under GAAP.	Wayne Holdings is not required to remeasure the defined benefit obligation in connection with pension plans where IAS 19 is already applied. However, the group should use consistent assumptions to measure the obligation and should adopt a consistent approach to the use of the corridor. The employee benefits exemption must be applied to all pension plans. All actuarial gains and losses that it had previously not recognised through application of the corridor in the GAAP financial statements must be recognised at the date of transition **(Adjustment P2).**

Adjustments to the opening IFRS balance sheet in connection with the employee benefits exemption:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
P1	Provision for termination benefits	310	
P1	Retained earnings		310

Being the restatement of the provision for termination benefits to a projected unit credit method basis.

Adjustment		Dr	Cr
P2	Provision for retirement benefits		825
P2	Retained earnings	825	

Being the recognition of actuarial gains and losses not recognised under GAAP at the date of transition for consistent application of the employee benefits exemption.

Cumulative translation differences exemption

Wayne Holdings' accounting policy under GAAP is consistent with IFRS. However, management has elected to use the exemption of setting the previously accumulated cumulative translation adjustment to zero. This exemption has been applied to all subsidiaries, as IFRS 1 requires (Adjustment D2).

Adjustments to the opening IFRS balance sheet in connection with the cumulative translation differences exemption:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
D2	Cumulative translation adjustment	300	
D2	Retained earnings		300

Being the reset of the cumulative currency translation adjustment reserve to zero.

Compound financial instruments exemption

The Group has issued no compound instruments. This exemption is not applicable.

Assets and liabilities of subsidiaries, associates and joint ventures exemption

This exemption is only applicable to subsidiaries and associates that are changing to IFRS.

Exemptions from restatement of comparatives for IAS 32 and IAS 39

The Group has elected to apply this exemption. It will therefore continue to apply the previous GAAP rules to derivatives, financial assets and financial liabilities and also to hedge relationships for the 2004 comparative information. The adjustments required for differences between GAAP and IAS 32 and IAS 39 will be determined and recognised at 1 January 2005.

The adjustments identified in Step 2 relating to IAS 32 and IAS 39 have been determined based on the financial instruments held by the Group at 1 January 2005.

Designation of financial assets and financial liabilities exemption

Wayne Holdings has reclassified various securities as available for sale investments and as financial assets at fair value through profit or loss (Adjustments G2, G3 and G4).

Adjustments to the opening balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with the designation of financial assets and financial liabilities exemption:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
G2	Available-for-sale investments	4,727	
G2	Investments in other companies		4,377
G2	Fair value reserve – equity		350

Being the restatement of investments in equity securities from cost to fair value and reclassification to available-for-sale.

Adjustment		Dr	Cr
G3	Available-for-sale investments	13,507	
G3	Investments in other companies		9,747
G3	Short-term securities		2,000
G3	Fair value reserve – equity		1,760

Being the restatement of securities from cost to fair value and reclassification to available-for-sale.

Adjustment		Dr	Cr
G4	Financial assets at fair value through profit or loss	4,043	
G4	Short-term securities		3,843
G4	Retained earnings		200

Being the restatement of short-term securities from cost to fair value and reclassification to held-for-trading.

Share-based payment exemption

The Group has elected to apply the share-based payment exemption. It will therefore apply IFRS 2 from 1 January 2004 to those options that were issued after 7 November 2002 but that have not vested by 1 January 2005 (Adjustment P3).

Adjustments to the opening IFRS balance sheet in connection with the share-based payment exemption:

Adjustment	Effect of transition to IFRS	
	Dr	**Cr**
P3 Retained earnings	120	
P3 Other reserves		120

Being the recognition in accordance with IFRS 2 of share options issued after 7 November 2002 not vested at 1 January 2005

Insurance contracts exemption

The Group does not issue insurance contracts so this exception is not relevant.

Step 4 – Applying mandatory exceptions

Section 1 of this publication provides an explanation of the mandatory exceptions from retrospective application. Management has assessed whether these exceptions are applicable in the context of the group. The summary of this assessment is presented below.

Derecognition of financial assets and liabilities exception

Financial assets and liabilities derecognised before 1 January 2004 are not re-recognised under IFRS. The application of the exemption from restating comparatives for IAS 32 and IAS 39 means that the Group will recognise from 1 January 2005 any financial assets and financial liabilities derecognised since 1 January 2004 which do not meet the IAS 39 derecognition criteria (see Step 3). Management has not chosen to apply the IAS 39 derecognition criteria to an earlier date. Management has identified the following arrangements and has assessed the application of this exception.

