Reading and understanding annual reports
4th edition

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A guide to understanding annual reports

This brochure was designed to give the reader an understanding of the individual components of annual reports in question and answer form. To explain the way the various concepts work in practice, individual sections contain excerpts from a fictitious company’s annual financial statements and consolidated financial statements. The numbers on the left-hand side of these examples refer to specific questions.

Following the individual questions you will occasionally find references to specific parts of the report or consolidated financial statements, such as the notes or directors’ report. These references tell you where you can usually find the various topics or additional information. References to the notes, the cash flow statement, statement of changes in equity etc., therefore, always refer to the relevant parts of the consolidated financial statements.

The subject of corporate governance and its effect on accounting together with the management and monitoring of companies are likewise discussed in a separate section. The last two sections of the brochure consider future developments in performance reporting and changes in Swiss company law.

“Results take unexpected tumble”, “AnyCompany barely in the black”, “Can AnyCompany survive?” These are the kind of headlines we occasionally read in the newspapers. But how can such a sudden downturn – and its magnitude – be explained? After all, the last annual report showed increasing profits and the auditors issued a “clean” report on their audit of the consolidated financial statements.

An annual report provides information about a company’s development in the past business year. However, it is not only a retrospective: The presentation of the financial position and the results of operations, combined with the numerous qualitative statements and additional information, enable the reader to draw conclusions about the sustainability of the results and the company’s future performance.

The consolidated financial statements are based on strict rules and principles of accounting, which serve to ensure the comparability and neutrality of financial reporting. Apart from this, the results are commented on in the directors’ report.

The parent company’s financial statements primarily serve the purpose of showing the distributable profit as well as the basis for the parent company’s tax declaration.

This publication is designed to help anyone with an interest in business to read and understand annual reports using the example of a fictitious company and to explain the responsibilities of the auditor.

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General questions and answers regarding the annual report

A group’s annual report – most Swiss companies listed on the stock exchange have a group structure – consists of a directors’ report, a corporate governance report, the consolidated financial statements and the parent company’s financial statements.

1. What information does the directors’ report provide?
The directors’ report is a verbal report submitted by the board of directors or by the group’s senior management management. In particular, it discusses the group’s business operations, financial situation and future development. Unlike the financial statements, it also provides an assessment of future performance. There is no obligation for the directors’ report to be audited by the statutory auditors and no specific standards apply to its presentation. However, it is advisable for the group auditor to read the directors’ report carefully to verify its consistency with the consolidated financial statements.

2. Why do the parent company’s financial statements provide no information about the group’s financial performance?
The parent of the group is, in many cases, a non-operating company. In such cases, the parent’s financial statements, which are drawn up in accordance with minimal legal requirements, simply serve to determine the distribution of profits to the parent company’s shareholders and the assessment of income taxes on the basis of earnings resulting primarily from internal group dividends and interest income. Assets include cash and cash equivalents as well as investments in and loans to subsidiaries. Liabilities comprise external financing by third parties and/or group companies as well as equity. The parent’s profit therefore does not directly depend on the group’s performance but rather on the internal dividend policy and the interest rates on intragroup loans determined by group management. In addition, as the financial statements are prepared under the historical cost basis, as required by company law, profits of subsidiaries do not result in an upward revaluation of the carrying amount of investments. Furthermore, Swiss law permits the creation and release of hidden reserves in the parent company’s financial statements, thus making an assessment of the true financial position and results of operations even more difficult.

3. What is the difference between the parent company’s financial statements and the consolidated financial statements?
Unlike the parent company’s financial statements, the consolidated financial statements provide a comprehensive insight into the financial position, result of operations and the cash flows of the group. The consolidated balance sheet provides an aggregate status of all the subsidiaries’ assets and liabilities, measured on the basis of uniform criteria. These assets and liabilities replace the investments that appear in the parent company’s balance sheet. The consolidated income statement aggregates the results of all the subsidiaries, applying the same criteria, including all revenues, operating expenses, financial results and taxes. Profit distributions from subsidiaries – which are presented as income from investments in the parent company’s financial statements – as well as income from interest on intra-group loans are in fact simply a transfer of cash within the group and are therefore eliminated in the consolidation process. After the elimination of all these group internal transactions, the financial position and performance are presented as if the group were one single company. This procedure is referred to as consolidation. Besides the balance sheet and income statement, the cash flow statement, the statement of changes in equity and the notes are further mandatory components of consolidated financial statements. In addition to the statement
of changes in equity, some consolidated financial statements include a so-called “Statement of recognized income and expenses” (for more detailed information, see pages 27 and 28). Taken as a whole, these components permit an in-depth analysis of the group’s financial performance and position.

**Accounting standards**

To date, Swiss law contains no detailed rules for the preparation of consolidated financial statements but simply requires the disclosure of the consolidation and accounting principles applied. Therefore, consolidated financial statements are usually prepared in accordance with other regulations such as Swiss GAAP FER/ARR (Swiss accounting and reporting recommendations), IFRS (International Financial Reporting Standards; previously IAS, International Accounting Standards) or US GAAP (US Generally Accepted Accounting Principles). Companies whose shares are listed in the main segment of the SWX Swiss Exchange have to apply IFRS or US GAAP, with the exception of banks, which are subject to special legislation. The aim of all these standards is ensuring that the financial reporting presents a true and fair view of the financial position, the results of operations and the cash flows (also called “fair presentation”). However, significant differences exist between these sets of standards, and within some standards also certain options. As a result, it is necessary to examine in detail the accounting principles applied by the group, which are set out in the notes.

**The significance of IFRS**

IFRS’s, which are issued by the International Accounting Standards Board (IASB), are increasingly becoming the globally adopted accounting framework. For example, their application is mandatory for listed companies in the European Union, Australia and Russia since 2005 while other countries are in the process of adopting these standards.

The IASB’s main aim is currently to harmonize these standards with US GAAP and thus achieve recognition of the IFRS by the US Securities and Exchange Commission (SEC). This is expected to take place by the end of this decade. This would greatly simplify access to the New York Stock Exchange (NYSE) or the NASDAQ for non-US companies, as considerable costs are incurred when converting from IFRS to US GAAP.

The globalization of IFRS results in a vast improvement in the comparability of consolidated financial statements. This was absolutely necessary given the increasing importance of crossborder raising of capital. It also means that the impact of national and cultural differences on the application of IFRS should be reduced. Audit firms and the supervisory authorities of the relevant stock exchanges are committed to these developments.

**What does the term corporate governance stand for?**

Corporate governance is the sum of the principles which support shareholders’ interests, striving for transparency and essentially providing for appropriate “checks and balances”, and at the same time allowing for judgment and efficiency at the highest echelons of management. In other words, corporate governance comprises all the principles and rules involved in the management and supervision of a company. Companies listed on the SWX are required to provide information about their corporate governance in a separate section of the annual report. For information regarding the corporate governance report, see the following double page feature.
Questions and answers regarding the corporate governance report

In recent years, hardly any other term has had such an impact on the Swiss business community as corporate governance. Conflicts of interest are inherent to economic activity. They are particularly pronounced in publicly owned companies because of the large number of anonymous shareholders. The guidelines assembled under the blanket term of corporate governance help harmonize the conduct of business leaders with the interests of the company’s owners.

What is the purpose of corporate governance?
“Corporate governance in the broader sense of the term comprises all the principles and rules that are designed to ensure the functional effectiveness of a business in order to optimize shareholders’ interests.” That is how the “Swiss Code of Best Practice”, issued by the business federation economiesuisse, describes corporate governance. Corporate governance defines the relationships and mutual responsibilities between shareholders, senior management and internal and external auditors. However, while focusing on control, supervisory and motivational structures, corporate governance is also intended to ensure a company’s long-term competitiveness, funding and operational scope.

What has to be published?
To ensure that the critical information regarding corporate governance is available in suitable form to institutional and private investors, the “Directive on Information Relating to Corporate Governance” (DCG) issued by the SWX Swiss Exchange requires listed companies to disclose relevant information on:

- Group structure and shareholders
- Capital structure
- Board of directors
- Senior management
- Compensations, shareholdings and loans
- Shareholders’ participation
- Changes of control and defense measures
- Auditors
- Information policy

On 1 January 2007, a revised, simplified version of the DCG was issued, which was also aligned with the Swiss Code of Obligations (CO). The revised Code introduces a requirement for listed companies to publish the remuneration paid to members of the board of directors and senior management in the notes to the financial statements.

If a listed company does not wish to publish some of the information required by the directive, an individual and substantiated justification must be provided in the annual report for each instance of such non-disclosure (the principle of “comply or explain”).

Who ensures that the information is complete and accurate?
In its supervisory role as a self-regulating organization, the SWX verifies the completeness and accuracy of the published information as well as the appropriateness of explanations in the event of the non-disclosure of individual items. If the issuer violates the directive, the SWX is authorized to impose penalties. These range from a reprimand to the delisting of the company. The external auditors are not required by law to verify the information that is to be published. However, in accordance with the revised CO, the compensation of the board of directors and the senior management must now (from business year 2007) be disclosed in the notes to the financial statements and are thus subject to the normal audit procedures by external auditors.

Why is there a requirement to disclose the CVs of the members of the board of directors and senior management?
The publication of these CVs provides an insight into current and prior commitments as well as cross-involvements with other companies and organizations. Information about the education and professional background of board members and about the composition of each committee, allows to assess whether the board of directors is balanced and able to act independently and critically vis-à-vis the senior management. It may also be
possible to draw conclusions concerning the availability of members of the board of directors.

**Does the law guarantee a reasonable compensation policy with regard to the board of directors and to senior management?**

No. Neither the CO, the DCG nor the “Swiss Code of Best Practice” offer a position on the level of compensation or a statement what a “reasonable” compensation policy would be. The DCG as a minimum requires disclosure of the content and procedures for determining salaries and stock option programs. It is, however, not the task of the stock exchange’s supervisory body or the external auditors to express an opinion on the extent or reasonableness of management compensation. In 2006, in light of the current public debate concerning the amounts paid as management compensation, KPMG together with the University of St. Gallen conducted a survey of the processes and company internal discussions concerning the methods of determining compensation, the amounts of salaries and existing shortcomings in the way this sensitive topic is handled. For more information, visit www.kpmg.ch.

**How do the relevant provisions help protect shareholders in the event of takeovers?**

The DCG demands the disclosure of the contents of any change-of-control clauses included in arrangements and plans designed to benefit members of the board of directors and/or senior management as well as other executives. These include “golden parachutes” which provide sizeable, one-off payments in the event of a takeover. This disclosure obligation specifically aims at the obvious conflict of interests a board member may face in the event of a takeover.

