



IFRS Development triggers Enhanced Transparency but Need for Continuing Education

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Agenda

1. Introduction | IFRS development
2. Preparers' view on current and expected IFRS changes
3. Capital markets' view on IFRS-based financial reporting
4. Conclusion | Need for continuing education
5. HHL & Bertelsmann IFRS Update Project

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Introduction | IFRS Reporting | Opinions

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“The successful operation of the capital markets is based on the presumption of readily available financial information presented in a timely and understandable manner. Those markets need one set of consistently applied global standards for measuring [...] financial results [...].”

*Sam DiPiazza, CEO PricewaterhouseCoopers Global
and trustee IASC Foundation Board, 2006*

“The “life blood” of capital markets is financial information that is:
1) comparable from company to company, 2) relevant to investment financing decisions,
3) a faithful depiction of economic reality and 4) neutral, favouring neither supplier nor user of capital, neither buyer nor seller of securities.”

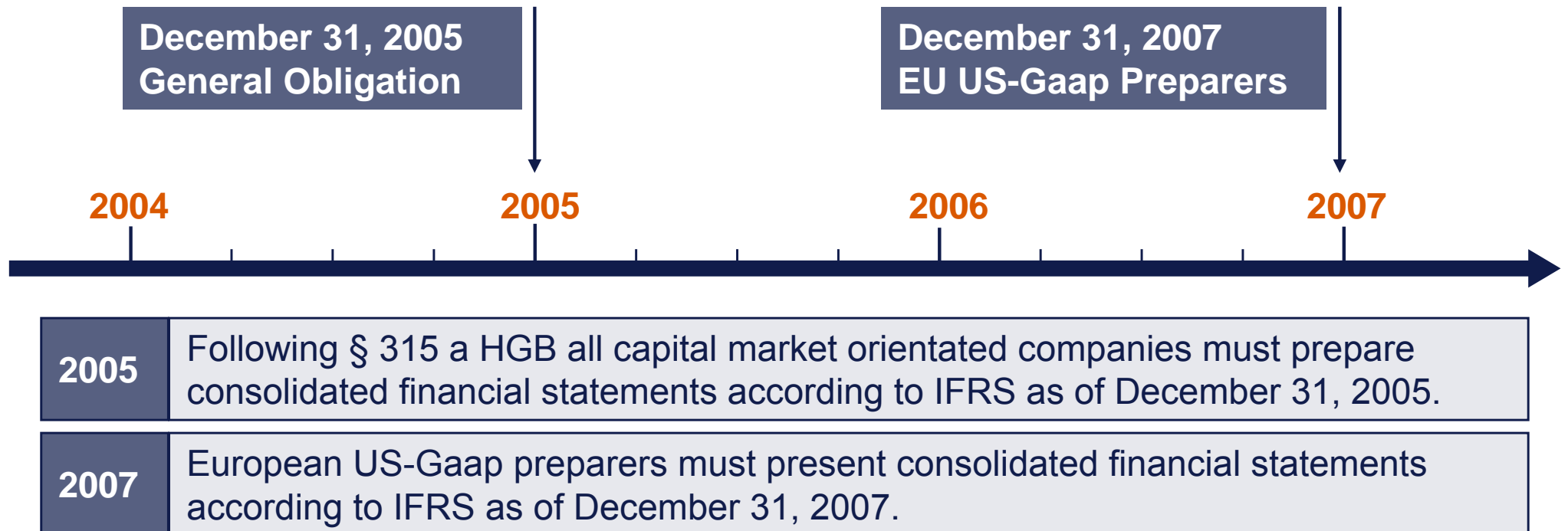
“**More than 100 countries** throughout the world, including the 27 European Union member states **are using IFRSs**. IFRSs are yet a **global standard**. [...] the vision is to make IFRSs the world’s primary financial reporting language.”

