GUIDELINES ON ACCOUNTING POLICY

IFRS OPERATING MANUAL

Approved by the Board of Directors on
22nd September 2016

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(*) The Annex will be sent on a quarterly basis simultaneously with reporting package.

2 GENERAL ASPECTS

2.1 PURPOSE

This operating manual has been developed in order to prepare and define Group financial reporting, according to applicable standards and principles (International accounting standards IAS/IFRS) and Regulator requirements (Bank of Italy Circular 262 of 22 December 2005 and subsequent updates).

It aims to ensure the correct application of accounting principles within the Group and to implement a monitoring tool for regulatory and supervisory purposes.

The document is for internal use only and it is not to be disclosed to third parties.

This Document contains the key issues for the Mediolanum Group, listed below:

- Consolidated Financial Statements (IFRS 10 – IFRS 12)
- Joint arrangements and investments in associates and joint venture (IFRS 11- IAS 28 – IFRS 12)
- Business combination (IFRS 3)
- Impairment of assets (IAS 36)
- Financial instruments (IAS 32 – IAS 39 – IFRS 9 – IFRS 13 – IFRS 7)
- Derivatives and hedge accounting (IAS 39 – IFRS 9)
- Insurance contacts (IFRS 4)
- Provisions (IAS 37)
- Employee benefits (IAS 19)
- Share-based payments (IFRS 2)
- Revenues (IAS 18 – IFRS 15)
- Property, plant and equipment (IAS 16 – IAS 40 – IAS 17 – IFRS 16)
- Intangible assets (IAS 38)

For any other issue not covered in this Document, please refer to *International accounting standards IAS / IFRS.*

IFRS 9 Financial Instruments and IFRS 4 Insurance Contracts Phase II are currently under discussion and are subject to managerial decisions.

2.2 VALIDITY

The following manual has been approved by the Board of Directors of Banca Mediolanum on **22nd September 2016** and it is in force since this date.

2.3 OWNERSHIP AND UPDATING

This Document will be updated at least on annual basis, according to IAS/IFRSs new standards by Bilancio & Data Reporting Office and it will be send to entities at each quarterly closing to supplement the Reporting Package.

For a better understanding of the dispositions contained in this Manual and to ensure uniformity in the application of accounting standards, round tables (through on-site visits or conference calls) will be periodically planned. They will concern the discussion of company performances, the effective application of Group policies, innovations and projects.

2.4 DOCUMENT RECIPIENTS

This Document has been compiled for the exclusive use of Mediolanum Group entities for the correct application of accounting principles. In particular:

- **Each entity is required to ensure that the principles contained in this Document are compliant with their general accounting system.**
- **Group companies, at each quarterly closing, are required to fill in the Checklist attached to this Document (Please see ANNEX 1).**
- **Group companies, at each quarterly closing, are required to provide comments and description about major transactions (Please see, ANNEX 2 AND ANNEX 3 attached to this Document).**
- **Each entity is required to provide the Submission form filled with relevant informations on new accounting standards applications and the related accounting**

proposal. This should be agreed and approved by the Head of Group Accounting & Financial Statements and the Chief Financial Officer of the Parent Company.

- **Any deviation from the rules here below described should be agreed and approved by the Head of Group Accounting & Financial Statements and the Chief Financial Officer of the Parent Company.**

For any communication each company is required to contact Bilancio & Data Reporting Department (bilancioedatareporting@mediolanum.it).

2.5 SOFTWARE AND TOOLS

For consolidation purposes, the Software platform in use by Group companies is **TAGETIK**.

Each user is required to fill in the **Prospects and Notes**, in according with the Instructions (Reporting Package) sent at each quarterly closing.

The accounting currency is **Euro** denominated.

Prospects and tables should be compiled in **Unit of Euro**.

2.6 STRUCTURE AND CONTENT OF THE DOCUMENT

This Document is divided in 13 chapters related to different main topics. Each chapter is structured in different section, as below:

Introduction and overview of rules

It contains an overview and scope of the standards, the analysis of the interconnections with other standards and informations on the date of issue, the list of the most recent amendments and expected development.

Accounting rules

It contains a summary of the main contents and an analysis of dispositions contained in the standards.

Group Policies and relevant topics to Mediolanum Group

Group operating decisions, analysis of material issues for Mediolanum Group and interconnections with supervisory and banking regulations.

Illustrative examples

Illustrative examples with reference to the main issues discussed, useful for a better understanding and a concrete application of Group policies.

Presentation

It contains disclosure required by the Regulator (Bank of Italy) and defined at consolidated level (Notes and other minimum information content).

3 GENERAL ACCOUNTING PRINCIPLES

3.1 QUALITATIVE CHARACTERISTICS OF USEFUL FINANCIAL INFORMATION AND PRESENTATION OF FINANCIAL STATEMENTS - CONCEPTUAL FRAMEWORK - IAS 1

The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions.

The financial statements must "present fairly" the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events, and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework.

The Conceptual Framework notes that financial statements are normally prepared assuming the entity is a going concern and will continue in operation for the foreseeable future.

IASB's Conceptual Framework for Financial Reporting considers the qualitative characteristics of decision-useful financial information, and constraints on the information that can be provided by financial reporting, so as to identify the types of information that are likely to be most useful to the primary users of general purpose financial reports.

The Conceptual Framework states that if financial information is to be useful, it must be relevant and faithfully represent what it purports to represent; these are the two fundamental qualitative characteristics of useful financial information – **'relevance'** and **'faithful representation'**.

Information must be both relevant and faithfully represented if it is to be useful. Neither a faithful representation of an irrelevant event or transaction, nor an unfaithful representation of a relevant event or transaction, helps users make good decisions.

The usefulness of financial information is considered to be enhanced if it is comparable, verifiable, timely and understandable. **'Comparability'**, **'verifiability'**, **'timeliness'** and **'understandability'** are therefore described as enhancing qualitative characteristics.

The Conceptual Framework notes that such enhancement should be maximised to the extent possible. However, these qualitative characteristics cannot make information useful if the information is irrelevant or not faithfully represented.

The application of IFRSs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.

IAS 1 requires an entity whose financial statements comply with IFRSs to make an explicit and unreserved statement of such compliance in the notes. Financial statements cannot be described as complying with IFRSs unless they comply with all the requirements of IFRSs (which includes International Financial Reporting Standards, International Accounting Standards, IFRIC Interpretations and SIC Interpretations).

Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used or by notes or explanatory material.

RELEVANCE

Financial information is relevant when it is **"capable of making a difference in the decisions made by users"**. Information is capable of making a difference in a decision-making process if it has predictive value (i.e. it can be used as an input to predict future outcomes), confirmatory value (i.e. it provides feedback about previous evaluations), or both.

In determining whether information is relevant to the needs of users, preparers of financial information need to take account of the nature and materiality of the information. Information is considered to be material if omitting it or misstating it could influence the decisions of users taken on the basis of the financial information. Because materiality is an entity-specific characteristic to be determined in the context of an individual entity's financial report, the IASB has concluded that it cannot specify a uniform quantitative threshold for materiality or predetermine what could be material in a particular situation.

FAITHFUL REPRESENTATION

Relevant financial information must also be faithfully represented to be useful. A faithful representation is one that is **"complete, neutral, and free from error"** to the extent possible.

A depiction is 'complete' if it includes all of the information that a user needs to understand what is being reported, including all necessary descriptions and explanations.

A depiction is 'neutral' if it is without bias in the selection or presentation of financial information (i.e. it is not slanted, weighted, emphasised, de-emphasised or otherwise manipulated to increase the probability that financial information will be received favourably or unfavourably by users).

A depiction is 'free from error' if there are no errors or omissions in the information provided and the process used to produce the reported information has been selected and applied with no errors in the process. In this context, free from error does not mean perfectly accurate in all respects.

Please note:

An entity shall use the same accounting policies in its opening IFRS statement of financial position and throughout all periods presented in its first IFRS financial statements. Those accounting policies shall comply with each IFRS effective at the end of its first IFRS reporting period.

The accounting policies that an entity uses in its opening IFRS statement of financial position may differ from those that it used for the same date using its previous GAAP. The resulting adjustments arise from events and transactions before the date of transition to IFRSs. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRSs.

Such approach must be specifically approved in advance by the Head of Group Accounting & Financial Statements.

Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict an event or transaction if both are considered equally relevant and faithfully represented.

COMPARABILITY

Information about an entity is considered to be more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items.

Using the same methods for the same items, either from period to period within an entity or in a single period across entities (i.e. consistency), helps to achieve comparability. Although an economic event or transaction can sometimes be faithfully represented in multiple ways, permitting alternative accounting methods for the same economic phenomenon diminishes comparability.

VERIFIABILITY

Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation.

Quantified information need not be a single point estimate to be verifiable – a range of possible amounts and the related probabilities can also be verified. Verifiability helps assure users that information faithfully represents the events or transactions it purports to represent.

Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation (e.g. by counting cash). Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology.

It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information, and other factors and circumstances that support the information.

TIMELINESS

Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information is the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

UNDERSTANDABILITY

Classifying, characterising and presenting information clearly and concisely makes it understandable.

The Conceptual Framework allows a preparer to assume that users have a reasonable knowledge of business and economic activities, and that users review and analyse the information diligently. Complex financial information should not be excluded from financial reports in order to make those financial reports easier to understand, because the resulting information would be incomplete and, therefore, potentially misleading.

3.2 MANAGEMENT OF ACCOUNTING PERIODS AND RECOGNITION PROCEDURES

The general accounting system must be updated whenever there is a corporate event that has an impact on the accounting.

Each corporate event that relates to a cash movement should be recorded within the month in which has been occurred, in order to allow the general ledger bank accounts to be promptly reconciled.

For all the others corporate events the accounting system must be updated according to the timetable issued every month and in any case no later than the thirtieth day from the occurrence of the event.

In particular, the procedure of recognizing the accounting events relating to each occurrence must take into account the distinction between:

- the recognition date; the date on which the recognized item is added to the general accounting system;
- Event date: the actual date of the accounting event (e.g., the movement of cash for payment of a note must carry the date of the payment order, i.e., the date on which the order was sent to the intermediary).

For all the cash movements the event date shall have the same month of the recognition date.

Each transaction must be accompanied by the relative description which must:

- explain the corporate event underlying the transaction (e.g.: for bank transactions, despite the ones automatically recorded the description must at least contain the information that is present in the account statement).

3.3 MANAGEMENT OF CHANGES IN ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS – IAS 8

CHANGES IN ACCOUNTING POLICIES

An accounting policy can be changed only if the change:

- is required by an IFRS;
- or results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

It is important that changes in accounting policies are only made if one of the above criteria is met; otherwise comparability over time within the financial statements will be lost.

Please note:

Every voluntary change of an accounting policy must be discussed in advance with the Parent Company and approved by the Head of Group Accounting & Financial Statements.

CHANGES IN ACCOUNTING ESTIMATES

The use of reasonable estimates is essential in the preparation of financial statements. A revision of an estimate may be required if the circumstances on which the estimate was based change, or if new information or experience is gained. The revision of an estimate does not relate to prior periods and is not equivalent to the correction of an error.

The effect of a change in an accounting estimate is recognised prospectively by including it in profit or loss in:

- the period of the change, if the change affects that period only (e.g. revision of a bad debts estimate);
- or the period of the change and future periods, if the change affects both (e.g. revision of the estimated useful economic life of a depreciable asset).

An entity discloses the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods. The disclosure of the effect on future periods is not required when it is impracticable to estimate that effect.

If the amount of the effect in future periods is not disclosed because estimating it is impracticable, the entity should disclose this fact.

Please note:

Any change of estimates that each entity should apply must be discussed in advance with the Parent Company and approved by the Head of Group Accounting & Financial Statements.

MANAGEMENT OF ERRORS

Financial statements do not comply with IFRSs if they contain either:

- material errors; or
- immaterial errors made intentionally in order to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Errors can occur in respect of the recognition, measurement, presentation or disclosure of elements of the financial statements.

If a current period error is discovered before the financial statements are authorised for issue, it is corrected in the current period. However, if a material error remains undetected until a subsequent period, the prior period error is corrected retrospectively in the first set of financial statements authorised for issue after its discovery.

Except when it is impracticable to do so, material prior period errors are corrected by:

- restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

The correction of the prior period error is excluded from profit or loss in the period of discovery.

A prior period error is corrected by retrospective restatement, except to the extent that it is impracticable to determine either:

- the period-specific effects; or
- the cumulative effect of the error.

Please note:

Any correction of errors must be discussed in advance by each entity with the Parent Company and approved by the Head of Group Accounting & Financial Statements and Group the Chief Financial Officer of the Parent Company.

3.4 EVENTS AFTER THE REPORTING PERIOD – IAS 10

Such entity shall adjust the amounts recognized in its financial statements to reflect adjusting events after the reporting period. Adjusting *events after the reporting period* are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue and that provide evidence of conditions that existed at the end of the reporting date.

An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the reporting period.

If non-adjusting events after the reporting period are material, non-disclosure could influence the economic decisions that users make on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting period:

- the nature of the event; and
- an estimate of its financial effect, or a statement that such an estimate cannot be made.

An entity shall disclose the date when the financial statements were authorized for issue and who gave that authorisation. If the entity’s owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

It is important for users to know when the financial statements were authorized for issue, because the financial statements do not reflect events after this date.

If an entity receives information after the reporting period about conditions that existed at the end of the reporting period, it shall update disclosures that relate to those conditions, in the light of the new information.

3.5 INTERIM FINANCIAL REPORTING – IAS 34

Governments, securities regulators, stock exchanges, and accountancy bodies often require entities whose debt or equity securities are publicly traded to publish interim financial reports.

Specifically, listed entities must:

- provide interim financial reports at least as of the end of the first half of their financial year; and
- make their interim financial reports available not later than 60 days after the end of the interim period.

Each financial report, annual or interim, is evaluated on its own for conformity to IFRSs: so each entity should prepare their interim report in accordance with the present Manual.

If a complete set of financial statements is published in the interim report, those financial statements should be in full compliance with IFRSs

If the annual financial statements were consolidated (group) statements, the interim statements should be group statements as well.

In the statement that presents the components of profit or loss for an interim period, an entity shall present basic and diluted earnings per share for that period when the entity is within the scope of IAS 33 *Earnings per Share*.

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Chapter 1
Consolidated Financial Statements

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the IFRS 10 — *Consolidated Financial Statements*;
- a reference to IFRS 12 — *Disclosure of Interests in Other Entities*;
- a list of most recent amendments to IFRS 10 and related.

1.1 Introduction

Under IFRSs, the main standard that addresses the requirements for the preparation and presentation of consolidated financial statements is *IFRS 10 – Consolidated Financial Statements*. In addition, there is a separate standard, IFRS 12 — *Disclosure of Interests in Other Entities*, which provides requirements of disclosures about an entity's interests in subsidiaries, joint arrangements and other similar type of entities. Moreover, other standards related to this topic are:

- IFRS 11 *Joint Arrangements;*
- IAS 27 *Separate Financial Statements* (2011);
- IAS 28 *Investments in Associates and Joint Ventures* (2011).

1.2 Overview of IFRS 10 and IFRS 12

IFRS 10 *Consolidated Financial Statements* outlines the requirements for the preparation and presentation of consolidated financial statements, requiring entities to consolidate entities it controls. Control requires exposure or rights to variable returns and the ability to affect those returns through power over an investee.