Derecognition arrangement	Application of exception
Sale of receivables Wayne Holdings has sold certain short-term receivables to third parties with full recourse. The Group has retained all of the credit risk in the case of default.	This transaction will not meet the IAS 39 criteria for derecognition. However, the derecognition of financial receivables is covered by one of the mandatory exceptions to the requirement for full retrospective application of IFRS. Those receivables derecognised before 1 January 2004 are not recognised subsequently on the opening balance sheet at 1 January 2005, the IAS 32/39 transition date. Receivables derecognised after 1 January 2004 and still outstanding at 1 January 2005 are recognised at 1 January 2005, and the transaction is accounted for as a secured financing (Adjustment K2).
Revolving securitisation Wayne Holdings has a revolving securitisation arrangement with XYZ Bank, set up in 1999. Wayne Holdings sells short-term trade receivables to the bank for 90% of the invoice value. The bank pays a further amount to Wayne Holdings, up to a maximum of 97% of the invoiced amount, depending on the level and speed of collections from the customers. The historical default rate on the receivables is less than 1%. The receivables have been derecognised from the balance sheet under GAAP.	The credit risk in the receivables, which is their principal risk, is not transferred to the bank. Consequently, the receivables should not be derecognised under IAS 39. Wayne Holdings is required to recognise any of the receivables transferred to the bank since 1 January 2004 that are still outstanding at 1 January 2005. Those receivables derecognised before 1 January 2004 are not recognised subsequently in accordance with the IFRS 1 mandatory exception relating to the recognition of derecognised financial assets (Adjustment U1).

Adjustments to the opening IFRS balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with the derecognition exemption:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
K2	Receivables	500	
K2	Borrowings		450
K2	Retained earnings		50

Being the recognition of receivables sold with full recourse since 1 January 2004.

		Dr	Cr
U1	Receivables	30	
U1	Borrowings		25
U1	Retained earnings		5

Being the recognition of securitised receivables derecognised since 1 January 2004.

Hedge accounting exception

Management should only claim hedge accounting after 1 January 2005, the Group's IAS 32/39 transition date, if the hedge relationship meets all the hedge accounting under IAS 39.

Description of hedging practice	Application of exception
Foreign exchange hedging GAAP permits Wayne Holdings to designate foreign exchange instruments as the hedge of a net position. IAS 39 does not permit this treatment. However, by 1 January 2005, management had designated individual items within the GAAP hedged net position as hedged items under IFRS. This designation covered some, but not all, of Wayne Holdings' net hedging arrangements.	The designation of individual items within the net position by 1 January 2005 allows Wayne Holdings to apply hedge accounting to those transactions in accordance with the IFRS 1 exception for hedge accounting. However, the remaining part of the hedged net position that was not designated in this way by the transition date will not qualify for hedge accounting **(Adjustment U2).** Wayne Holdings must meet the IAS 39 designation, documentation and effectiveness testing requirements in order to achieve hedge accounting for the remaining position on a gross basis, from which time it may apply hedge accounting prospectively on that gross basis.
Interest-rate hedging: fair value hedges Wayne Holdings' Group treasury only uses hedging instruments that are identified with specific borrowings. However, the Group's management decided against performing the necessary effectiveness tests for this hedge relationship.	Hedge accounting under IAS 39 can only be achieved from the date from which all of the hedge accounting criteria, including documentation and effectiveness testing, are met. Management cannot use hedge accounting in respect of the interest rate hedging but the hedge relationship is of a type that is permitted under IAS 39. The relationship should be recognised in the opening balance sheet at 1 January 2005, the Group's IAS 32/39 transition date **(Adjustment U3).**

The following adjustments are made to the opening balance sheet at 1 January 2005, the IAS 32/39 transition date, in connection with hedge accounting.

Adjustment		Effect of transition to IFRS	
		Dr	Cr
U2	Borrowings – Foreign currency risk	150	
U2	Derivatives – Foreign exchange contracts		150

Being the discontinuance of hedge accounting in respect of the hedge of a net position under GAAP that was not appropriately designated in accordance with IFRS 1 by the IAS 32/39 transition date.

Adjustment		Dr	Cr
U3	Borrowings – Interest rate risk	80	
U3	Derivatives – Interest rate swaps		80

Being the recognition of the interest rate fair value hedge accounting relationship previously identified under GAAP.

Estimates exception

Estimates under IFRS at the date of transition to IFRS should be consistent with estimates made for the same date under previous GAAP, unless there is evidence that those estimates were in error. Management has identified the following situation where this mandatory exception is applicable.