Sir David Tweedie, Chairman IASB, 2007

▶ “**Common language**”, **comparability and relevance are crucial for capital markets.**

Introduction | IFRS First-time Adoption

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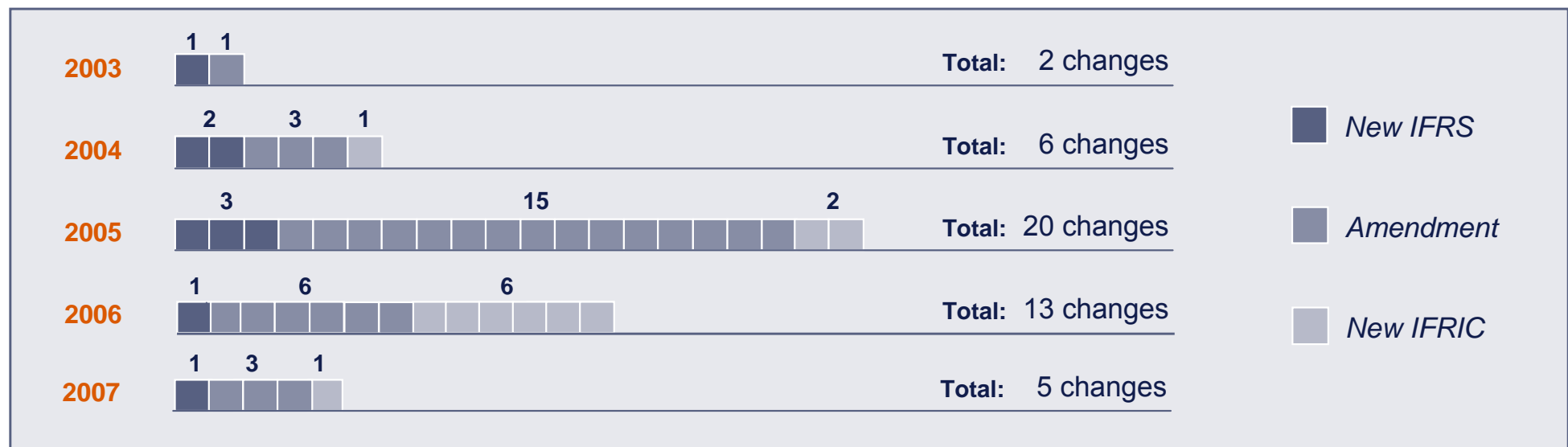
▶ **First time application might result in tremendous changes in assets, liabilities, equity and net result.**

▶ **Fair Value accounting leads to fluctuations e.g. in assets and results. Periodic comparability and benchmarks among peers are limited.**

Introduction | Recent Development of IFRS

1

- » Frequent, rapid and material changes to IFRS.
- » Between 2003 and 2007 the IASB introduced 46 changes to the IFRS (8 new Standards, 28 Amendments and 10 new IFRICs).



▶ Frequent IFRS changes and various transition rules lead to only limited comparability (periodic and benchmarks).

Introduction | Recent Development 2004 - 2005

1

2004 → 2005

	Effective date	
	2004	2005
New IFRS Standards		
IFRS 2 Share-based payment		x
IFRS 3 Business Combinations	x	
IFRS 5 Non-current Assets Held for Sale and Discontinued Operations		x
New Amendments to:	2004	2005
IAS 1 Presentation of Financial Statements (revised 2003)		x
IAS 19 Employee Benefits: Reporting Actuarial Gains and Losses	x	
IAS 27 Consolidated and separate Financial Statements (revised 2003)		x
IAS 32 Financial Instruments: Presentation (revised 2003)		x
IAS 38 Intangible Assets	x	

▶ Highlights with significant impact so far:

- ✓ IFRS 3: Replacing regular Goodwill amortization with Impairment-Only-Approach.
- ✓ IFRS 5: Introducing the Asset-Held-for-Sale Concept.
- ✓ IAS 32: Introducing Puttable Instruments for Liability Definition in Partnerships.

Introduction | Actual Development

1

Ongoing Projects with effective dates beyond 2007

Item	Status	Expected IFRS	Impact	
Amendments to IFRS 2 – Vesting conditions	ED	Q4 2006	low	●
Segment reporting (replacement of IAS 14)	ED	Q4 2006	moderate	●
IAS 23 Borrowing costs	ED	Q1 2007	low	●
Financial Statement Presentation – Phase A	ED	Q1 2007	high	●
Business Combinations (BC) – Phase II	ED	Q3 2007	high	●
Liabilities – amendments to IAS 37 and IAS 19	ED	Q3 2007	high	●
Earnings per share – Amendment	ED in Q4 2006	Q2 2007	low	●
Financial Statement Presentation – Phase B	DP in Q1 2007	2008+	high	●

Framework (Phase A – D)	Status	Expected IFRS	Impact	
Objectives and qualitative characteristics (Phase A)	DP	2008+	low	●
Elements, recognition and measurement (Phase B)	ED in Q1 2007	2008+	moderate	●
Initial and subsequent measurement (Phase C)	RT in Q1 2007	2008+	moderate	●
Reporting entity (Phase D)	DP in Q1 2007	2008+	moderate	●