IFRS 10 was issued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

Date	**Development**	**Comments**
17 December 2015	Amended by *Effective Date of Amendments to IFRS 10 and IAS 28*	defer the effective date of the September 2014 amendments to these standards indefinitely
18 December 2014	Amended by *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS*	Effective for annual periods beginning on or after 1 January 2016

	28) (project history)	
11 September 2014	Amended by *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*	Deferred indefinitely
31 October 2012	Amended by *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* (project history)	Effective for annual periods beginning on or after 1 January 2014
28 June 2012	Amended by *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (project history)	Effective for annual periods beginning on or after 1 January 2013
12 May 2011	IFRS 10 *Consolidated Financial Statements* published	Effective for annual periods beginning on or after 1 January 2013
29 September 2010	Staff draft of IFRS X *Consolidated Financial Statements* published	
18 December 2008	ED 10 *Consolidated Financial Statements* published	Comment deadline 20 March 2009
April 2002	Project on consolidation added to the IASB's agenda (project history)	

IFRS 12 *Disclosure of Interests in Other Entities* is a consolidated disclosure standard requiring a wide range of disclosures about an entity's interests in subsidiaries, joint arrangements, associates and unconsolidated 'structured entities'. Disclosures are presented as a series of objectives, with detailed guidance on satisfying those objectives.

IFRS 12 was issued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

Date	Development	Comments
April 2002	Project on consolidation added to the IASB's agenda	History of the project
November 2004	Project on joint arrangements added to the IASB's agenda	History of the project
13 September 2007	ED 9 *Joint Arrangements* published	Comment deadline 11 January 2008
18 December 2008	ED 10 *Consolidated Financial Statements* published	Comment deadline 20 March 2009
January 2010	IASB decision to issue a separate disclosure standard addressing a reporting entity's involvement with other entities that are not in the scope of IAS 39/IFRS 9	
12 May 2011	IFRS 12 *Disclosure of Interests in Other Entities* issued	Effective for annual periods beginning on or after 1 January 2013
28 June 2012	Amended by *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities: Transition Guidance* (project history)	Effective for annual periods beginning on or after 1 January 2013
31 October 2012	Amended by *Investment Entities (Amendments to IFRS 10, IFRS 12 and IAS 27)* (project history)	Effective for annual periods beginning on or after 1 January 2014
18 December 2014	Amended by *Investment Entities: Applying the Consolidation Exception*	Effective for annual periods beginning on or after 1 January 2016

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IFRS 10 and IFRS 12, that have to be followed:

- by the holding company for preparing the Group's consolidated financial statements;
- by the intermediate sub-holding companies of the Group for preparing their IFRS sub-consolidated reporting package.

2.1 General definition

Consolidated financial statements
The financial statements of a group in which the assets, liabilities, equity, income, expenses and cash flows of the parent and its subsidiaries are presented as those of a single economic entity.

Control of an investee
An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Parent
An entity that controls one or more entities.

Power
Existing rights that give the current ability to direct the relevant activities.

Protective rights
Rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate.

Relevant activities
Activities of the investee that significantly affect the investee's returns.

Interest in another entity
Refers to contractual and non-contractual involvement that exposes an entity to variability of returns from the performance of the other entity. An interest in another entity can be evidenced by, but is not limited to, the holding of equity or debt instruments as well as other forms of involvement such as the provision of funding, liquidity support, credit enhancement and guarantees. It includes the means by which an entity has control or joint control of, or significant influence over, another entity. An entity does not necessarily have an interest in another entity solely because of a typical customer supplier relationship.

Structured entity

An entity that has been designed so that voting or similar rights are not the dominant factor in deciding who controls the entity, such as when any voting rights relate to administrative tasks only and the relevant activities are directed by means of contractual arrangements.

Investment entity

An entity that:

1. obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;
2. commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and
3. measures and evaluates the performance of substantially all of its investments on a fair value basis.

IFRS 10-12

2.2 Scope of rules

The objective of IFRS 10 is to establish principles for the presentation and preparation of consolidated financial statements when an entity controls one or more other entities.

The Standard:

- requires a parent entity (an entity that controls one or more other entities) to present consolidated financial statements;
- defines the principle of control, and establishes control as the basis for consolidation;
- sets out how to apply the principle of control to identify whether an investor controls an investee and therefore must consolidate the investee;
- sets out the accounting requirements for the preparation of consolidated financial statements;
- defines an investment entity and sets out an exception to consolidating particular subsidiaries of an investment entity.

The objective of IFRS 12 is to require the disclosure of information that enables users of financial statements to evaluate:

- the nature of, and risks associated with, its interests in other entities;
- the effects of those interests on its financial position, financial performance and cash flows.

Where the disclosures required by IFRS 12, together with the disclosures required by other IFRSs, do not meet the above objective, an entity is required to disclose whatever additional information is necessary to meet the objective.

IFRS 12 is required to be applied by an entity that has an interest in any of the following:

- subsidiaries;
- joint arrangements (joint operations or joint ventures);
- associates;
- unconsolidated structured entities.

IFRS 12 does not apply to certain employee benefit plans, separate financial statements to which IAS 27 *Separate Financial Statements* applies (except in relation to unconsolidated structured entities and investment entities in some cases), certain interests in joint ventures held by an entity that does not share in joint control, and the majority of interests in another entity accounted for in accordance with IFRS 9 *Financial Instruments*.

An investment entity that prepares financial statements in which all of its subsidiaries are measured at fair value through profit or loss presents the disclosures relating to investment entities required by IFRS 12. **IFRS 10.1**

2.3 Accounting requirements

Control

An investor determines whether it is a parent by assessing whether it controls one or more investees. An investor considers all relevant facts and circumstances when assessing whether it controls an investee. An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

An investor controls an investee if and only if the investor has all of the following elements:

- power over the investee, i.e. the investor has existing rights that give it the ability to direct the relevant activities (the activities that significantly affect the investee's returns) **IFRS 12.1**
- exposure, or rights, to variable returns from its involvement with the investee
- the ability to use its power over the investee to affect the amount of the investor's returns.

IFRS 12.3 Power arises from rights. Such rights can be straightforward (e.g. through voting rights) or be complex (e.g. embedded in contractual arrangements). An investor that holds only protective rights cannot have power over an investee and so cannot control an investee.

An investor must be exposed, or have rights, to variable returns from its involvement with an investee to control the investee. Such returns must have the potential to vary as a result of the investee's performance and can be positive, negative, or both. **IFRS 12.5**

A parent must not only have power over an investee and exposure or rights to variable returns from its involvement with the investee, a parent must also have the ability to use its power over the investee to affect its returns from its involvement with the investee.

IFRS 12.6

When assessing whether an investor controls an investee an investor with decision-making rights determines whether it acts as principal or as an agent of other parties. A number of factors are considered in making this assessment. For instance, the remuneration of the decision-maker is considered in determining whether it is an agent.

Preparation of consolidated financial statements

Each company that is a "parent" company (as defined above) need to prepare consolidated financial statements using uniform accounting policies for like transactions and other events in similar circumstances.

However, a parent need not present consolidated financial statements if it meets all of the following conditions:

IFRS 10.5-6

- it is a wholly-owned subsidiary or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements
- its debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets)
- it did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market, and
- its ultimate or any intermediate parent of the parent produces financial statements available for public use that comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10.

IFRS 10.7

Investment entities are prohibited from consolidating particular subsidiaries. Furthermore, post-employment benefit plans or other long-term employee benefit plans to which IAS 19 *Employee Benefits* applies are not required to apply the requirements of IFRS 10.

IFRS 10.11-14

Consolidation procedures

IFRS 10.15

Consolidated financial statements:

- combine like items of assets, liabilities, equity, income, expenses and cash flows of the parent with those of its subsidiaries;
- offset (eliminate) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary;
- eliminate in full intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between entities of the group (profits or losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full).

IFRS 10.17

IFRS 10.58-60

A reporting entity includes the income and expenses of a subsidiary in the consolidated financial statements from the date it gains control until the date when the reporting entity ceases to control the subsidiary. Income and expenses of the subsidiary are based on the amounts of the assets and liabilities recognised in the consolidated financial statements at the acquisition date.

The parent and subsidiaries are required to have the same reporting dates, or consolidation based on additional financial information prepared by subsidiary, unless impracticable. Where impracticable, the most recent financial statements of the subsidiary are used, adjusted for the effects of significant transactions or events between the reporting dates of the subsidiary and consolidated financial statements. The difference between the date of the subsidiary's financial statements and that of the consolidated financial statements shall be no more than three months. **IFRS 10.19** **IFRS 10.4**

Non-controlling interests (NCIs)

A parent presents non-controlling interests in its consolidated statement of financial position within equity, separately from the equity of the owners of the parent.

A reporting entity attributes the profit or loss and each component of other comprehensive income to the owners of the parent and to the non-controlling interests. The proportion allocated to the parent and non-controlling interests are determined on the basis of present ownership interests.

The reporting entity also attributes total comprehensive income to the owners of the parent and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Changes in ownership interests

Changes in a parent's ownership interest in a subsidiary that do not result in the parent losing control of the subsidiary are equity transactions (i.e. transactions with owners in their capacity as owners). When the proportion of the equity held by non-controlling interests changes, the carrying amounts of the controlling and non-controlling interests area adjusted to reflect the changes in their relative interests in the subsidiary. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity and attributed to the owners of the parent. **IFRS 10.86**

If a parent loses control of a subsidiary, the parent:

- derecognises the assets and liabilities of the former subsidiary from the consolidated statement of financial position
- recognises any investment retained in the former subsidiary when control is lost and subsequently accounts for it and for any amounts owed by or to the former subsidiary in accordance with relevant IFRSs. That retained interest is remeasured and the remeasured value is regarded as the fair value on initial recognition of a financial asset in accordance with IAS 39/IFRS 9 or, when appropriate, the cost on initial recognition of an investment in an associate or joint venture **IFRS 10.88**
- recognises the gain or loss associated with the loss of control attributable to the former controlling interest.

IFRS 10.92-93

If a parent loses control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture gains or losses resulting from those transactions are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture.

Investment entities consolidation exemption

IFRS 10 contains special accounting requirements for investment entities. Where an entity meets the definition of an 'investment entity', it does not consolidate its subsidiaries, or apply IFRS 3 *Business Combinations* when it obtains control of another entity. **IFRS 10.22** **IFRS 10.89**

An entity is required to consider all facts and circumstances when assessing whether it is an investment entity, including its purpose and design. IFRS 10 provides that an investment entity should have the following typical characteristics: **IFRS 10.94**

- it has more than one investment;
- it has more than one investor;
- it has investors that are not related parties of the entity;
- it has ownership interests in the form of equity or similar interests.

IFRS 10.23

The absence of any of these typical characteristics does not necessarily disqualify an entity from being classified as an investment entity.

An investment entity is required to measure an investment in a subsidiary at fair value through profit or loss in accordance with IFRS 9 *Financial Instruments* or IAS 39 *Financial Instruments: Recognition and Measurement*.

However, an investment entity is still required to consolidate a subsidiary where that subsidiary provides services that relate to the investment entity's investment activities. **IFRS 10.25**

Because an investment entity is not required to consolidate its subsidiaries, intragroup related party transactions and outstanding balances are not eliminated.
Special requirements apply where an entity becomes, or ceases to be, an investment entity.

The exemption from consolidation only applies to the investment entity itself. Accordingly, a parent of an investment entity is required to consolidate all entities that it controls, including those controlled through an investment entity subsidiary, unless the parent itself is an investment entity.

IFRS 10.31

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by the holding company for preparing the Group consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) and by the intermediate sub-holding companies of the Group for preparing their sub-consolidated reporting package;
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

IFRS 10.28

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

IFRS 10.31

IFRS 10.32

3.1 Group policies

When assessing control, the Group should first consider the purpose and design of the investee in order to identify:

- the relevant activities (i.e. the activities of the investee that significantly affect the investee's returns);
- how decisions about the relevant activities are made;
- who has the current ability to direct those activities;
- who receives returns from those activities.

IFRS 10.B100

IFRS 10.33

Sometimes, this assessment will be very straightforward; it may be clear that control over the investee is exercised directly and solely by means of equity instruments (e.g. ordinary shares) that give the holder proportionate voting rights.

In such circumstances, unless more complex arrangements have been put in place that alter decision-making, the assessment of control should focus on which party, if any, is able to exercise voting rights sufficient to determine the investee's operating and financing policies. In clear-cut situations, the investor that holds a majority of those voting rights, in the absence of any other factors controls the investee.

As specified by the Basis for Conclusions on IFRS 10, it has to be taken into account by the Group that:

- only one party (if any) can control an investee; and
- the fact that other entities have protective rights relating to the activities of an investee does not prevent an investor from having control of an

investee.

Power over an investee

A Group Component has power over an investee when it has existing rights that give it the current ability to direct the relevant activities.

Key steps in the determination as to whether an entity has power over an investee are:

- identifying the relevant activities;
- understanding how decisions about relevant activities are made; and
- determining whether the investor's rights give it the current ability to direct the relevant activities.

Relevant activities are defined as "activities of the investee that significantly affect the investee's returns".

It could be difficult to determine the relevant activities of an investee in certain scenarios. In these situations, it is important for an investor to understand the purpose and design of an investee.

IFRS 10 requires to focus on the activities that significantly affect the returns of an investee.

- When the investee is directed through voting or similar rights, power often relates to governing the strategic operating and financing policies of an investee. However, as explained in the Basis for Conclusions on IFRS 10, that is only one of the ways in which power to direct the activities of an investee can be achieved. Referring to the power to govern the financial and operating policies of an investee is not necessarily appropriate for investees that are not directed through voting or similar rights.
- It is important to focus on activities that have a *significant* effect on the investee's returns rather than on administrative activities that have little or no effect on the investee's returns. This focus is particularly important when assessing control of investees that are not directed through voting or similar rights and for which there may be multiple parties with decision-making rights over different activities.

IFRS 10 does not provide a definitive list of which activities should be considered to be relevant activities but rather observes that, for many investees, various operating and financing activities significantly affect their returns. Examples of activities that, depending on the circumstances, can be relevant activities include, but are not limited to:

- selling and purchasing of goods or services;
- managing financial assets during their life (including upon default);
- selecting, acquiring or disposing of assets;
- researching and developing new products or processes; and
- determining a funding structure or obtaining funding.

Having identified the relevant activities of an investee, the next key step in understanding who has power over an investee is to understand the mechanisms for making decisions about those relevant activities.
Examples of decisions about relevant activities include, but are not limited to:

- establishing operating and capital decisions of the investee, including budgets; and
- appointing and remunerating an investee's key management personnel or service providers and terminating their services or employment.

Accordingly, it will often be appropriate to focus on the purpose and design of the investee and how decisions are made in relation to, for example:

- changes of strategic direction, including acquisitions and disposals of subsidiaries;
- major capital purchases and disposals;
- appointment and remuneration of directors and other key management personnel;
- approval of the annual plan and budget; and
- dividend policy.

Power arises from rights. To have power over an investee, a company must have existing rights that give it the current ability to direct the relevant activities.
Therefore, the assessment of power is based on the ability to direct the relevant activities of the investee; specifically, IFRS 10 does not require to have actually exercised its power. A company with the current ability to direct the relevant activities of an investee has power over the investee even if its rights to direct have yet to be exercised. Conversely, evidence that the company has been directing the relevant activities of the investee can help determine whether the investor has power, but such evidence is not, in itself, conclusive in determining whether it has power over the investee.

A company can have power over an investee even if other entities have existing rights that give them the current ability to participate in the direction of the relevant activities (e.g. when another entity has significant influence).

The rights that give an investor power can differ between investees. Different types of rights that, either individually or in combination, can give an investor power over an investee include, but are not limited to:

- rights in the form of voting rights (or potential voting rights) of an investee;
- rights to appoint, reassign or remove members of an investee’s key management personnel who have the ability to direct the relevant activities;
- rights to appoint or remove another entity that directs the relevant activities;
- rights to direct the investee to enter into, or veto any changes to, transactions for the benefit of the investor; and
- other rights (such as decision-making rights specified in a management contract) that give the holder the ability to direct the relevant activities.

