

Are you keeping up with the pace?*

IFRS Real Estate Survey – Details of 2007 Results

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*connectedthinking

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Executive summary

IFRS – Did we move forward?

International Financial Reporting Standards (IFRS) are widely adopted accounting principles used by many listed companies throughout the world. In last year's survey¹ of a sample of financial statements for the financial year 2006, PricewaterhouseCoopers² concluded that the real estate sector still had some way to go to increase transparency and comparability between the financial statements of companies, this being one of the most important goals of IFRS. Entities' financial statements are significantly affected by certain accounting policy options under IFRS (e.g. the choice to measure investment properties at fair value or at cost less depreciation and impairment), making transparency and comparability even more difficult to achieve.

Companies find transparency and comparability relevant. We noticed, for example, in the 2007 survey that of the six entities using the cost model in 2006, two changed the measurement of the investment properties in 2007 to fair value, which is by far the most common measurement basis in the sector. The rationale given by the two entities for this change was that they believe that the fair value model improves the presentation of the balance sheet, makes the annual report more comparable with competitors and reveals the 'hidden value' of the entities' investment property. In 2007, 46 out of the 50 entities surveyed (92%) measured their investment property at fair value.

Industry bodies have issued guidance on the options the sector should choose under IFRS and what disclosure details should be given in the financial statements – for example EPRA (the European Public Real Estate Association) has issued Best Practices Policy Recommendations. Although not a disciplinary body, EPRA actively encourages adherence to these policies. The survey reveals that only one entity stated that the financial statements fully complied with the EPRA guidance.

To really accelerate the progress on the way to more transparency and comparability of financial statements, entities within the sector should take up the challenge themselves and contribute by giving more extensive disclosures. Where appropriate the disclosures should be tailored to the real estate industry.

¹ PricewaterhouseCoopers, 'Increasing transparency and comparability: The way forward', November 2007.

² 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

IFRS – Our key findings

We identified differences in the application of IFRS and mapped the diversity of industry practice through a desktop review of the presentation and disclosures in the financial statements. The following points detail our key findings:

Topic	Key findings
Classification, recognition and transfers	<p>Real estate entities have several types of real estate on their balance sheet (e.g. investment property, inventory, non-current assets held for sale and property, plant and equipment). Investment property remains the main balance sheet item. The notes to the financial statements provide useful disclosures on classification, recognition and transfers. Limited information is given on the type of costs included in the transaction costs at initial measurement of investment property. The most frequent transfer between different categories of real estate was from development property to investment property.</p>
Measurement	<p>Forty-six out of the 50 entities surveyed (92%) apply the fair value model for subsequent measurement of investment property. For determining the fair value almost all entities involve an external appraiser. The names of the external appraiser firms are often mentioned in the annual report. In 11 cases an extract of the appraisers' report is included in the annual report. The disclosure of the external appraiser fees and the assumptions used in the external valuation (e.g. discount rate and inflation) is limited. Furthermore, it is unclear in what way the entities take into account the risk of double counting for lease incentives in the fair value of the investment property.</p>
Income statement	<p>Only two out of the 50 entities (4%) present revenue on a net basis in the income statement. Different presentation of the income statement (e.g. revenue on gross or net basis and presentation of expenses by function or nature) reduces comparability of the entities. Due to the fact that trading in real estate is part of the core business, 15 entities present proceeds on disposal of real estate as part of revenue and the carrying value as part of cost of sales in the income statement. Furthermore, disclosures on the accounting treatment of service charges (e.g. clarification on whether the entity acts as an agent or as a principal) are limited. Acting as a principal or as an agent can have a significant impact on the presentation in the income statement.</p>

Topic	Key findings
Consolidation	Real estate acquisitions are accounted for both as asset deals and business combinations depending on the nature of the transaction. Seventeen entities account for their joint ventures using the proportionate consolidation method. Based on Exposure Draft 9 'Joint Arrangements' this might lead to changes in the accounting policy of those entities in the future.
IFRS 7	The most common assumptions used for the analysis of sensitivity of the interest rate risk were 0.5%, 1% and 100 basis points. For the currency risk the most common used assumptions were movements of 5% and 10%. Disclosures on market price risks are limited.
Segment reporting	Only one of the entities surveyed early adopted IFRS 8. IFRS 8 will be effective from 1 January 2009. Under IFRS 8 disclosures about segments of an entity and related information must be identified in the same way as in the internal management accounts. The primary segmentation of the entities surveyed is generally business segments (e.g. offices, residential and retail) and the secondary segment generally used is geography.
Deferred tax	Nearly all entities surveyed present deferred tax on the face of the balance sheet, as required by IAS 1. The deferred tax is not discounted and is calculated using applicable tax rates that have been enacted or substantively enacted by the balance sheet date and are expected to apply when the deferred tax is realised or settled. The disclosure on the percentages used to calculate the deferred tax and the influence of fiscal facilities (e.g. tax structures such as SIIC in France or FBI in the Netherlands) on the deferred tax is limited.
Industry-specific guidance	Thirteen entities disclose the NNAV or EPRA NAV and 14 entities disclose the like-for-like growth in rental income. Only one entity stated that the financial statements are fully compliant with EPRA guidelines. Four entities disclosed 'direct result' and 'indirect result', two of them on the face of the income statement and two in a separate overview in the primary statements.

About this survey

We identified differences in applying IFRS and mapped the diversity of industry practice through a desktop review of the presentation and disclosure in the financial statements surveyed. This survey is not intended to give any judgement on which method of presentation or disclosure gives more information or is better than the other, nor does it intend to judge whether the selected companies applied IFRS correctly. The items reviewed in the survey and the outcome thereof are not necessarily based on obligations under IFRS. In the survey we do not explicitly mention which presentations and disclosures are obligatory and which presentations and disclosures have been made voluntarily.

The 50 IFRS financial statements on which the survey is based fulfil the following criteria:

- A significant part of the firm's business is in real estate (investment property);
- In the 2007 financial statements reporting is done under IFRS;³
- The entity is listed on a stock exchange;
- The financial statements have been audited.

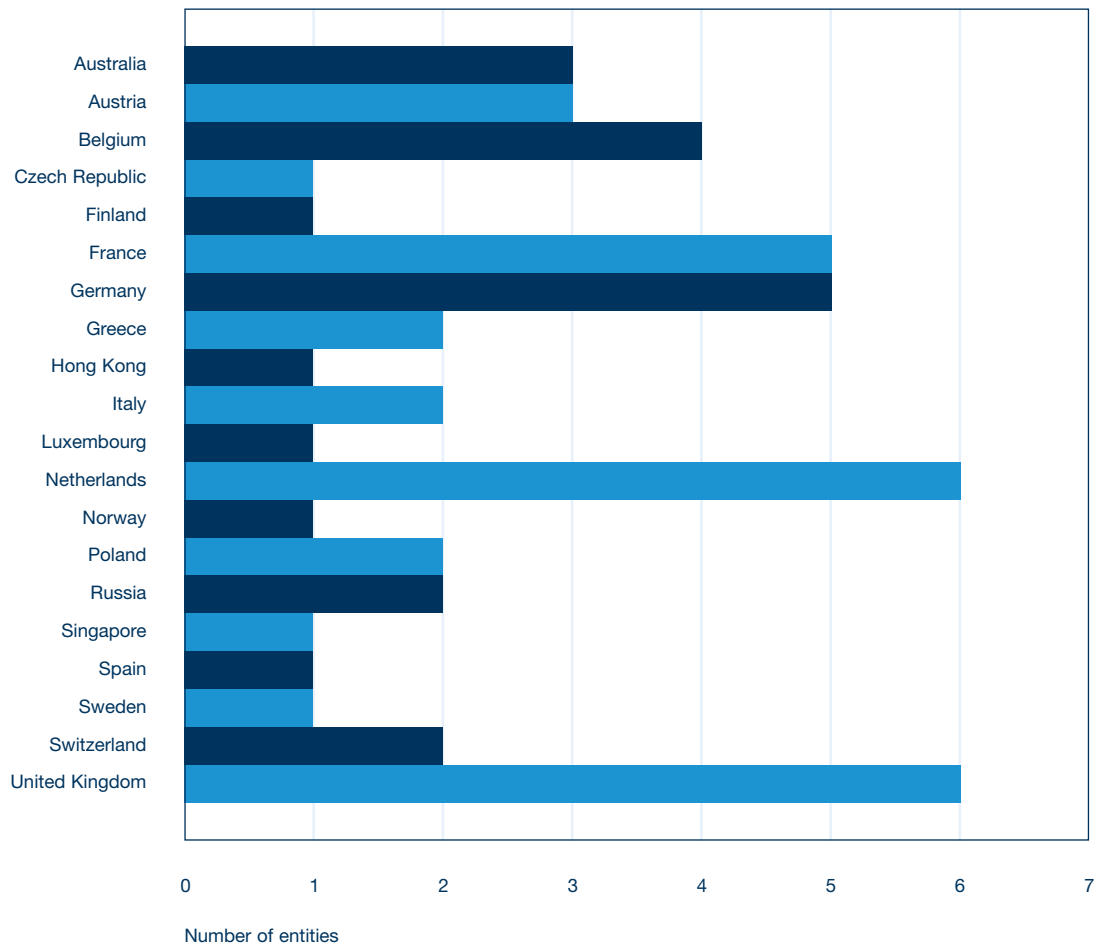
All financial statements analysed are publicly available. No preference has been given to a particular country, entity size or complexity of operations. Refer to appendix 1 for the list of companies' financial statements surveyed.