DP: Discussion Paper | ED: Exposure Draft | RT: Round Table Discussion

Introduction | Impact on Group Accounting 2007

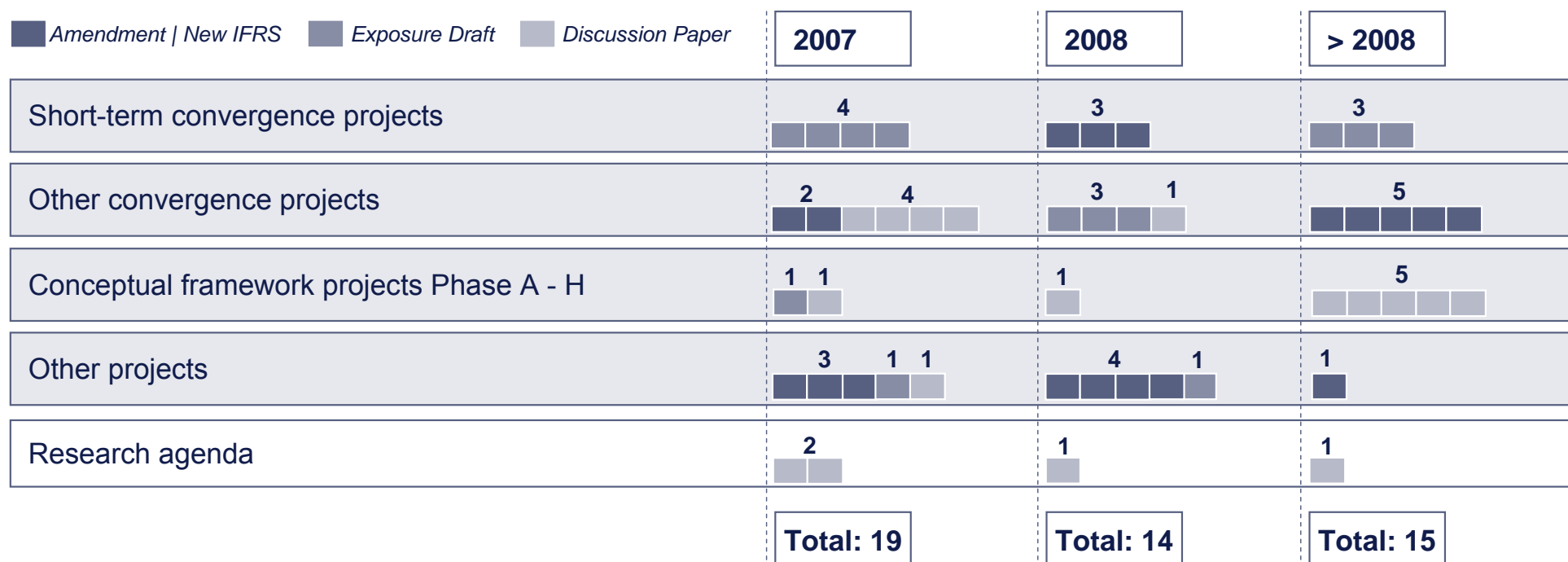
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New IFRS Standards	Publication date	Effective date	Impact	
IFRS 7 Financial Instruments: Disclosures	28 August 2005	Jan 2007	high	●
New Amendments to:	Publication date	Effective date	Impact	
Amendments to IFRS 2 – Vesting Conditions and Cancellations	Q4 2006	Jan 2007	low	●
Amendments to IAS 1: Capital Disclosures	28 August 2005	Jan 2007	moderate	●
Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation	Q2 2007	Probably 2007	moderate	●
Amendments to IAS 19 Employee Benefits: Reporting Actuarial Gains and Losses	Q2 2004	Jan 2007	high	●
Amendments to IAS 23 Borrowing costs	Q1 2007	Probably 2007	low	●
Amendments to IAS 32 Financial Instruments: Presentation: Financial Instruments Puttable at Fair Value	Q2 2007	Probably 2007	high	●
New IFRICs	Publication Date	Effective date	Impact	
IFRIC 10 Interim Financial Reporting	20 July 2006	Nov 2006	high	●
IFRIC 11 IFRS 2 – Group and Treasury Share Transaction	2 November 2006	March 2007	low	●
IFRIC D12 – D14 Service Consession Arrangements	probably Q4 2006	Q1 2007	moderate	●
IFRIC D19 IAS 19 - The Asset Ceiling: Availability of Economic Benefits and Minimum Funding Requirements	probably Q3 2007	Q3 2007	high	●
IFRIC D20 Customer Loyalty Programmes	probably Q3 2007	Q3 2007	high	●

Introduction | IASB's Active Agenda

1

IASB work plan as of March 2007:



▶ The IASB's Active Agenda provides for more than 45 projected changes. The majority will become effective 2009 and later.