Only substantive rights relating to an investee should be considered; the substantive rights to be considered are those held by the investor and those held by others. For a right to be substantive, the holder must have the practical ability to exercise that right.

Determining whether or not rights are substantive requires the exercise of judgement, taking into account all facts and circumstances. IFRS 10 sets out a number of factors that an investor should consider in assessing whether rights are substantive (the list is not exhaustive):

- whether there are any barriers (economic or otherwise) that prevent the holder (or holders) from exercising the rights;
- when the exercise of rights requires the agreement of more than one party, or when the rights are held by more than one party, whether a mechanism is in place that provides those parties with the practical ability to exercise their rights collectively if they choose to do so; and
- whether the party or parties that hold the rights would benefit from the exercise of those rights.

In addition, for a right to be substantive, the right needs to be exercisable when decisions about the direction of the relevant activities need to be made.

Consideration of the factors listed in IFRS 10:B23 will assist in the determination as to whether a company has a real ability in practice to direct the relevant activities of an investee. Ultimately, the assessment as to whether rights are substantive is a matter requiring the exercise of careful judgement taking into account all available facts and circumstances.

In evaluating whether rights give power over an investee, it is required to assess whether its rights, and rights held by others, are protective rights. Protective rights are defined as "rights designed to protect the interest of the party holding those rights without giving that party power over the entity to which those rights relate". Given the nature of protective rights, a company that has only protective rights cannot have power or prevent another party from having power over an investee.

IFRS 10 states that protective rights relate to fundamental changes to the activities of an investee or apply in exceptional circumstances. However, not all rights that apply in exceptional circumstances or are contingent on events are protective.
Examples of protective rights include, but are not limited to:

- a lender's right to restrict a borrower from undertaking activities that could significantly change the credit risk of the borrower to the detriment of the lender;
- the right of a party holding a non-controlling interest in an investee to approve capital expenditure greater than that required in the ordinary course of business, or to approve the issue of equity or debt instruments; and

- the right of a lender to seize the assets of a borrower if the borrower fails to meet specified loan repayment conditions.

Frequently, it will be voting or similar rights that give an investor power, either individually or in combination with other arrangements. For example, this will generally be the case when an investee has a range of operating and financing activities that significantly affect the investee's returns and when substantive decision-making with respect to these activities is required continuously.

In some other circumstances voting rights cannot have a significant effect on an investee's returns (e.g. when contractual arrangements determine the direction of the relevant activities and voting rights relate to administrative tasks only). When an investee has been designed so that voting rights are not the dominant factor in determining who controls it, an investor should also focus on the following matters when considering the purpose and design of the investee:
- the risks to which the investee was designed to be exposed;
- the risks it was designed to pass on to the parties involved with the investee; and
- whether the investor is exposed to some or all of those risks.

In such circumstances, consideration of the risks includes not only the downside risk, but also the potential for upside.

Exposure, or rights, to variable returns
The second element of control is that a component is exposed, or has rights, to variable returns from its involvement with the investee. This is the case when the returns from its involvement have the potential to vary as a result of the investee's performance. The returns can be only positive, only negative, or both positive and negative.

Only one company can control an investee, but more than one party can share in the returns of an investee (e.g. holders of non-controlling interests can share in the profits or distributions of an investee).

Examples of returns include:
- dividends, other distributions of economic benefits from an investee (e.g. interest from debt securities issued by the investee), and changes in the value of the investor's investment in that investee;
- remuneration for servicing an investee's assets or liabilities, fees and exposure to loss from providing credit or liquidity support, residual interests in the investee's assets and liabilities on liquidation of that investee, tax benefits, and access to future liquidity that an investor has from its involvement with an investee; and
- returns that are not available to other interest holders. For example, a company might use its assets in combination with the assets of the investee, such as combining operating functions to achieve economies of scale, cost

savings, sourcing scarce products, gaining access to proprietary knowledge or limiting some operations or assets, to enhance the value of the investor's other assets.

If a company is exposed to variable returns by holding equity instruments, those returns may take the form of changes in value of the equity instruments as well as dividends. Often the unilateral ability to set dividend policy is a key factor in demonstrating control, but there may be circumstances in which control exists even though the company does not have the ability to set dividend policy.

Variable returns are returns that are not fixed and have the potential to vary as a result of the performance of an investee. In assessing whether returns from an investee are variable and how variable those returns are, IFRS 10 requires to consider the substance of the arrangement, regardless of the legal form of the returns.

IFRS 10 provides the following examples of variable returns:

- An investor holds a bond with fixed interest payments. The fixed interest payments are variable returns for the purposes of IFRS 10 because they are subject to default risk and they expose the investor to the credit risk of the issuer of the bond. The amount of variability (i.e. how variable those returns are) will depend on the credit risk of the bond.
- An investor receives fixed performance fees in return for managing assets of the investee. The fixed performance fees are variable returns because they expose the investor to the performance risk of the investee. The amount of variability will depend on the investee's ability to generate sufficient income to pay the fee.

These examples illustrate the need for Mediolanum Group’s components to focus on the substance of an arrangement, regardless of the legal form of the returns. In the examples, the legal form is that of a fixed return, but the substance of the return is that it is variable because it will be affected by the ability of the investee to pay.

Link between power and returns

The third and final element of control is that, in addition to having power over the investee and being exposed, or having rights, to variable returns from its involvement with the investee, the investor must have the ability to use its power to affect the investor's returns from its involvement with the investee.

In this context, an investor with decision-making rights is required to determine whether it is acting as a principal or as an agent. An investor that is an agent does not control an investee when it exercises decision-making rights delegated to it.

3.2 Relevant topics

Taking in to account the current context of operations, relevant issues to Mediolanum Group are those related to the treatment in the consolidated financial statements of the "Unit Linked" internal insurance funds and of the funds promoted by the Group.

Mediolanum Group does not consolidate those "Unit Linked" internal insurance funds (for which it holds 100% of the outstanding) and those funds promoted (securities, real estate and Sicav) for which are not respected the conditions for control in IFRS 10.

In relation to the Unit Linked the holding company and each component of the Group potentially interested by the issue verify that:

- they do not exercise full power over the entity of the investment (Unit Linked) as limited by the requirements laid down in the regulations of the funds in terms of asset allocation and management policies;
- they are not significantly exposed to variable returns of the entity involved in the investment.

This happens since the profits or losses related to the valuation of the assets included in the Unit Linked are fully recognized to policyholders through the change in the mathematical reserve and only the change in the relative commission impact remains with the Group (impact compared to the variability of flows of the entity and not considered significant).

In relation to the funds, the Group components verify that:

- they do not own the majority of outstanding units and directly support the investment risk (for example: unit funds that hold shares in funds managed, the risk of which is borne by policyholders);
- they do not exercise full power over the entity of the investment (funds) as limited by the requirements laid down in the regulations of the funds in terms of asset allocation and management policies;
- they are not significantly exposed to variable returns of the entity of the investment as they do not hold a marginal portion of the funds or hold units for which they do not bear the investment risk.

In particular it has to be verified that exposure to changes in the value of the funds, i.e. the gains or losses related to the valuation of assets, are attributable to the subscribers and only the change in the relative commission impact remains with the Group. In particular if the previous conditions are verified the Group is only exposed to the risk of variability of subscription fees and charges on premiums, linked to the performance of inflows, management fees relating to assets under management and incentive fees linked to the performance of managed funds, as well as operational, compliance and reputational risks typical of the sector in which the Group operates.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Accounting requirements (paragraph 4.1)
- Non-controlling interests (paragraph 4.2)
- Investment entities (paragraph 4.3)

that could be considered by Group Component to make decisions on issues related to consolidated financial statement.

4.1 Accounting Requirements

4.1.1 Consolidation procedures

Example 4.1.1.1

Unrealised profit on transfer of a non-current asset

F Limited holds 80 per cent of the issued share capital of G Limited. G Limited purchased a machine on 1 January 20X1 at a cost of CU 4 million. The machine has a life of 10 years.

On 1 January 20X3, G Limited sells the machine to F Limited at a price of CU 3.6 million, being its fair value.

In preparing the consolidated financial statements of F Limited at 31 December 20X3, the effects of the sale from G Limited to F Limited should be eliminated.

At 31 December 20X3, the carrying amount of the machine in the books of F Limited will be CU 3.15 million, after depreciation of CU 450,000 has been recognised (i.e. assuming that the cost to F Limited of CU 3.6 million will be written off over the asset's remaining life of eight years).

G Limited will have recognised a profit on transfer of the asset of CU 400,000 (disposal proceeds of CU 3.6 million less carrying amount, after two years depreciation, of CU 3.2 million).

If there had been no transfer, the asset would have been included in the statement of financial position of G Limited at 31 December 20X3 at CU 2.8 million and depreciation of CU 400,000 would have been recognised in the 20X3 reporting period.

Therefore, the required consolidation entries are as follows.

		CU '000	CU '000
Dr	Consolidated profit or loss (profit on sale)	400	
Cr	Consolidated profit or loss (excess depreciation)		50
Dr	Machine (restore to original cost)	400	
Cr	Accumulated depreciation (based on original date of acquisition)		750

To eliminate the effects of the intragroup transaction.

Because G Limited (the seller) is a non-wholly-owned subsidiary, F Limited will need to apply its accounting policy regarding whether to allocate a proportion of the elimination of the unrealised profit to non-controlling interests (NCIs). If F Limited's accounting policy is to allocate a proportion of the elimination of the unrealised profit to NCIs, a further entry is required to allocate a proportion of the profit or loss adjustment to the NCIs. This ensures that the amount presented for NCIs in the consolidated financial statements appropriately reflects the NCIs' share of the net assets reported in the consolidated financial statements (i.e. after the elimination of the intragroup profit and consequential excess depreciation). The proportion to be attributed to the non-controlling interests is determined as follows.

	CU '000
NCIs' share of profit on sale (20% × CU 400,000)	80
NCIs' share of excess depreciation (20% × CU 50,000)	(10)
	70

Therefore, the following additional journal entry is required.

		CU '000	CU '000
Dr	Non-controlling interests	70	
Cr	Retained earnings		70

If F Limited's accounting policy is not to allocate any of the elimination of the unrealised profit to the NCIs, all of the profit or loss adjustment of CU 350 is attributable to the owners of the parent and this final entry is not required.

Example 4.1.1.2

Unrealised losses

The facts are as in example 4.1.1.1, except that the machine was transferred from G Limited to F Limited at CU 2.4 million, being its fair value.

At 31 December 20X3, the carrying amount of the machine in the books of F Limited will be CU 2.1 million, after depreciation of CU 300,000 has been recognised (i.e. assuming that the cost of CU 2.4 million will be written off over the asset's remaining life of eight years).

G Limited will have recognised a loss on transfer of the asset of CU 800,000 (disposal proceeds of CU 2.4 million less carrying amount of CU 3.2 million).
If there had been no transfer, the asset would have been included in the statement of financial position of G Limited at 31 December 20X3 at CU 2.8 million and depreciation of CU 400,000 would have been recognised in the 20X3 reporting period.

Provided that the entity is satisfied that the original carrying amount of the asset can be recovered, the following consolidation entries are required.

		CU '000	CU '000
Dr	Consolidated profit or loss (additional depreciation)	100	
Cr	Consolidated profit or loss (loss on sale)		800
Dr	Machine (restore to original cost)	1,600	
Cr	Accumulated depreciation (based on original date of acquisition)		900

To eliminate the effects of the intragroup transaction.

Because G (the seller) is a non-wholly-owned subsidiary, F Limited will need to apply its accounting policy regarding the allocation of a proportion of the elimination of the unrealised profit/loss to non-controlling interests (NCIs). If F Limited's accounting policy is to allocate a proportion of the elimination of the unrealised profit/loss to NCIs, a further entry is required to allocate a proportion of the profit or loss adjustment to the NCIs. This ensures that the amount presented for NCIs in the consolidated financial statements appropriately reflects the NCIs' share of the net assets reported in the consolidated financial statements (i.e. after the elimination of the intragroup loss and consequential additional depreciation). The proportion to be attributed to the NCIs is determined as follows.

	CU '000
NCIs' share of unrealised loss on sale (20 per cent × CU 800,000)	160
NCIs' share of additional depreciation (20 per cent × CU 100,000)	(20)
	140

Therefore, the following additional journal entry is required.

		CU '000	**CU '000**
Dr	Retained earnings	140	
Cr	NCIs		140

If F Limited's accounting policy is not to allocate any of the elimination of the unrealised loss to the NCIs, this final entry is not required.

Note that when the transfer at the lower amount indicates that the previous carrying amount of the asset cannot be recovered, an impairment loss should be recognised in accordance with IAS 36 *Impairment of Assets*.

4.1.2 Potential voting rights – impact on consolidation

Example 4.1.2.1

Assessment of in-substance present access to the returns associated with an ownership interest

P Limited holds 60 per cent of the shares in S Limited. It has been determined that this 60 per cent interest results in P Limited controlling S Limited. P Limited also holds an option to acquire an additional 20 per cent of the shares in S Limited.

What factors should P Limited consider in assessing whether its option to acquire an additional 20 per cent interest results, in substance, in P Limited having "an existing ownership interest that currently gives access to the returns associated with an ownership interest" as contemplated in IFRS 10?

The term 'returns associated with an ownership interest' is not defined in IFRSs. However, the economic benefits commonly associated with an ownership interest in an entity may include, for example, access to changes in value of the entity and rights to dividend cash flows.

The determination as to whether a potential voting right corresponds to an in-substance ownership interest will require the exercise of judgement based on the specific terms of the potential voting right. In making that determination, it is helpful to focus on whether the parent is already, in substance, in the same economic position as if it owned the shares that are the subject of the potential voting right (the underlying shares).

One scenario in which this will often be true is when the parent holds a call option with a zero strike price that can be converted into the underlying shares with no notice period. Assuming that it has the practical ability to exercise its option, the parent can ensure that it receives the same return as if it already owned the shares (e.g. by exercising the option prior to any dividend being paid).

When assessing whether its option to acquire an additional 20 per cent interest corresponds to an in-substance ownership interest, other factors that may need to be considered by P Limited include, but are not limited to, the following.

- Is P Limited able to ensure that it receives all or substantially all of the returns to which it would be entitled if it already owned the shares (e.g. by way of dividends and share appreciation)? For example, this might be achieved either through an agreement that any dividends paid to the current holder of the underlying shares will be passed on to P Limited (e.g. in cash or by an adjustment to the exercise price), or by P Limited being in a position to ensure that no dividends are paid until after it has obtained the underlying shares. If P Limited is unable to access some of the returns to which it would be entitled if it already owned the shares, this may suggest that it does not have an in-substance ownership interest;
- What is the basis for the option exercise price? If the transaction price is based on the fair value of the underlying shares at the transaction date (i.e. the date the option is exercised), this will typically indicate that the economic benefits of ownership are retained by the current holder of the underlying shares until the option is exercised;
- Is the option currently exercisable? If the option is not currently exercisable, it should be considered to result in an in-substance ownership interest only if P Limited has the ability to prevent the current holder of the underlying shares from receiving the economic benefits of ownership until such time as

the option becomes exercisable;
- Does the option have economic substance? When the terms of the option have no economic substance, such that P Limited could not conceivably be expected to exercise the rights under the option, the economic benefits of ownership have not been transferred to P Limited.

Note that the considerations and factors set out above also apply to potential voting rights held by a third party. For example, X Limited, a third party, has an option to acquire 5 per cent of the shares in S Limited from P Limited. In determining the appropriate proportions of profit or loss and changes in equity of S Limited to be allocated to P Limited and to the non-controlling interests, P Limited needs to determine whether the potential voting rights held by X Limited represent an in-substance ownership interest for X Limited.