This is a global survey, but the main focus is on Europe. Compared to the previous year the sample is more diverse and also includes annual reports of some Central and Eastern European as well as Scandinavian countries. In comparison to the 2006 survey we also included more financial statements from the Asia Pacific region. For an overview of the entities by country refer to the bar chart on page 5.

The outcome of this year's survey cannot be directly compared to last year's – as we have changed the sample base to encompass different companies and a wider spread of countries and regions. However, where relevant we will compare our findings for those entities which were also part of last year's survey.

³ For example, in Europe this will be IFRS as adopted by the European Union (EU-IFRS) and in Australia this will be A-IFRS.

Entities per country



In this survey we examined the following topics for the reasons set out:

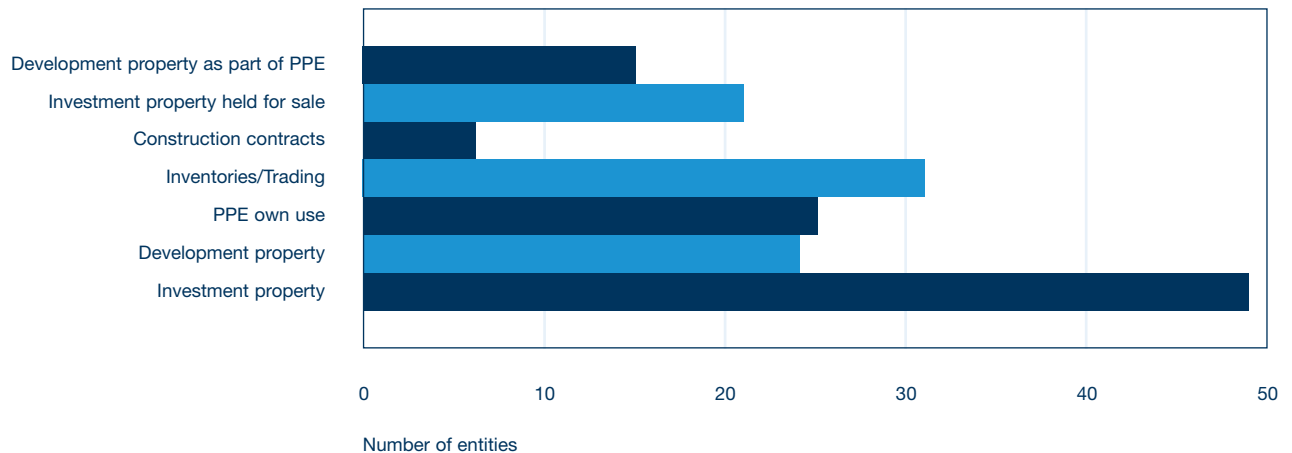
Topic	Reason for examination
Classification, recognition and transfers	The categories presented in the balance sheet should be defined and described in the accounting policies relating to these categories. We aimed to reveal whether the relevant aspects of classification, recognition and transfers are disclosed properly in the accounting policies.
Measurement	We focused on the disclosure of the method of valuing investment property, the assumptions used, the frequency of appraisals and who carried out the valuations. In addition we also reviewed the annual reports for the inclusion of external valuation reports.
Income statement	This topic focuses on the comparability of revenue and on disclosures relating to service charges.
Consolidation	In response to the issuance of an exposure draft on the accounting for joint ventures we included the accounting treatment for joint ventures in this report.
IFRS 7	This standard became effective in 2007 and we examined the risk management disclosures relating to financial instruments, in particular the sensitivity analysis.
Segment reporting	We assessed which primary and secondary segments are used under IAS 14 and whether real estate entities have early adopted IFRS 8.
Deferred tax	We assessed the disclosures on several aspects of deferred taxes, as this is the subject of intense debate.
Industry-specific guidance	Industry bodies for (listed) real estate entities have issued best practice guidance. We aim to reveal to what extent compliance with best practice guidance is disclosed.

1 Classification, recognition and transfers

How are real estate assets classified in the balance sheet?

Our survey reveals that investment property is included on the face of the balance sheet of almost all financial statements. Refer to the graph below for the categories of real estate which were classified on the face of the balance sheet.

Categories of real estate available on the face of the balance sheet



Investment property is, as in 2006, the most frequently used category of real estate asset on the balance sheet. Only one entity in the survey did not list investment property on the balance sheet but recognised it as property, plant and equipment instead. This entity, however, does have an accounting policy on investment property. Although the entity does not list investment property on the balance sheet we include it into the scope as having investment property on the balance sheet. As can be observed from the above graph a range of real estate asset classifications is being presented on the face of the balance sheet. The challenge for all real estate entities is to appropriately account for these categories and for the possible transfers between categories.

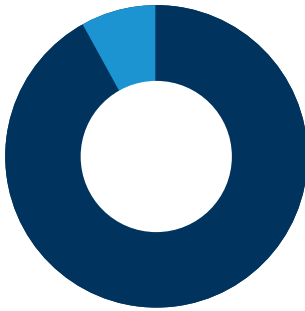
The category 'Development property' comprises the development property accounted for under IAS 16 as well as those accounted for under IAS 40.

How are investment properties valued?

According to IAS 40, entities can choose to subsequently measure their investment property at cost less depreciation and less impairment or at fair value. For information purposes the accounting policy chosen had to be disclosed, including the bases for initial measurement and subsequent measurement. An entity following the cost model should also disclose the fair value of the investment properties in the notes. The majority of the entities do not specifically disclose their initial measurement basis for investment property. However, the subsequent measurement has been disclosed in the accounting policy for all entities represented in the survey.

Entities which did disclose the initial measurement basis (19 of the 50 entities (38%)) mainly disclosed that transaction costs are part of the initial measurement. Only four of those 19 entities (21%) disclosed what is included in the transaction costs (e.g. registration costs, legal and other consultants' fees) in more detail.

Are investment properties subsequently valued at fair value?



■ Yes 46 (92%)
■ No, (at cost less depreciation and less impairment) 4 (8%)

Industry bodies have determined that fair value accounting is the best practice for investment property, as it gives better insight into the net asset value of the entity. The survey reveals that four of the 50 entities (8%) accounted for their real estate investment property at cost. Compared to the previous year we noted that two entities changed their accounting policy from the cost model to the fair value model. The rationale for this change was that the entities believe that the fair value model improves presentation of the balance sheet and reveals the 'hidden reserves' of the entity's investment property. It also makes the annual report of the entities more comparable to those of their competitors, as most real estate entities apply the fair value model for investment property.

Changes in fair value of investment property can have a significant impact on the profit or loss reported for real estate entities. According to IAS 40 paragraph 35, changes in the fair value of investment property must be recognised in the income statement for the period in which it arises.

We refer to appendix 2 for guidance on accounting policies for investment property under IFRS.

What is the accounting policy for the other real estate properties included in the financial statements under review?

IAS 16 states that owner-occupied property which is being used for operational activities by the reporting entity can either be measured subsequently at cost or at revalued amounts (being the fair value at the date of the revaluation less any subsequently accumulated depreciation and less accumulated impairment charges). Twenty-five out of 50 entities (50%) disclosed PPE for own use separately from investment property and other property, plant and equipment. The accounting treatment of the entities surveyed for this type of real estate property is at cost.