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Current and expected IFRS Changes - IAS 19

2

IAS 19.93A/19.93B

BAG Applicability 2007

- “ (...) an entity adopts a policy of recognising actuarial gains and losses in the period in which they occur, it may recognise them **outside profit or loss** (...). “
- “ Actuarial gains and losses recognised outside profit or loss (...) shall be presented in a **statement of changes in equity** titled „statement of recognised income and expense (...).“ **(SoRIE Approach)**

For 31 December 2006 Actuarial losses amount to 477 Mio Euro.

This change in accounting policy requires a one time credit to pension provisions resulting in a swap between equity and liabilities in 2007 and 2006 [restatement].

Application of SoRIE approach (IAS 19)

Leverage Factor



Increased – significant one time impact.

Equity ratio



Decreased

Current and expected IFRS Changes - IFRS 3

2

ED-IFRS 3.19/3.49



Applicability 2009

- “ The acquirer shall measure the **fair value of the acquiree, as a whole**, as of the acquisition date.”
- “ (...) This requirement applies even if the acquirer owns **less than 100 per cent** of the equity interests in the acquiree at the acquisition date (...).”

Goodwill is measured as the **difference** between the **fair values of the business** acquired and the **net fair value of its identifiable assets and liabilities**.

All of the goodwill of the acquiree, including **goodwill** attributable to **minority** interests, is recognised.

Application of Full Goodwill Method (IFRS 3)

Invested Capital		Increased by corresponding minority share in Goodwill
BVA		Decreased

Current and expected IFRS Changes - IAS 37

2



ED-IAS 37

Applicability 2009

- **ED IAS 37 eliminates** the terms “**provision**” and “**contingent liability**” since liabilities are unconditional in nature and cannot be contingent or conditional.
- The ED omits the “**probability criterion**” in IAS 37.14 (b) when **recognizing** liabilities and provisions.
- Instead **uncertainties** in amount and timing are relevant **only for measure of the liability**.

▶ Various **contingent liabilities** will very likely be treated **on-balance** in future.

On-balance treatment of Contingent Liabilities (IAS 37)

Equity		Decreased
Leverage Factor		Possibly increased by additional liability

Current and expected IFRS Changes - IAS 1 [1/2]

2

ED-IAS 1

Applicability 200X

- **Single statement approach** will very likely replace the traditional allocation of income and expense to *Income Statement* and *Statement of Changes in Equity*.
- **Comprehensive Income** including all realized and unrealized components of income and expense will very likely replace *Net Income* as bottom line in the *Income Statement*.
- **Financial statements will very likely be structured in a uniform way** showing operational, financing and investment-related components separately but traceable among financial statements (“cohesiveness”).

▶ **Presentation of financial statements** will very likely be **changed fundamentally**.
Complexity in financial reporting might **be increased** dramatically.

▶ **(Internal) KPIs** must very likely be **adjusted effectively**. **Integration** of management and statutory reporting **might have to be scrutinized**.

Current and expected IFRS Changes - IAS 1 [2/2]

2

Set of required Financial Statements

IAS 1	ED-IAS 1
Balance sheet	Statement of financial position as at the beginning of the period Statement of financial position as at the end of the period
Income Statement	Statement of comprehensive income for the period
Statement of Changes in Equity	Statement of Changes in Equity
Statement of cash flows	Statement of cash flows

- » Currently OCI-items (e.g. available-for-sale and cash flow hedge adjustments) are presented in the **Statement of Changes in Equity**.
- » In future, the **Statement of Comprehensive Income** will contain **all** elements of income and expense.