4.1.3 Reporting dates and periods of subsidiaries

Example 4.1.3.1

Change in reporting period of a subsidiary

In prior reporting periods, a subsidiary (Company S) used a 31 December reporting date whereas its parent's reporting date was 31 March. In accordance with IFRS 10, for consolidation purposes each year the parent adjusted Company S's financial statements for the period ended 31 December for significant transactions or events that took place between 1 January and 31 March.

In 20X2, Company S changes its reporting date to align to that of its parent (31 March). As a result of this change, Company S will prepare financial statements for the 12-month periods ended 31 March 20X1 and 31 March 20X2. The financial statements for the year ended 31 March 20X1 may differ from those used for consolidation in the prior period, because the latter used financial statements as of 31 December 20X0 adjusted for significant events that took place between 1 January 20X1 and 31 March 20X1.

Should the adjustment resulting from Company S's change in reporting date be recognised in the consolidated financial statements as a change in accounting policy or as a change in estimate?

In prior reporting periods, for consolidation purposes, the parent estimated what Company S's financial statements for the period ended 31 March would have been by adjusting the subsidiary's financial statements for the period ended 31 December for significant transactions or events that took place in the intervening period. The change in Company S's reporting date will result in a revision of the parent's previous estimate of Company S's 31 March 20X1 financial statements. Therefore, the adjustments required in preparing the consolidated financial statements should be recognised as a change in estimate.

Because Company S's reporting date was changed in the accounting period ending 31 March 20X2, in accordance with IAS 8:36 *Accounting Policies, Changes in Accounting Estimates and Errors*, the impact of the change in estimate should be recognised prospectively in consolidated profit or loss for the year ended 31 March 20X2.

4.2 Non-Controlling interests

4.2.1 Measurement of non-controlling interest

Example 4.2.1.1

Part of an interest in a subsidiary held indirectly through an associate

Parent P owns 70 per cent of Subsidiary S. It also owns 40 per cent of Associate A, over which it has significant influence and which it accounts for using the equity method. Associate A owns the remaining 30 per cent of Subsidiary S.

How should Parent P determine the non-controlling interests (NCIs) in Subsidiary S for the purposes of its consolidated financial statements?

It depends on whether Parent P views the equity method of accounting as a one-line consolidation or as a valuation methodology.

Whether the equity method is considered a one-line consolidation or a valuation methodology is a matter of accounting policy to be applied consistently to all associates and to all aspects of the application of the equity method.

Equity method as a one-line consolidation

Under this view, many of the adjustments and calculations normally performed for consolidation purposes are also performed when applying the equity method.

If Parent P's accounting policy is to apply the equity method as a one-line consolidation, it should include in its percentage of ownership in Subsidiary S the interest held indirectly through Associate A; that is, it should determine the NCIs using the indirect method. Under the indirect method, the proportion of equity and total comprehensive income of Subsidiary S allocated to the NCIs in Parent P's consolidated financial statements is 18 per cent (i.e. 30% × 60%), being the proportion not held by Parent P, its subsidiaries, joint ventures or associates.

Equity method as a valuation methodology

This is often referred to as a 'closed box' approach to the equity method.

If Parent P's accounting policy is to apply the equity method as a valuation methodology, it should not include the interest in Subsidiary S held by Associate A in determining its percentage of ownership in Subsidiary S; that is, it should determine the NCIs using the direct method. Under the direct method, the proportion of equity and total comprehensive income of Subsidiary S allocated to the NCIs in Parent P's consolidated financial statements is 30 per cent, being the proportion not held by Parent P or its subsidiaries.

4.2.2 Changes in the proportion held by non-controlling interests

Example 4.2.2.1

Parent disposes of part of its interest to non-controlling interests

In 20X1, Entity A acquired a 100 per cent equity interest in Entity B for cash consideration of CU 125,000. Entity B's identifiable net assets at fair value were CU 100,000. Goodwill of CU 25,000 was identified and recognised.

In the subsequent years, Entity B increased net assets by CU 20,000 to CU 120,000. This is reflected in equity attributable to the parent.

Entity A then disposed of 30 per cent of its equity interest to non-controlling interests for CU 40,000. The adjustment to equity will be as follows.

	CU
Fair value of consideration received	40,000
Amount recognised as non-controlling interests (30% × 120,000)*	36,000
Positive movement in parent equity	4,000

Note that there is no adjustment to the carrying amount of goodwill of CU 25,000 because control has been retained.

* In this example, it is assumed that NCIs are measured based on their share of identifiable assets. Other approaches may also be acceptable to determine the amount by which non-controlling interests are adjusted (e.g. non-controlling interests might instead be measured initially at the fair value of consideration received, CU 40,000).

Example 4.2.2.2

Non-cash acquisition of non-controlling interests
Entity P has an 80 per cent interest in Entity Q. The remaining 20 per cent is owned by Entity R.

In Entity P's consolidated financial statements, the carrying amount of Entity R's non-controlling interest in Entity Q is CU 30 million. Entity P purchases Entity R's interest for consideration of an intangible asset with a fair value of CU 40 million.

The carrying amount of the intangible asset in Entity P's financial statements is CU 20 million.

When it purchases Entity R's interest in Entity Q, how should Entity P account for the difference of CU 20 million between the fair value of the intangible asset (i.e. the consideration for the purchase) and its carrying amount?

Entity P should recognise a gain of CU 20 million in profit or loss in respect of the difference between the fair value of the intangible asset and its carrying amount. This is in accordance with IAS 38 *Intangible Assets** which requires that "the gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognised in profit or loss when the asset is derecognised".

In contrast, the difference of CU 10 million between the carrying amount of the non-controlling interests (CU 30 million) and the fair value of the consideration paid (CU 40 million) is recognised in equity in accordance with IFRS 10.

Therefore, the journal entry required to record Entity P's purchase of Entity R's interest is as follows.

		CU '000	**CU '000**
Dr	Non-controlling interests	30,000	
Dr	Equity	10,000	
Cr	Intangible asset		20,000
Cr	Gain (profit or loss)		20,000

This conclusion was confirmed by the IFRS Interpretations Committee in the January 2013 *IFRIC Update*.

* Similar requirements apply for other categories of assets. For example, if the asset transferred as consideration is an item of property, plant and equipment, the equivalent reference is IAS 16 *Property, Plant and Equipment*.

4.3 Investment entities

4.3.1 Determining whether an entity is an investment entity

Example 4.3.1.1

Exit strategy for equity investments holding fixed-term assets

Entity G is listed on a stock exchange and has a wide range of shareholders. Its business model, as set out in its listing prospectus, is to raise capital from investors in order to acquire controlling interests in entities which hold fixed-term assets.

Entity G has committed to its investors that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both.

Entity G expects to hold these investments for the whole of the life of the underlying assets. The investments will then be liquidated. Entity G measures and evaluates the performance of all of its investments on a fair value basis, and reports internally on this basis.

It is clear that an investment entity does not need an exit strategy for assets with a limited life, even if it plans to hold them to maturity. However, in the circumstances under consideration, Entity G holds the fixed-term assets indirectly through equity investments which have the potential to be held indefinitely. Entity G therefore needs to have documented exit strategies for the entities in which it has invested. Although the entities themselves do not have limited lives, because Entity G's business model is that they will be liquidated after a pre-determined period, this is evidence of an exit strategy.

The only exception to this requirement is if the entities in which Entity G invests are themselves investment entities; if the conditions in that paragraph were met, Entity G would not need to plan to liquidate the investment entity investee entities after the fixed-term investments have matured.

Example 4.3.1.2

Illustrative Example (1)

An entity, Limited Partnership, is formed in 20X1 as a limited partnership with a 10-year life. The offering memorandum states that Limited Partnership's purpose is to invest in entities with rapid growth potential, with the objective of realising capital appreciation over their life. Entity GP (the general partner of Limited Partnership) provides 1 per cent of the capital to Limited Partnership and has the responsibility of identifying suitable investments for the partnership. Approximately 75 limited partners, who are unrelated to Entity GP, provide 99 per cent of the capital to the partnership.

Limited Partnership begins its investment activities in 20X1. However, no suitable investments are identified by the end of 20X1. In 20X2 Limited Partnership acquires a controlling interest in one entity, ABC Corporation. Limited Partnership is unable to close another investment transaction until 20X3, at which time it acquires equity interests in five additional operating companies. Other than acquiring these equity interests, Limited Partnership conducts no other activities. Limited Partnership measures and evaluates its investments on a fair value basis and this information is provided to Entity GP and the external investors.

Limited Partnership has plans to dispose of its interests in each of its investees during the 10-year stated life of the partnership. Such disposals include the outright sale for cash, the distribution of marketable equity securities to investors following the successful public offering of the investees' securities and the disposal of investments to the public or other unrelated entities.

Conclusion

From the information provided, Limited Partnership meets the definition of an investment entity from formation in 20X1 to 31 December 20X3 because the following conditions exist:

- Limited Partnership has obtained funds from the limited partners and is providing those limited partners with investment management services;
- Limited Partnership's only activity is acquiring equity interests in operating companies with the purpose of realising capital appreciation over the life of the investments. Limited Partnership has identified and documented exit strategies for its investments, all of which are equity investments; and
- Limited Partnership measures and evaluates its investments on a fair value basis and reports this financial information to its investors.

In addition, Limited Partnership displays the following typical characteristics of an investment entity:

- Limited Partnership is funded by many investors;
- its limited partners are unrelated to Limited Partnership; and
- ownership in Limited Partnership is represented by units of partnership interests acquired through a capital contribution.

Limited Partnership does not hold more than one investment throughout the period. However, this is because it was still in its start-up period and had not identified suitable investment opportunities.

Example 4.3.1.3

Illustrative Example (2)

High Technology Fund was formed by Technology Corporation to invest in technology start-up companies for capital appreciation. Technology Corporation holds a 70 per cent interest in High Technology Fund and controls High Technology Fund; the other 30 per cent ownership interest in High Technology Fund is owned by 10 unrelated investors. Technology Corporation holds options to acquire investments held by High Technology Fund, at their fair value, which would be exercised if the technology developed by the investees would benefit the operations of Technology Corporation. No plans for exiting the investments have been identified by High Technology Fund. High Technology Fund is managed by an investment adviser that acts as agent for the investors in High Technology Fund.

Conclusion

Even though High Technology Fund's business purpose is investing for capital appreciation and it provides investment management services to its investors, High Technology Fund is not an investment entity because of the following arrangements and circumstances:

- Technology Corporation, the parent of High Technology Fund, holds options to acquire investments in investees held by High Technology Fund if the assets developed by the investees would benefit the operations of Technology Corporation. This provides a benefit in addition to capital appreciation or investment income; and
- the investment plans of High Technology Fund do not include exit strategies for its investments, which are equity investments. The options held by Technology Corporation are not controlled by High Technology Fund and do not constitute an exit strategy.

Example 4.3.1.4

Illustrative Example (3)

Real Estate Entity was formed to develop, own and operate retail, office and other commercial properties. Real Estate Entity typically holds its property in separate wholly-owned subsidiaries, which have no other substantial assets or liabilities other than borrowings used to finance the related investment property. Real Estate Entity and each of its subsidiaries report their investment properties at fair value in accordance with IAS 40 *Investment Property*. Real Estate Entity does not have a set time frame for disposing of its property investments, but uses fair value to help identify the optimal time for disposal. Although fair value is one performance indicator, Real Estate Entity and its investors use other measures, including information about expected cash flows, rental revenues and expenses, to assess performance and to make investment decisions. The key management personnel of Real Estate Entity do not consider fair value information to be the primary measurement attribute to evaluate the performance of its investments but rather a part of a group of equally relevant key performance indicators.

Real Estate Entity undertakes extensive property and asset management activities, including property maintenance, capital expenditure, redevelopment, marketing and tenant selection, some of which it outsources to third parties. This includes the selection of properties for refurbishment, development and the negotiation with suppliers for the design and construction work to be done to develop such properties. This development activity forms a separate substantial part of Real Estate Entity's business activities.

Conclusion

Real Estate Entity does not meet the definition of an investment entity because:

- Real Estate Entity has a separate substantial business activity that involves the active management of its property portfolio, including lease negotiations, refurbishments and development activities, and marketing of properties to provide benefits other than capital appreciation, investment income, or both;
- the investment plans of Real Estate Entity do not include specified exit strategies for its investments. As a result, Real Estate Entity plans to hold those property investments indefinitely; and
- although Real Estate Entity reports its investment properties at fair value in accordance with IAS 40, fair value is not the primary measurement attribute used by management to evaluate the performance of its investments. Other performance indicators are used to evaluate performance and make investment decisions.

5 PRESENTATION

5.1 Disclosure rules

An entity discloses information about significant judgements and assumptions it has made (and changes in those judgements and assumptions) in determining:

- that it controls another entity;
- that it has joint control of an arrangement or significant influence over another entity;
- the type of joint arrangement (i.e. joint operation or joint venture) when the arrangement has been structured through a separate vehicle.

Interests in subsidiaries

An entity shall disclose information that enables users of its consolidated financial statements to:

- understand the composition of the group;
- understand the interest that non-controlling interests have in the group's activities and cash flows;
- evaluate the nature and extent of significant restrictions on its ability to access or use assets, and settle liabilities, of the group;
- evaluate the nature of, and changes in, the risks associated with its interests in consolidated structured entities;
- evaluate the consequences of changes in its ownership interest in a subsidiary that do not result in a loss of control;
- evaluate the consequences of losing control of a subsidiary during the reporting period.

Shall be given information relating to significant restrictions referred to in IFRS 12.13.

IFRS 12.7

Interests in unconsolidated subsidiaries

In accordance with IFRS 10 *Consolidated Financial Statements*, an investment entity is required to apply the exception to consolidation and instead account for its investment in a subsidiary at fair value through profit or loss.

Where an entity is an investment entity, IFRS 12 requires additional disclosure, including:

- the fact the entity is an investment entity;
- information about significant judgements and assumptions it has made in determining that it is an investment entity, and specifically where the entity does not have one or more of the 'typical characteristics' of an investment entity;
- details of subsidiaries that have not been consolidated (name, place of business, ownership interests held);
- details of the relationship and certain transactions between the investment entity and the subsidiary (e.g. restrictions on transfer of funds, commitments, support arrangements, contractual arrangements);
- information where an entity becomes, or ceases to be, an investment entity.

IFRS 12.10

An entity making these disclosures are not required to provide various other disclosures required by IFRS 12.

IFRS 12.13

Interests in joint arrangements and associates
An entity shall disclose information that enables users of its financial statements to evaluate:

IFRS 10.31

- the nature, extent and financial effects of its interests in joint arrangements and associates, including the nature and effects of its contractual relationship with the other investors with joint control of, or significant influence over, joint arrangements and associates;
- the nature of, and changes in, the risks associated with its interests in joint ventures and associates.

IFRS 12.19

Interests in unconsolidated structured entities
An entity shall disclose information that enables users of its financial statements to:

- understand the nature and extent of its interests in unconsolidated structured entities;
- evaluate the nature of, and changes in, the risks associated with its interests in unconsolidated structured entities.

5.2 Mediolanum Financial Statements disclosures

In the consolidated financial statement, the Group must show the area and the consolidation methods.

IFRS 12.21-25

The changes relating to the configuration of the group arising from business combinations or business units is contained in Part G "combinations involving companies or business units" in the notes.

IFRS 12.20

The Group is required to give a list that include the companies consolidated using the integral method.

For each company must indicate:

a) the name and registered office;
b) the "type of relationship";
c) the percentage share of capital held, either directly or through trust companies or intermediaries, by the parent company and each of its subsidiaries;
d) if different from that referred to in letter c), the percentage of total votes in the ordinary shareholders are entitled, distinguishing between actual and potential

IFRS 12.24

It is required to give a list that include the investments in subsidiary companies exclusively with significant minority interests.

Furthermore is required give a reconciliation of the Parent Company’s shareholders’ equity to consolidated shareholders’ equity.