Under the current IAS 40, entities generally account for development property that is being constructed or developed for future use as investment property in accordance with IAS 16. Under the revised IAS 40 issued in May 2008 (mandatory for periods commencing on 1 January 2009), development property has to be accounted for under IAS 40 as part of investment property. (For entities applying IFRS as adopted for use in the EU, the revised standard cannot be applied prior to endorsement by the EU, which is expected in the first quarter of 2009.) Development property can then be measured at cost less depreciation and less impairment or at fair value. Under the fair value model there is a rebuttable presumption in IAS 40 (Revised) that the fair value can be determined reliably. Of the entities included in the survey 39 (78%) included development activities as part of their business. We encountered a variety of names given to development properties (e.g. pipeline project, development properties, PPE development property). Thirty-two of those

39 entities (82%) apply the cost model for measuring development property to be constructed for future use as investment property, and six entities out of the 39 (15%) value the development property at fair value. One entity did not disclose its accounting policy.

Another balance sheet item which can include real estate is inventory. In accordance with IAS 2, inventory should be accounted for at the lower of cost and net realisable value. Our survey reveals that a real estate category such as 'inventory' or 'inventory and trading' was included on the face of the balance sheet for 31 out of 50 financial statements surveyed (62%). All 31 entities reported their inventory accordingly at the lower of cost or net realisable value.

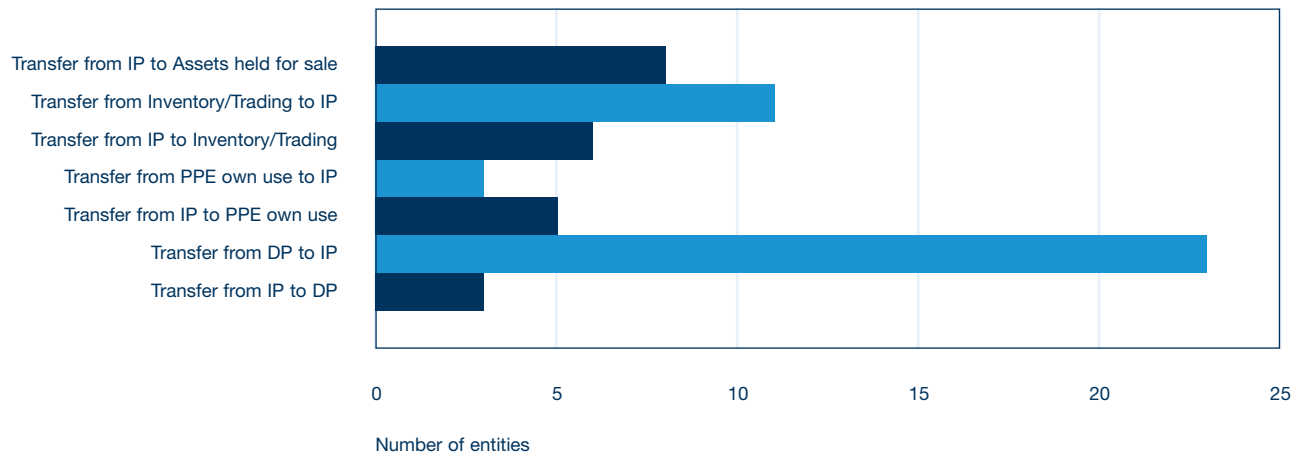
Construction contracts as a reporting line were included on the face of the balance sheet for 6 entities in the survey (12%). The accounting policy states that construction contracts are accounted for in accordance with IAS 11, with the percentage of completion method as the basis for revenue recognition.

We refer to chapter 9 on IFRS developments, especially to IFRIC 15 'Agreements for the Construction of Real Estate' of the International Financial Reporting Interpretations Committee (IFRIC), which gives more guidance on the way revenue on the sale of constructed real estate should be accounted for. In IFRIC 15 the definition of a construction contract was clarified and also the articulation between IAS 11 'Construction Contracts' and IAS 18 'Revenue' was given, including guidance on how to account for revenue when the agreement for the construction of real estate falls within the scope of IAS 18.

Assets held for sale are those non-current real estate assets available for immediate sale in their current condition; and of which the sale is highly probable. As from the date of reclassification of investment property to non-current assets held for sale the asset should be measured at the lower of fair value less costs to sell or its carrying amount in case these were measured at cost. As of that point in time real estate is not depreciated any more. In the case of using the fair value model under IAS 40, the measurement provisions under IFRS 5 are scoped out (though the entity still has to reclassify the investment property to a separate line item 'Non-current assets held for sale'), and the entity continues to carry the investment property at fair value. We noticed that 21 out of 50 entities (42%) disclosed assets held for sale on the face of the balance sheet.

To which categories do the real estate assets transfer?

IFRS sets criteria for the transfer of assets from one real estate category to another. The accounting policies should reflect the criteria to be met to trigger a transfer from one category to another. Consequently the accounting policies should also address whether the transfer will have an impact on the accounting method and on the carrying amount. Refer to appendix 2 for more guidance on transfers under IFRS and their accounting impact.

Transfers included in the financial statements

IAS 40 paragraph 57 mentions five options to transfer real estate from and to investment property. Our survey reveals that the main transfers take place from development property to investment property. This means that many entities develop real estate for their own portfolio.

Conclusion

Our survey reveals several types of real estate categories on the face of the balance sheet. The notes to the financial statements provide useful disclosures to assist users in understanding the business of the entity. However, information on the costs included in transaction costs at initial measurement is limited. The most frequent transfer between different categories of real estate was from development property to investment property.

2 Measurement

As mentioned in the first chapter, investment property is initially measured at cost and subsequently measured at cost or at fair value. Forty-six of the 50 entities surveyed (92%) subsequently measured their investment property at fair value. The other four entities (8%) use the cost model. In this chapter we will focus on the way the measurement is carried out.

How is fair value determined?

Management is responsible for determining the fair value of investment property. IFRS does not require the involvement of an external independent appraiser in determining the fair value of the investment property. Therefore, the entity has a choice to determine the fair value based on fully internal valuations, fully external valuations or a mix of internal and external valuations. In cases where the entity does not use an external appraiser, additional disclosures should be made.

In some instances local law may require that periodic valuations take place by an external independent appraiser. This is, for example, obligatory under Dutch supervision law, applicable to (real estate) investment institutions in the Netherlands.

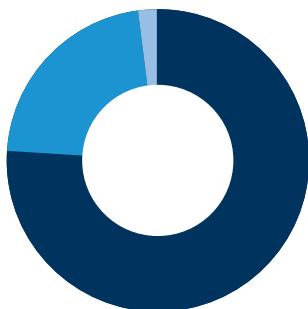
Investment property stated at fair value is often based on valuations performed by independent external appraisers. Our survey reveals that even the four entities using the cost model engaged external appraisers in order to determine the fair value of the investment property, which is disclosed in the notes to investment property.

Only one entity did not engage external independent appraisers in order to determine the fair value of the investment property at the reporting date. The entity discloses the basis for the discount rate used in the discounted cash flow model.

IAS 40 paragraph 75(e) requires an entity to disclose the extent to which the fair value of its investment property is based on a valuation by an independent valuer who holds a recognised and relevant professional qualification and has recent experience in the location and category of the investment property being valued. Most of the entities which engage external appraisers for the valuation process disclosed the name of the external appraiser firm in the annual report. Only 11 out of 50 entities (22%) did not disclose the name of the external appraiser.

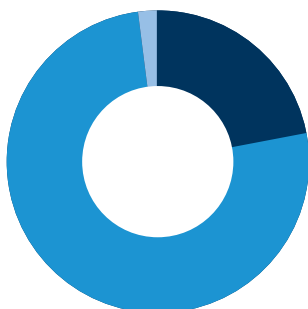
Our survey reveals that 11 entities (22%) included an extract of an appraiser's report in the annual report. The reports differ from each other, but the appraiser generally explains the instructions received, the appraiser's independence from the entity, the valuation method, the procedures performed and the assumptions made. We noted that the assumptions were given mainly in narrative form and were not substantiated by numbers or percentages.

Is the name of the firm performing the external valuation disclosed in the financial statements?



■ Yes 38 (76%)
■ No 11 (22%)
■ Internal valuation 1 (2%)

Is an independent appraiser's report included in the annual report?