Statement of Comprehensive Income		
	2006	2005
(in millions)		
BUSINESS		
Operating Income		
Net sales	11,292	10,055
Costs and expenses:		
Cost of products sold	(2,815)	(2,446)
R&D expense	(1,113)	(951)
SG&A expense	(3,537)	(3,092)
Pension expense	(142)	(131)
"Recycled" gain on CF hedges *	20	10
Litigation charges	(100)	(854)
Goodwill impairment	(364)	
Other operating expense	(179)	(294)
Net operating income	3,082	2,495
<i>Other comprehensive income:</i>		
Gain on cash flow hedges	26	36
Translation adjustment	(14)	63
Actuarial (loss) on pension oblig	(9)	(5)
Comprehensive operating income	3,068	2,589
Investing Income		
Realized gain (loss) on AFS	12	3
Net investing income	12	3
<i>Other comprehensive income:</i>		
Unrealized gain (loss) on AFS	1	(16)
Comprehensive investing income	13	(13)
Comprehensive business income	3,079	2,576
FINANCING		
Financing income		
Interest income	203	100
Financing expenses		
Interest expense	(116)	(55)
Comprehensive financing income	87	45
INCOME TAXES		
Provision for income taxes	(615)	(740)
Total comprehensive income	2,552	1,882

Interim Conclusion

2

- 1 First-time application of IFRS might result in **tremendous changes to assets, liabilities, equity and net result** – but introduction of a “common reporting language” is required by capital markets.
- 2 **IASB changes** reporting standards further on **dynamically**. After 2009 **IFRS-preparer will face significant adaptations** increasing complexity in financial reporting.
- 3 Main changes to accounting treatments will refer to **pensions** (IAS 19), **business combinations** (IFRS 3 | IAS 27), **liabilities resp. provisions** (IAS 37) and **presentation of financial statements** (IAS 1).
- 4 Ongoing **implementation** of IFRS changes **affects reporting systems and processes significantly**.
- 5 **Financial Statements’ presentation** will very likely be **revised** fundamentally. **Integration** of management and statutory reporting **might have to be scrutinized**.

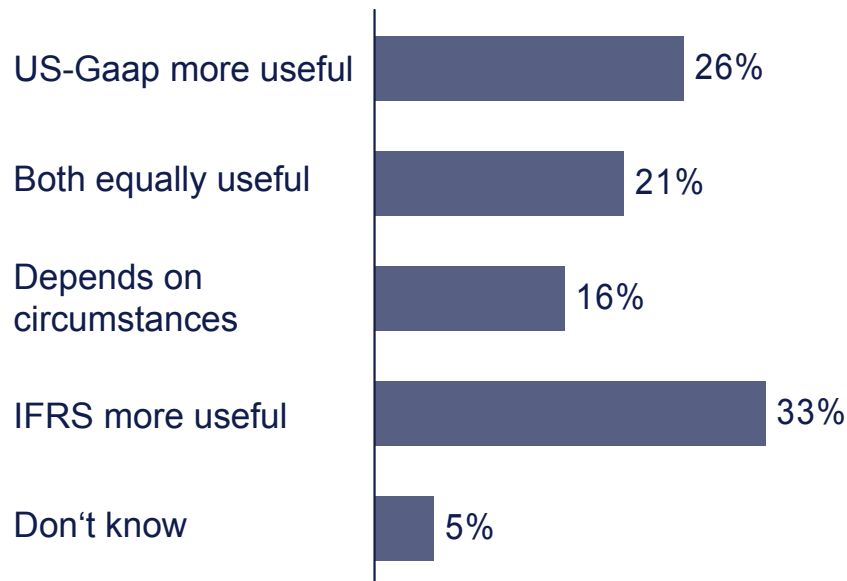
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PwC ¹⁾ | Usefulness & Transparency

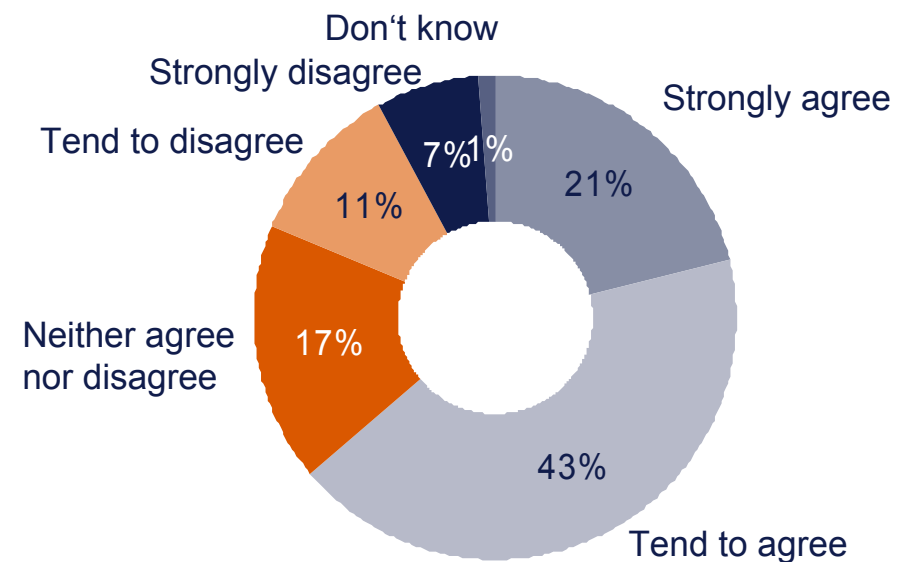
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▶ Which set of rules (IFRS vs. US-GAAP) do you find most useful in understanding the performance of the company?