IFRS Operating Manual

Chapter 2
Joint Arrangements and Investments in Associates and Joint Ventures

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:
- an overview of the IAS 28 — *Investments in Associates and Joint Ventures*;
- an overview of the IFRS 11 — *Joint Arrangements*;
- a list of most recent amendments to IFRS 11 and IAS 28.

1.1 Introduction

Under IFRSs, the main standard that addresses the accounting requirements for investments in associates and joint ventures is IAS 28 — *Investments in Associates and Joint Ventures*. In addition, there is a separate standard, IFRS 11 —*Joint Arrangements,* which outlines the accounting by entities that jointly control an arrangement. Moreover, other standards related to this topic are:
- IFRS 10 *Consolidated Financial Statements;*
- IFRS 12 *Disclosure of Interests in Other Entities;*
- IAS 27 *Separate Financial Statements* (as amended in 2011).

1.2 Overview of IAS 28 and IFRS 11

IAS 28 *Investments in Associates and Joint Ventures* (as amended in 2011) outlines how to apply, with certain limited exceptions, the equity method to investments in associates and joint ventures. The standard also defines an associate by reference to the concept of "significant influence", which requires power to participate in financial and operating policy decisions of an investee (but not joint control or control of those polices).

IAS 28 was reissued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

Date	Development	Comments
17 December 2015	Amended by *Effective Date of Amendments to IFRS 10 and IAS 28*	defer the effective date of the September 2014 amendments to these standards

		indefinitely
18 December 2014	Amended by *Investment Entities: Applying the Consolidation Exception (Amendments to IFRS 10, IFRS 12 and IAS 28)* (project history)	Effective for annual periods beginning on or after 1 January 2016
11 September 2014	Amended by *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Amendments to IFRS 10 and IAS 28)*	~~Effective on a prospective basis to transactions occurring in annual periods beginning on or after 1 January 2016~~ deferred indefinitely
12 May 2011	IAS 28 *Investments in Associates and Joint Ventures* (2011) issued (supersedes IAS 28 (2003))	Effective for annual periods beginning on or after 1 January 2013
22 May 2008	Amended by *Improvements to IFRSs* (impairment testing)	Effective for annual periods beginning on or after 1 January 2009
10 January 2008	Amended by IFRS 3 *Business Combinations* (loss of significant influence)	Effective for annual periods beginning on or after 1 July 2009
18 December 2003	IAS 28 *Investments in Associates* issued	Effective for annual periods beginning on or after 1

		January 2005
December 1998	Amended by IAS 39 *Financial Instruments: Recognition and Measurement*	Effective 1 January 2001
1994	IAS 28 was reformatted	
April 1989	IAS 28 *Accounting for Investments in Associates* issued	Effective 1 January 1990
July 1986	Exposure Draft E28 *Accounting for Investments in Associates and Joint Ventures*	

IFRS 11 *Joint Arrangements* outlines the accounting by entities that jointly control an arrangement. Joint control involves the contractually agreed sharing of control and arrangements subject to joint control are classified as either a joint venture (representing a share of net assets and equity accounted) or a joint operation (representing rights to assets and obligations for liabilities, accounted for accordingly).

IFRS 11 was issued in May 2011 and applies to annual reporting periods beginning on or after 1 January 2013.

Date	**Development**	**Comments**
6 May 2014	Amended by *Accounting for Acquisitions of Interests in Joint Operations (Amendments to IFRS 11)*	Effective for annual periods beginning on or after 1 January 2016
28 June 2012	Amended by *Consolidated Financial Statements, Joint Arrangements and Disclosure of Interests in Other Entities*	Effective for annual periods beginning on or after 1 January 2013

12 May 2011	IFRS 11 *Joint Arrangements* issued	Effective for annual periods beginning on or after 1 January 2013
13 September 2007	Exposure Draft ED 9 *Joint Arrangements* published	Comment deadline 11 January 2008
November 2004	Project on joint arrangements added to the IASB's agenda	History of the project

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 28 and IFRS 11, that have to be followed:

- by the holding company for preparing the Group's consolidated financial statements;
- by the intermediate sub-holding companies of the Group for preparing ther IFRS sub-consolidated reporting package.

2.1 General definitions

Associate
An entity over which the investor has significant influence.

IAS 28.3
IFRS 11

Significant influence
The power to participate in the financial and operating policy decisions of the investee but is not control or joint control of those policies.

Joint arrangement
An arrangement of which two or more parties have joint control.

Joint control
The contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Joint operation
A joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement.

Joint venture
A joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement.

Joint venturer
A party to a joint venture that has joint control of that joint venture.

Party to a joint arrangement
An entity that participates in a joint arrangement, regardless of whether that entity has joint control of the arrangement.

Separate vehicle

A separately identifiable financial structure, including separate legal entities or entities recognised by statute, regardless of whether those entities have a legal personality.

Equity method

A method of accounting whereby the investment is initially recognised at cost and adjusted thereafter for the post-acquisition change in the investor's share of the investee's net assets. The investor's profit or loss includes its share of the investee's profit or loss and the investor's other comprehensive income includes its share of the investee's other comprehensive income.

2.2 Scope of rules

The objective of IAS 28 (as amended in 2011) is to prescribe the accounting for investments in associates and to set out the requirements for the application of the equity method when accounting for investments in associates and joint ventures. **IAS 28.1**

IAS 28 applies to all entities that are investors with joint control of, or significant influence over, an investee (associate or joint venture). **IAS 28.2**

The core principle of IFRS 11 is that a party to a joint arrangement determines the type of joint arrangement in which it is involved by assessing its rights and obligations and accounts for those rights and obligations in accordance with that type of joint arrangement. **IFRS 11.1-2**

2.3 Significant influence

Where an entity holds 20% or more of the voting power (directly or through subsidiaries) on an investee, it will be presumed the investor has significant influence unless it can be clearly demonstrated that this is not the case. If the holding is less than 20%, the entity will be presumed not to have significant influence unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an entity from having significant influence. **IAS 28.5**

The existence of significant influence by an entity is usually evidenced in one or more of the following ways: **IAS 28.6**

- representation on the board of directors or equivalent governing body of the investee;

- participation in the policy-making process, including participation in decisions about dividends or other distributions;
- material transactions between the entity and the investee;
- interchange of managerial personnel; or
- provision of essential technical information.

The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances that affect potential rights. **IAS 28.7-8**

An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. **IAS 28.9**

2.4 Joint arrangements

A joint arrangement is an arrangement of which two or more parties have joint control. **IFRS 11.4**

A joint arrangement has the following characteristics: **IFRS 11.5**

- the parties are bound by a contractual arrangement; and
- the contractual arrangement gives two or more of those parties joint control of the arrangement.

A joint arrangement is either a joint operation or a joint venture. **IFRS 11.6**

Joint control

Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control. **IFRS 11.7**

Before assessing whether an entity has joint control over an arrangement, an entity first assesses whether the parties, or a group of the parties, control the arrangement (in accordance with the definition of control in IFRS 10 *Consolidated Financial Statements*). **IFRS 11.B5**

After concluding that all the parties, or a group of the parties, control the arrangement collectively, an entity shall assess whether it has joint control of the **IFRS 11.B6** arrangement. Joint control exists only when decisions about the relevant activities require the unanimous consent of the parties that collectively control the arrangement.

The requirement for unanimous consent means that any party with joint control of the arrangement can prevent any of the other parties, or a group of the parties, from making unilateral decisions (about the relevant activities) without its consent. **IFRS 11.B7**

Types of joint arrangements

Joint arrangements are either joint operations or joint ventures:

- A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Those parties are called joint operators. **IFRS 11.15**
- A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Those parties are called joint venturers. **IFRS 11.16**

Classifying joint arrangements

The classification of a joint arrangement as a joint operation or a joint venture depends upon the rights and obligations of the parties to the arrangement. An entity determines the type of joint arrangement in which it is involved by considering the structure and form of the arrangement, the terms agreed by the parties in the contractual arrangement and other facts and circumstances. **IFRS 11.6-17**

Regardless of the purpose, structure or form of the arrangement, the classification of joint arrangements depends upon the parties' rights and obligations arising from the arrangement. **IFRS 11.14-15**

A joint arrangement in which the assets and liabilities relating to the arrangement are held in a separate vehicle can be either a joint venture or a joint operation. **IFRS 11.B19**

A joint arrangement that is not structured through a separate vehicle is a joint operation. In such cases, the contractual arrangement establishes the parties' rights to the assets, and obligations for the liabilities, relating to the arrangement, and the parties' rights to the corresponding revenues and obligations for the corresponding expenses. **IFRS 11.B16**

2.5 Financial statements of parties to a joint arrangement

Joint operations

IFRS 11.20

A joint operator recognises in relation to its interest in a joint operation:

- its assets, including its share of any assets held jointly;
- its liabilities, including its share of any liabilities incurred jointly;
- its revenue from the sale of its share of the output of the joint operation;
- its share of the revenue from the sale of the output by the joint operation; and
- its expenses, including its share of any expenses incurred jointly.

IFRS 11.21

A joint operator accounts for the assets, liabilities, revenues and expenses relating to its involvement in a joint operation in accordance with the relevant IFRSs.

IFRS 11.B33C

The acquirer of an interest in a joint operation in which the activity constitutes a business, as defined in IFRS 3 *Business Combinations*, is required to apply all of the principles on business combinations accounting in IFRS 3 and other IFRSs with the exception of those principles that conflict with the guidance in IFRS 11. These requirements apply both to the initial acquisition of an interest in a joint operation, and the acquisition of an additional interest in a joint operation (in the latter case, previously held interests are not remeasured).

IFRS 11.23

A party that participates in, but does not have joint control of, a joint operation shall also account for its interest in the arrangement in accordance with the above if that party has rights to the assets, and obligations for the liabilities, relating to the joint operation.

Joint ventures

IFRS 11.24

A joint venturer recognises its interest in a joint venture as an investment and shall account for that investment using the equity method in accordance with IAS 28 *Investments in Associates and Joint Ventures* unless the entity is exempted from applying the equity method as specified in that standard.

IFRS 11.25

A party that participates in, but does not have joint control of, a joint venture accounts for its interest in the arrangement in accordance with IFRS 9 *Financial Instruments* unless it has significant influence over the joint venture, in which case it accounts for it in accordance with IAS 28 (as amended in 2011).

Separate Financial Statements

The accounting for joint arrangements in an entity's separate financial statements depends on the involvement of the entity in that joint arrangement and the type of the joint arrangement:

- If the entity is a joint operator or joint venturer it shall account for its interest in
  - a joint operation in accordance with paragraphs 20-22 of IFRS 11;
  - a joint venture in accordance with paragraph 10 of IAS 27.

- If the entity is a party that participates in, but does not have joint control of, a joint arrangement shall account for its interest in:

  - a joint operation in accordance with paragraphs 23 of IFRS 11;
  - a joint venture in accordance with IFRS 9, unless the entity has significant influence over the joint venture, in which case it shall apply paragraph 10 of IAS 27 (as amended in 2011).

2.6 The equity method of accounting

Basic principle - Under the equity method, on initial recognition the investment in an associate or a joint venture is recognised at cost, and the carrying amount is increased or decreased to recognise the investor's share of the profit or loss of the investee after the date of acquisition. **IAS 28.10**

Distributions and other adjustments to carrying amount - The investor's share of the investee's profit or loss is recognised in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's other comprehensive income (e.g. to account for changes arising from revaluations of property, plant and equipment and foreign currency translations.) **IAS 28.11**

Potential voting rights - An entity's interest in an associate or a joint venture is determined solely on the basis of existing ownership interests and, generally, does not reflect the possible exercise or conversion of potential voting rights and other derivative instruments. **IAS 28.12**

Interaction with IFRS 9 - IFRS 9 Financial Instruments does not apply to interests in associates and joint ventures that are accounted for using the equity method. Instruments containing potential voting rights in an associate or a joint venture are accounted for in accordance with IFRS 9, unless they currently give access to the **IAS 28.14** returns associated with an ownership interest in an associate or a joint venture.

IAS 28.15

Classification as non-current asset - An investment in an associate or a joint venture is generally classified as non-current asset, unless it is classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations.

Application of the equity method of accounting

IAS 28.16

Basic principle - In its consolidated financial statements, an investor uses the equity method of accounting for investments in associates and joint ventures. Many of the procedures that are appropriate for the application of the equity method are similar to the consolidation procedures described in IFRS 10. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture.

IAS 28.26

Exemptions from applying the equity method - An entity is exempt from applying the equity method if the investment meets one of the following conditions:

IAS 28.17

- The entity is a parent that is exempt from preparing consolidated financial statements under IFRS 10 Consolidated Financial Statementsor or if all of the following four conditions are met (in which case the entity need not apply the equity method):
    - the entity is a wholly-owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method;
    - the investor or joint venturer's debt or equity instruments are not traded in a public market;
    - the entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; and
    - the ultimate or any intermediate parent of the parent produces financial statements available for public use that comply with IFRSs, in which subsidiaries are consolidated or are measured at fair value through profit or loss in accordance with IFRS 10.

IAS 28.18-19

- When an investment in an associate or a joint venture is held by, or is held indirectly through, an entity that is a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure investments in those associates and joint ventures at fair value through profit or loss in accordance with IFRS 9. When an entity has an investment in an associate, a portion of which is held indirectly through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds, the entity may elect to measure that portion of the investment in the associate at fair value through profit or loss in accordance with IFRS 9 regardless of whether the venture capital organisation, or the mutual fund, unit trust and similar entities including investment-linked insurance funds, has significant influence over that portion of the investment. If the entity makes that election, the entity shall apply the equity method to any remaining portion of its investment in an associate that is not held through a venture capital organisation, or a mutual fund, unit trust and similar entities including investment-linked insurance funds. **IAS 28.20**

Classification as held for sale - When the investment, or portion of an investment, meets the criteria to be classified as held for sale, the portion so classified is accounted for in accordance with IFRS 5. Any remaining portion is accounted for using the equity method until the time of disposal, at which time the retained investment is accounted under IFRS 9, unless the retained interest continues to be an associate or joint venture. **IAS 28.22**

Discontinuing the equity method - Use of the equity method should cease from the date that significant influence or joint control ceases:

- If the investment becomes a subsidiary, the entity accounts for its investment in accordance with IFRS 3 Business Combinations and IFRS 10;
- If the retained interest is a financial asset, it is measured at fair value and subsequently accounted for under IFRS 9;
- Any amounts recognised in other comprehensive income in relation to the investment in the associate or joint venture are accounted for on the same basis as if the investee had directly disposed of the related assets or liabilities (which may require reclassification to profit or loss); **IAS 28.24**
- If an investment in an associate becomes an investment in a joint venture (or vice versa), the entity continues to apply the equity method and does not remeasure the retained interest. **IAS 28.25**

Changes in ownership interests - If an entity's interest in an associate or joint venture is reduced, but the equity method is continued to be applied, the entity reclassifies to profit or loss the proportion of the gain or loss previously recognised in other comprehensive income relative to that reduction in ownership interest.