The law governing stock exchange transactions contains further provisions for shareholder protection. For example, any investor who exceeds the threshold of 33 1/3 percent of voting rights in a listed company is obliged to issue a public bid offer for all the company’s listed shares. When this 33 1/3 percent threshold is exceeded then a change of control is presumed to have occurred. In such situations, the minority shareholders should obtain the possibility to terminate their investment. However, a company’s articles may state that no such bid need be issued if a takeover exceeds the threshold of 33 1/3 percent (opting out) or that such a bid is mandatory only when a percentage of up to 49% has been reached (opting up). Nevertheless, the ex post introduction of such clauses is subject to limitations. The DCG requires disclosure of any such opting-out or opting-up clauses in the corporate governance section of the annual report.

**Can the reader find out anything about the independence of the auditors?**

The following details concerning the external auditors have to be disclosed in the annual report:

- The date on which the current audit mandate was acquired.
- The date when the auditor in charge became responsible for the mandate.
- The total audit fees charged by the auditors in the year under review.
- The total of the fees charged in the year under review by the auditors and/or their related parties for additional services performed for the issuer or one of the issuer’s subsidiaries.
- A description of the instruments available to the board of directors that assist in obtaining information on the activities of the external auditors.

The auditor in charge – but not the audit firm – must give up the mandate after a maximum of seven years. This rotation rule, which is set out in the “Swiss Code of Obligations,” is intended to strengthen the independence of the external auditors. The details concerning fees, and in particular the ratio of audit to advisory fees, may provide information concerning the importance of the customer relation and indicate the complexity of the audited company’s business. The required details relate to the holding company’s statutory auditors as well as to the mandate of the group auditors. However, caution is advised when comparing the audit fees charged by different audit companies: For example, Group A may work with only one audit firm. In contrast, Group B may call on the services of several different audit firms, in which case only the consolidated audit fees of the group auditors have to be published.

Following the lead given by the US legislation, a supervisory body is currently being set up in Switzerland to monitor audit companies and their activities. This should enhance audit quality and thus strengthen one of the fundamental aims of corporate governance.
Questions and answers regarding the balance sheet

The consolidated balance sheet presents the group’s financial situation as of the balance sheet date – 31 December for most companies.

What is the basis of preparation of the consolidated balance sheet and the parent’s balance sheet?
Generally, the balance sheet is prepared under the assumption that the company’s operations are ongoing (“going concern”). However, if the assumption of going concern is no longer justified (for example due to insolvency), it is necessary to move from the general valuation rules to the liquidation value of assets and liabilities. The liquidation value (sometimes referred to as break-up value) is usually significantly below the ongoing business values, thus generally resulting in over indebtedness or negative equity.

A group’s over indebtedness has no legal consequences. However, it indicates that the value of the investments in the parent company’s balance sheet has decreased. If the parent company’s balance sheet also presents an obvious over indebtedness, the judge must be notified in accordance with article 725, paragraph 2 of the Swiss Code of Obligations. The CO also provides for an early warning system that obliges the board of directors to propose financial restructuring measures to the general meeting of shareholders if half of the share capital and legal reserves are no longer covered.

What is the basis of preparation under the going concern assumption?
Traditionally, consolidated financial statements are based on historical costs. On the basis of these values, depreciation (for example of equipment and buildings), amortization (for example of patents and other intangible assets) and impairments or valuation allowances (for example of goodwill, trade accounts receivable or inventories) are accounted for as a function of the utilization of the respective assets. More recently, fair values – or current market values – are increasingly used in consolidated financial statements. Today, most securities are stated at their market price, derivatives at their fair value, investment property at fair value, and the fair value of pension fund assets is used to calculate any employee benefit liabilities from underfunded defined benefit plans. When fair values are used, the question arises as to whether or not changes in value, i.e. the non-realized profits and losses, are recognized in the income statement. Statement of changes in equity, group accounting policies

1. Why have assets and liabilities increased or decreased?
There may be various reasons for changes in a consolidated balance sheet item: purchase or sale of assets, increase or repayment of third-party financial debt or equity, changes in valuation such as inventory write-downs or the depreciation of property, plant and equipment as well as changes in the group of consolidated companies as a result of the acquisition or divestment of subsidiaries. It is impossible to understand the changes in a balance sheet without studying the other components of the consolidated financial statements, in particular the cash flow statement and the notes. For example, an increase in inventories and a simultaneous decrease in trade accounts receivable could be related to a sharp decline in sales and a related build-up of goods on stock. Then again, increased inventory levels might also be due to the acquisition of a subsidiary. Notes, cash flow statement

2. How does goodwill arise and what is its effect on the consolidated financial statements?
In the parent company’s balance sheet, the purchase of a subsidiary is recognized as an investment at the cost of acquisition (=purchase price including transaction costs). In contrast, in the consolidated financial statements, the assets and liabilities (net assets) acquired are recorded at their fair values at the date of acquisition. These fair values represent the cost basis for their subsequent accounting. Any difference between the purchase price and the net assets is called goodwill, which is capitalized and – depending on the relevant accounting standards – either amortized over a number of years (e.g. under Swiss GAAP FER) or is subject to an annual impairment test (e.g. IFRS and US GAAP).

The goodwill reflects the added value or future potential for which the acquiring company was prepared to pay over and above the fair value of the net assets. Both IFRS and US GAAP require that this amount – in the past simply aggregated under the heading “goodwill” – is now, as far as possible, assigned to identifiable intangible assets such as acquired R&D projects, customer lists, order backlog, brand and trade names etc. These intangible assets often have a determinable useful life and are therefore subject to a systematic, periodic amortization. In contrast, the remaining
goodwill need only be written-down if the carrying amount can no longer be justified on the basis of future discounted cash flows. The use of the impairment test concept in place of systematic amortization tends to improve the annual result. However, in the case of unfavorable business developments, impairment losses on goodwill may have a considerable negative impact on results.

Notes

What are associated companies?
Companies in which the group has an interest of between 20 and 50 percent are commonly referred to as “associated companies”. Interests of this size give the investor a significant, but not a controlling, influence (this means, for example, participating in financial and other policy-making decisions without being able to impose them). Such interests are not consolidated but recognized in the consolidated financial statements proportionate to the equity held. If the company in question makes a profit, the carrying amount of the investment increases while a respective financial income is recognized in the income statement. If the associated company distributes a dividend, the carrying amount of the investment is decreased, while the group’s cash position increases. By contrast, in the parent company’s financial statements, such investments are recorded at the cost of acquisition, adjusted for any impairment losses, and dividends received are part of the financial income.

Companies in which the investor holds less than 20 percent of the voting rights are generally presented as other financial assets.

The terms printed in blue refer to the relevant sections in the annual report.
Does the consolidated balance sheet of AnyCompany Group contain financial instruments?
In general, a significant portion of the consolidated balance sheet consists of financial instruments. Apart from cash and cash equivalents, these include marketable securities, trade accounts payable and receivable, minority shareholdings (excluding investments in associated companies), loans, financial liabilities and derivative financial instruments (e.g. forward exchange transactions, share options, interest rate swaps etc.)

In accordance with international accounting standards, derivative financial instruments must be recorded in the consolidated balance sheet at their fair value and are presented either separately or, quite frequently, as part of other short-term receivables or (financial) liabilities. Depending on whether or not these instruments serve the purpose of hedging future transactions or other purposes (e.g. trade), changes in the fair value are recognized either directly in equity or in the income statement. Accordingly, the background of the transaction and/or the underlying strategy pursued by group management are relevant in determining the accounting.

Notes

4 Why are treasury shares presented as a negative item in equity?
Under current Swiss law, treasury shares represent an asset in the parent company’s financial statements; in the consolidated balance sheet, however, they are deducted from the issued capital. Consequently, a purchase of the company’s treasury shares is treated as a capital decrease, even if this is only of a temporary nature. Correspondingly, the subsequent sale of such shares is recognized as a capital increase and any excess over or shortfall below the original cost is not recognized as a profit or loss but within additional paid-in capital (capital reserves). This treatment is based on the concept that transactions in treasury shares represent either a payment received from shareholders or payments made to shareholders, since a company cannot make a profit or loss on its own capital.

Statement of changes in equity, Notes

5 What are employee benefit assets?
Assets relating to employee pension plans either represent advance payments and loans to the pension fund or surpluses in the plan that are considered to be eligible for capitalization. Care is required when dealing with surpluses: these may be capitalized if the employer can make use of them in the form of reimbursements or future reductions in contributions. In Switzerland, this is primarily the case for readily available employer’s contribution reserves. These reserves may be funded by additional contributions to the pension plan and used in future years for the settlement of employer’s contributions.

Notes

6 What are deferred taxes?
In many respects, the values reported in the consolidated balance sheet differ from those applied in the tax balance sheet. These differences, also known as temporary differences, do not impact the company’s tax situation until they are resolved. The majority of accounting standards require the recognition of this type of future tax effect, almost without exception, when the temporary difference occurs or when its value changes. For example, if securities with a fair value of CHF 150 are carried in the tax balance sheet at the lower acquisition cost of CHF 100 then the unrealized gain of CHF 50 is not taxable until the securities are sold. At this later point in time, the tax balance sheet will show a profit of CHF 50, which will then result in a tax payment. As the gain of CHF 50 has already been recorded in the consolidated balance sheet in the form of an unrealized profit, the corresponding future tax expense must be recognized in the same reporting period in the form of a deferred tax liability at the full tax rate. In contrast, future profits can be offset against loss carryforwards, thus reducing future tax expenses. This potential receivable from the government can be capitalized as a deferred tax asset if its realization is probable.

Notes

7 For what purposes have provisions been set up?
A provision represents a probable obligation arising from an event in the past, whose amount and date of maturity are uncertain but can be estimated. Examples are warranties relating to sales, expected losses on existing contracts, litigation risks, additional tax charges or personnel costs (obligations in respect of early retirement, restructuring costs such as severance payments etc.). Given the aim of a “true and fair view”, provisions for expected operating losses, the costs of relocating production, future marketing projects,
Are there any covenants in loan agreements, which, if breached, would require immediate repayment of the interest-bearing liabilities?

Notes

Is the group exposed to any significant foreign currency risks and how are they hedged?

Notes

Has the group issued or acquired derivative financial instruments or has it made any speculative financial transactions? Are there any repurchase obligations (e.g. for own shares) that are not reflected in the balance sheet?

Accounting policies, Notes

Are there any contingent liabilities, e.g. for legal or warranty claims or due to legal requirements (e.g. relating to environmental matters or healthcare) which could impair the group’s financial situation?

Notes

What are minority interests?