Base: all those who follow or invest in companies using US-GAAP (43)

▶ To what extent do you agree or disagree with the following statement?
IFRS has helped companies be more transparent about their reporting!



Base: all respondents (75)

▶ **IFRS in general more useful than US-GAAP.**

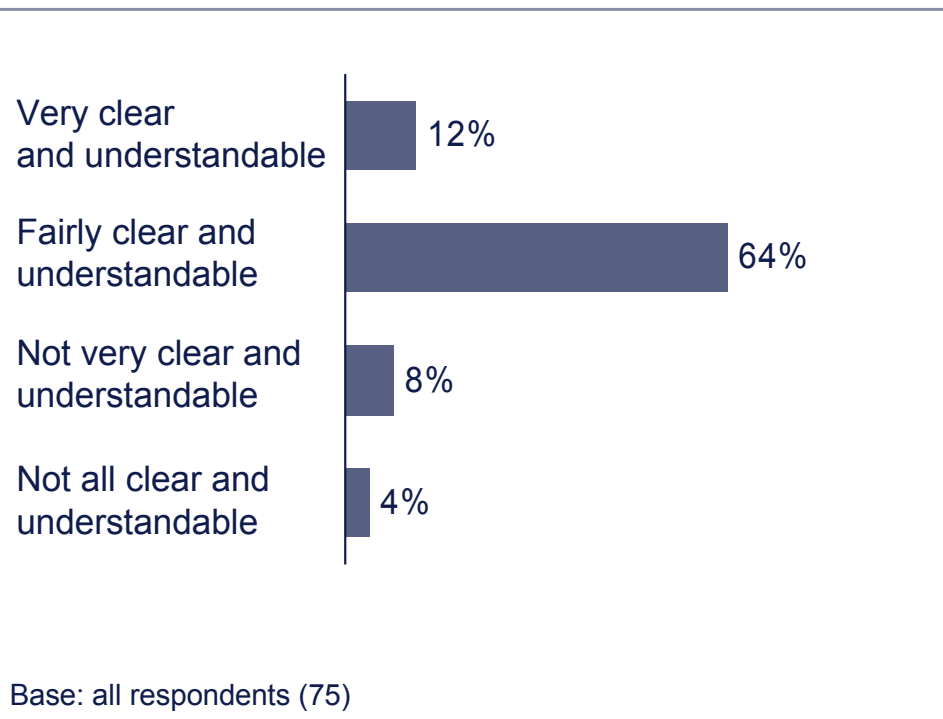
▶ **Clear positive view of IFRS improving transparency.**

¹⁾ PwC survey of 75 UK fund managers with total funds under management of over GBP 2 trillion mid 2006.