■ Yes 11 (22%)
■ No 38 (76%)
■ Internal valuation 1 (2%)

Although not required by IFRS, four entities disclosed the way in which the external valuation fee was determined. In three of these cases the fee was fixed. One entity disclosed that the external valuation fee was based on a percentage of the valuation of the investment property. No disclosures have been made as to whether the external appraiser has rendered other services to the entity.

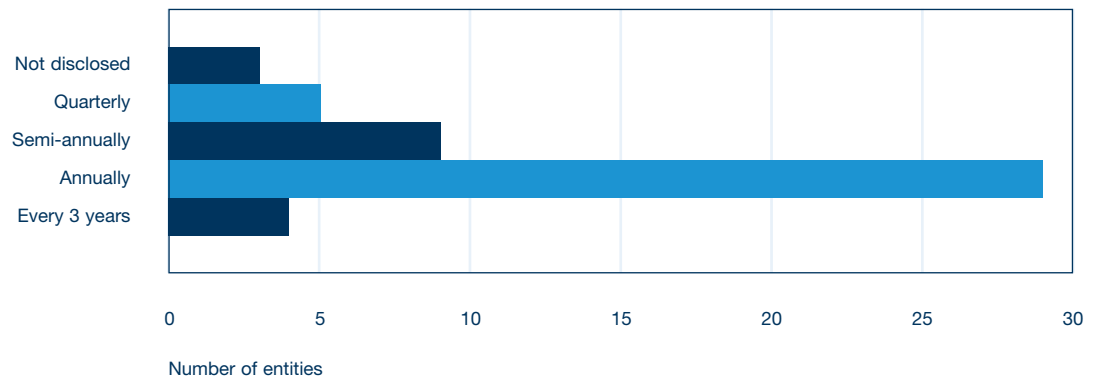
The entities which determine the fair value based on a mix of internal and external valuations do not clearly disclose how the valuation process is performed. In general it is unclear which part of the portfolio is valued internally. Furthermore, the timing of the valuation is not clearly disclosed, nor how the fair value is assessed as of reporting date.

What is the frequency of external valuations and which model and assumptions are being used by the external appraiser?

What is the frequency of external valuations?

The entities disclose that they determine the fair value of investment properties by using external valuations every three years, annually, semi-annually or quarterly. Most entities obtain external valuations of investment properties once a year.

Frequency of external valuations



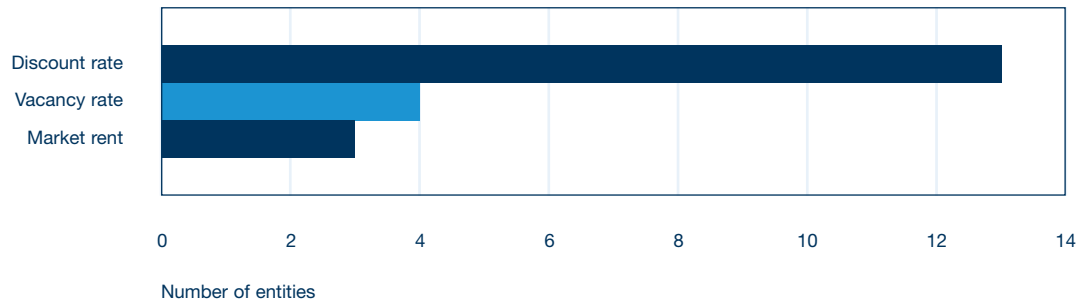
Which model is used for external valuation?

Many entities do not specifically disclose the calculation model they use. The calculation model mentioned for determining the fair value is mainly the discounted cash flow model (DCF). Some entities specifically mention that the valuation is based on the RICS book of the Royal Institution of Chartered Surveyors (RICS) or the International Valuation Standards (IVS) of the International Valuation Standards Committee (IVSC).

Which assumptions are disclosed?

The survey reveals that in general entities do not disclose any assumptions used in determining the valuation. Of the surveyed entities 13 (26%) gave some information on the discount rate used in the discounted cash flow model.

Assumptions disclosed in the financial statements



Are lease incentives deducted from the external valuation?

Under IAS 17 'Leases', initial direct costs (including lease incentives) incurred by lessors in negotiating and arranging an operating lease are added to the carrying amount of the asset leased and recognised as an expense over the lease term. Nearly all entities disclose their accounting policy on lease incentives. They all expensed lease incentives through the income statement on a straight-line basis. It is, however, unclear for most entities whether additions to and amortisation of lease incentives are appropriately accounted for in arriving at the fair value of the investment property, so as to avoid double counting.

Conclusion

The survey reveals that external appraisers are involved in determining the fair value at subsequent measurement of investment property, generally reporting on an annual basis. The firm performing the external valuation is often named and some entities include an extract of the appraiser's report in the annual report.

For the users of the financial statements, more transparency could be achieved by detailing the assumptions used in the valuation process.

Furthermore, the way the entities have accounted for lease incentives so as to avoid double counting in arriving at the fair value of the investment property is not clear.

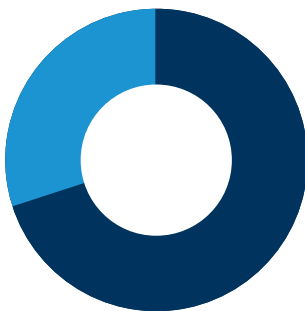
3 Income statement

Revenue is defined as the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity. Under IFRS it is possible to present revenue on a gross or net basis, depending on the activities performed.

Is revenue presented on a gross or net basis?

Gross is defined as showing both income and operational costs on the face of the income statement (as well as a reconciliation between gross and net) and net is defined as showing only net revenue (being revenue minus costs) on the face of the income statement. All entities showed revenue on a gross basis on the face of the income statement; however, only two entities did not show the operating expenses relating to the gross revenue on the face of the income statement

Are realised gains part of revenue?



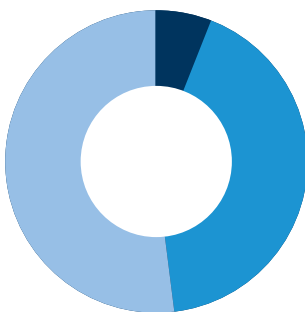
■ No 35 (70%)
■ Yes 15 (30%)

Where are realised gains presented in the income statement?

Under IFRS the proceeds of real estate sold can be presented as a component of revenue when the entity's core business is trading in real estate (purchasing properties for resale or developing new or existing properties for sale). In that situation the carrying amount of the real estate immediately prior to sale (including additional construction costs in the case of developed properties) should be presented as cost of sales. In other circumstances, like the disposal of investment property, the realised gains or losses should be presented on a net basis outside of revenue.

Fifteen entities presented the proceeds of real estate sold in revenue, either on the face of the income statement or in the notes. Other entities that sold real estate presented the realised gains and losses on a net basis as a separate line item in the income statement.

How are service charges disclosed?



■ Net 3 (6%)
■ Gross 21 (42%)
■ Not disclosed 26 (52%)

Service costs and service charges

Income and expenses in respect of service costs are presented on a gross basis or on a net basis depending on whether the entity is acting as an agent or as a principal. On a net basis, service charge costs are offset against service charge recoveries from tenants, and on a gross basis they are reported separately. If acting as an agent, an entity discloses service charges on a net basis. If acting as principal, service charge costs should be disclosed on a gross basis and the service charge recoveries from tenants should be recorded as a component of revenue. Our survey reveals that 26 entities did not disclose any service charges in the income statement or notes to the income statement. Of the remaining entities the survey reveals that 21 entities present service charges on a gross basis (as a principal) and three entities on a net basis (as an agent). Just a few entities disclosed in their accounting policies whether they are acting as an agent or as a principal and the basis for this determination. IAS 1 requires entities to disclose the judgements that have the most significant effect on the amounts recognised in the financial statements. None of the entities disclosed any such significant judgement in respect of the agent/principal determination for service charges. For further guidance relating to this matter we refer to appendix 3.