Description of estimate required	Application of exception
Major litigation Wayne Holdings was involved in major litigation with Sharon Inc. Management expected to lose the case and recognised a provision of €315 for the liability under GAAP at 31 December 2003. The provision was based on management's best estimate of the outcome of the litigation at that time. The case was settled in late 2005 for €500.	The estimate required by GAAP and the basis of the provision under GAAP is the same as would be required by IFRS. There should be no adjustment to the provision in the opening IFRS balance sheet even though the outcome is known, and even though the use of the original estimate will result in a further charge for the same legal case being recognised in 2005.

Assets held-for-sale exception

This exception restricts the extent to which a company can apply IFRS 5, Non-current Assets for Sale and Discontinued Operations, to periods before 1 January 2005. A company with an adoption date before 1 January 2006 can only restate its comparatives for non-current assets that meet the IFRS 5 criteria before 1 January 2005 if the information required by IFRS 5 was obtained at the time that the criteria were met. However, a company must re-classify its comparatives in the income statement for discontinued operations that meet the IFRS 5 criteria after 1 January 2005.

A company with a date of adoption after 31 December 2005 must restate its comparatives for IFRS 5.

Wayne Holdings did not have any assets that met the held-for-sale criteria during the periods presented. No adjustment is required.

Step 5 – Prepare the opening balance sheet at the date of transition to IFRS

Management should prepare the opening IFRS balance sheet at the date of transition by applying the adjustments identified in Steps 2, 3 and 4 to the balance sheet prepared under previous GAAP at 1 January 2004 and to the IFRS balance sheet at 1 January 2005, as applicable. Management should also calculate deferred tax in accordance with IAS 12 after all other adjustments have been made, and then determine the value of the minority interest.

One of the adjustments identified in Step 3, Adjustment F1, was the derecognition of an intangible that had been recognised under previous GAAP in a past business combination. Appendix B, paragraph B29(g)(i) requires that the consequential deferred tax and minority interest adjustments are recognised against goodwill. All other adjustments to deferred tax and minority interest are recognised against retained earnings.

Calculation of deferred tax

The deferred tax balances are calculated by comparing the tax base of each asset and liability with its IFRS carrying amount in the opening IFRS balance sheet. Deferred tax assets and liabilities can only be offset if the offset criteria in IAS 12 paragraph 71 are met. Consequently, it is likely that the calculation of deferred tax will need to be performed on an individual subsidiary or country basis, with additional adjustments to reflect the deferred tax effects of consolidation adjustments. The calculation of deferred tax should also incorporate determination of the amount of deferred tax that should be included in specific equity reserves, for example the deferred tax arising on the revaluation of available-for-sale financial assets, which should be debited against the AFS revaluation reserve in equity. The corresponding entry is to retained earnings.

Adjustments to the opening IFRS balance sheet at 1 January 2004 to reflect the deferred tax balances on an IFRS basis after processing the adjustments in Steps 2, 3 and 4:

Adjustment		Effect of transition to IFRS	
		Dr	**Cr**
O1	Goodwill	88	
O1	Deferred tax asset (to be presented gross of deferred tax liability)	725	
O1	Deferred tax liability		1,735
O1	Retained earnings	922	

Being the net adjustment required to present the deferred tax on an IAS 12 basis.

Adjustments to the opening balance sheet at 1 January 2005 to reflect the deferred tax balances arising from the adjustments in Steps 2, 3 and 4 relating to the application of IAS 32 and IAS 39:

Adjustment		Effect of transition to IFRS	
		Dr	Cr
O2	Deferred tax asset	80	
O2	Deferred tax liability		450
O2	Fair value reserve	190	
O2	Retained earnings	180	

Being the net adjustment required to reflect the deferred tax implications of applying IAS 32 and IAS 39 from 1 January 2005.

Calculation of minority interest

The minority interest in the balance sheets of part-owned subsidiaries must be calculated after all adjustments have been made to the transition balance sheet, including relevant deferred tax adjustments included in the above net adjustment. The minority interest balance for each subsidiary is calculated by reference to the opening IFRS balance sheet prepared for that subsidiary for consolidation purposes. The total minority interest calculated on an IFRS basis is compared with that included in the previous GAAP balance sheet at transition date and the net adjustment made with the corresponding entry to retained earnings.

Adjustment to the opening balance sheet at 1 January 2004 to reflect the minority interest after processing the adjustments in Steps 2, 3 and 4:

Adjustment		Effect of transition to IFRS	
		Dr	Cr
C6	Goodwill	65	
C6	Minority interest		590
C6	Retained earnings	525	

Being the net adjustment required to present the minority interest balance on an IFRS basis.