Minority interests relate to the percentage of equity of subsidiaries owned by third-party shareholders. In the process of consolidation the balance sheets of subsidiaries are incorporated at 100 percent in the consolidated financial statements, irrespective of the actual capital share in these companies held by the group. Therefore, the corresponding proportion of the equity and profit or loss pertaining to third-party shareholders is separately stated in the consolidated balance sheet and income statement. Minority interests do not have to be repaid and are not subject to interest payments. Therefore, they do not represent a liability for the group. At the same time, the group or parent company’s shareholders are not entitled to these interests. Consequently, they are stated within the group’s equity but separate from the equity attributable to the parent company’s shareholders.

Are the group’s retained earnings available for distribution?

In principle, only the parent company’s retained earnings may be distributed, and only if they are not subject to any legal restrictions and if the required liquidity is available. The group’s reserves are, on the one hand, determined by using a different valuation basis (see above) and, on the other hand, are mostly contained in the balance sheets of subsidiaries. They need first be distributed to the holding company, which again requires sufficient liquidity and that the related reserves are freely available.

Notes

Other questions which investors should ask about the balance sheet:

- Does the group possess sufficient liquidity, assets that can be realized in the short term or refinancing possibilities to cover short-term liabilities?
  
  Balance sheet, Notes, Directors’ report

- Are there any assets such as employee benefit assets or deferred tax assets over which the group has only limited control and/or which may be difficult or impossible to realize?
  
  Accounting policies, Notes

- Have sufficient adjustments been made for debtors’ solvency risks and slow-moving goods?
  
  Notes

- In the case of a recently acquired company, when is the turnaround expected on which the recoverable amount of the goodwill depends? Has it already been necessary to recognize impairment losses?
  
  Income statement, Notes

- Are there any covenants in loan agreements, which, if breached, would require immediate repayment of the interest-bearing liabilities?
  
  Notes

- Is the group exposed to any significant foreign currency risks and how are they hedged?
  
  Notes

- Has the group issued or acquired derivative financial instruments or has it made any speculative financial transactions? Are there any repurchase obligations (e.g. for own shares) that are not reflected in the balance sheet?
  
  Accounting policies, Notes

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Questions and answers regarding the income statement

The consolidated income statement provides an insight into the group’s business during the period between the balance sheet dates.

“Nature of expense” method or “cost of sales” method?
The income statement can be presented either in accordance with the “nature of expense” method or the “cost of sales” method. The former is more commonly used in continental Europe whereas the latter is primarily applied in the English-speaking world. According to the “nature of expense” method, the total output for the period is presented inclusive of (as yet) unsold production during the period (inventory changes and capitalized production for own plant and equipment). This total output is compared with the expenses arising during the period. In keeping with the “cost of sales” method, only those goods and services that have actually been sold during the period are presented and compared with the associated production costs.

There is a further difference in the way incurred expenses are presented. In the “nature of expense” method, expenses are aggregated according to their nature (e.g. material costs, employee benefits, etc.), whereas in the “cost of sales” method, expenses are assigned to the cost centers: production, research and development, sales and administration. Consequently, only the “cost of sales” method allows the calculation of a gross margin, defined as gross profit as a percentage of sales revenue. However, the operating result and net profit are the same whichever method is used.

1. What needs to be considered when comparing the income statement with the prior year?
When analyzing changes compared with the previous year, the first question to ask is whether there have been any changes to the scope of consolidation which might lead to a distorted view. For example, the acquisition of a company during the year under review could result in an increase in sales while simultaneously reducing the consolidated profit due to the associated integration costs. The disposal of a subsidiary may result in a gain or loss due to the difference between the derecognized (transferred) assets and liabilities and the proceeds from the sale. In the case of multinational groups, changes in exchange rates may also have a significant impact on the profit and the previous-year comparison. Furthermore, changes in accounting policies or the application of new standards may cloud the previous-year comparison. In general, however, such changes have to be implemented retrospectively, i.e. the previous year’s income statement which is presented as a basis for the comparison is restated as if the new policy had already been applied in the previous year.

Notes

How reliable is the net profit?
The net profit is heavily influenced by the valuation of the assets and liabilities in the consolidated balance sheet. This valuation is often subject to considerable uncertainty and a certain level of judgment and is generally the result of many different assumptions. Examples include the valuation of investments, the assessment of legal disputes and the corresponding provisions, the evaluation of whether a capitalized tax loss carryforward can actually be realized or the impairment testing for goodwill.

In a tough competitive environment, companies look for new forms of transactions and ways of providing their goods and services. Depending on the business model, the recognition of revenue and gains may be subject to certain risks. For example, in the case of long-term construction contracts it is necessary to ask whether a proportion of revenue and profits can be recorded during the construction period itself. It is often unclear whether a sale can be deemed to have been realized and the resulting gain can be posted. Sale and lease back transactions that lead to the sale and simultaneous leasing or renting of an item of equipment generate cash and a gain or loss without there being any change in the way the company uses the equipment. Companies are also increasingly turning to complex financial transactions, such as “selling” their debtor portfolios for financing purposes, issuing guarantees, options or other securities. Standard setters and legislators are finding it hard to keep up with the furious pace of developments. For that reason, it is at times necessary to interpret the standards in order to determine the proper accounting for such transactions.
How sustainable are the profits?
Nowadays, it is common to talk about “normalized profit”. Analysts examine the notes to the financial statements and question the group management to determine a profit figure free from extraordinary, unusual or non-recurring transactions and use this value as the basis for valuing the company and its shares. Companies often assist in these efforts by incorporating additional subtotals in the income statement in order, for example, to indicate operating profit before special items such as restructuring costs, impairment losses or losses resulting from the sale of subsidiaries. The standard-setters do not find this type of presentation convincing. They do not consider such special influences and volatility to be extraordinary and complain about the subjective nature of these statements. They therefore prefer a qualitative explanation of unusual expenses, income, losses and profits in the notes to the consolidated balance sheet. Results from discontinued areas of business represent an exception here. These are stated separately from the results for the company’s ongoing business activity in accordance with international accounting regulations.

What do EBIT, EBITA, EBITDA stand for?
They are commonly used subtotals in the income statement and relate to the group’s operating performance. EBIT (earnings before interest and taxes) corresponds to the operating profit presented in AnyCompany’s income statement, the operating result or the profit before the financial result and income tax. EBITA (earnings before interest, taxes and amortization) describes the operating profit before deductions for amortization and impairment losses relating to intangible assets. EBITDA (earnings before interest, taxes, depreciation and amortization) also excludes depreciation. The aim of these measures is to gain an approximation to the operating cash flow by adding back the most important non-cash expenses to the operating profit. In the example for AnyCompany Group, EBITDA in 2005 was CHF 55 million (operating profit CHF 14 million, depreciation and amortization CHF 9 million and impairment of goodwill CHF 32 million). However, the fact that this amount differs quite significantly from the operating cash flow of CHF 63 million can be seen from the cash flow statement.

What is an impairment?
The commonly applied accounting standards require the monitoring of the recoverability of long-term assets. An asset is considered to be impaired if its carrying amount exceeds both the net selling price (fair value minus costs to sell) and its future discounted cash flows (value in use). Once indicators of such an impairment are identified, it is necessary to calculate the recoverable amount accordingly (“impairment test”) and if applicable to recognize an impairment loss. This type of calculation may be prompted, for example, by technical obsolescence, new or better products by competitors or insufficient yields.

The assessment of the recoverable amount of goodwill is particularly complex since, on the one hand, this relates to entire business segments or

<table>
<thead>
<tr>
<th>Consolidated income statement (CHF m)</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>364</td>
<td>419</td>
</tr>
<tr>
<td>Other operating income</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Increase/decrease in finished goods and work-in-process</td>
<td>(2)</td>
<td>7</td>
</tr>
<tr>
<td><strong>Operating income</strong></td>
<td>366</td>
<td>430</td>
</tr>
<tr>
<td>Cost of materials</td>
<td>(149)</td>
<td>(172)</td>
</tr>
<tr>
<td>Personnel expenses</td>
<td>(130)</td>
<td>(129)</td>
</tr>
<tr>
<td>Depreciation and amortization</td>
<td>(9)</td>
<td>(12)</td>
</tr>
<tr>
<td>Impairment loss on goodwill</td>
<td>(32)</td>
<td>–</td>
</tr>
<tr>
<td>Other operating expenses</td>
<td>(32)</td>
<td>(51)</td>
</tr>
<tr>
<td><strong>Operating profit</strong></td>
<td>14</td>
<td>66</td>
</tr>
<tr>
<td>Financial expense</td>
<td>(9)</td>
<td>(6)</td>
</tr>
<tr>
<td>Income from investments in associated companies</td>
<td>5</td>
<td>–</td>
</tr>
<tr>
<td>Other financial income</td>
<td>2</td>
<td>13</td>
</tr>
<tr>
<td><strong>Profit before tax</strong></td>
<td>12</td>
<td>74</td>
</tr>
<tr>
<td>Income tax</td>
<td>(4)</td>
<td>(12)</td>
</tr>
<tr>
<td><strong>Net profit</strong></td>
<td>8</td>
<td>62</td>
</tr>
<tr>
<td>Attributable to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders of AnyCompany Holding AG</td>
<td>5</td>
<td>52</td>
</tr>
<tr>
<td>Minority interests</td>
<td>3</td>
<td>10</td>
</tr>
<tr>
<td><strong>Earnings per share (undiluted)</strong></td>
<td>0.22</td>
<td>2.36</td>
</tr>
<tr>
<td><strong>Earnings per share (diluted)</strong></td>
<td>0.21</td>
<td>2.36</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Income statement of the parent company (CHF m)</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income from investments in subsidiaries</td>
<td>2</td>
<td>9</td>
</tr>
<tr>
<td>Operating expense</td>
<td>(2)</td>
<td>(2)</td>
</tr>
<tr>
<td>Financial expense</td>
<td>(1)</td>
<td>–</td>
</tr>
<tr>
<td>Financial income</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Extraordinary income: release of provisions</td>
<td>2</td>
<td>–</td>
</tr>
<tr>
<td><strong>Net profit</strong></td>
<td>7</td>
<td>11</td>
</tr>
</tbody>
</table>
entities and, on the other, it reflects evaluations of an acquisition’s future potential. IFRS and US GAAP require goodwill to be subjected to an annual impairment test. This type of test calls for numerous assumptions that are, to some extent, subject to judgment. For this reason, the notes need to include detailed disclosures on impairments and the associated calculations.

Are financial expenses synonymous with interest expenses?
In addition to interest expenses, financial expenses often include realized and unrealized foreign exchange losses and impairment losses relating to non-consolidated investments, loans and other financial investments.