<u>Equity method procedures</u> **IAS 28.28-30**

Transactions with associates or joint ventures. Profits and losses resulting from upstream (associate to investor, or joint venture to joint venturer) and downstream (investor to associate, or joint venturer to joint venture) transactions are eliminated to the extent of the investor's interest in the associate or joint venture. However, unrealised losses are not eliminated to the extent that the transaction provides evidence of a reduction in the net realisable value or in the recoverable amount of the assets transferred. Contributions of non-monetary assets to an associate or joint venture in exchange for an equity interest in the associate or joint venture are also accounted for in accordance with these requirements. **IAS 28.32**

Initial accounting. An investment is accounted for using the equity method from the date on which it becomes an associate or a joint venture. On acquisition, any difference between the cost of the investment and the entity's share of the net fair value of the investee's identifiable assets and liabilities in case of goodwill is included in the carrying amount of the investment (amortisation not permitted) and any excess of the entity's share of the net fair value of the investee's identifiable assets and liabilities over the cost of the investment is included as income in the determination of the entity's share of the associate or joint venture's profit or loss in the period in which the investment is acquired. Adjustments to the entity's share of the associate's or joint venture's profit or loss after acquisition are made, for example, for depreciation of the depreciable assets based on their fair values at the acquisition date or for impairment losses such as for goodwill or property, plant and equipment. **IAS 28.33-34**

Date of financial statements. In applying the equity method, the investor or joint venturer should use the financial statements of the associate or joint venture as of the same date as the financial statements of the investor or joint venturer unless it is impracticable to do so. If it is impracticable, the most recent available financial statements of the associate or joint venture should be used, with adjustments made for the effects of any significant transactions or events occurring between the accounting period ends. However, the difference between the reporting date of the associate and that of the investor cannot be longer than three months. **IAS 28.35**

Accounting policies. If the associate or joint venture uses accounting policies that differ from those of the investor, the associate or joint venture's financial statements are adjusted to reflect the investor's accounting policies for the purpose of applying the equity method. **IAS 28.36**

Application of the equity method by a non-investment entity investor to an investment entity investee. When applying the equity method to an associate or a joint venture, a non-investment entity investor in an investment entity may retain the fair value measurement applied by the associate or joint venture to its interests in subsidiaries. **IAS 28.38-39**

Losses in excess of investment. If an investor's or joint venturer's share of losses of an associate or joint venture equals or exceeds its interest in the associate or joint venture, the investor or joint venturer discontinues recognising its share of further losses. The interest in an associate or joint venture is the carrying amount of the investment in the associate or joint venture under the equity method together with any long-term interests that, in substance, form part of the investor or joint venturer's net investment in the associate or joint venture. After the investor or joint venturer's interest is reduced to zero, a liability is recognised only to the extent that the investor or joint venturer has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate or joint venture subsequently reports profits, the investor or joint venturer resumes recognising its share of those profits only after its share of the profits equals the share of losses not recognised.

IAS 28.40-43

Impairment. After application of the equity method an entity applies IAS 39 Financial Instruments: Recognition and Measurement to determine whether it is necessary to recognise any additional impairment loss with respect to its net investment in the associate or joint venture. If impairment is indicated, the amount is calculated by reference to IAS 36 Impairment of Assets. The entire carrying amount of the investment is tested for impairment as a single asset, that is, goodwill is not tested separately. The recoverable amount of an investment in an associate is assessed for each individual associate or joint venture, unless the associate or joint venture does not generate cash flows independently.

Separate financial statements. An investment in an associate or a joint venture shall be accounted for in the entity's separate financial statements in accordance with IAS 27 Separate Financial Statements (as amended in 2011).

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by the holding company for preparing the Group consolidated financial statements in accordance with International Financial Reporting Standards (IFRSs) and by the intermediate sub-holding companies of the Group for preparing their sub-consolidated reporting package;
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Group guidelines on identification of associates

Assessment of significant influence is, in certain cases, not straightforward but it is an important managerial decision to be taken on a case by case basis that may have relevant effects on the whole Group.

Accordingly such assessment shall be shared and agreed with the Holding Company.

Existence of significant influence depends generally on voting right and not on share ownership.

Accordingly it may be possible to have significant influence without owning at least 20% of the investee shares as long as agreements are in place that assign the Group significant influence.

When the voting rights held are lower than 20% significant influences has to be demonstrated by assessing existence of several conditions indicating that the Group is able to participate in the financial and operating policy decisions of the investee.

This condition is deemed to be verified when the Group has the right to appoint at

least 20% (but no more than 50%) of the governing body of the entity.
The governing body of the entity is the body which has the right to determine the operating and financial policies of the entity. Depending on the legislation and on the corporate governance model chosen this body may be either the Board of Directors or Supervisory Committee or Executive Committee.

In any case the body that has the task to approve plans, budgets and commercial initiatives of the entity is the governing body of the entity.

Significant influence might also exist when the Group has the right to appoint less than 20% of the governing body of the entity but its representation in such body is still meaningful.

In such circumstance, however, additional factors indicating that the Group has the power to participate in the financial and operating policies of the entity must be present. These factors might be, but are not limited to, the following:

- veto rights on financial and operating decisions,
- right to appoint (or share) significant member of the management team of the entity, or
- right of the members of the Board appointed by the Group to participate in other committees (executive committees, nomination committees etc.) able to influence the policy of the investee.

Costs incurred to acquire an equity-method investee

The investment in an associate or a joint venture accounted for using the equity method is initially recognised at cost. Generally, cost includes the purchase price and other costs directly attributable to the acquisition of the asset such as professional fees for legal services, transfer taxes and other transaction costs.

Therefore, the cost of an investment in an equity-method investee at initial recognition comprises the purchase price for the investment and any directly attributable expenditure necessary to acquire it.
This applies to both the consolidated financial statements of the investor and the separate financial statements, when prepared.

Although IFRS 3 Business Combinations requires the costs associated with acquiring a subsidiary to be recognised as an expense in consolidated financial statements, this has not changed the appropriate treatment of the costs incurred in acquiring an equity-method investee.

Reporting periods of associates and joint ventures

When applying the equity method, the Group uses the most recent financial statements of the associate or joint venture. When the end of the reporting period of the associate or joint venture is different from that of the investor, the associate or joint venture will prepare additional financial statements, for the investor's use, corresponding to the investor's reporting period, unless it is impracticable to do so, in which case financial statements prepared for a different reporting period may be used.
The difference between the end of the reporting period of the associate or joint venture and that of the investor, however, can never be more than three months.
The length of the reporting periods used and any difference between the ends of the reporting periods should be consistent from period to period.

When financial statements of an associate or a joint venture with a different reporting period are used, it should be valuated by the Group if adjustments are necessary for the effects of any significant events or transactions that occur between the end of the associate's or joint venture's reporting period and the end of the investor's reporting period.

3.2 Relevant topics

Emendments to IAS 27

It was published in the Official Journal L 336 of 23 December 2015, the Commission Regulation (EU) 2441/2015 of the Commission of 18 December 2015 to adopt amendments to IAS 27 published by the IASB on 12 August 2014.
The document introduces the option of using the separate financial statements of an entity under the equity method for the detection of investments in subsidiaries, jointly controlled entities and associates. Accordingly, an entity shall recognize those investments in their separate financial statements either:

- cost; or
- in accordance with IFRS 9 (or IAS 39); or
- using the equity method.

The changes will apply from 1 January 2016 but early application is allowed.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- The equity method (paragraph 4.1)
- Joint arrangements (paragraph 4.2)

that could be considered by Group Component to make decisions on issues related to these topics.

4.1 The equity method

4.1.1 Exemptions from applying the equity method

Example 4.1.1.1

Consolidated financial statements of the parent of a venture capital organisation

Company P, which is not a venture capital organisation, is a parent entity in a group that has an 80 per cent ownership in a subsidiary, Company S. Company S has a 40 per cent ownership in an associate, Company A. Company S is a venture capital organisation and has elected under 28 to account for its interest in the associate at fair value through profit or loss in accordance with IFRS 9.

The accounting treatment applied by Company S under IAS 28 can be applied in Company P's consolidated financial statements because the exemption is available when an investment in an associate or a joint venture is held either (1) directly by a venture capital organisation, or (2) indirectly through a venture capital organisation. As a result, Company P has a choice either to carry the associate at fair value under IFRS 9 to apply the equity method in its consolidated financial statements.

Note that the same conclusion would be reached in this example if Company A were a joint venture of Company S instead of an associate.

Example 4.1.1.2

Portion of an associate held indirectly through a venture capital organization

Company M holds directly a 100 per cent interest in Company N and a 15 per cent interest in Company O. Company N is a venture capital organisation which acquires a further 10 per cent interest in Company O during the current period. Company M determines that it has obtained significant influence over Company O during the current period as a result of Company N's share purchase, which has taken Company M's combined direct and indirect shareholding to 25 per cent.

Following the purchase of shares by Company N, Company M has the following alternatives when accounting for its interest in Company O in its consolidated financial statements:

- it can account for the group's entire interest of 25 per cent using the equity method; or
- it can account for its 15 per cent direct interest using the equity method and Company N's 10 per cent interest at fair value through profit or loss in accordance with IFRS 9.

4.1.2 Application of the equity method

Example 4.1.2.1

Aggregation of group interests in an equity-method investee

Company A has a 70 per cent interest in Group B. Group B has a 20 per cent investment in an equity-method investee.

Company A's consolidated financial statements fully consolidate the assets and liabilities of Group B, i.e. they include 100 per cent of the assets and liabilities from Group B's consolidated financial statements (which include Group B's equity-method investee). Therefore, the appropriate share of the results of the equity-method investee to include in Company A's consolidated financial statements is the entire 20 per cent share in the investee, not 14 per cent (i.e. not 70 per cent × 20 per cent).

By way of example, assume that the net assets of the equity-method investee are CU 100 million, including a net profit for the period of CU 40 million. For simplicity, assume that no adjustments are required for the purposes of applying the equity method. The investment in the equity-method investee is shown as CU 20 million in Company A's consolidated statement of financial position and the share of profit is CU 8 million (20 per cent × CU 40 million).

Of that profit of CU 8 million, CU 2.4 million (30 per cent) is attributed to the non-controlling interests and CU 5.6 million to the equity holders of the parent.

Example 4.1.2.2

Reciprocal interests held by an associate or a joint venture of a venture capital organization

Company A owns an interest in an associate, Company B, and Company B concurrently owns an interest in Company A. The investments are determined to be reciprocal interests. Company A is a venture capital organisation that measures its investment in Company B at fair value through profit or loss in accordance with IFRS 9.

How should Company A account for the reciprocal equity interest held by Company B?

The reciprocal interest should not be eliminated. Although IAS 28 states that many of the procedures that are appropriate for the application of the equity method are similar to consolidation procedures, and that "the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate or a joint venture", it does so under the heading 'Equity method procedures'. But venture capitalists that measure their investment at fair value in accordance with IFRS 9 are not required to apply the equity method. Therefore, IAS 28 does not apply. Consequently, the reciprocal equity interests are not eliminated at the investor level.

Note that the same conclusion would be reached if in the example above Company B were a joint venture of Company A instead of an associate.

Example 4.1.2.3

Distributions received from an equity-method investee in excess of the investor's carrying amount (1)

Company A has invested CU 1 million for a 50 per cent ownership interest in Company C. Company A uses the equity method to account for its investment in Company C. Company C subsequently incurs a loss of CU 2.4 million, 50 per cent of which exceeds Company A's investment balance by CU 200,000. Company A is not liable for the obligations of Company C or otherwise committed to provide financial support to Company C. Accordingly, Company A recognises losses of CU 1 million, and reduces its investment in Company C to CU nil. Company A does not recognise further losses of CU 200,000 because it is neither liable for the obligations of Company C nor otherwise committed to provide financial support to Company C.

Subsequently, because the losses are due to non-cash depreciation expense and Company C has available cash, Company C distributes CU 100,000 to Company A.

The CU 100,000 distribution made to Company A is not refundable by agreement or law. Therefore, Company A should continue to recognise its investment in Company C at zero and recognise the CU 100,000 received as income. When Company C becomes profitable such that Company A's share of Company C's earnings exceeds the distributions and share of unrecognised losses attributable to Company A (i.e. CU 300,000), Company A will resume applying the equity method in accordance with IAS 28.

Example 4.1.2.4

Distributions received from an equity-method investee in excess of the investor's carrying amount (2)

Company B has invested CU 1 million for a 50 per cent ownership interest in Company C. Company B uses the equity method to account for its investment in Company C. Company C subsequently incurs a loss of CU 2.4 million, 50 per cent of which exceeds Company B's investment balance by CU 200,000. Because the losses are due to non-cash depreciation expense and Company C has available cash, it distributes CU 100,000 to Company B.

The CU 100,000 distribution made to Company B is not refundable by agreement or law, and Company B is not liable for Company C's obligations. However, Company B has committed to providing financial support to Company C. Therefore, Company B should recognise losses of CU 1.2 million, reduce its investment in Company C to zero and also recognise a liability of CU 300,000 in respect of the losses of CU 200,000 and the CU 100,000 cash received. When Company C becomes profitable, Company B will reverse the liability before increasing the carrying amount in its investment in Company C.

Separately, Company B should consider whether any additional provision or disclosure is required in accordance with IAS 37.

Example 4.1.2.5

Contingent consideration for the acquisition of an equity-method investee

Entity I acquires a 45 per cent interest in Entity A which results in it having significant influence over Entity A. The consideration is payable in two tranches:

- an immediate payment of CU 1 million; and
- a further payment of CU 500,000 million after two years if the cumulative profit of Entity A before interest and tax for the two-year period following acquisition exceeds CU 400,000.

At the date of acquisition, the fair value of the contingent consideration (i.e. the amount payable if the specified profit target is met) is assessed as CU 220,000.

One year after acquisition, on the basis of a revised earnings forecast, the fair value of the contingent consideration is deemed to have increased by CU 80,000 to CU 300,000.

How should Entity I account for the contingent consideration payable in respect of the acquisition of its interest in Entity A in its consolidated financial statements?

IAS 28 does not provide any specific guidance on the measurement of the cost of acquiring an investment in an associate accounted for using the equity method. However, IAS 28 explains that "the concepts underlying the procedures used in accounting for the acquisition of a subsidiary are also adopted in accounting for the acquisition of an investment in an associate". Therefore, in the circumstances described, by analogy to IFRS 3 *Business Combinations*, at the date of acquisition the investment in Entity A is recognised in Entity I's consolidated financial statements at a cost of CU 1,220,000.

The subsequent accounting for the contingent consideration is determined under IFRS 9 (or, for entities that have not yet adopted IFRS 9, IAS 39). The contingent consideration should therefore be subsequently measured at fair value with the resulting loss of CU 80,000 recognised in profit or loss. This is consistent with the treatment specified in IFRS 3 for changes in contingent consideration in a business combination.

It is not appropriate for Entity I to increase the carrying amount of its investment in Entity A to reflect the change in the fair value of the contingent consideration.

Example 4.1.2.6

Elimination of profits and losses on transactions with equity-method investees

Assume the following facts.

- An investor owns 30 per cent of an investee.
- The investment is accounted for using the equity method.
- The income tax rate for both investor and investee is 40 per cent.

Upstream transaction

The investee sells inventories to the investor. At the end of the investor's reporting period, the investor holds inventories for which the investee has recorded a gross profit of CU 200,000. In the computation of the investor's share of the investee's earnings, CU 120,000 (CU 200,000 less 40 per cent income tax) would be deducted from the investee's net income and CU 36,000 (the investor's 30 per cent share of the gross profit earned on the transaction after income tax) would be eliminated from the investor's equity-method income. The investor also would reduce the carrying amount of its inventories by CU 60,000 (the investor's share of the investee's gross profit) and recognise a deferred tax asset of CU 24,000 (CU 60,000 × 40 per cent) (subject to the usual recognition criteria in IAS 12.

Downstream transaction

The investor sells inventories to the investee. At the end of the investee's reporting period, the investee holds inventories for which the investor has recorded a gross profit of CU 300,000. The investor's net income would be reduced by CU 54,000 to reflect a CU 90,000 (300,000 × 30 per cent) reduction in gross profit and a CU 36,000 (90,000 × 40 per cent) reduction in income tax expense. The investor reduces its investment in the investee by CU 90,000 and recognises a CU 36,000 deferred tax asset (subject to the usual recognition criteria in IAS 12).