PwC | Understandability

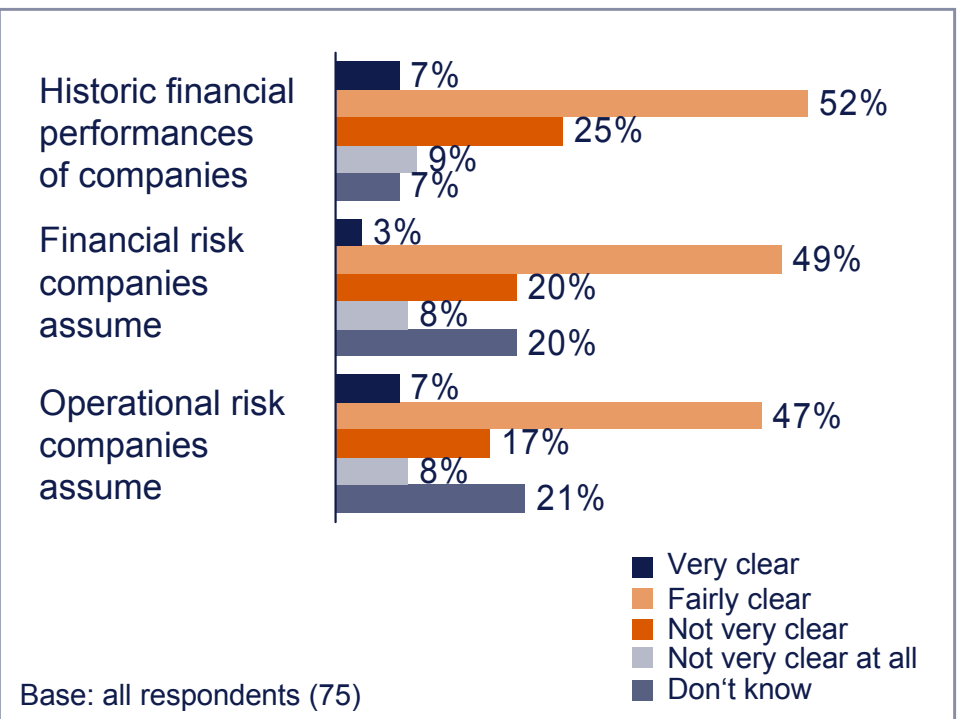
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▶ How clear and understandable would you say the information presented by companies in their annual accounts have been?



▶ **IFRS delivers at least fairly clear and understandable information.**

▶ How clear would you say IFRS makes the following?

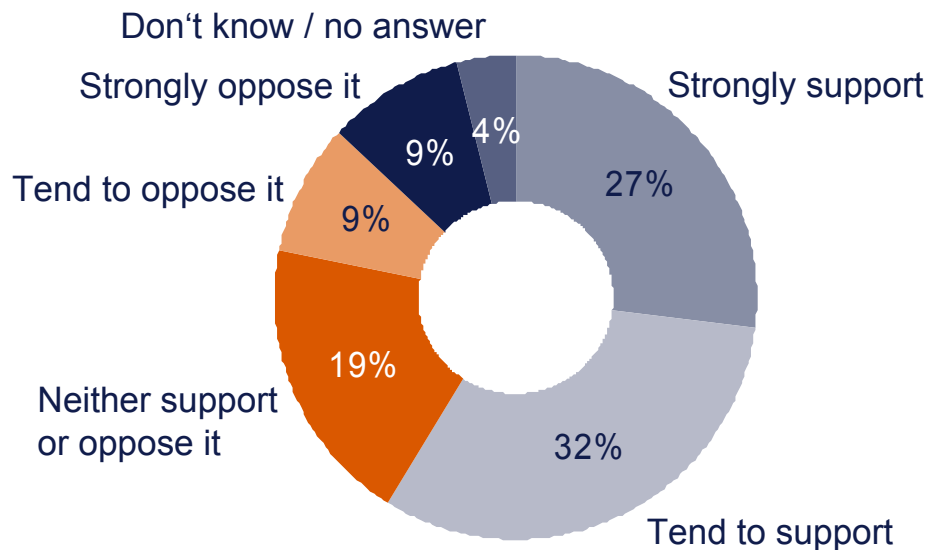


▶ **IFRS delivers at least fairly clear information on performance and risks.**

PwC | Future Priorities and Optimism

3

▶ How much do you support or oppose the trend towards greater use of fair values in the Balance Sheet?



Base: all respondents (75)

▶ **The majority supports greater use of fair values.**

▶ How confident are you that the current international standard setting process will produce high quality, enforceable global standards?



Base: all respondents (75)

▶ **The majority believes changes will lead to high quality global standards.**

Interim Conclusion

3

- 1 **Capital markets welcome** the introduction of **IFRS** as pan-european/global reporting language. IFRS are considered **understandable** delivering at least **fairly clear information on performance and risks**.
- 2 IFRS has helped companies **be more transparent** in financial reporting. Greater use of **fair value** accounting is generally **supported**.
- 3 **But, changes** in accounting policies trigger extended **volatility in performance** and recently have supported **increasing results**.

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Conclusion

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– Preparers face ...

A dynamically changing IFRS environment combined with ongoing analysis activities.

Cost-intensive/sophisticated IFRS implementation and maintenance **work**.

Necessity for **intensified IFRS trainings** on local and central level.

Enhanced difficulties to keep management and statutory reporting **fully stable and integrated**.