And how are interest expenses determined?
Interest expenses often include more than just the agreed interest payments on financial liabilities. For example, if a 1 percent loan of a nominal amount of CHF 100 million is issued at CHF 90 million (discounted) for a period of 10 years with transaction costs amounting to CHF 2 million, then the company has a net cash inflow of CHF 88 million. After 10 years, the nominal amount of CHF 100 million is repaid. In this example, the annual interest expense consists of 1 percent on CHF 100 million and an annual amortization of the difference between the amount initially obtained and the amount to be repaid. This difference (CHF 100 million – CHF 88 million = CHF 12 million) is expensed over a period of 10 years and increases the loan to the amount owed at repayment date. International accounting standards require disclosure of the so-called “effective interest rate” which reflects this total interest burden.

Why is income tax stated separately?
The income tax presented in the income statement includes, on the one hand, the tax liability arising from the statutory or tax results of the period under review as well as tax arrears or credits from previous periods (together referred to as current tax) and, on the other hand, changes in deferred tax assets and liabilities recognized in the income statement. This tax is exclusively income-related. Other taxes, such as taxes on capital or non-reclaimable value added tax are included in operating expenses. To determine the group’s effective tax burden, it is necessary to consider income tax in relation to the profit before taxes. Both IFRS and US GAAP demand that the notes contain detailed qualitative statements on this subject.

Why is the net profit attributed to the parent company’s shareholders and to minority shareholders?
The shareholders’ entitlement to dividend payments is based on the profits of the company in which they hold shares. The consolidated financial statements combine a number of companies as if they formed a single entity. By presenting this attribution, the consolidated financial statements point out the share of the group result that is attributable to the subsidiaries’ minority shareholders.

Does the consolidated net profit represent the actual performance?
The income statement only indicates part of the group’s financial performance. Established accounting standards allow certain components of performance to be recorded directly in equity. These additional gains and losses, which are disclosed in the statement of changes in equity, should also be taken into account when assessing the performance.

Statement of changes in equity
For more information on performance reporting, see pages 26 to 28.

What is the difference between the normal or undiluted and the diluted earnings per share?
The normal, or undiluted, earnings per share indicate the amount of the consolidated profit that is attributable to the parent company’s shareholders per ordinary share outstanding. The diluted earnings per share also takes into account all the potential ordinary shares which would result in profit dilution if all options and conversion rights were exercised. In this context, the term “dilution” refers to the reduction in the profit per share due to an increase in the total number of shares.

Notes

Which division contributed most / least to profits?
Listed companies are obliged to present certain performance factors (revenue, operating result) for each segment. Segment reporting is usually performed on a divisional basis and/or by geographical areas. It permits a more detailed insight into what may be the very different performances of a group’s business segments or geographical regions.

Quantitative and qualitative details concerning the segments that go beyond the scope of the notes can be found in the director’s report.
How are share-based payments to employees or members of the board of directors recorded?
Many companies compensate their leading employees partly in the form of options or shares of the company. In the past, this type of remuneration was often not recognized in the income statement, sometimes with the argument that it is ultimately the parent company’s shareholders who bear these costs through the dilution of their own shares. However, modern international accounting standards consider such payments to be a group expense. This expense is measured on the basis of the current market value at the time the options or free shares are granted and is recorded in the income statement over the time during which the employee is required to work for the company.

Why does the extraordinary release of provisions recorded in the parent company’s income statement not appear in the consolidated financial statements?
Provisions formed by the holding company may relate to investment risks. These must be removed from the consolidated financial statements where the carrying amounts for investments in subsidiaries are replaced by their assets and liabilities and because, within the framework of a “true and fair view”, provisions may not be recognized for general risks. However, in the case of the release of a provision which also existed in the consolidated financial statements, international accounting standards do not permit this to be referred to as “extraordinary” transactions. Instead, the provision must be released in the line item in which it was previously created (e.g. as a reduction in other operating expenses in the case of a legal dispute). The transaction must also be disclosed in the table that shows the changes in provisions which can be found in the notes to the consolidated financial statements.

Other questions which investors should ask about the income statement:

- Are there any significant unusual or non-recurring expenses or income such as provisions for restructuring, impairments, profits or losses, e.g. from the disposal of subsidiaries, which put a different perspective on the prior-year comparison and the sustainability of the net profit?
- How realistic is the expected long-term yield of the pension plan assets on which the calculation of the pension expense as an element of employee benefit expenses is based?
- What is the relation of the effective tax expense to the expected consolidated tax expense. What are the reasons for material changes in tax expenses?
- Are there any risks which could negatively influence future profits or even jeopardize the group’s existence (technological developments, image problems, quality problems, claims for damages etc.)?
- Are there any risks which could negatively influence future profits or even jeopardize the group’s existence (technological developments, image problems, quality problems, claims for damages etc.)?

<table>
<thead>
<tr>
<th>Consolidated income statement (CHF m) “Cost of sales” method</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>364</td>
<td>419</td>
</tr>
<tr>
<td>Cost of sales</td>
<td>(240)</td>
<td>(265)</td>
</tr>
<tr>
<td>Gross profit</td>
<td>124</td>
<td>154</td>
</tr>
<tr>
<td>Marketing, sales and administrative expenses</td>
<td>(79)</td>
<td>(77)</td>
</tr>
<tr>
<td>Research and development expenses</td>
<td>(33)</td>
<td>(10)</td>
</tr>
<tr>
<td>Other operating income</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>Other operating expense</td>
<td>(2)</td>
<td>(5)</td>
</tr>
<tr>
<td>Operating profit</td>
<td>14</td>
<td>66</td>
</tr>
<tr>
<td>Financial expense</td>
<td>(9)</td>
<td>(5)</td>
</tr>
<tr>
<td>Other financial income</td>
<td>5</td>
<td>–</td>
</tr>
<tr>
<td>Profit before tax</td>
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<td>74</td>
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<tr>
<td>Attributable to:</td>
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<td>10</td>
</tr>
<tr>
<td>CHF</td>
<td>0.22</td>
<td>2.36</td>
</tr>
<tr>
<td>CHF</td>
<td>0.21</td>
<td>2.36</td>
</tr>
</tbody>
</table>
Questions and answers regarding the statement of changes in equity

The statement of changes in equity provides information about increases and decreases of equity, reserves and minority interests.

What does equity consist of?
Equity arises from paid in capital (share capital and capital reserves or share premiums) as well as generated capital (retained earnings including accumulated foreign currency translation differences). The company’s treasury shares represent a correction to the issued share capital. Equity also includes the minority interests attributable to third-party shareholders of subsidiaries.

1 

What is the origin of accumulated foreign currency translation differences?
The accumulated foreign currency translation differences result from the conversion of the financial statements for the purpose of consolidation and from the long-term financing of foreign subsidiaries. On the one hand, the net assets (=equity) of a foreign subsidiary at the start of a business year have to be converted at the new exchange rate prevailing at the end of the year. The same applies to movements in equity, including net profit, which are stated at the average exchange rate in the consolidated financial statements. In order to capture the resulting short-term volatility of resources that are in fact intended to be long-term, these foreign currency effects are included directly in equity in the consolidated financial statements. When a foreign subsidiary is sold, the accumulated foreign currency gains (or losses) are transferred to the income statement (so called “recycling”) and either increase or decrease the gain on the sale.

What are the reasons for changes in equity?
In principle, changes in equity can be divided in transactions with shareholders, changes in accounting in the form of restatements and performance items.

Transactions with shareholders comprise capital increases and decreases (including the purchase and sale of treasury shares) and profit distributions.

Restatements include changes to the accounting policies and the correction of material errors. As a matter of principle, both types of restatement are performed retroactively, i.e. through an adjustment, not affecting the income statement, of the assets and liabilities at the starting date of the preceding period as if the new accounting policies had always been applied or the error had never occurred. The profit presented in the previous year may also be subject to adjustment. This enables the comparison of two periods presented. Changes in accounting and valuation methods are only permitted if this is due to the introduction of a new standard or if they provide a more relevant picture of the company’s business activity. The correction of errors should not be confounded with the amount of judgment required in connection with the valuation of balance sheet items. In general, such re-assessments must be recognized in the income statement. Examples of errors are mathematical mistakes made in the past or if important information was simply overlooked. The retroactive correction of errors is so conspicuous that it is normally only applied in serious cases.

Performance factors comprise not only the net profit as per the income statement but also certain unrealized gains and losses which, based on the applicable accounting standard, do not affect the income statement but are recorded in equity either definitively or up to the point of their realization. These items include, for example:

1. Foreign currency translation differences as explained above
2. The increase in the value of property, plant and equipment to its fair value not recognized in the income statement
3. Adjustments of employee benefit liabilities and assets not recognized in the income statement (see page 22)
4. The “parking” in equity of changes in fair values of financial investments which are available for sale
5. The “parking” in equity of unrealized gains and losses from hedges relating to future transactions. These are transferred to the income statement at the time at which the underlying transaction affects the income statement (hedge accounting).

Comments on the income statement, Accounting policies, Notes
4. What is the group’s overall performance?

The overall performance consists of the net profit and the gains and losses recognized directly in equity, which are presented separately in the statement of changes in equity. For more information, see also “Performance reporting” on pages 26 and 28.

Is the equity identical to the actual value of the whole group?

This is not quite the case. The increasing use of fair values in the consolidated financial statements, for example with regard to financial instruments, investment property, employee benefit liabilities, etc., leads to a certain approximation of equity and the enterprise value. However, value increases in the majority of items of property, plant and equipment and internally generated goodwill (own brands, know-how, research pipeline, customer base, competitive advantages, etc.) are not (yet) taken into account. After all, this goodwill reflects the group’s future potential but it may not be capitalized because of the lack of a reliable valuation. As a result, the market capitalization (number of shares multiplied by the stock exchange price) is the closest to the current value for listed groups and reflects investors’ expectations concerning the group’s future profitability.

Other questions which investors should ask about the statement of changes in equity:

- What types of shares (ordinary shares, preference shares, shares with preferred voting rights, etc.) make up the share capital and what are the associated rights and obligations on the part of the shareholders and the group?
  Notes

- What is the group’s dividend policy? Possibly directors’ report (disclosure of payout ratios), statements made to the general meeting
  Notes

- What is the background of transactions involving treasury shares (share price support measures, speculation, share-based compensation plans, repurchase obligations, etc.) and are the treasury shares held for a specific purpose (e.g. for mergers and acquisitions) or freely available?
  Notes

- Does equity contain elements of performance that should more properly be recognized in the income statement (e.g. an accounting change which should have been recognized in the form of a value adjustment)? Knowledge of the accounting standards on which the consolidated financial statements are based

- Is distribution of the group’s reserves subject to legal restrictions and, if so, to what extent?
  Notes
Questions and answers regarding the cash flow statement

The cash flow statement provides an overview of the cash and cash equivalents that have entered and left the company during the period under review. It is commonly presented in three sections showing the group’s operating, investing and financing activities. For the parent company’s financial statements, which comply with minimum legal requirements, a cash flow statement is not required.