Conclusion

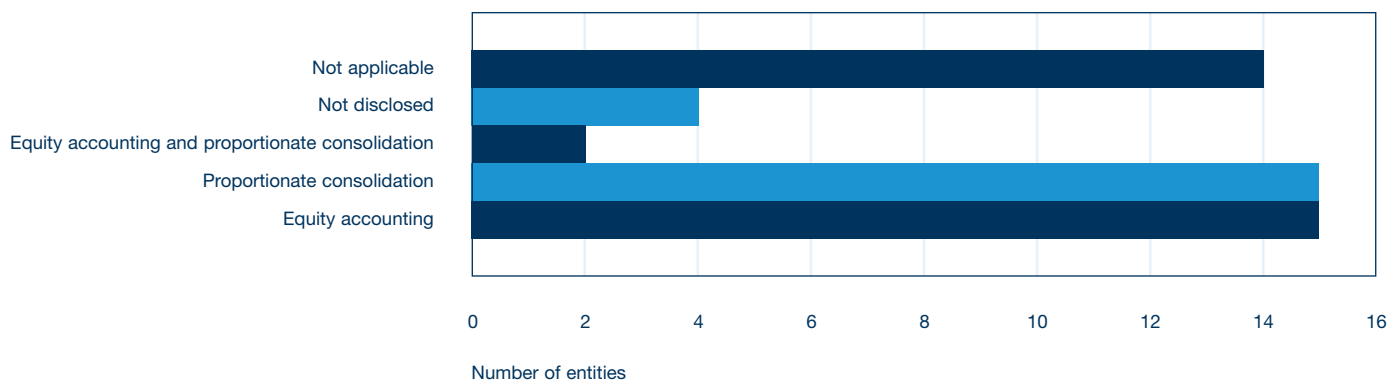
Forty-eight of the entities (96%) present their revenue on a gross basis. Due to the fact that trading in real estate is part of the core business, 15 entities present the proceeds on the disposal of real estate as part of revenue and the carrying value as part of cost of sales in the income statement. Disclosures on the accounting treatment of service charges (e.g. clarification on whether the entity is an agent or a principal) are limited; most entities determined that they were acting as a principal in respect of service charges. The determination of whether the entity is acting as agent or principal can have a significant impact on the presentation in the income statement.

4 Consolidation

How are joint ventures accounted for?

All of the 50 entities surveyed disclosed in their financial statements that they had consolidated other entities as a part of their financial group. Thirty-six out of 50 (72%) disclosed that they had entered into joint ventures. For the remaining entities no joint venture scenarios were disclosed, so these entities appeared not to have entered into such arrangements. IAS 31 provides two options for accounting for joint ventures; proportionate consolidation and the equity method. Seventeen of the 36 entities (47%) disclosed in their accounting policy that they consolidate their joint ventures proportionately. The International Accounting Standards Board (IASB) Exposure Draft ED 9 'Joint Arrangements' may remove the possibility to proportionately consolidate joint ventures. For further details on ED 9 we refer to chapter 9 on IFRS developments.

How are joint ventures accounted for?



Acquisition of a business versus acquisition of an asset

In accordance with IFRS 3, in the case of a business combination the deferred tax recognised in respect of the acquisition of an entity (which may in substance consist of a corporate wrapper containing only property) should be based on the temporary differences between the carrying value of assets and liabilities recognised by the acquirer at the moment of acquisition and their tax base. The deferred tax liability recorded on the balance sheet will most likely lead to additional goodwill, which should be tested for impairment at each reporting period end.

In the case of an asset deal, the acquirer allocates the purchase cost to the individual identifiable assets and liabilities acquired, and no goodwill will be recognised in the consolidated financial statements regarding the acquisition. For these acquisitions, the initial recognition exemption generally applies, which means that the tax basis of the underlying asset will be the value recognised in the consolidated financial statements at the date of acquisition, such that no temporary differences and no deferred tax

arise in respect of the asset at the date of acquisition. A new exposure draft on IAS 12 is expected in due course. It is expected that the initial recognition exemption will disappear.

The guidance in IFRS 3 and IAS 12 overlaps on the subject of deferred tax and may lead to confusion. In the survey we observed that the accounting policies did not depart from standard disclosures in this area, with very few survey participants detailing the treatment of deferred tax relating to acquisitions. We also refer to chapter 9 for the revised IFRS 3.

Conclusion

Each year many acquisitions take place. Acquisitions can be characterised as either asset deals or business combinations. The IASB Exposure Draft ED 9 'Joint Arrangements' may remove the possibility to consolidate joint ventures proportionately. One significant aspect of acquisitions is also how the deferred tax balances are dealt with. IAS 12 currently provides the initial recognition exemption in relation to asset deals, although a new draft on IAS 12 is expected which might eliminate this exemption.

5 IFRS 7

Entities with an annual accounting period beginning on or after 1 January 2007 were required to apply IFRS 7 for the first time. This standard requires entities to provide disclosures in their financial statements that enable users to assess the significance of financial instruments for the entities’ financial position and performance, the nature and extent of risks arising from financial instruments, and the way the entities’ management is managing those risks.

The principles outlined in the standard are designed to complement those for recognising, measuring and presenting financial assets and financial liabilities in IAS 32 and IAS 39.

As such, in the context of real estate entities, this standard does not apply to real estate assets such as investment properties (covered by IAS 40) or properties for own use (covered under IAS 16). It mainly applies to balances such as rent receivables, tenants’ deposits and loans and borrowings and other financial instruments such as derivatives.

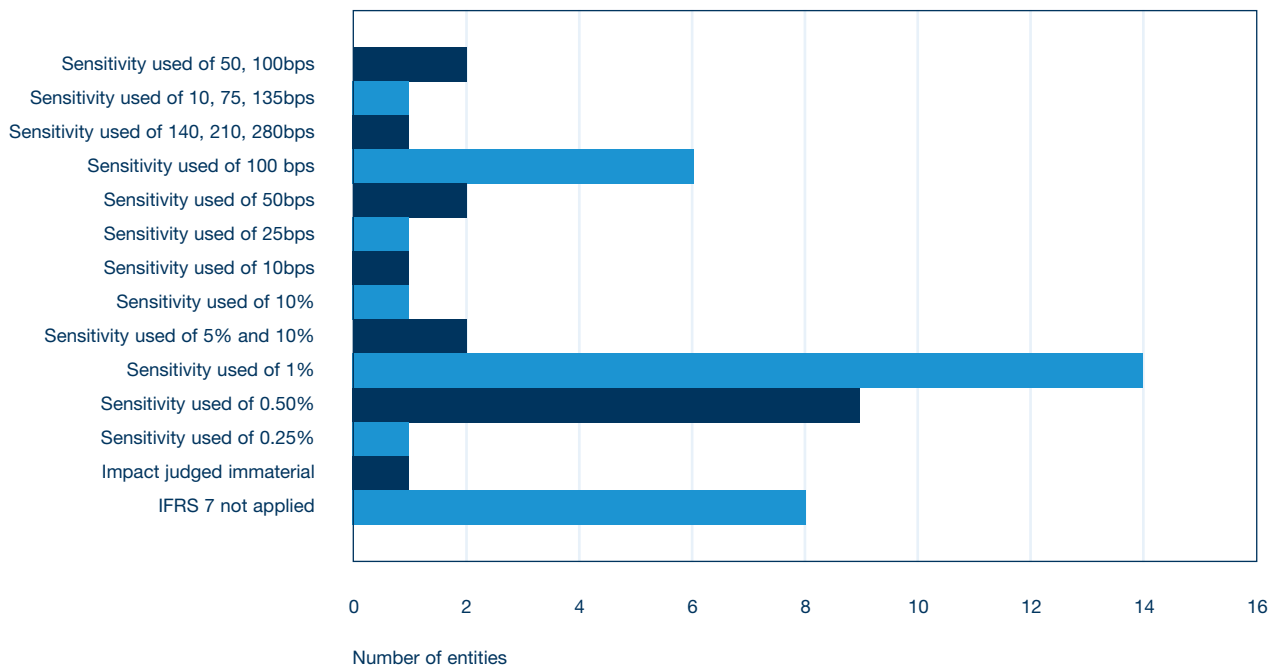
It was noted that eight of the 50 entities surveyed had not applied IFRS 7 in their financial statements due to balance sheet dates of either 31 March 2007 or 30 June 2007. This was correctly explained in the accounting policies under ‘new accounting standards issued not yet effective’.

In this survey we explicitly examined only the sensitivity analysis as required under IFRS 7 (p 40) for each of the various types of market risks.