Example 4.1.2.7

Equity-method investee with net asset deficiency

Entity A invests CU 10 million to acquire 25 per cent of the equity share capital of Entity B. Entity A accounts for Entity B using the equity method. Entity A has entered into no other guarantees or commitments in respect of Entity B. Entity B is in a start-up situation and expects to make significant losses in the first year and to generate profits thereafter. Entity B has sufficient cash resources to meet its liabilities as they fall due.

In the first year, Entity B loses CU 50 million. Entity A should recognise a loss of CU 10 million in respect of its equity stake. However, the balance of Entity A's share of the net loss (i.e. 25 per cent of CU 50 million less CU 10 million) is not recognised.

In the next year, Entity B makes a profit of CU 10 million. Entity A recognises no profit because its share of the profit (CU 2.5 million) equals the amount of the unrecognised loss in the previous period. For any profits made by Entity B in excess of CU 10 million, Entity A recognises its proportionate share.

Example 4.1.2.8

Impairment of equity-method investments – impact of a restructuring to which the investee is not yet committed

Entity F holds 25 per cent of the shares in Entity G. Entity F accounts for its interest in Entity G using the equity method.

Entity F applies the requirements of IAS 28 and determines that its net investment in Entity G may be impaired. Consequently, in accordance with IAS 28, Entity F applies the requirements of IAS 36 by comparing the carrying amount of its net investment in Entity G with its recoverable amount (i.e. the higher of fair value less costs of disposal and value in use).

Entity G is intending to carry out a restructuring in the future. However, applying the requirements of paragraphs 70 to 77 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, Entity G is not sufficiently committed to the plan to recognise the restructuring provision at the end of the reporting period.

In calculating the value in use of its net investment in Entity G, should Entity F include the estimated costs and associated benefits of the planned restructuring?

No. The estimated future restructuring costs and the effects of that restructuring on subsequent expected cash flows should not be included in the calculation of the value in use of Entity F's net investment in Entity G.

IAS 28 requires Entity G to apply the requirements of IAS 36 in determining the recoverable amount of its net investment in Entity G. In accordance with IAS 36, the calculation of value in use should exclude estimated future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed.

Example 4.1.2.9

Non-recourse debt and impairment of equity-method investments

Company A and Company B each make a CU 6 million investment in a real estate venture, Company C. Their investments are financed in part by each borrowing CU 5 million. The terms of the borrowing are such that, to the extent that they fail to recover their investments from Company C, Company A and Company B are not required to repay their borrowings.

If Company A's and Company B's investments in Company C are determined to be impaired under the principles set out in IAS 28, Company A and Company B must write their investments down in accordance with that paragraph. The existence of non-recourse debt is not justification for limiting the impairment loss. The borrowings are accounted for separately under IAS 39.

4.2 Joint Arrangements

4.2.1 Accounting for joint arrangements

Example 4.2.1.1

Obligation to purchase output is disproportionate to ownership percentage

Two parties enter into a joint arrangement. The arrangement is structured through a separate vehicle. Each party initially subscribes for 50 per cent of the shares in the jointly controlled vehicle. The joint arrangement specifies that the parties are obliged to purchase the output of the arrangement in the ratio 60:40. The parties' obligations to purchase output are therefore disproportionate to their ownership interests. The joint arrangement is determined to be a joint operation.

In circumstances such as those described, for the purpose of applying IFRS 11, how should the joint operators' 'share' of assets held and liabilities incurred jointly be determined?

IFRS 11 does not provide any explicit guidance in this regard and a joint operator should establish and disclose an accounting policy that treats similar joint operations in a similar manner.

In the absence of guidance in IFRS 11, and subject to considering the specific facts and circumstances of the joint operation, the Standard could be interpreted in two ways.

- *Approach 1* – although the joint operators' obligations to purchase output are a determinant of the classification of a joint arrangement, each party's share of assets and liabilities is nevertheless established based on its *ownership percentage*. Applying this approach would result in each party recognising its share of the assets and liabilities either on the basis of (1) its share of dividends and its entitlement on sale, or (2) assuming a liquidation of the joint arrangement vehicle at book value as at the reporting date.
- *Approach 2* – to view the joint operators' obligations to purchase output not only as a determinant of classification, but also of their proportionate shares

of assets held and liabilities incurred jointly. Applying this interpretation would lead to the parties recognising their shares of assets and liabilities based on their *output percentages* (i.e. the shares of assets they will take and liabilities they will fund on an ongoing basis).

When selecting which of the two approaches described above should be applied to a particular joint operation, caution should be exercised to ensure that the approach adopted results in an appropriate reflection of the economic share of each party in the joint operation. For example, if the parties contribute only a nominal amount to equity, and they have no rights to accumulated profits (or the arrangement was not designed to generate profits), it might be concluded that the ownership percentage is not a substantive feature of the arrangement.

If, in the example described earlier, the joint operators recognised their shares of assets held and liabilities incurred jointly on the basis of their output percentages (i.e. 60 and 40 per cent, respectively), there would be a difference between the amount of the assets and liabilities initially recognised by the joint operators and their initial contributed equity. Specifically, when the joint arrangement is first established, the net share of assets and liabilities recognised by the joint operator taking the 60 per cent share will be higher than its initial contributed equity; conversely, the share recognised by the joint operator taking the 40 per cent share will be lower than its initial contributed equity. IFRS 11 does not provide any guidance on whether these differences should initially be recognised in profit or loss or as an asset or a liability. Further, it does not provide any guidance on the subsequent accounting for such differences.

Example 4.2.1.2

Obligation to repay third party debt

Entity E and Entity F (the parties) enter into a contractual agreement to incorporate a new entity, Entity G, to manufacture materials required by the parties for their own, individual manufacturing processes. Each party has a 50 per cent ownership interest in Entity G and made a cash subscription for its equity investment. The contractual agreement is such that the parties jointly control Entity G.

The legal form of Entity G does not confer rights to the assets, and obligations for the liabilities, of Entity G on its shareholders.

The purpose of the arrangement is to provide the parties with the output they require and each party is required to purchase half of the total output produced by Entity G.

The equity subscribed by the parties is not sufficient to fund the initial equipment costs; consequently, Entity G takes out a long-term loan from a bank over which both Entity E and Entity F provide a guarantee. The terms of the agreement are silent as to how the third party debt is to be settled.

Do Entity E and Entity F have rights to the assets and obligations for the liabilities relating to the joint arrangement (Entity G), including the third party debt?

Yes. The terms of the agreement are such that the parties have an obligation to purchase all of Entity G's output and there are no expected sales to third parties. This leads to the conclusion that the parties have a right to the assets of the joint arrangement.

The assessment as to whether the parties have the obligation for the liabilities relating to the joint arrangement (including the third party debt) must take into consideration whether the parties have the primary, ongoing obligation to settle the liabilities. Based on the purpose and design of the arrangement and the requirement to purchase all of the output, the parties are the only ongoing source of cash for the arrangement. At the time the debt principal becomes repayable, if the cash from the parties for the purchase of output has not been sufficient to fund repayment, there appear to be a number of ways to settle the third party debt:

- the parties fund the repayment (either by providing additional cash to Entity G or by paying the bank directly possibly through exercise of the guarantee); or
- the parties decide to reduce the capacity or wind up the arrangement by selling assets to generate funds to settle the liability, or by selling Entity G (including its debt) to another third party.

Each of these methods will require the parties to provide substantially all of the cash flows required to settle the third party borrowings by using either their own assets or assets of the arrangement to which they have rights.

The assessment of the purpose of the arrangement together with the obligation of the parties to purchase output is sufficient to conclude that the parties have substantially all the obligation for the liabilities of the arrangement. Although in this case the guarantee to the bank provides another means by which the parties could provide cash to settle the debt, in the absence of such a guarantee the same conclusion would be reached because the debt would still be settled by assets of the parties or assets to which they have rights.

4.2.2 Illustrative examples

Example 4.2.2.1

Bank operated jointly

Banks A and B (the parties) agreed to combine their corporate, investment banking, asset management and services activities by establishing a separate vehicle (bank C). Both parties expect the arrangement to benefit them in different ways. Bank A believes that the arrangement could enable it to achieve its strategic plans to increase its size, offering an opportunity to exploit its full potential for organic growth through an enlarged offering of products and services. Bank B expects the arrangement to reinforce its offering in financial savings and market products.

The main feature of bank C's legal form is that it causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). Banks A and B each have a 40 per cent ownership interest in bank C, with the remaining 20 per cent being listed and widely held. The shareholders' agreement between bank A and bank B establishes joint control of the activities of bank C.

In addition, bank A and bank B entered into an irrevocable agreement under which, even in the event of a dispute, both banks agree to provide the necessary funds in equal amount and, if required, jointly and severally, to ensure that bank C complies with the applicable legislation and banking regulations, and honours any commitments made to the banking authorities. This commitment represents the assumption by each party of 50 per cent of any funds needed to ensure that bank C complies with legislation and banking regulations.

Analysis
The joint arrangement is carried out through a separate vehicle whose legal form confers separation between the parties and the separate vehicle. The terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, of bank C, but it establishes that the parties have rights to the net assets of bank C. The commitment by the parties to provide support if bank C is not able to comply with the applicable legislation and banking regulations is not by itself a determinant that the parties have an obligation for the liabilities of bank C. There are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets of bank C and that the parties have an obligation for the liabilities of bank C. The joint arrangement is a joint venture.

Both banks A and B recognise their rights to the net assets of bank C as investments and account for them using the equity method.

Example 4.2.2.2

Shopping centre operated jointly

Two real estate companies (the parties) set up a separate vehicle (entity X) for the purpose of acquiring and operating a shopping centre. The contractual arrangement between the parties establishes joint control of the activities that are conducted in entity X. The main feature of entity X's legal form is that the entity, not the parties, has rights to the assets, and obligations for the liabilities, relating to the arrangement. These activities include the rental of the retail units, managing the car park, maintaining the centre and its equipment, such as lifts, and building the reputation and customer base for the centre as a whole.

The terms of the contractual arrangement are such that:

a) entity X owns the shopping centre. The contractual arrangement does not specify that the parties have rights to the shopping centre.
b) the parties are not liable in respect of the debts, liabilities or obligations of entity X. If entity X is unable to pay any of its debts or other liabilities or to discharge its obligations to third parties, the liability of each party to any third party will be limited to the unpaid amount of that party's capital contribution.
c) the parties have the right to sell or pledge their interests in entity X.
d) each party receives a share of the income from operating the shopping centre (which is the rental income net of the operating costs) in accordance with its interest in entity X.

Analysis
The joint arrangement is carried out through a separate vehicle whose legal form causes the separate vehicle to be considered in its own right (ie the assets and liabilities held in the separate vehicle are the assets and liabilities of the separate vehicle and not the assets and liabilities of the parties). In addition, the terms of the contractual arrangement do not specify that the parties have rights to the assets, or obligations for the liabilities, relating to the arrangement. Instead, the terms of the contractual arrangement establish that the parties have rights to the net assets of entity X.

On the basis of the description above, there are no other facts and circumstances that indicate that the parties have rights to substantially all the economic benefits of the assets relating to the arrangement, and that the parties have an obligation for the liabilities relating to the arrangement. The joint arrangement is a joint venture.

The parties recognise their rights to the net assets of entity X as investments and account for them using the equity method.

5 PRESENTATION

5.1 Disclosure rules

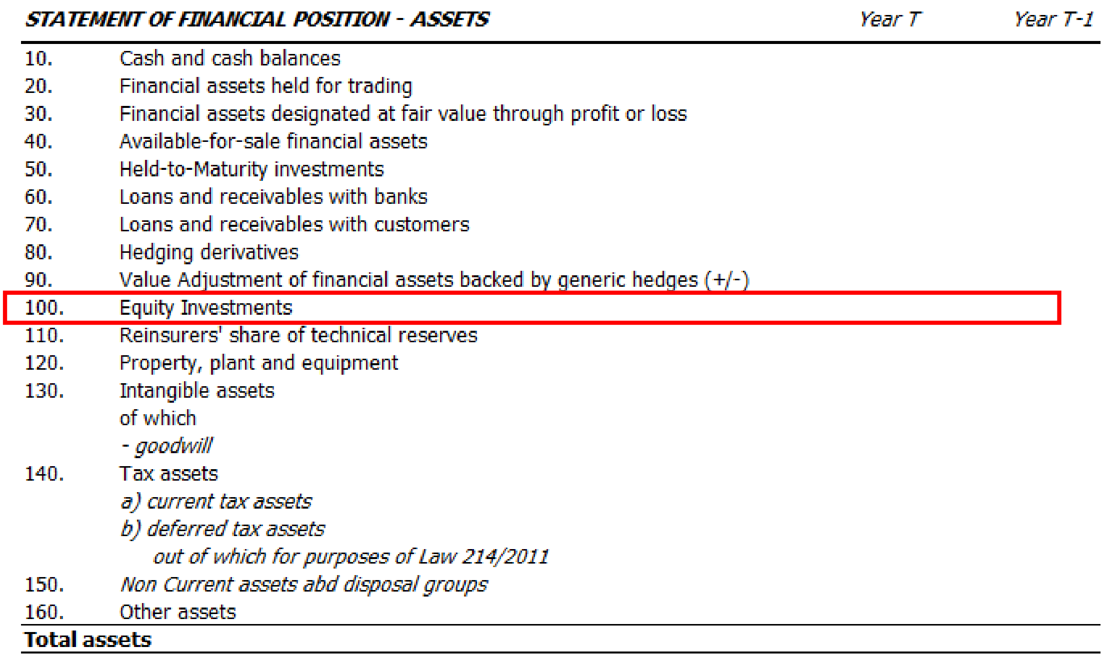
There are no disclosures specified in IAS 28 and in IFRS 11. Instead, IFRS 12 Disclosure of Interests in Other Entities outlines the disclosures required for entities with joint control of, or significant influence over, an investee (see Chapter 1).

5.2 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present joint arrangements in the consolidated financial statements.

As required by Bank of Italy, caption 100. Equity investments receives the following subcategories:

- Joint ventures;
- Companies under significant influence.