1. **How liquid are cash and cash equivalents?**
   In accordance with international accounting standards, cash and cash equivalents include cash and funds in postal and bank accounts on the one hand and, on the other, cash equivalents such as call deposits, fixed-term deposits or money market instruments, provided these have an original term of less than 90 days and that significant fluctuations in their value are unlikely. In compliance with these standards, marketable securities may not be included in cash and cash equivalents; instead their movements are presented as cash flows from investing activities or, possibly, operating activities (in terms of “working capital”).

2. **Why is the cash flow from operating activities relevant?**
   The operating cash flow indicates the generation and/or consumption of cash and cash resulting from procurement, production, administration and revenue recognition activities. It comprises the part of the operating profit which has an effect on liquidity as well as all changes to the net working capital. The so-called indirect method is often used to calculate the part of the operating result that has an effect on liquidity. In this case – as in the example presented for the AnyCompany Group – net profit is, on the one hand, reconciled to the operating profit by adding back the tax expense and the financial result and, on the other, is adjusted for the effects of transactions of a non-cash nature, such as depreciation, the creation of provisions, etc. Alternatively, it is possible to apply the direct method (which is used less frequently in practice) that discloses cash receipts from customers and cash payments for staff costs, material costs, etc.

   To the extent that it has an effect on liquidity, the financial result (in particular interest expenses and income) is often assigned to the financing or investing activities.

3. **What information does the cash flow from investing activities provide?**
   The group’s investing activities include cash purchases and sales of property, plant, equipment and financial assets (incl. securities) as well as interest income and dividends received in cash. These are therefore transactions in the context of fixed asset management that have an effect on liquidity. Acquisitions and sales of consolidated subsidiaries are also shown in this section by presenting the purchase price or the proceeds from the sale, minus the cash and cash equivalents acquired with the subsidiary – or disposed of in the event of a sale.

4. **What information can be derived from the cash flow from financing activities?**
   Financing activities include the acquisition and repayment of equity and external funding, interest payments and dividend distributions. Since the group’s treasury shares are deducted from equity, the purchase or sale of treasury shares should not be presented as an investing activity but instead is shown as a
financing activity like any other capital
decrease or capital increase.

What is the influence of foreign
currency translation differences
on the cash flow statement?
The amount of cash and cash equivalents
held by foreign subsidiaries at the
beginning of the period is translated at
the year-end rate of the previous year.
Items of profit or loss and changes in
balance sheet positions (investments,
divestments, financing activities,
repayments) of foreign subsidiaries
which are included in the cash flow
statement and which result in an
increase or decrease in cash and cash
equivalents must be converted at the
average rate for the period under
review. In contrast, the cash and cash
equivalents held by foreign subsidiaries
are translated at the prevailing rate at
balance sheet date. The resulting
differences in the amount of cash and
cash equivalents are set out separately
at the end of the cash flow statement.

Why do increases and decreases in
balance sheet items not correspond
to the changes apparent from the
balance sheet?
These discrepancies are due partly to
the differing translation of balance sheet
items recorded in foreign currencies
(converted at the rate on the balance
sheet date) and transactions (converted
at the average rate). In addition, although
changes in the scope of consolidation
(acquisitions and sales of subsidiaries)
are stated in a single line in the cash flow
statement (see also “What information
does the cash flow from investing
activities provide?”), they actually relate
to a large number of balance sheet
items. Furthermore, transactions that
have no effect on liquidity also result in
changes in the balance sheet, for
example the acquisition of assets
financed by finance leasing
agreements, which do not require any
cash at the time of the acquisition.

See example in the section to the notes
Other questions which investors
should ask about the cash flow
statement:
- Has the group been able to generate
cash and cash equivalents from its
business activities? Have these
resources been used for investments
or to repay external capital or equity?
Cash flow statement
- Is the group able to meet its
obligations and repay loans and
interest on time?
Cash flow statement, summary of
maturities in the notes, possibly
disclosure of credit limits and the
free cash flow in the notes or the
directors’ report
- Is the assessment of the useful life of
property, plant and equipment realistic?
Accounting policies, investing
activities based on the analysis of
property, plant and equipment in
the notes
- Are there any significant capital
commitments that lead to an outflow
of funds in the future?
Notes
- Have the right investments been
made at the right time and at a
reasonable cost?
Possibly directors’ report

<table>
<thead>
<tr>
<th>Cash flow statement (CHF m)</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Any Company Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net profit</td>
<td>8</td>
<td>62</td>
</tr>
<tr>
<td>Revenue</td>
<td>8</td>
<td>62</td>
</tr>
<tr>
<td>Operating profit</td>
<td>6</td>
<td>57</td>
</tr>
<tr>
<td>Non-cash income and expenses:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Depreciation</td>
<td>9</td>
<td>12</td>
</tr>
<tr>
<td>Impairment loss on goodwill</td>
<td>32</td>
<td>–</td>
</tr>
<tr>
<td>Gains from sale of property, plant and equipment</td>
<td>(1)</td>
<td>–</td>
</tr>
<tr>
<td>Income from investments in associated companies</td>
<td>(5)</td>
<td>–</td>
</tr>
<tr>
<td>Release of provisions, net</td>
<td>(5)</td>
<td>(3)</td>
</tr>
<tr>
<td>Use of prepaid employer’s contributions</td>
<td>2</td>
<td>–</td>
</tr>
<tr>
<td>(Increase) in employee benefit assets</td>
<td>–</td>
<td>(1)</td>
</tr>
<tr>
<td><strong>Changes in net working capital:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Increase/(decrease) in current receivables</td>
<td>99</td>
<td>(7)</td>
</tr>
<tr>
<td>(Increase) in inventories</td>
<td>(23)</td>
<td>(3)</td>
</tr>
<tr>
<td>iDecrease in current non-interest-bearing liabilities</td>
<td>(39)</td>
<td>(6)</td>
</tr>
<tr>
<td>Income tax:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Income tax paid</td>
<td>(15)</td>
<td>(12)</td>
</tr>
<tr>
<td><strong>Cash flow from operations</strong></td>
<td>63</td>
<td>46</td>
</tr>
<tr>
<td>Purchase of property, plant and equipment</td>
<td>(29)</td>
<td>(24)</td>
</tr>
<tr>
<td>Proceeds from sale of property, plant and equipment</td>
<td>3</td>
<td>1</td>
</tr>
<tr>
<td>Purchase of intangible assets</td>
<td>–</td>
<td>(4)</td>
</tr>
<tr>
<td>Acquisition of subsidiaries</td>
<td></td>
<td></td>
</tr>
<tr>
<td>net of cash and cash equivalents acquired</td>
<td>(56)</td>
<td>(7)</td>
</tr>
<tr>
<td>Sale of securities</td>
<td>2</td>
<td>–</td>
</tr>
<tr>
<td>Interest received</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td><strong>Cash flow from investing activities</strong></td>
<td>78</td>
<td>(23)</td>
</tr>
<tr>
<td>Share capital increase</td>
<td>4</td>
<td>–</td>
</tr>
<tr>
<td>Dividends paid</td>
<td>(18)</td>
<td>(9)</td>
</tr>
<tr>
<td>Transactions in treasury shares</td>
<td>(3)</td>
<td>(1)</td>
</tr>
<tr>
<td>Capital contributions by minorities</td>
<td>3</td>
<td>–</td>
</tr>
<tr>
<td>Increase in financial liabilities</td>
<td>25</td>
<td>10</td>
</tr>
<tr>
<td>Interest paid</td>
<td>(8)</td>
<td>(3)</td>
</tr>
<tr>
<td><strong>Cash flow from financing activities</strong></td>
<td>3</td>
<td>(3)</td>
</tr>
<tr>
<td><strong>Translation differences</strong></td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td><strong>(Decrease)/increase in cash and cash equivalents</strong></td>
<td>(11)</td>
<td>20</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at the beginning of the year</strong></td>
<td>38</td>
<td>18</td>
</tr>
<tr>
<td><strong>Cash and cash equivalents at the end of the year</strong></td>
<td>27</td>
<td>38</td>
</tr>
</tbody>
</table>
Questions and answers regarding the notes

The notes to the consolidated financial statements consist of a summary of the accounting policies applied, comments on individual items included in the financial statements and additional information. The notes are an integral part of the consolidated financial statements.

What is the purpose of studying the accounting policies?
In the summary of accounting policies, the group explains, among other things, which accounting framework it uses (e.g. IFRS, Swiss GAAP FER, US GAAP), how the scope of consolidation is defined and what accounting and valuation principles are applied. For example, information may be provided about the choice of available options in accounting or about the extent to which fair values are used in the consolidated balance sheet.

It is also interesting to ask whether and why companies have been excluded from consolidation. For example, so-called “special purpose entities” or foundations may be set up for complex financing transactions, but are sometimes not consolidated. However, it is imperative that they are included in the scope of consolidation if the risks and rewards associated with these transactions remain with the group.

What is the purpose of the analysis of fixed and intangible assets?
The analysis presents gross changes in property, plant and equipment and intangible assets, i.e. on the basis of cost of acquisition and accumulated depreciation. Changes to the scope of consolidation (acquisitions/sales of subsidiaries), other additions, disposals (sales, scrapping), depreciation, impairment losses and foreign exchange differences are set out separately. With the exception of transactions that have no effect on liquidity (purchases or sales in the form of exchanges or finance leasing transactions), it should be possible to reconcile additions and disposals with the cash flow statement when taking account of gains and losses from disposals. Explanations of such non-cash transactions are required by international standards.

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What important additional information can be found in the notes?
Informative details concern the so-called off-balance sheet transactions. These refer to transactions and uncertainties which (as yet) have no impact on the balance sheet. Examples are obligations in respect of non-cancellable, long-term rental agreements (“operating leases”), capital commitments, legal disputes, warranties, joint and several guarantees and other contingent liabilities. Readers of the notes should be able to identify the major risks facing the group and how these risks may affect the consolidated financial statements and in particular the earnings and cash flows.

What are “related parties”?
A related party is a party – either a natural or legal person – which may have a significant influence on the company’s financial or operating decisions. This includes, for example, majority shareholders, members of the board of directors and the senior management as well as any companies in which these have a controlling interest. Transactions with related parties cannot automatically be compared with those undertaken with independent third-parties since, as a result of the special relationship, the conditions may not necessarily be “at arm’s length”. Consequently, transactions with related parties and any outstanding balances must be disclosed in the notes. International standards further require the disclosure of the compensation of the members of the Group Management and the Board of Directors in the notes to the consolidated financial statements (as of 2007, the Swiss Code of Obligations requires that listed companies disclose similar details in the notes to the parent company’s financial statements. See also “New developments in Swiss company law”, pages 29 to 30.