Adjustment to the opening balance sheet at 1 January 2005 to reflect the minority interest balance arising from the adjustments in Steps 2, 3 and 4 relating to the application of IAS 32 and IAS 39:

Adjustment		Effect of transition to IFRS	
		Dr	Cr
C7	Minority interest		85
C7	Retained earnings	85	

Being the net adjustment required to reflect the minority interest in the adjustments made relating to IAS 32 and IAS 39 from 1 January 2005.

Transition spreadsheet: Preparation of the opening IFRS balance sheet at 1 January 2004

(all amounts in € thousands)

		Adjustments	
	GAAP balance sheet at transition date	Consolidation of subsidiaries (Step 2)	Changes in accounting policies (Step 2)
ASSETS			
Non-current assets			
Property, plant and equipment	40,241	1,350	(23,406)
Goodwill	1,987	350	–
Intangible assets	4,470	120	(1,100)
Investment in associates	1,778	–	–
Receivables	2,114	–	16,890
Deferred income tax assets	–	10	–
Investments/financial assets in:			
– unconsolidated subsidiaries	758	(758)	–
– other companies	14,124	–	–
	65,472	1,072	(7,616)
Current assets			
Inventories	16,182	430	75
Trade and other receivables	4,303	520	(900)
Short-term securities	6,043	50	–
Financial receivables	5,444	–	5,644
Cash and cash equivalents	2,200	120	–
Other accrued income and prepaid expenses	3,487	–	–
	37,659	1,120	4,819
Total assets	103,131	2,192	(2,797)
EQUITY			
Capital and reserves attributable to equity holders			
Share capital	5,018	–	–
Treasury shares	–	–	–
Fair value and other reserves	–	–	120
Cumulative translation adjustment	300	–	–
Consolidation reserve	1,050	–	(1,050)
Retained earnings and other reserves	7,190	–	918
	13,558	–	(12)
Minority interest	1,404	50	–
Total equity	14,962	50	(12)
LIABILITIES			
Non-current liabilities			
Borrowings	13,814	430	–
Deferred income tax liabilities	4,000	70	–
Retirement benefit obligations	13,966	250	–
Provisions	4,577	345	(110)
Other liabilities	10,649	550	(2,400)
	47,006	1,645	(2,510)
Current liabilities			
Trade and other payables	30,094	252	(275)
Current income tax liabilities	200	45	–
Borrowings	10,869	200	–
	41,163	497	(275)
Total liabilities	88,169	2,142	(2,785)
Total equity and liabilities	103,131	2,192	(2,797)

Adjustments			Adjustments		
Application of optional exemptions (Step 3)	Application of mandatory exceptions (Step 4)	Sub-total	Deferred tax (Step 5)	Minority interests (Step 5)	Opening IFRS balance sheet
4,270	–	22,455	–	–	22,455
350	–	2,687	88	65	2,840
(110)		3,380	–	–	3,380
–	–	1,778	–	–	1,778
–	–	19,004	–	–	19,004
–	–	10	725	–	735
–	–	–	–	–	–
–	–	14,124	–	–	14,124
4,510	–	63,438	813	65	64,316
–	–	16,687	–	–	16,687
–	–	3,923	–		3,923
–	–	6,093	–	–	6,093
–	–	11,088	–	–	11,088
–	–	2,320	–	–	2,320
–	–	3,487	–	–	3,487
–	–	43,598	–	–	43,598
4,510	–	107,036	813	65	107,914
–	–	5,018	–	–	5,018
–	–	–	–	–	–
–	–	120	–	–	120
(300)	–	–	–	–	–
–	–	–	–	–	–
3,845		11,953	(922)	(525)	10,506
3,545	–	17,091	(922)	(525)	15,644
–	–	1,454	–	590	2,044
3,545	–	18,545	(922)	65	17,688
300	–	14,544	–	–	14,544
–	–	4,070	1,735	–	5,805
515	–	14,731	–	–	14,731
–	–	4,812	–	–	4,812
–	–	8,799	–	–	8,799
815		46,956	1,735	–	48,691
–	–	30,071	–	–	30,071
–	–	245	–	–	245
150	–	11,219	–	–	11,219
150	–	41,535	–	–	41,535
965	–	88,491	1,735	–	90,226
4,510		107,036	813	65	107,914

Transition spreadsheet: Preparation of the opening IFRS balance sheet at 1 January 2005

(all amounts in € thousands)