Sensitivity analysis for market risks

The entities disclosed the sensitivity analysis for the following market risks to which the entities are exposed at the end of the reporting period: (i) interest rate risk; (ii) currency risk; and (iii) other price risks. The survey showed the following percentages used as an indicator for the changes in the relevant risk variables that were reasonably possible at the end of the reporting period:

Interest rate risk

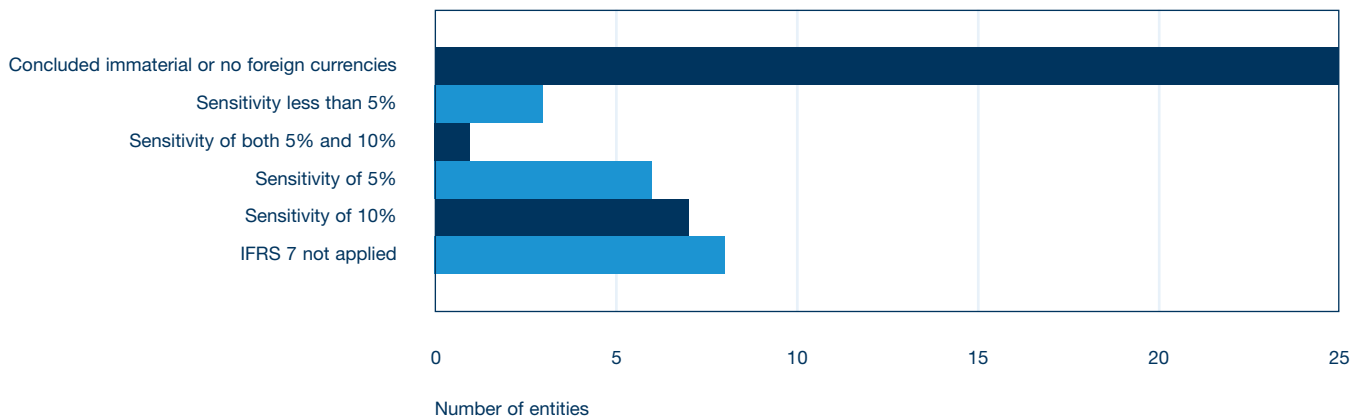


For the 42 entities applying IFRS 7, the disclosed reasonable possible shift in interest rates ranged from 0.1% to 10% and from 10 basis points to 280 basis points. The three most frequently used scenarios were an increase and/or decrease of interest risk by 1%, 0.5% and 100 basis points. One entity mentioned that the impact was judged immaterial and included no further disclosures in relation to interest rate movements.

Of the eight entities not applying IFRS 7 two included a sensitivity analysis. Two entities applied different assumptions for the interest increase and decrease applicable to interest rate risk on loans in different currencies.

Only limited explanations were given of the methodologies used in choosing the assumptions to allow the users of the financial statements to understand why a particular assumption (increase/decrease by a certain %) was chosen for that particular set of financial statements.

Foreign currency risk



Of the 42 entities applying IFRS 7 for the first time in 2007, 25 (60%) concluded in their foreign currency risk disclosure that a sensitivity analysis was not material to users of the financial statements, either because the entity only operated in regions where the national currency was the same as the entity's functional currency, such that the entity experienced no foreign currency exposure, or because the foreign currency exposure had no significant impact on the financial statements as a whole due to the balance of financial instruments denominated in foreign currencies being less than 10% of total assets and liabilities.

The two main assumptions applied within the sensitivity analysis were an increase/decrease in the relevant exchange rate of 5% and 10%. Only one entity expressed the sensitivity in terms of movements in currency amounts (e.g. 5 cents on US dollar) instead of using percentages.

Other price risks

The standard defines other price risk as the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or by factors affecting all similar financial instruments traded in the market.

Of the 42 entities applying IFRS 7 for the first time in 2007, nine (21%) included a disclosure on other price risks. Of those nine entities three had chosen to present a narrative only without a sensitivity calculation.

The definitions of other price risks vary between entities and include property price and property rental risk, the volatility of property funds listed on a stock exchange, property derivatives and equity security price risk. Property price and property rental risk are generally not risks that relate to the entities' financial instruments, and therefore the entities disclosing such risks are effectively including additional information over and above that required by IFRS 7.

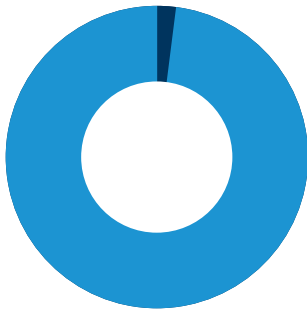
Conclusion

The most commonly used assumptions for the analysis of sensitivity of the interest rate risk were 0.5%, 1% and 100 basis points. For the currency risk the most common used assumptions were movements of 5% and 10%. Disclosures on other market price risks are limited.

6 Segment reporting

Our survey reveals that only one out of 50 entities (2%) stated that it had early adopted IFRS 8. Under IAS 14 (which is still applicable for listed entities up to and including fiscal year 2008, unless IFRS 8 is early adopted) a primary segment and a secondary segment must be determined and disclosure must be provided for both segmentations based on similar accounting principles to those used in the financial statements. IFRS 8 requires that the entity uses segments identified in the same way as in internal reporting to the Chief Operating Decision Maker (CODM), based on accounting policies used internally. The entity applying IFRS 8 in the annual report mentions that early application of IFRS 8 in the consolidated financial statements would lead to additional disclosures in the notes and provide a more detailed insight into segment financial position and performance. This entity, however, explains that the notes used in the financial statements are in line with the requirements of both IAS 14 and IFRS 8.

Did entities early adopt IFRS 8?



■ Yes 1 (2%)
■ No 49 (98%)

Of the remaining 49 entities applying IAS 14, the primary segment is mainly based on the business segments, being a split into e.g. retail, offices and residential. The secondary segment chosen by the 49 entities surveyed was generally geography.

For further details on IFRS 8 we refer to chapter 9 on IFRS developments.

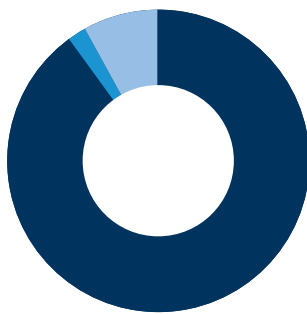
Conclusion

Only one of the entities surveyed early adopted IFRS 8. IFRS 8 will be effective for annual periods commencing from 1 January 2009, with comparative disclosures required. Under IFRS 8, disclosures on segments of an entity and related information must be identified in the same way as in the internal management accounts. The primary segment of the remaining 49 entities surveyed is generally business segments (e.g. offices, residential and retail) and the secondary segment is generally geography.

7 Deferred tax

Forty-five entities presented their deferred tax liability on the face of the balance sheet under non-current liabilities. One entity presented the deferred tax liability only in the notes to the long-term liabilities. Four entities did not disclose any deferred tax liabilities due to the use of special tax structures, as a result of which they are not liable for income taxes.

Presentation of deferred tax liabilities



- Face of the balance sheet 45 (90%)
- Only in the notes to the balance sheet 1 (2%)
- No deferred tax liability 4 (8%)

The deferred taxes are not discounted and are calculated using tax rates that are expected to apply in the year in which the asset is realised or the liability is settled based on tax rates that have been enacted or substantively enacted by the balance sheet date. One entity mentioned that the exit tax under the SIIC regime was discounted as at the balance sheet date. This exit tax is a current tax which is eligible for discounting instead of a deferred tax which is not. The survey reveals that entities using special fiscal structures, like the SIIC in France or the FBI in the Netherlands, explain in detail the effect of the structure on the income tax expense. One entity disclosed that it had not recognised deferred taxes in respect of temporary differences arising from changes in the fair value of investment properties in view of management's intention to sell the corporate wrapper holding these assets rather than the assets themselves. The survey revealed that disclosure of various tax rates used to calculate the deferred tax rate based on expected recovery and settlement (the blended rate approach) was limited. For explanation of the blended rate approach refer to appendix 4.

Conclusion

Nearly all entities surveyed present deferred tax on the face of the balance sheet, as required by IAS 1. The deferred tax is not discounted and is calculated using applicable tax rates that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the deferred tax is realised or settled. The disclosure on the percentages used to calculate the deferred tax and the influence of fiscal facilities (e.g. tax structures such as SIIC in France or FBI in the Netherlands) on the deferred tax is limited.