What is the purpose of the consolidation of properties, plant and equipment?
The explanations present the composition of individual balance sheet and income statement line items and describe the reasons for significant changes to the prior year. Of particular importance are the summaries of movements required by a number of different standards, for example the analysis of property, plant and equipment or the summary of movements in provisions. Other disclosures of interest are those relating to financial risk management as well as the status of employee benefits and income taxes.

What purpose serve the explanations of individual items of the consolidated financial statements?
The explanations present the composition of individual balance sheet and income statement line items and describe the reasons for significant changes to the prior year. Of particular importance are the summaries of movements required by a number of different standards, for example the analysis of property, plant and equipment or the summary of movements in provisions. Other disclosures of interest are those relating to financial risk management as well as the status of employee benefits and income taxes.
What conclusions can be drawn from the summary of movements in provisions?

For each significant category of provisions, the summary of movements in provisions indicates the creation, the utilization (not recognized in the income statement) and the release (recognized in the income statement) of provisions during the period under review. Significant releases of no longer required provisions may be due to inaccuracies in the creation of provisions or to unexpected positive developments. Such releases should be explained if they have a material influence on the income statement. Uncertainties associated with the different provision categories and the expected timing of outflow of resources should be described.

What does the cash outflow for acquisitions refer to?

Acquisitions of subsidiaries can have a significant effect on the consolidated financial statements. They should therefore be explained in detail in the notes. The cash outflow presented equals the purchase price for the acquired enterprise, reduced by the transferred cash and cash equivalents that are now included in the consolidated financial statements. This amount is compared with the acquired assets and liabilities including goodwill. The breakdown of the cash outflow for acquisitions enables the reader to understand the changes in balance sheet items compared to the amounts presented in the cash flow statement. The influence of an acquisition on the balance sheet, will thus become apparent.

The same principle is applied to the disposal of subsidiaries although, of course, in the opposite direction.

### Analysis of fixed and intangible assets (CHF m)

<table>
<thead>
<tr>
<th>AnyCompany Group</th>
<th>Other</th>
<th>Real estate*</th>
<th>Goodwill</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>plant and equipment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Cost</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>January 1, 2006</td>
<td>91</td>
<td>62</td>
<td>153</td>
<td>44</td>
</tr>
<tr>
<td>Additions due to acquisition</td>
<td>10</td>
<td>1</td>
<td>11</td>
<td>97</td>
</tr>
<tr>
<td>Other additions</td>
<td>20</td>
<td>9</td>
<td>29</td>
<td>–</td>
</tr>
<tr>
<td>Revaluation</td>
<td>6</td>
<td>–</td>
<td>6</td>
<td>–</td>
</tr>
<tr>
<td>Disposals</td>
<td>–</td>
<td>(6)</td>
<td>(6)</td>
<td>–</td>
</tr>
<tr>
<td>Translation differences</td>
<td>(2)</td>
<td>(1)</td>
<td>(3)</td>
<td>–</td>
</tr>
<tr>
<td><strong>December 31, 2006</strong></td>
<td>125</td>
<td>65</td>
<td>190</td>
<td>141</td>
</tr>
</tbody>
</table>

### Summary of movements in provisions (CHF m)

<table>
<thead>
<tr>
<th>AnyCompany Group</th>
<th>Warranties</th>
<th>Legal disputes</th>
<th>Other provisions</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>January 1, 2006</strong></td>
<td>7</td>
<td>4</td>
<td>1</td>
<td>12</td>
</tr>
<tr>
<td>Creation and increases</td>
<td>2</td>
<td>1</td>
<td>–</td>
<td>3</td>
</tr>
<tr>
<td>Utilization</td>
<td>–</td>
<td>(1)</td>
<td>–</td>
<td>(1)</td>
</tr>
<tr>
<td>Release</td>
<td>(4)</td>
<td>(3)</td>
<td>(1)</td>
<td>(8)</td>
</tr>
<tr>
<td>Additions due to acquisition</td>
<td>2</td>
<td>–</td>
<td>–</td>
<td>2</td>
</tr>
<tr>
<td><strong>December 31, 2006</strong></td>
<td>7</td>
<td>1</td>
<td>–</td>
<td>8</td>
</tr>
</tbody>
</table>

### Acquisition of consolidated companies (CHF m)

<table>
<thead>
<tr>
<th>AnyCompany Group</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash and cash equivalents</td>
<td>8</td>
</tr>
<tr>
<td>Receivables</td>
<td>27</td>
</tr>
<tr>
<td>Inventories</td>
<td>20</td>
</tr>
<tr>
<td>Property, plant and equipment</td>
<td>11</td>
</tr>
<tr>
<td>Current non-interest-bearing liabilities</td>
<td>(1)</td>
</tr>
<tr>
<td>Financial liabilities</td>
<td>(66)</td>
</tr>
<tr>
<td>Provisions</td>
<td>(2)</td>
</tr>
<tr>
<td>Deferred tax liabilities and assets, net</td>
<td>(10)</td>
</tr>
<tr>
<td><strong>Total acquired net assets/(net liabilities)</strong></td>
<td>(33)</td>
</tr>
<tr>
<td>Goodwill</td>
<td>97</td>
</tr>
<tr>
<td><strong>Total cost of the acquisition</strong></td>
<td>64</td>
</tr>
<tr>
<td>Minus cash and cash equivalents acquired</td>
<td>(8)</td>
</tr>
<tr>
<td><strong>Cash outflow, net</strong></td>
<td>56</td>
</tr>
</tbody>
</table>

*including investment property*
**What is the status of obligations relating to employee benefits?**
The disclosures on employee benefit obligations reveal a variety of information including any deficits or surpluses in defined benefit pension plans (“funded status”) determined on the basis of uniform criteria as well as the components of the pension expense and changes in the group’s employee benefit liabilities and assets. Post-employment benefit or pension liabilities must be recognized in the balance sheet in the case of defined benefit pension plans, i.e. when pre-determined benefits are promised and the employee is exposed to neither the actuarial nor the investment risk. The “funded status” compares the present value of this obligation with the fair value of the pension fund assets in order to determine any surplus or deficit that is to be recorded in the company’s balance sheet. Any deficits must be recognized if the company is subject to any legal or constructive obligation to recapitalize the fund either by increasing its contributions or by an extra lump-sum payment. In the example provided, there is a surplus of CHF 34 million at the balance sheet date of which the group considers CHF 8 million eligible for capitalization because, for example, it has prepaid employer’s contributions, i.e. is able to reduce its future contributions to this extent.

When recognizing changes in deficits or surpluses, it is possible to apply the so-called corridor approach. This may lead to an obligation not included in full in the balance sheet because there is a delay in the recording of a deterioration in the status. This approach is justified by the fact that this balance sheet item represents a very long-term commitment and therefore short-term fluctuations need not be accounted for. The use of the corridor approach and the amount of the as yet unrecognized improvement or deterioration of the status are disclosed in the notes.

**How much tax does the group pay?**
Depending on the accounting framework applied, the notes to the income tax situation may include a reconciliation from the expected tax rate to the effective tax rate (“tax rate reconciliation”). The expected tax rate corresponds to the weighted average of all locally applicable tax rates. The effective tax rate is calculated on the basis of the income tax expense presented in the consolidated income statement as a proportion of the profit before tax. Among others, the following factors can influence the effective tax rate compared with the expected tax rate:

- Expenses recorded in the consolidated financial statements, which have reduced profit but cannot be deducted for tax purposes, increase the effective tax expense (e.g. expenses resulting from goodwill impairment).
- Income recorded in the consolidated financial statements that has increased profit but is not subject to tax reduces the effective tax expense (e.g. government grants).
- Non-capitalized tax loss carryforwards from previous periods that have been set off with profits of certain subsidiaries reduce the effective tax expense.
In accordance with international standards, tax losses carried forward whose positive effect cannot be capitalized because of uncertainties regarding potential future offsets need to be disclosed. This allows determining potential future reductions in the effective tax expense. In the example presented, a potential tax reduction of CHF 8.3 million (36 percent of CHF 23 million) can be assumed if all the loss carryforwards can be offset against profits in the future.

Other questions which investors should ask about the notes:

- What are the reasons for changes in the accounting policies and valuation methods?
- Has the acquisition of subsidiaries resulted in an increase in goodwill? How is this goodwill justified? How much has the acquired company contributed to the earnings of the group during the current business year?
- What was the basis for determining an impairment loss, i.e. the recoverable amount of goodwill, and what are the reasons for the impairment?
- Are the provisions for warranties, legal disputes, loss orders, tax risks, etc. sufficient? Have any significant amounts of provisions been released?

<table>
<thead>
<tr>
<th>4 Pension costs and employee benefit asset (CHF m)</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AnyCompany Group</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Determination of the surplus:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Present value of the defined benefit obligation</td>
<td>(275)</td>
<td>(280)</td>
</tr>
<tr>
<td>Fair value of plan assets</td>
<td>309</td>
<td>320</td>
</tr>
<tr>
<td>Surplus</td>
<td>34</td>
<td>40</td>
</tr>
<tr>
<td>Of which not capitalized</td>
<td>(26)</td>
<td>(30)</td>
</tr>
<tr>
<td>Capitalized employee benefit asset</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td><strong>Breakdown of pension costs:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Current service costs</td>
<td>22</td>
<td>18</td>
</tr>
<tr>
<td>Employee contributions</td>
<td>(5)</td>
<td>(5)</td>
</tr>
<tr>
<td>Interest on obligation</td>
<td>4</td>
<td>3</td>
</tr>
<tr>
<td>Expected return on plan assets</td>
<td>(4)</td>
<td>(4)</td>
</tr>
<tr>
<td>Amortization of actuarial gains/losses</td>
<td>–</td>
<td>–</td>
</tr>
<tr>
<td>Unrecognized reduction in surplus</td>
<td>(4)</td>
<td>–</td>
</tr>
<tr>
<td><strong>Total cost of defined benefit plans</strong></td>
<td>13</td>
<td>12</td>
</tr>
<tr>
<td><strong>Cost of defined contribution plans</strong></td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total pension costs</strong></td>
<td>18</td>
<td>16</td>
</tr>
<tr>
<td><strong>Employee benefit asset included in the balance sheet:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>January 1</td>
<td>10</td>
<td>10</td>
</tr>
<tr>
<td>Cost of defined benefit plans</td>
<td>(13)</td>
<td>(12)</td>
</tr>
<tr>
<td>Employer’s contributions</td>
<td>11</td>
<td>13</td>
</tr>
<tr>
<td>Use of prepaid employer’s contributions</td>
<td>2</td>
<td>–</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(2)</td>
<td>(1)</td>
</tr>
<tr>
<td>December 31</td>
<td>8</td>
<td>10</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>5 Interest-bearing liabilities (CHF m)</th>
<th>Maturity (years)</th>
<th>31.12.06</th>
<th>31.12.05</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>AnyCompany Group</strong></td>
<td>up to 1</td>
<td>up to 5</td>
<td>over 5</td>
</tr>
<tr>
<td>Bank liabilities</td>
<td>15</td>
<td>63</td>
<td>35</td>
</tr>
<tr>
<td>Mortgage loans</td>
<td>13</td>
<td>58</td>
<td>19</td>
</tr>
<tr>
<td>Other interest-bearing liabilities</td>
<td>3</td>
<td>18</td>
<td>6</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>31</td>
<td>139</td>
<td>60</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>6 Tax rate reconciliation</th>
<th>2006 in %</th>
<th>AnyCompany Group</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average expected tax rate for the group</td>
<td>36%</td>
<td></td>
</tr>
<tr>
<td>Effect of non-deductible expenses</td>
<td>5%</td>
<td></td>
</tr>
<tr>
<td>Effect of tax-exempt income</td>
<td>(1%)</td>
<td></td>
</tr>
<tr>
<td>Use of unrecognized tax loss carryforwards</td>
<td>(7%)</td>
<td></td>
</tr>
<tr>
<td><strong>Effective tax rate</strong></td>
<td>33%</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Expiry of tax loss carryforwards whose tax effect was not capitalized:</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
<th>2011 or later</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>2007</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>2008</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>5</td>
</tr>
<tr>
<td>2009</td>
<td>–</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>–</td>
</tr>
<tr>
<td>2010</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td>2011 or later</td>
<td>11</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>11</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>23</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>23</td>
</tr>
</tbody>
</table>
The auditor’s role