	IFRS balance sheet at 31 December 2004	Adjustments Changes in accounting policies (Step 2)
ASSETS		
Non-current assets		
Property, plant and equipment	23,402	–
Goodwill	2,745	–
Intangible assets	5,241	–
Investment in associates	3,958	–
Available-for-sale investments	–	–
Receivables	18,762	–
Deferred income tax assets	522	–
Investments financial assets in:	–	–
– unconsolidated subsidiaries	–	–
– other companies	14,377	–
	69,007	–
Current assets		
Inventories	17,665	–
Trade and other receivables	3,519	(450)
Available-for-sale investments	–	–
Financial assets at fair value through profit or loss	–	–
Short-term securities	8,480	(200)
Financial receivables	10,894	–
Cash and cash equivalents	2,233	–
Other accrued income and prepaid expenses	1,350	–
	44,141	(650)
Total assets	113,148	(650)
SHAREHOLDERS' EQUITY		
Share capital	5,018	(1,000)
Treasury shares	–	(200)
Fair value and other reserves	200	–
Cumulative translation adjustment	(279)	–
Consolidation reserve	–	–
Retained earnings and other reserves	9,902	(450)
	14,841	(1,650)
Minority interest	1,993	–
Total Equity	16,834	(1,650)
LIABILITIES		
Non-current liabilities	–	–
Borrowings	18,362	1,000
Deferred income tax liabilities	5,477	–
Retirement benefit obligations	15,131	–
Provisions	4,848	–
Other liabilities	9,194	–
	53,012	1,000
Current liabilities		
Trade and other payables	32,275	–
Current income tax liabilities	442	–
Borrowings	10,585	–
	43,302	–
Total liabilities	96,314	1,000
Total equity and liabilities	113,148	(650)

Adjustments				
Application of mandatory exceptions (Step 3)	**Sub-total**	**Deferred tax (Step 5)**	**Minority interests (Step 5)**	**IFRS balance sheet 1 January 2005**
–	23,402	–	–	23,402
–	2,745	–	–	2,745
–	5,241	–	–	5,241
–	3,958	–	–	3,958
16,034	16,034	–	–	16,034
(200)	18,562	–	–	18,562
–	522	80	–	602
				–
				–
(14,124)	253			253
1,710	70,717	80	–	70,797
–	17,665	–	–	17,665
500	3,569	–	–	3,569
2,200	2,200	–	–	2,200
4,043	4,043	–	–	4,043
(5,843)	2,437	–	–	2,437
–	10,894	–	–	10,894
–	2,233	–	–	2,233
–	1,350	–	–	1,350
900	44,391	–	–	44,391
2,610	115,108	80	–	115,188
–	4,018	–	–	4,018
–	(200)	–	–	(200)
2,110	2,310	(190)	–	2,120
–	(279)	–	–	(279)
–	–	–	–	–
255	9,707	(180)	(85)	9,442
2,365	15,556	(370)	(85)	15,101
–	1,993		85	2,078
2,365	17,549	(370)	–	17,179
–	–	–	–	–
(230)	19,132	–	–	19,132
–	5,477	450	–	5,927
–	15,131	–	–	15,131
–	4,848	–	–	4,848
–	9,194	–	–	9,194
(230)	53,782	450		5°4,232
–	–	–	–	
–	32,275	–	–	32,275
–	442	–	–	442
475	11,060	–	–	11,060
475	43,777	–	–	43,777
245	97,559	450	–	98,009
2,610	115,108	80	–	115,188

Step 6 – Identify the areas where extensive disclosures will be required

The effect of transition

Wayne Holdings must provide an explanation of how the transition from previous GAAP to IFRS has affected its reported financial position, financial performance and cash flows. Wayne Holdings first adopted IFRS in 2005, with the IFRS transition date of 1 January 2004. The last consolidated financial statements prepared under previous GAAP were for the year ended 31 December 2004.

Wayne Holdings should provide the required explanation by providing the following reconciliations with sufficient explanatory notes to enable a reader of the first IFRS financial statements to understand the principal adjustments processed:
- Detailed reconciliations of equity reported under previous GAAP to IFRS at 1 January 2004 and at 31 December 2004; and
- Detailed reconciliation of profit or loss reported under previous GAAP to IFRS for the year ended 31 December 2004.

Other disclosures

Wayne Holdings must also present the following:
- The disclosures required by IAS 36, in respect of any impairment charges recognised or reversed in preparing its opening IFRS balance sheet; and
- The aggregate fair values used as deemed cost in the opening IFRS balance sheet and the aggregate adjustment to the carrying amounts reported under previous GAAP for each line item in the opening IFRS balance sheet.
- Details of financial instruments to which it has applied the optional exemption to classify as financial assets or financial liabilities ‘at fair value through profit or loss’ or as available for sale.