8 Industry-specific guidance

The European Public Real Estate Association (EPRA) endeavours to develop policies concerning standards of reporting disclosure, ethics and industry practices. Although not a disciplinary body, EPRA actively encourages adherence to these policies. In January 2006 the EPRA Best Practices Committee released the Best Practices Policy Recommendations, the latest edition of which is dated May 2008.

Of the 50 entities surveyed one entity stated that the financial statements complied with the EPRA Best Practices Policy Recommendations. Another entity mentioned that the consolidated income statement was structured in line with the format suggested by EPRA. One entity mentioned that management and internal reporting structures (and we assume therefore the financial statements) were changed with a view to incorporate the EPRA Best Practices Policy Recommendations.

The survey encompasses 45 entities registered with EPRA. Thirteen entities calculated an EPRA Net Asset Value (EPRA-NAV)⁴ or Triple NAV (NNNAV) and 14 presented the like-for-like growth. The majority of the entities presenting a NAV or NNNAV mentioned that this was calculated in accordance with the EPRA Best Practices Policy Recommendations.

When we surveyed the 50 entities we noted that four entities disclosed 'direct' and 'indirect' result⁵, two of them on the face of the income statement and two in a separate overview in the primary statements. The four entities all give a brief disclosure on what is meant by direct and indirect result, but a statement that it is a non-IFRS measurement was not included.

⁴ EPRA NAV is derived from the net assets based on EPRA. The net assets are the balance sheet net assets plus the surplus on trading properties, excluding fair value adjustments for debt and related derivatives, deferred taxation on revaluations and capital allowances as well as the effect of shares potentially issuable under employee share schemes.

⁵ In general the direct result consists of net rental income, general costs, other gains and losses (other than exchange rate differences), financial income and expense (other than the interest addition to leasehold obligations, the interest addition to the real value of the conversion rights of convertible bonds, premiums paid on repurchased interest-bearing debt and actuarial gains and losses from pension plans) and tax charges.

In general the indirect result consists of valuation results, exchange rate differences that are accounted for under other financial income and expense, the interest addition to leasehold obligations, the real value of the conversion rights on convertible bonds, actuarial gains and losses from pension plans and the movement in deferred tax liabilities.

9 IFRS developments

IFRS 8

This standard, adopted by the European Union in November 2007, supersedes IAS 14 'Segment Reporting' and brings segment reporting into line with US GAAP (SFAS 131 – 'Disclosures about Segments of an Enterprise and Related Information'). IFRS 8 will be effective from 1 January 2009. The main change of IFRS 8 compared to IAS 14 is that IFRS 8 requires that the entity uses segments identified in the same way as in internal reporting to the Chief Operating Decision Maker (CODM). IAS 14 required segment information to be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity. IFRS 8 requires information based on the accounting policies used internally, with an explanation on the definitions used, such as revenue, expenses, results, assets and liabilities for the segments presented and a reconciliation to the balance sheet and income statement of the entity. Therefore the accounting policies, as well as the presentation of segments, can change.

IFRIC 15

Based on evidence in the market, it became apparent that real estate developers did not always interpret IFRS in the same way and that they recorded the revenue from the sale of units at different points in time. In order to assist the accounting practice on this matter IFRIC issued the interpretation IFRIC 15, 'Agreements for the Construction of Real Estate', on 3 July 2008. IFRIC 15 applies to the accounting for revenue and associated expenses by entities that undertake the construction of real estate directly or through subcontractors. The interpretation is effective for annual periods beginning on or after 1 January 2009 and is to be applied retrospectively. Endorsement by the EU is expected in the first quarter of 2009.

IFRIC 15 standardises accounting practice across jurisdictions for the recognition of revenue by real estate developers for sales of units, such as apartments or houses, 'off plan' – that is, before construction is complete. The fundamental issue is whether the developer is selling a product (goods) – e.g. a completed apartment or house – or is selling a service – a construction service as a contractor engaged by the buyer. Under IAS 18 revenue from selling products is normally recognised at delivery. Revenue from selling construction services is normally recognised on a percentage-of-completion basis as construction progresses. In other words IFRIC 15 provides guidance on how to determine whether an agreement for the construction of real estate is within the scope of IAS 11 'Construction Contracts' or IAS 18 'Revenue' and, accordingly, when revenue from the construction should be recognised.

The main indicator that a construction agreement is to be accounted for under IAS 11 is whether the buyer has the ability to specify the major structural elements of the design of the real estate before construction begins and/or specify major structural changes once construction is in

progress. If the buyer has the ability but does not use it, the construction contract is still classified as a construction contract under IAS 11. In cases where the buyer does not have the ability to specify major structural changes before or during construction, IAS 18 applies.

The main expected change in practice is a shift for some entities from recognising revenue as construction progresses to recognising revenue at a single point in time – at completion upon or after delivery. Agreements that will be affected will be mainly those currently accounted for in accordance with IAS 11 that do not meet the definition of a construction contract as interpreted by the IFRIC, and that do not transfer to the buyer control and the significant risks and rewards of ownership of the work-in-progress in its current state as construction progresses.

ED 9

In September 2007 the IASB published an exposure draft to amend the accounting for joint arrangements. The proposal in ED 9 ‘Joint Arrangements’ will replace IAS 31 ‘Interests in Joint Ventures’. The main proposal of the exposure draft is that an entity should recognise an interest in a joint venture (i.e. an interest in a share of the outcome generated by the activities of a group of assets and liabilities subject to joint control) using the equity method. Proportionate consolidation would therefore no longer be permitted. Furthermore the exposure draft proposes to enhance the disclosures with financial information for each individually material joint venture and in total for all joint ventures.

IFRS 3R

The revised IFRS 3 was issued in January 2008 and is effective for accounting periods beginning on or after 1 July 2009, but it may be applied earlier.⁶ The main changes in the revised IFRS 3 are:

- Acquisition costs must be expensed (currently included in the cost of acquisition). Examples of acquisition costs are registration costs, stamp duties, advisory, legal, accounting, valuation and other professional or consulting fees. These costs are typically significant in the real estate industry.
- If contingent consideration taken into account in the initial accounting for the acquisition changes due to a post-acquisition event, accounting for the change in consideration depends on whether the additional consideration is an equity instrument (original amount not remeasured) or paid in cash or other assets (amount is changed and change is recognised in profit and loss account).
- It is permitted to recognise 100% of the goodwill of the acquired entity, not just the acquiring entity’s portion of the goodwill. This is known as the “full goodwill” option and may be elected on a transaction-by-transaction basis.

⁶ This standard has to be endorsed by the EU before application in the EU. It is expected that the endorsement will take place in the first quarter of 2009.

Appendix 1

Financial statements surveyed

Entity	Country ⁷
1 Aedes	Italy
2 Babis Vovos	Greece
3 Befimmo	Belgium
4 British Land	United Kingdom
5 Brixton	United Kingdom
6 CA Immobilien Anlagen	Austria
7 Cofinimmo	Belgium
8 Conwert	Austria
9 Corio	Netherlands
10 Deutsche Wohnen	Germany
11 DIC Asset	Germany
12 Eastern Property Holdings	A British Virgin Islands company with main business in Russia
13 ECM Real Estate Investments	A Luxembourg entity with main business in the Czech Republic
14 Eurocommercial Properties	Netherlands
15 Foncière des Régions	France
16 Gecina	France
17 GPT Group	Australia
18 Groothandelsgebouwen	Netherlands
19 Globe Trade Centre SA	Poland
20 Hammerson	United Kingdom
21 Hongkong Land	A Bermuda company with main business in Hong Kong
22 ICADE	France
23 Immofinanz	Austria
24 IVG Immobilien	Germany
25 Képpel Land	Singapore
26 Klépierre	France
27 Kungleden	Sweden
28 LAMDA Development	Greece
29 Land Securities	United Kingdom
30 Leaseinvest Real Estate	Belgium

Continued overleaf

⁷ The country is based on the registered office of the entity. For the purpose of the graph in the chapter 'About this survey' a few holding companies are classified based on the country that the entity is active.

Continued from previous page

Entity	Country
31 Meinl European Land	A Jersey Channel Islands company with main activities in Eastern Europe ⁸
32 Metrovacesa	Spain
33 MirLand	A Cyprus company with main activities in Russia
34 Norwegian Property	Norway
35 ORCO	Luxembourg
36 Pirelli	Italy
37 PSP Swiss Property	Switzerland
38 Quintain Estates and Development	United Kingdom
39 Spazio Investment	Netherlands
40 Sponda	Finland
41 Stockland	Australia
42 TAG	Germany
43 Unibail Rodamco	France
44 VastNed Retail	Netherlands
45 VGP	Belgium
46 Vivacon	Germany
47 Wereldhave	Netherlands
48 Westfield	Australia
49 Workspace Group	United Kingdom
50 Züblin Immobilien	Switzerland

⁸ In the graph in 'About this survey' this entity is classified as Polish.