As one of the bodies required by law, the external auditors contribute significantly to the confidence in a company or its external reporting. However, even they cannot avert losses or even bankruptcy.

The expectation gap
The explanations on the previous pages indicate just how much consolidated financial statements are based on judgments. The reported results represent a combination of actual or expected cash flows and value adjustments. Wherever such judgment is required, it is also necessary to make an assessment of future developments. It is true to say that “accounting is an art, and not a science”.

Faithful representation, understandability and prudence are key accounting concepts which companies and their auditors must bear in mind at all times. In view of the accelerated pace at which our environment is developing, accounting standards can merely provide a framework for fair presentation. There is room for interpretation and the use of common sense. However, even the application of the most rigorous accounting standards cannot always provide an early warning of impending company crashes, as recent economic history illustrates.

An audit should provide reasonable assurance that the financial statements as a whole are free of material misstatements. However, an auditor cannot provide absolute assurance since the limitations inherent to an audit (the use of samples, limitations to the effectiveness of company internal controls, non-detection of deception and fraud, judgments, etc.) mean there is always a risk that material misstatements may remain undetected even if the audit is performed with diligence.

The significance of the auditor’s report
It is the auditor’s task to audit transactions and balances on the basis of samples, to critically review the accounting policies and to form an opinion whether the consolidated financial statements and the statutory financial statements have been prepared in accordance with the relevant accounting standards. Auditors must be independent of the company they are auditing. They have to know and understand the company and its business model. There is an increasing need for them to have recourse to specialists, for example when assessing tax provisions, verifying the impact of complex contractual arrangements on accounting or reviewing the valuation of business segments and the related goodwill. Their work is characterized by the need to weigh up various arguments and best and worst-case scenarios. They provide management with a mirror and take care that entrepreneurial optimism does not stand in the way of a balanced view of the financial position and results of operation.

Report of the group auditors
The report of the group auditors is the result of the audit of the consolidated financial statements that is available to the public. It follows a standard text set out by IFAC (International Federation of Accountants) and the national association (Swiss Institute of Certified Accountants and Tax Consultants). The report identifies the object of the audit (the consolidated financial statements), clarifies the responsibilities, describes an audit and leads to the auditor’s opinion in the fourth paragraph. This paragraph expresses the auditor’s – unqualified or qualified – opinion that the financial statements give a true and fair view in accordance with the applicable accounting framework and the law. In rare cases, the auditors will express an adverse opinion or even a disclaimer of opinion. Whenever analyzing consolidated financial statements, it is advisable to read the report of the group auditors in order to identify whether the auditors have pointed out any transgressions of accounting standards that impair a “true and fair view” or whether they highlight significant uncertainties with regard to measurement or any going concern problem.

In the example presented, the auditors draw attention to a material uncertainty concerning the company’s ability to continue as a going concern. There may be various reasons for this type of uncertainty: There may be refinancing
problems which result in a liquidity shortfall, changes in legislation expected to adversely affect the entity or major technological problems. Despite these uncertainties, the auditors were able to express an unqualified opinion because they concluded that these problems were adequately disclosed in the notes. The corresponding note is of great importance for the interpretation of the group’s financial position and results of operation.

Fraud and error
The responsibility for preventing and detecting fraud lies with the Board of Directors (and possibly its Audit Committee) and the company’s management. By law, these bodies have to design, implement, enforce and monitor internal control instruments that ensure the correct conduct of activities. Under the supervision of the responsible bodies, the management should set the right tone ("tone at the top"), create a culture of honesty and ethical behavior and set up an appropriate Internal Control System (ICS) to ensure that fraudulent activities in the company can be prevented or detected.

Auditors must go about their work with a critical attitude and with professional skepticism. They need to pay attention to circumstances which increase the risk of material misstatements in the financial statements. When planning the work, the auditor discusses with his team the company’s susceptibility to misstatements as a result of fraud. It is also necessary to make inquiries with the board of directors and the senior management whether they are aware of any fraud affecting the company, on how they assess the risk of material misstatements due to fraud and what measures they have introduced to exercise their oversight.

When the auditor identifies a misstatement which is due to fraud or suspected fraud then he should communicate these matters as soon as practicable to the appropriate level of management.

Auditors also have an obligation to provide information to the general meeting, although this is limited by confidentiality requirements.

The audit is a significant contribution to corporate governance and risk management of a company.

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1. The reference to international standards on auditing is common for consolidated statements that are prepared in accordance with IFRS.
2. Reference to the applicable accounting framework (e.g. Swiss GAAP FER or International Financial Reporting Standards (IFRS)).
In principle, a group’s performance is reflected in the income statement. This statement subdivides performance into the operating result, the financial result and the expenses and income from income-related taxes. This traditional income statement, which is the norm today, is impaired by a number of uncertainties and sometimes even deficiencies which reduce its information value.

- The income statement is the result of changes to balance sheet items, i.e. it is the outcome from drawing up the balance sheet. As such, it reflects changes in the values of assets and liabilities and expected (accrued) or already realized gains and losses without, however, clearly distinguishing between these. Changes in value include, for example, adjustments to the value of goods (included in costs of goods sold), allowances for bad debts (possibly presented as part of financial expenses), the creation and release of provisions (present in various income statement line items) as well as depreciation and impairment losses. These are all to a certain extent a matter of judgment and require more or less complex assumptions such as the determination of the useful lives of fixed and intangible assets or an estimate of the future costs of cleaning up contaminated land that need to be provided for. The realized results include income (e.g. revenue from sales that have already been paid for), expenses (e.g. production costs relating to the products sold), gains (e.g. from the disposal of assets) and losses (e.g. from the sale of subsidiaries). In connection with the recognition of revenue, it is often necessary to deal with complexity concerning the transfer of risks and rewards associated with sold products.

- Under all current accounting standards, the balance sheet is based on a mixed accounting approach that uses both historic costs and fair values. For example, under IFRS, some balance sheet items such as inventories, property, plant and equipment or financial liabilities are all stated at (amortized) cost. At the same time, IFRS requires that other balance sheet items such as share portfolios, derivative financial instruments or biological assets (plantations, livestock, vineyards, etc.) are valued at their fair or market values. Other balance sheet items, such as investment property, certain commodities/inventories or property, plant and equipment, may either be recognized at amortized cost or at fair value. This mixed approach leads to a complex statement of results, which in some cases makes comparisons difficult.

- Amongst those changes in value that are directly recognized in equity, there are some which are transferred to the income statement at the time of disposal or the recognition of an impairment loss (this practice is known as “recycling”). They are therefore only temporarily “parked” in equity before being realized. Such changes include accumulated foreign currency translation differences which are recycled when a subsidiary is sold; losses on securities which are initially recorded in equity but are subsequently transferred to the financial result in the income statement when a significant or prolonged decline in the fair value provides evidence of impairment; gains and losses on hedging instruments which are transferred to the income statement once the underlying hedged transaction is also recognized in the income statement (so-called “hedge accounting”). Although these reclassifications from equity to the income statement affect the profit, they do not increase...
or decrease the total equity amount (i.e. the retained earnings). Other changes in value that are recorded directly in equity, such as the revaluation of property, plant and equipment or designated intangible assets and certain adjustments of employee benefit liabilities are never recycled to the income statement.

Consequently, the profit as presented in the income statement does not in itself provide a well-rounded picture of a group’s performance. On the one hand, the various judgments and estimates, external influences and volatilities require a qualitative explanation in the notes or in the directors’ report. On the other, the profit in the income statement must be considered in connection with the changes in value recorded in equity.

These shortcomings have been recognized by the publisher of the IFRS, the International Accounting Standards Board (IASB). Consequently, it is already possible to draw up a so-called “Statement of recognized income and expense” which presents a total performance measure by adding the profit from the income statement to the income and expense items recognized in equity. This form of presentation reduces the amount of information to be presented within the statement of changes in equity to the extent that this “only” reflects the transactions with shareholders (capital increases or decreases, distributions, purchase and sale of treasury shares), the total performance (“Total recognized income and expense”) and any restatements resulting from changes in accounting policies or the correction of an error.