C – Wayne Holdings Inc.
Extracts from the consolidated financial statements in accordance with GAAP for the year ended 31 December 2004

Consolidated income statement for the year ended 31 December 2004

(all amounts in € thousands)

	Year ended 31 December	
	2004	**2003**
Value of production		
Revenues from sale and services	48,042	47,600
Change in inventories of finished goods	438	(21)
Other income and revenues	3,314	3,200
Sales	51,794	50,779
Cost of production		
Raw materials, supplies	(23,400)	(23,800)
Services	(7,342)	(6,843)
Personnel costs	(7,800)	(7,780)
Amortisation, depreciation and write-downs	(3,426)	(3,528)
Changes in raw materials, supplies	110	(63)
Provision for risks	(1,038)	(1,047)
Other operating costs	(7,308)	(6,863)
	(50,204)	(49,924)
Difference between the value and costs of productions	1,590	855
Financial income and expenses		
Investment income	300	400
Other financial income	2,188	1,680
Other financial expenses	(3,200)	(2,380)
	(712)	(300)
Extraordinary income and (expenses)	(135)	812
Income/(loss) before taxes	**743**	**1,367**
Income taxes	(294)	(472)
Income/(loss) before minority interest	449	895
Minority interest	**(346)**	**86**
Net income/(loss)	103	981

Consolidated balance sheet as at 31 December 2004

(all amounts in € thousands)

	Year ended 31 December	
	2004	2003
ASSETS		
Non-current assets		
Goodwill	1,859	1,987
Intangible assets and deferred charges	6,021	4,470
Property, plant and equipment	41,451	40,241
Receivables	1,822	2,114
Investments/financial assets in:		
– unconsolidated subsidiaries	634	758
– associated companies	3,958	1,778
– other companies	14,377	14,124
Total non-current assets	70,122	65,472
Current assets		
Inventories	17,257	16,182
Trade and other receivables	4,189	4,303
Short-term securities	8,440	6,043
Financial receivables	5,215	5,444
Cash	2,133	2,200
Other accrued income and prepaid expenses	1,350	3,487
	38,584	37,659
Total assets	108,706	103,131
SHAREHOLDERS' EQUITY		
Capital stock	5,018	5,018
Retained earnings and other reserves	7,567	7,559
Net/income (loss)	103	981
Total	12,688	13,558
Minority interest	1,437	1,404
Total shareholders' equity	14,125	14,962
LIABILITIES		
Reserves for risks and charges		
Reserve for pension and other similar obligations	14,021	13,966
Income tax reserves	4,284	4,200
Other reserves	4,883	4,577
	23,188	22,743
Bonds and borrowings from banks:		
– due within one year	10,215	10,869
– due beyond one year	17,830	13,814
	28,045	24,683
Trade and other payables:		
– due within one year	32,105	30,094
– due beyond one year	6,890	6,814
– other liabilities	4,353	3,835
	43,348	40,743
Total liabilities	94,581	88,169
Total liabilities and shareholders' equity	108,706	103,131

Notes to the consolidated financial statements

Accounting policies

Basis of preparation

a) The consolidated financial statements have been prepared in accordance with generally accepted accounting principles (GAAP).

Principles of consolidation

b) The assets and liabilities, and revenues and expenses, of subsidiaries consolidated on a line-by-line basis are included in the consolidated financial statements, regardless of the percentage of ownership. The carrying values of investments are eliminated against the equity of the subsidiaries' stockholders. The portion of stockholders' equity and results of operations attributed to minority interests are disclosed separately in the consolidated financial statements.

c) Entities whose operations are not homogeneous with those of the Group have been excluded, as required by the law, from the scope of consolidation. Entities for which it would be not practicable to obtain the necessary information on a timely basis or without disproportionate expense have not been consolidated.

d) Since 1998, differences arising from the elimination of investments against the related stockholders' equity of the investment at the date of acquisition are allocated to the assets and liabilities of the company being consolidated, up to the limit of their current value. The residual value, if positive, is capitalised as goodwill, and is amortised using the straight-line method over the estimated period of recoverability. Negative residual amounts are recorded as a component of stockholders' equity 'consolidation reserve' (or as a liability 'consolidation reserve for future risks and charges', when it is attributable to a forecast of future losses).

e) Unrealised intercompany profits and losses are eliminated net of related tax effects, together with all intercompany receivables, payables, revenues and expenses arising on transactions between consolidated companies that have not been realised by transactions outside the Group. The gross margin on intercompany sales of plant and equipment produced and sold at prices in line with market conditions are not eliminated. Guarantees, commitments and risks relating to companies included in the consolidation are also eliminated.

f) The balance sheets of foreign subsidiaries are translated into euros by applying year-end exchange rates. Foreign subsidiaries' income statements are translated using the average exchange rates. The financial statements of subsidiaries operating in high-inflation countries (cumulative inflation in excess of 100% in three years) are prepared using accounting principles for hyperinflationary economies.

g) Exchange differences resulting from the translation of opening stockholders' equity at current exchange rates and at the exchange rates used at the end of the previous year, as well as differences between net income expressed at average exchange rates and that expressed at current exchange rates, are reflected in stockholders' equity as 'cumulative translation adjustments'. Such reserves relating to investments in subsidiaries or associated companies are included in the income statement when the investments are sold to third parties.