+ Analysts welcome IFRS since ...

A common reporting language provides for **increased transparency**.

Performance and business risks are **fairly clear presented**.

Valuation of companies is increasingly based on [1] **results**, [2] **OCI information** and [3] **cash flows** in an **integral approach**.

▶ **IFRS-preparers must meet extensive analysts' expectations in full** by delivering high-quality financial information in a timely manner.

▶ **Dynamic development** of IFRS accounting **requires continuing education** of local and central **employees** engaged in financial reporting.

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IFRS Update Project | Introduction [1/2]

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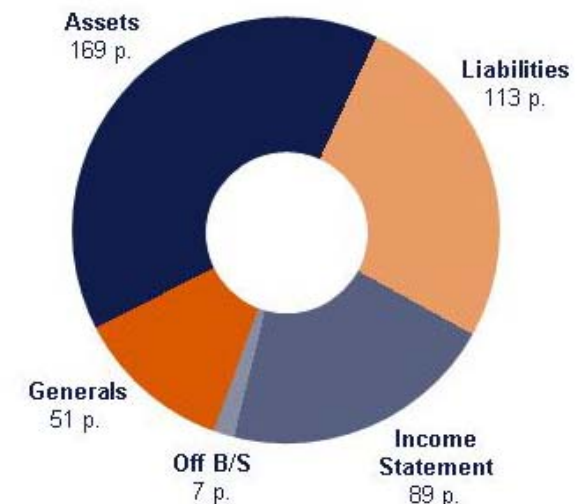
General conditions

- Introduction of IFRS in 2001
- Integrated IFRS Statutory and Management Reporting since 2005:
 - One unified group reporting system (group and divisions)
 - Group and divisional guidelines applicable to all consolidated entities

Available group reporting manuals and guidelines

- Reporting guidelines (IFRS Manual):
 - IFRS accounting principles
 - Economic key ratios
- User guidelines reporting system

IFRS Manual Dec. 2006: No. of pages



IFRS Update Project | Introduction [2/2]

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IFRSs apply within Bertelsmann Group to:

1,309 entities (Scope of Consolidation December 31, 2006)

910 fully consolidated entities

201 joint ventures are proportionately consolidated

198 associated companies are included at equity

≈ **400 IFRS Key Users** depending on continuing education

at the Corporate Center

≈ 150 employees

at divisional level

≈ 250 employees

▶ IFRS Manual is updated on a quarterly basis.

▶ IFRS Newsletter is published every two months.

▶ IFRS Trainings are offered semi-annually and on demand.

IFRS Update Project | Tasks

5

Preparation of IFRS Education Materials

STRUCTURE	CONTENT
<ul style="list-style-type: none"> • PowerPoint deliverables • Bertelsmann Corporate Design • On-site working facilities available • Media sources provided 	<ul style="list-style-type: none"> • Definitions of relevant reporting terms • Creation of diagrams, examples, overviews • Integration of reporting system related content

EDITORIAL & TECHNICAL REALIZATION

IFRS Update Project | Profile & Time Frame

5

Project team's profile

- | | |
|--|--|
| <ul style="list-style-type: none"> • 4 advanced students focusing on accounting and auditing • Excellent written and spoken English • Excellent MS Office skills • Starting on May 2, 2007 | <ul style="list-style-type: none"> • 10 weeks project phase • Work on- and off-site • Accommodation will be organized and travel expenses will be borne by Bertelsmann AG |
|--|--|



IFRS Update Project | Topics [1/2]

5

A Accounting for tangible and intangible assets

- Component Approach | IAS 16
- Current and future treatment of Borrowing Costs | IAS 23
- Decommissioning and Restoration Costs | IFRIC 1
- Goodwill-Impairment Test | IAS 36

B Revenue Recognition

- Sale of Goods | IAS 18
- Rendering of Services | IAS 18
- Barter Transactions | IAS 18
- Application of PoC Method | IAS 11

IFRS Update Project | Topics [2/2]

5

C Presentation and Disclosure Requirements

- Non-current Assets held for sale and Discontinued Operations | IFRS 5
- Operating Segments | IFRS 8
- Presentation of Financial Statements | ED-IAS 1

D Future Development of IFRS and US-GAAP

- IFRS | Future Application of Proportionate Consolidation
- IFRS | Provisions and Liabilities
- Norwalk Agreement and Roadmap to Convergence
- US-GAAP FAS 157 | Fair Value Measurement