This comprehensive performance statement might therefore have the following structure:

Example: Swiss Industry Group
Statement of recognized income and expense for business year 2009
(in CHF. 000)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the year</td>
<td>39100</td>
<td>33700</td>
</tr>
<tr>
<td>Other recognized income and expense:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Exchange differences on translating foreign operations</td>
<td>1250</td>
<td>–750</td>
</tr>
<tr>
<td>Available-for-sale financial assets</td>
<td>–500</td>
<td>8000</td>
</tr>
<tr>
<td>Cash flow hedges</td>
<td>–4000</td>
<td>–350</td>
</tr>
<tr>
<td>Gains on property revaluation</td>
<td>300</td>
<td>200</td>
</tr>
<tr>
<td>Actuarial losses on defined benefit pension plans</td>
<td>–100</td>
<td>–800</td>
</tr>
<tr>
<td>Share of other recognized income and expense of associates</td>
<td>80</td>
<td>–70</td>
</tr>
<tr>
<td>Income tax relating to components of other recognized income and expense</td>
<td>600</td>
<td>–1400</td>
</tr>
<tr>
<td>Other recognized income and expense, net of tax</td>
<td>–2370</td>
<td>4830</td>
</tr>
<tr>
<td>Total recognized income and expense</td>
<td>36730</td>
<td>38530</td>
</tr>
<tr>
<td>Total recognized income and expense attributable to Shareholders of Swiss Industry AG</td>
<td>36730</td>
<td>38530</td>
</tr>
<tr>
<td>Minority interests</td>
<td>6230</td>
<td>3530</td>
</tr>
</tbody>
</table>

Example of a statement of recognized income and expense in accordance with Exposure Draft to IAS 1 as a complementary performance statement.

Example: Swiss Industry Group
Statement of recognized income and expense for business year 2009
(in CHF. 000)

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<thead>
<tr>
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<th>2009</th>
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</tr>
</thead>
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</table>

Example of a statement of recognized income and expense in accordance with Exposure Draft to IAS 1 as a complementary performance statement.
In addition, the IASB recently proposed to incorporate the above-mentioned condensed “Statement of recognized income and expense” or a comprehensive income statement as a mandatory component of all IFRS consolidated financial statements. The comprehensive statement consists of the traditional income statement and the income and expense items directly recorded in equity and could be presented as shown on the right.

These improvements and suggestions currently only deal with questions concerning the formal presentation of profit. The key aspects of performance reporting, such as the presentation of operating revenues (“management performance”) separately from revaluations that are partly determined on the basis of fair values, questions regarding the meaningful use of fair values and whether certain performance items should actually be recognized in equity and later transferred to the income statement, as well as the inter-relationship between the income statement and the cash flow statement and how these two performance statements should complement each other, remain as challenges for the future.

Example: Swiss Industry Group
Statement of recognized income and expense for business year 2009 (in CHF. 000)

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue</td>
<td>980000</td>
<td>905000</td>
</tr>
<tr>
<td>Increase/decrease in inventories</td>
<td>–6000</td>
<td>5000</td>
</tr>
<tr>
<td>Other operating income</td>
<td>8500</td>
<td>6500</td>
</tr>
<tr>
<td>Total income</td>
<td>982500</td>
<td>916500</td>
</tr>
<tr>
<td>Cost of materials</td>
<td>420000</td>
<td>380000</td>
</tr>
<tr>
<td>Other operating expense</td>
<td>180000</td>
<td>170000</td>
</tr>
<tr>
<td>Personnel expenses</td>
<td>250000</td>
<td>242000</td>
</tr>
<tr>
<td>Depreciation</td>
<td>46500</td>
<td>44800</td>
</tr>
<tr>
<td>EBIT</td>
<td>86000</td>
<td>79700</td>
</tr>
<tr>
<td>Income from investments in associated companies</td>
<td>1500</td>
<td>1200</td>
</tr>
<tr>
<td>Interest expenses</td>
<td>–44000</td>
<td>–42000</td>
</tr>
<tr>
<td>Interest income</td>
<td>5000</td>
<td>4000</td>
</tr>
<tr>
<td>Profit before tax</td>
<td>48500</td>
<td>42900</td>
</tr>
<tr>
<td>Income tax expense</td>
<td>–9400</td>
<td>–9200</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>39100</td>
<td>33700</td>
</tr>
</tbody>
</table>

Other recognized income and expense:

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Exchange differences on translating foreign operational(a)</td>
<td>1250</td>
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<td>–100</td>
<td>–800</td>
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<td>80</td>
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<td>Income tax relating to components of other recognized income and expense</td>
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<tr>
<td><strong>Other recognized income and expense, net of tax</strong></td>
<td>–2370</td>
<td>4830</td>
</tr>
</tbody>
</table>

Total recognized income and expense

<table>
<thead>
<tr>
<th></th>
<th>2009</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit attributable to:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Shareholders of Swiss Industry AG</td>
<td>39100</td>
<td>33700</td>
</tr>
<tr>
<td>Minority interests</td>
<td>7100</td>
<td>4700</td>
</tr>
<tr>
<td>Total recognized income and expense attributable to:</td>
<td>36730</td>
<td>38530</td>
</tr>
<tr>
<td>Shareholders of Swiss Industry AG</td>
<td>30500</td>
<td>35000</td>
</tr>
<tr>
<td>Minority interests</td>
<td>6230</td>
<td>3530</td>
</tr>
<tr>
<td>Earnings per share in CHF</td>
<td>37</td>
<td>39</td>
</tr>
<tr>
<td>Diluted earnings per share in CHF</td>
<td>32</td>
<td>34</td>
</tr>
</tbody>
</table>

Example of a statement of recognized income and expense in accordance with Exposure Draft to IAS 1 as a single statement.

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(a) This example provides a summarized presentation, whereby the changes in value for the current period and the effects of recycling are explained in the notes. Alternatively, a gross presentation may be chosen.

(a) This amount includes the share of other recognized income and expense of associated companies.
New developments in Swiss company law

In 2007, the Swiss economy will see a number of new or revised laws, some of which relate closely to corporate governance. The following two pages provide an overview of the most important new regulations.

The new or modified laws relate to the following aspects:

- Audit requirement for legal persons
- Internal control systems for companies
- Approval and supervision of auditors
- Disclosure of payments to members of the board of directors and to senior management, and
- Full revision of the law governing limited liability company (GmbH) and further adaptations to the Swiss Code of Obligations (CO) incl. specifications for conducting risk assessments.

What do the new provisions governing audit obligations entail?

Currently, a company’s legal form is the criterion that determines whether or not the annual financial statements and the accounting records must be audited by an external auditor. More specifically, the audit requirement has so far applied to corporation (AG) irrespective of their size but not to LLCs (GmbHs). In the future, a company’s economic relevance will determine the audit requirement, the audit scope and the requirements which the auditors must fulfill in terms of independence. The new provisions apply to corporations, LLCs, cooperative societies, partnerships limited by shares, associations and foundations. The revised law distinguishes between the following four categories of companies:

- Publicly held companies
- Companies of economic relevance which are required to prepare consolidated financial statements or which exceed two of the following values in two consecutive fiscal years: Total assets of CHF 10 million, sales of CHF 20 million or 50 full-time employees
- Small and medium-sized companies
- Very small companies, i.e. small and medium-sized companies which do not, on average, have more than ten full-time employees annually.

The requirements placed on the audit are more or less exacting depending on the size of the company. Small, medium-sized and very small companies can, in the future, make do with a so-called limited audit based primarily on surveys, analytical audit procedures and limited tests of details. Very small companies can even forego an audit altogether provided all of the equity holders of the company agree.

What is an ICS and why is it subject to legal requirements?

The Internal Control System (ICS) is an important corporate management tool: it comprises all the processes, methods and measures put in place by management in order to ensure the correct conduct of business activity. The ICS forms part of the operating processes and covers all levels of the company. The ICS makes an important contribution to good corporate governance.

In the past, the ICS has not been explicitly mentioned in the CO. However, the general accounting principles have implicitly required the presence of certain internal controls. The new audit law now obliges the auditors to check as part of a normal audit whether an ICS exists. The CO does not stipulate any specifications for an ICS. Consequently, the company management must or can determine the nature and scope of internal controls itself.
What does the Audit Supervision Act (ASA) govern?
Firstly, the ASA introduces an approval procedure under which a supervisory authority checks whether auditors and audit companies comply with the legal requirements relating to audits. Furthermore, the auditors of publicly held companies are subject to state supervision and are reviewed by the supervisory authority at least every three years. They are also subject to special regulations concerning independence.

This law has emerged in the light of the more rigorous requirements now set out in US legislation and will simplify international cooperation in this area.

What will the new regulations concerning transparency contribute?
The new provisions in the CO require listed companies to publish information on compensation, credits and loans to members of the board of directors, the advisory council and the senior management in the notes to the annual financial statements. Payments to former members of the board of directors, the advisory council and the senior management must be disclosed if they depart from normal commercial practice or are related to the previously exercised activity.

Some of this information has already been required by the SWX Swiss Exchange as part of corporate governance reporting. Some of these details are now to be transferred to the audited notes to the annual financial statements. However, the new legal provisions go materially further than the previously applicable SWX requirements. For example, the total compensation paid must be disclosed individually for each member of the board of directors. Furthermore, any payments or loans to individuals who are closely related with members of the board of directors, advisory council or senior management must now be disclosed if they deviate from standard commercial practice.

Why is the law relating to LLCs being revised?
Since the last revision of company law in 1991, LLCs have grown in importance. However, the corresponding articles in the legislation were last adapted in 1936 and were no longer appropriate for today’s economic world.

LLCs are now, effectively, personally owned stock companies. The members’ personal and subsidiary liability for the authorized capital has been abolished and the liability now resides exclusively in the corporate assets. The CHF 2 million capital “ceiling” has also been abolished. Only one person is now required for setting up a LLC. It is also easier to transfer shareholders’ equity. An official authentication is no longer required. Instead, a simple written confirmation suffices. A single member of the company may now also hold multiple shares. In contrast to a corporation, it is possible to introduce calls for additional contributions, subsidiary obligations and veto rights.

This legal form continues to be suitable primarily for small companies. With a minimum capital commitment of CHF 20,000, the members can play a role in economic life without incurring the risks of personal liability.

What do the specifications relating to risk assessment contain and what is their aim?
In the notes to the financial statements, companies have to explain their risk assessment procedure. Risk assessment forms part of risk management and contributes to the monitoring and control of corporate risks. The new provisions apply to all publicly held companies and other businesses which are required to produce notes in accordance with company law.

As is the case for the ICS, the law does not set out any detailed rules but instead entrusts the board of directors with the design of the risk assessment procedure. However, it is expected to take an in-depth view of the specific risks the company in question is facing. The new provisions apply only to those risks which are of significance for the evaluation of the annual financial statements. A certain discretionary scope is left regarding the content and extent of the information disclosed in the notes. Companies might therefore decide simply to indicate the risk assessment process or instead to describe all the existing significant risks.

What does the future hold?
One of the most important ongoing projects is the comprehensive revision of corporate and accounting law, which is set to introduce a wide variety of new developments. A key aspect is an improvement in corporate governance, for example by strengthening shareholders’ rights to scrutinize company activity and obtain information, and an updating of the ruling on admission rights to general meetings. The project also includes a comprehensive revision of accounting law. A preliminary draft legislation was submitted for public commenting, but the subsequent procedure and a concrete schedule are not yet known at the time of this publication.