Intangible fixed assets

h) Intangible assets and deferred charges expected to benefit future periods are recorded at cost, adjusted by amortisation on a straight-line basis over the period to be benefited. Goodwill is amortised over a period of not more than 20 years, taking into account the expected period of recovery. The Group periodically and critically

ascertains that the carrying value of such assets is not higher than the estimated recoverable value, in relation to their use or realisation determined by reference to the most recent corporate plans.

i) The costs of researching and developing new products and/or processes are mainly included in the income statement in the period in which such costs are incurred, in line with the principle of conservatism and with international practice in the sector.

Property, plant and equipment

j) Property, plant and equipment are recorded at purchase or construction cost. These values are adjusted where specific laws of the country in which the assets are located allow or require revaluation, in order to reflect, even if only partially, changes in the currency's purchasing power. Cost also includes financing expenses incurred during the construction period for specific loans, where significant.

k) Depreciation is provided on a straight-line basis at rates that reflect the estimated useful life of the related assets.

l) When, at the balance sheet date, property, plant and equipment shows a permanent impairment in value, it is written down to the lower value.

m) Repairs and maintenance expenses related to property, plant and equipment are charged to the statement of operations in the year in which they are incurred, while maintenance expenses that increase the value of property, plant and equipment are capitalised.

Financial fixed assets

n) Financial fixed assets include investments in unconsolidated subsidiaries, associated companies and other companies, financial receivables held for investment purposes, treasury stock and other securities.

o) Investments in unconsolidated subsidiaries, companies in which the Group exercises joint control with other partners, and associated companies are normally accounted for using the equity method. Investments in other companies are valued at cost. A permanent impairment in value is provided as a direct reduction of the investment account.

p) Financial receivables arising from equipment sales with extended credit periods are recorded at estimated realisable value.

q) Securities are recorded at cost, including additional direct charges. A permanent impairment is provided as a direct reduction of the securities account.

r) Investment in leased equipment is recorded at cost. The related depreciation is calculated, using the financial method, based on the life of the lease and the related risk in managing such contracts.

Current assets

s) Inventories are valued at the lower of cost and market value, cost being determined on a first-in-first-out (FIFO) basis. The valuation of inventories includes the direct costs of materials and labour and variable indirect costs. Fixed indirect production costs are expensed as incurred.

t) Work in progress on long-term contracts is valued based on the stage of completion, and is recorded gross of advance payments received from customers. Eventual losses on such contracts are fully recorded when they become known.

u) Provision is made for obsolete and slow-moving raw materials, finished goods, spare parts and other supplies, based on their expected future use and realisable value.

v) Receivables are recorded at estimated realisable value. Any unearned interest included in the nominal value of financial receivables is deferred to future periods when it is earned. Receivables sold to third parties with recourse or without recourse (including those sold as part of securitisation transactions) are eliminated from receivables. Receivables denominated in foreign currency are translated at the exchange rate in effect at year end. Resulting exchange gains and losses are included in the income statement.

w) Current assets also include investments and securities acquired as a temporary investment, which are valued at the lower of cost and market, cost being determined on a last-in-first-out (LIFO) basis.

Reserves for risks and charges and employee severance indemnities

x) Reserves for risks and charges include provisions to cover losses or liabilities that are likely to be incurred, but where the amount or the date on which they will arise are uncertain.

y) The reserve for pensions and similar obligations includes provisions for long service or other bonuses (including pension funds required by some countries in which the Group operates) payable to employees and former employees under contractual agreements or by law, determined on an actuarial or legal basis, where applicable.

z) Restructuring reserves include the costs to carry out corporate reorganisation and restructuring plans and are provided in the year the company formally decides to implement such plans, if such costs can be reasonably estimated.

Payables

aa) Payables are recorded at face value; the portion of interest included in the payable is deferred until future periods in which it is incurred. Accounts payable denominated in foreign currency are translated at the exchange rate in effect at year end. Resulting exchange gains and losses are included in the income statement.

bb) Taxes payable includes the tax charge for the current year.

Accruals and deferrals

cc) Accruals and deferrals are determined using the accrual method, based on the income and expense to which they relate.