Appendix 2

Guidance on accounting policies for investment property under IFRS

Initial and subsequent measurement

IFRS states that an investment property shall be measured initially at cost. Transaction costs shall be included in the initial measurement (IAS 40 paragraph 20). IFRS offers a choice for investment properties on subsequent measurement between accounting using the fair value model or the cost model.

Generally entities will select the fair value model as a basis to give more useful information on their performance. After initial recognition, an entity choosing the fair value model shall measure all of its investment property at fair value, except in the cases described in IAS 40 paragraph 53, when fair value is not reliably determinable on a continuing basis. A gain or loss arising from a change in the fair value of investment property shall be recognised in profit or loss for the period in which it arises (IAS 40 paragraph 35). After initial recognition, an entity choosing the cost model shall measure all of its investment property in accordance with IAS 16's requirements for that model, except for those properties that meet the criteria to be classified as held for sale. Investment properties measured using the cost model that meet the criteria to be classified as held for sale (or included in a disposal group that is classified as held for sale) shall be reclassified as non-current assets held for sale and measured at the lower of carrying amount and fair value less costs to sell in accordance with IFRS 5 (IAS 40 paragraph 56). Investment properties valued using the fair value model are excluded from the scope of the measurement provisions in IFRS 5, though reclassification to a separate line item 'Non-current assets held for sale' is still required.

Transfers to or from investment property

Effective date of transfer

Transfers to or from investment property shall be made when, and only when, there is a change in use, evidenced by the criteria set out in the standard (IAS 40 paragraph 57). See also the table below which summarises the implications of various transfers. It is assumed that the fair value model in IAS 40 applies. For entities using the cost model, transfers between investment property, owner-occupied property and inventories do not initially change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.

Initial status	Transfer	New status	Accounting impact
Investment property (IAS 40)	Redevelopment of existing investment property for continued future use as an investment property	Investment property (IAS 40)	No impact
Investment property (IAS 40)	Available with a view to (immediate) sale	Non-current assets held for sale (IFRS 5)	Transfer to 'Non-current assets held for sale' (without remeasuring in case of using the fair value model under IAS 40). In case of using the cost model under IAS 40 the property has to be remeasured at the lower of the carrying amount and the fair value less costs to sell
Investment property (IAS 40)	Commencement of owner occupation	PPE own use (IAS 16)	Transfer to PPE own use made at fair value. The fair value is the deemed cost, and the asset is (further) depreciated over the useful life of the asset
PPE own use (IAS 16)	End of owner-occupation with a view to holding and letting as investment property	Investment property (IAS 40) (at fair value)	Any difference at that date between the carrying amount of the property and its fair value is treated the same way as a revaluation in accordance with IAS 16. This means that there will be a revaluation reserve within equity
Inventory (IAS 2)	Development completed	Inventory (IAS 2)	No impact
Inventory (IAS 2)	View to develop and sell changed to holding and letting as investment property and there is commencement of operating lease	Investment property (IAS 40) (at fair value)	Difference between the fair value of the property at the date of transfer and its previous carrying amount shall be recognised in profit or loss
Development property, accounted for under IAS 16	Development completed and let as investment property	Investment property (IAS 40) (at fair value)	Difference between the fair value of the property at the date of transfer and its previous carrying amount shall be recognised in profit or loss

Derecognition

Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognised in profit or loss as a separate line item below revenue (unless IAS 17 requires otherwise on a sale and leaseback transaction) in the period of the retirement or disposal (IAS 40 paragraph 69). When dealing with assets held for sale the measurement provisions of IFRS 5 do not apply to non-current assets that are accounted for at fair value under IAS 40. An entity shall present and disclose information that enables users of the financial statements to evaluate the financial effects of discontinued operations and disposals of non-current assets (or disposal groups) (IFRS 5 paragraph 30).

Appendix 3

Guidance on ‘Acting as an agent or as a principal’ under IFRS

IAS 18 paragraph 8 states that ‘in an agency relationship, the gross inflows of economic benefits include amounts collected on behalf of the principal and which do not result in increases in equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of commission.’

Determining whether an entity is acting as a principal or an agent depends on facts and circumstances and requires judgement. An entity is acting as a principal when it is exposed to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that, individually or in combination, may indicate that an entity is acting as a principal include:

- (a) the entity has the primary responsibility for providing the goods or services desired by the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- (b) the entity has inventory risk before or after the customer order, during shipping or on return;
- (c) the entity has discretion in establishing prices directly or indirectly, such as by providing additional goods or services;
- (d) the entity bears the customer’s credit risk;
- (e) the entity has discretion in selecting suppliers;
- (f) an expectation by the customer that the entity is acting as the primary obligor in the arrangement;
- (g) the amount the entity earns is not predetermined (a fixed fee per transaction or a stated percentage of the amount billed to the customer).

Appendix 4

Guidance on deferred taxes under IFRS

IAS 12 is based on the balance sheet liability method. It is based on the principle that a deferred tax liability or asset should be recognised if the carrying amount of an asset or a liability is higher (or lower) than its tax base, which is the amount attributed to the asset or liability for tax purposes. The measurement of the deferred tax asset or liability shall follow the expected manner of recovery or settlement of the related assets and liabilities (IAS 12 paragraph 51). In such cases, an entity measures deferred tax liabilities and deferred tax assets using the tax rate and the tax base that are consistent with the expected manner of recovery or settlement (IAS 12 paragraph 52).

The method of recovery in the above paragraphs is of particular relevance to the measurement of deferred tax liabilities that arise on investment property. Generally, an entity expects to recover the carrying amount of an asset through use, through sale or through use and subsequent sale. Tax authorities may levy different rates of tax depending on whether the asset is recovered through use (income tax) or through sale (capital gains tax). Furthermore, certain assets may be revalued for tax purposes (increase due to indexation to eliminate the effects of inflation) only if the asset is sold. Therefore, the manner in which the entity expects, at the balance sheet date, to recover the asset directly affects the amount of tax that would be payable in future and should be reflected in the measurement of deferred tax at the balance sheet date.

The deferred tax liability or asset that arises from the revaluation of a non-depreciable asset in accordance with IAS 16 paragraph 31 shall be measured on the basis of the tax consequences that would follow from recovery of the carrying amount of that asset through sale, regardless of the basis of measuring the carrying amount of that asset. Accordingly, if the tax law specifies a tax rate applicable to the taxable amount derived from the sale of an asset that differs from the tax rate applicable to the taxable amount derived from using an asset, the former rate is applied in measuring the deferred tax liability or asset related to a non-depreciable asset (SIC-21 paragraph 5). Land, having an infinite life, is not depreciated and therefore no part of the asset's carrying amount is expected to be recovered (that is, consumed) through use. It follows that the carrying amount of a non-depreciable asset can only be recovered through sale. This is confirmed by SIC-21 to apply also to land that is carried at revalued amounts under IAS 40.

Buildings are depreciable assets and are therefore excluded from the scope of SIC 21. Management's intention should be assessed when measuring deferred taxes, and the intention should be clearly demonstrated and supported, in particular to support specific timing for a sale. When the actual plans of the entity are to retain the property for a period of time and then sell it, the use of a blended rate reflects management's intention best. Even if the buildings are to be sold after a short period of rental, the carrying amount of the buildings should not be deemed to be recovered only through sale. This is consistent with IAS 12 paragraph 51. There seems to be no technical barrier to this approach being used.

When using a blended rate, there must be an apportionment of the carrying value; it should therefore not be assumed that the carrying amount will be fully recovered through sale. Deferred tax computation for investment properties should be performed on an asset-by-asset basis.

There are three possible methods for calculating the rate that should be used to determine the deferred tax related to the revaluation of properties:

1. Use of sale rate (CGT). This is appropriate in the right circumstances – i.e. if a particular property is up for sale;
2. Use of income rate. This would be appropriate if no sales were envisaged;
3. Use of blended rate. This is the most realistic method, as it reflects the actual practices of most entities relating to retaining or selling their properties.

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