Derivative financial instruments

dd) Derivative financial instruments are designated ‘hedging ‘ or ‘non-hedging instruments’. The transactions that, according to the Group’s policy for risk management, are able to meet the conditions for hedge accounting are classified as hedging transactions; the others, although set up for the purpose of managing risk (as the Group’s policy does not permit speculative transactions), have been designated as ‘trading’.

ee) The Group records derivative financial instruments at cost. The gains and losses on derivative financial instruments are included in the income statement on maturity to match the underlying hedged transactions where relevant.

ff) For foreign exchange instruments designated as hedges, the premium (or discount) representing the difference between the spot exchange rate at the inception of the contract and the forward exchange rate is included in the income statement, in financial income and expenses, in accordance with the accrual method.

gg) For interest rate instruments designated as hedges, the interest rate differential is included in the income statement, in financial income and expenses, in accordance with the accrual method, offsetting the effects of the hedged transaction.

hh) Derivative financial instruments designated as trading instruments are valued at year-end market value, and the difference between the nominal contract value and fair value is recorded in the income statement under financial income and expenses.

Revenue recognition

ii) Revenues from sales and services are recognised on the accrual basis net of returns, discounts, allowances and rebates. Revenues from sales of products are recognised at the moment title passes to the customer, which is generally at the time of shipment. Revenues from services are recorded when they are performed. Revenues from long-term contracts are recognised using the percentage of completion method. Revenues also include amounts received from financing leases, net of depreciation, and income from company assets on operating leases.

Costs

jj) Costs are recognised on an accrual basis. Research and development costs are generally charged to the income statement in the period in which they are incurred. Advertising and promotion expenses are charged to the income statement in the year they are incurred. Estimated product warranty costs are charged to the income statement at the time the sale is recorded.

Financial income and expenses

kk) Financial income and expenses are recorded on the accrual basis.

ll) Income and expenses resulting from derivative financial instruments and year-end exchange differences are included in the income statement in accordance with the policies disclosed above.

Income taxes

nn) Income taxes currently payable are provided for in accordance with the existing legislation of the various countries in which the Group operates.

oo) Deferred tax assets or deferred tax liabilities are determined on all the timing differences between the consolidated assets and liabilities and the corresponding amounts for purposes of taxation, including those deriving from the most significant consolidation adjustments. GAAP allows the recognition of deferred taxes to account for the tax benefit of tax loss carry-forwards whenever the specific conditions for future recoverability are met.

pp) Deferred tax assets have only been recorded if there is a reasonable certainty of their future recovery.

qq) Deferred tax liabilities are not recorded if it is unlikely that a future liability will arise.

rr) Deferred tax assets and liabilities are offset if they refer to the same company. The balance from offsetting the amounts is recorded in other receivables in current assets, if a deferred tax asset is involved, and in the deferred tax reserve, if a deferred tax liability.

Note 29: Changes in shareholders' equity

(all amounts in € thousands)

	Share capital	Cumulative Translation Adjustments	Consolidation Reserves	Retained earnings	Total
Balance at 1 January 2003	3,518	397	1,050	6,784	11,749
Currency translation adjustments		(97)			(97)
Net gains not recognised in net profit		(97)			(97)
Dividend relating to 2003				(575)	(575)
Net profit				981	981
Issue of share capital	1,500				1,500
Balance at 1 January 2004	5,018	300	1,050	7,109	13,558
Currency translation adjustments		200			200
Net gains not recognised in net profit		200			200
Dividend relating to 2004				(1,173)	(1,173)
Net profit				103	103
Balance at 31 December 2004	5,018	500	1,050	6,120	12,688

Note 30: Group cash flows

(all amounts in € thousands)

	Year Ended 31 December	
	2004	**2003**
Cash flows from operating activities		
Cash generated from operations	6,527	1,603
Interest paid	(3,340)	(1,015)
Tax paid	(210)	(211)
Net cash from operating activities	2,977	377
Cash flows from investing activities		
Purchase of property, plant and equipment	(3,343)	(2,265)
Purchase of intangible assets	(2,480)	–
Proceeds from sale of property, plant and equipment	809	–
Dividends received	144	40
Net cash used in investing activities	(4,870)	(2,225)
Cash flows from financing activities		
Proceeds from issue of ordinary shares	–	1,500
Proceeds from borrowings	8,400	4,087
Repayments of borrowings	(5,038)	(2,804)
Dividends paid to group shareholders	(1,173)	(575)
Dividends paid to minority interests	(313)	(157)
Net cash from financing activities	1,876	2,051
Effects of exchange rate changes	(50)	(307)
Net (decrease)/increase in cash and cash equivalents	(67)	(104)
Cash and cash equivalents at beginning of year	2,200	2,304
Cash and cash equivalents at end of year	2,133	2,200

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