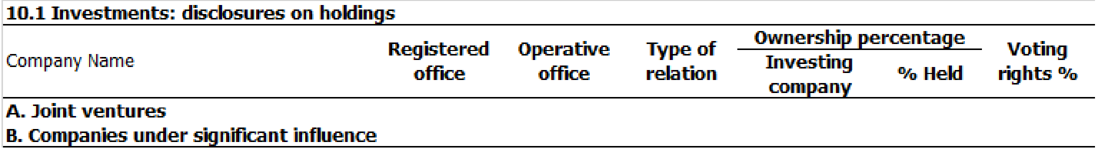


	STATEMENT OF FINANCIAL POSITION - ASSETS	*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			

IFRS 12

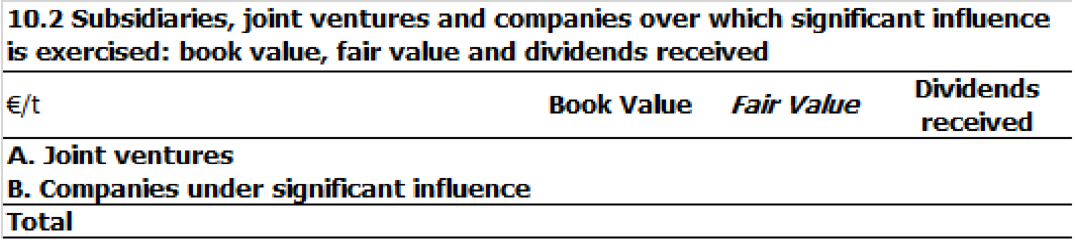
IFRS 12.20

In the tables below, a more detailed analysis of the item highlighted:



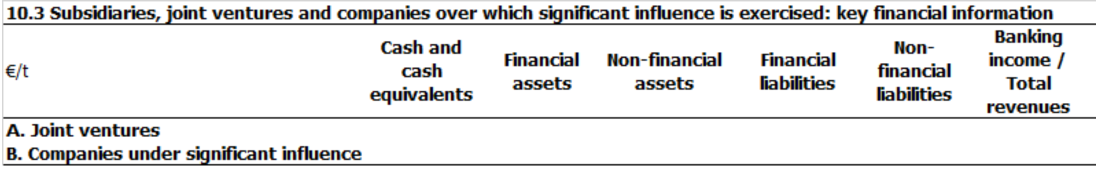
10.1 Investments: disclosures on holdings

Company Name	Registered office	Operative office	Type of relation	Ownership percentage		Voting rights %
				Investing company	% Held	
A. Joint ventures						
B. Companies under significant influence						



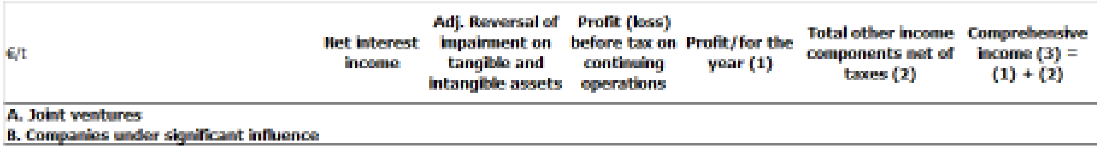
10.2 Subsidiaries, joint ventures and companies over which significant influence is exercised: book value, fair value and dividends received

€/t	Book Value	*Fair Value*	Dividends received
A. Joint ventures			
B. Companies under significant influence			
Total			



10.3 Subsidiaries, joint ventures and companies over which significant influence is exercised: key financial information

€/t	Cash and cash equivalents	Financial assets	Non-financial assets	Financial liabilities	Non-financial liabilities	Banking income / Total revenues
A. Joint ventures						
B. Companies under significant influence						



€/t	Net interest income	Adj. Reversal of impairment on tangible and intangible assets	Profit (loss) before tax on continuing operations	Profit/for the year (1)	Total other income components net of taxes (2)	Comprehensive income (3) = (1) + (2)
A. Joint ventures						
B. Companies under significant influence						

IFRS Operating Manual

Chapter 3
Business Combinations

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the IFRS 3 – Business Combinations;
- a list of most recent amendment to IFRS 3.

1.1 Introduction

IFRS 3 (2008) seeks to enhance the relevance, reliability and comparability of information provided about business combinations (e.g. acquisitions and mergers) and their effects. It sets out the principles on the recognition and measurement of acquired assets and liabilities, the determination of goodwill and the necessary disclosures.

IFRS 3 (2008) resulted from a joint project with the US Financial Accounting Standards Board (FASB) and replaced IFRS 3 (2004). FASB issued a similar standard in December 2007. The revisions result in a high degree of convergence between IFRSs and US GAAP in the accounting for business combinations, although some potentially significant differences remain.

1.2 Overview IFRS 3

IFRS 3 *Business Combinations* outlines the accounting when an acquirer obtains control of a business (e.g. an acquisition or merger). Such business combinations are accounted for using the 'acquisition method', which generally requires assets acquired and liabilities assumed to be measured at their fair values at the acquisition date.

A revised version of IFRS 3 was issued in January 2008 and applies to business combinations occurring in an entity's first annual period beginning on or after 1 July 2009.

Date	Development	Comments
12 December 2013	Amended by *Annual Improvements to IFRSs 2011–2013 Cycle* (scope exception for joint ventures)	Effective for annual periods beginning on or after 1 July 2014
12 December 2013	Amended by *Annual Improvements to IFRSs*	Applicable for business

	2010–2012 Cycle (contingent consideration)	combinations for which the acquisition date is on or after 1 July 2014
6 May 2010	Amended by *Annual Improvements to IFRSs 2010* (measurement of non-controlling interests, replaced share-based payment awards, transitional arrangements for contingent consideration)	Effective for annual periods beginning on or after 1 July 2010
10 January 2008	IFRS 3 *Business Combinations* (2008) issued	Applies to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009
30 June 2005	Exposure Draft *Proposed Amendments to IFRS 3* published	Comment deadline 28 October 2005
29 April 2004	Exposure Draft *Combinations by Contract Alone or Involving Mutual Entities* published (These proposals were not finalised, but instead considered as part of the June 2005 exposure draft)	Comment deadline 31 July 2004
31 March 2004	IFRS 3 *Business Combinations* (2004) and related amended versions of IAS 36 and IAS 38 issued (IFRS 3 supersedes IAS 22)	Effective for business combinations for which the agreement date is on or after 31 March 2004

5 December 2002	Exposure Draft ED 3 *Business Combinations* and related exposure drafts proposing amendments to IAS 36 and IAS 38 published	Comment deadline 4 April 2003
July 2001	Project added to IASB agenda	History of the project

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IFRS 3 that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of business combination

A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as 'true mergers' or 'mergers of equals' are also business combinations as that term is used in IFRS 3.

Definition of business

An integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants.

Definition of acquisition date

The date on which the acquirer obtains control of the acquiree.

Definition of acquirer

The entity that obtains control of the acquiree.

Definition of acquiree

The business or businesses that the acquirer obtains control of in a business combination.

2.2 Scope of rules

IFRS 3 must be applied when accounting for business combinations, but does not apply to:

- The formation of a joint venture[1];
- The acquisition of an asset or group of assets that is not a business, although general guidance is provided on how such transactions should be accounted for;
- Combinations of entities or businesses under common control (the IASB has a separate agenda project on common control transactions);
- Acquisitions by an investment entity of a subsidiary that is required to be measured at fair value through profit or loss under IFRS 10 *Consolidated Financial Statements*.

Determining whether a transaction is a business combination

IFRS 3 provides additional guidance on determining whether a transaction meets the definition of a business combination, and so accounted for in accordance with its requirements. This guidance includes:

- Business combinations can occur in various ways, such as by transferring cash, incurring liabilities, issuing equity instruments (or any combination thereof), or by not issuing consideration at all (i.e. by contract alone);
- Business combinations can be structured in various ways to satisfy legal, taxation or other objectives, including one entity becoming a subsidiary of another, the transfer of net assets from one entity to another or to a new entity;
- The business combination must involve the acquisition of a business, which generally has three elements:
    - *Inputs* – an economic resource (e.g. non-current assets, intellectual property) that creates outputs when one or more processes are applied to it;
    - *Process* – a system, standard, protocol, convention or rule that when applied to an input or inputs, creates outputs (e.g. strategic management, operational processes, resource management);
    - *Output* – the result of inputs and processes applied to those inputs.

2.3 Method of accounting for business combinations

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[1] *Annual Improvements to IFRSs 2011–2013 Cycle*, effective for annual periods beginning on or after 1 July 2014, amends this scope exclusion to clarify that is applies to the accounting for the formation of a joint arrangement in the financial statements of the joint arrangement itself.

Acquisition method

The acquisition method (called the 'purchase method' in the 2004 version of IFRS 3) is used for all business combinations.

Steps in applying the acquisition method are:

- Identification of the 'acquirer';
- Determination of the 'acquisition date';
- Recognition and measurement of the identifiable assets acquired, the liabilities assumed and any non-controlling interest (NCI, formerly called minority interest) in the acquire;
- Recognition and measurement of goodwill or a gain from a bargain purchase.

Identifying an acquirer

The guidance in IFRS 10 Consolidated Financial Statements is used to identify an acquirer in a business combination, i.e. the entity that obtains 'control' of the acquiree.

If the guidance in IFRS 10 does not clearly indicate which of the combining entities is an acquirer, IFRS 3 provides additional guidance which is then considered:

- The acquirer is usually the entity that transfers cash or other assets where the business combination is effected in this manner;
- The acquirer is usually, but not always, the entity issuing equity interests where the transaction is effected in this manner, however the entity also considers other pertinent facts and circumstances including:
  - relative voting rights in the combined entity after the business combination; the existence of any large minority interest if no other owner or group of owners has a significant voting interest;
  - the composition of the governing body and senior management of the combined entity;
  - the terms on which equity interests are exchanged.
- The acquirer is usually the entity with the largest relative size (assets, revenues or profit);
- For business combinations involving multiple entities, consideration is given to the entity initiating the combination, and the relative sizes of the combining entities.

Acquisition date

An acquirer considers all pertinent facts and circumstances when determining the acquisition date, i.e. the date on which it obtains control of the acquiree. The acquisition date may be a date that is earlier or later than the closing date.

IFRS 3 does not provide detailed guidance on the determination of the acquisition date and the date identified should reflect all relevant facts and circumstances. Considerations might include, among others, the date a public offer becomes unconditional (with a controlling interest acquired), when the acquirer can effect change in the board of directors of the acquiree, the date of acceptance of an unconditional offer, when the acquirer starts directing the acquiree's operating and financing policies, or the date competition or other authorities provide necessarily clearances.

Acquired assets and liabilities

IFRS 3 establishes the following principles in relation to the recognition and measurement of items arising in a business combination:

- Recognition principle: identifiable assets acquired, liabilities assumed, and non-controlling interests in the acquiree, are recognised separately from goodwill;
- Measurement principle: all assets acquired and liabilities assumed in a business combination are measured at acquisition-date fair value.

In applying the principles, an acquirer classifies and designates assets acquired and liabilities assumed on the basis of the contractual terms, economic conditions, operating and accounting policies and other pertinent conditions existing at the acquisition date. For example, this might include the identification of derivative financial instruments as hedging instruments, or the separation of embedded derivatives from host contracts. However, exceptions are made for lease classification (between operating and finance leases) and the classification of contracts as insurance contracts, which are classified on the basis of conditions in place at the inception of the contract.

Acquired intangible assets must be recognised and measured at fair value in accordance with the principles if it is separable or arises from other contractual rights, irrespective of whether the acquiree had recognised the asset prior to the business combination occurring. This is because there is always sufficient information to reliably measure the fair value of these assets. There is no 'reliable measurement' exception for such assets, as was present under IFRS 3 (2004).

Goodwill

Goodwill is measured as the difference between:

- the aggregate of (i) the value of the consideration transferred (generally at fair value), (ii) the amount of any non-controlling interest (NCI, see below), and (iii) in a business combination achieved in stages (see below), the acquisition-date fair value of the acquirer's previously-held equity interest in the acquire; and
- the net of the acquisition-date amounts of the identifiable assets acquired and the liabilities assumed (measured in accordance with IFRS 3).

This can be written in simplified equation form as follows:

Goodwill = Consideration transferred + Amount of non-controlling interests + Fair value of previous equity interests - Net assets recognized

If the difference above is negative, the resulting gain is a bargain purchase in profit or loss, which may arise in circumstances such as a forced seller acting under compulsion. However, before any bargain purchase gain is recognised in profit or loss, the acquirer is required to undertake a review to ensure the identification of assets and liabilities is complete, and that measurements appropriately reflect consideration of all available information.

Choice in the measurement of non-controlling interests (NCI)

IFRS 3 allows an accounting policy choice, available on a transaction by transaction basis, to measure non-controlling interests (NCI) either at:

- fair value (sometimes called the full goodwill method);or
- the NCI's proportionate share of net assets of the acquiree.

The choice in accounting policy applies only to present ownership interests in the acquiree that entitle holders to a proportionate share of the entity's net assets in the event of a liquidation (e.g. outside holdings of an acquiree's ordinary shares). Other components of non-controlling interests at must be measured at acquisition date fair values or in accordance with other applicable IFRSs (e.g. share-based payment transactions accounted for under IFRS 2 Share-based Payment).

Business combination achieved in stages (step acquisitions)

Prior to control being obtained, an acquirer accounts for its investment in the equity interests of an acquiree in accordance with the nature of the investment by applying the relevant standard, e.g. IAS 28 Investments in Associates and Joint Ventures (2011), IFRS 11 Joint Arrangements, IAS 39 Financial Instruments:

Recognition and Measurement or IFRS 9 Financial Instruments. As part of accounting for the business combination, the acquirer remeasures any previously held interest at fair value and takes this amount into account in the determination of goodwill as noted above. Any resultant gain or loss is recognised in profit or loss or other comprehensive income as appropriate.

The accounting treatment of an entity's pre-combination interest in an acquiree is consistent with the view that the obtaining of control is a significant economic event that triggers a remeasurement. Consistent with this view, all of the assets and liabilities of the acquiree are fully remeasured in accordance with the requirements of IFRS 3 (generally at fair value). Accordingly, the determination of goodwill occurs only at the acquisition date. This is different to the accounting for step acquisitions under IFRS 3(2004).

Measurement period

If the initial accounting for a business combination can be determined only provisionally by the end of the first reporting period, the business combination is accounted for using provisional amounts. Adjustments to provisional amounts, and the recognition of newly identified asset and liabilities, must be made within the 'measurement period' where they reflect new information obtained about facts and circumstances that were in existence at the acquisition date. The measurement period cannot exceed one year from the acquisition date and no adjustments are permitted after one year except to correct an error in accordance with IAS 8.

2.4 Related transactions and subsequent accounting

General principles

In general:

- transactions that are not part of what the acquirer and acquiree (or its former owners) exchanged in the business combination are identified and accounted for separately from business combination;
- the recognition and measurement of assets and liabilities arising in a business combination after the initial accounting for the business combination is dealt with under other relevant standards, e.g. acquired inventory is subsequently accounted under IAS 2 Inventories.

When determining whether a particular item is part of the exchange for the acquiree or whether it is separate from the business combination, an acquirer considers the reason for the transaction, who initiated the transaction and the timing of the transaction.

Contingent consideration

Contingent consideration must be measured at fair value at the time of the business combination and is taken into account in the determination of goodwill. If the amount of contingent consideration changes as a result of a post-acquisition event (such as meeting an earnings target), accounting for the change in consideration depends on whether the additional consideration is classified as an equity instrument or an asset or liability:

- If the contingent consideration is classified as an equity instrument, the original amount is not remeasured;
- If the additional consideration is classified as an asset or liability that is a financial instrument, the contingent consideration is measured at fair value and gains and losses are recognized in either profit or loss or other comprehensive income in accordance with IFRS 9 Financial Instruments or IAS 39 Financial Instruments: Recognition and Measurement;
- If the additional consideration is not within the scope of IFRS 9 (or IAS 39), it is accounted for in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets or other IFRSs as appropriate.

Where a change in the fair value of contingent consideration is the result of additional information about facts and circumstances that existed at the acquisition date, these changes are accounted for as measurement period adjustments if they arise during the measurement period.

Acquisition costs

Costs of issuing debt or equity instruments are accounted for under IAS 32 Financial Instruments: Presentation and IAS 39 Financial Instruments: Recognition and Measurement/IFRS 9 Financial Instruments. All other costs associated with an acquisition must be expensed, including reimbursements to the acquiree for bearing some of the acquisition costs. Examples of costs to be expensed include finder's fees; advisory, legal, accounting, valuation and other professional or consulting fees; and general administrative costs, including the costs of maintaining an internal acquisitions department.

Pre-existing relationships and reacquired rights

If the acquirer and acquiree were parties to a pre-existing relationship (for instance, the acquirer had granted the acquiree a right to use its intellectual property), this must must be accounted for separately from the business combination. In most cases, this will lead to the recognition of a gain or loss for the amount of the consideration transferred to the vendor which effectively represents a 'settlement' of the pre-existing relationship. The amount of the gain or loss is measured as follows:

- for pre-existing non-contractual relationships (for example, a lawsuit): by reference to fair value;
- for pre-existing contractual relationships: at the lesser of (a) the favourable/unfavourable contract position and (b) any stated settlement provisions in the contract available to the counterparty to whom the contract is unfavourable.

However, where the transaction effectively represents a reacquired right, an intangible asset is recognised and measured on the basis of the remaining contractual term of the related contract excluding any renewals. The asset is then subsequently amortised over the remaining contractual term, again excluding any renewals.

Contingent liabilities

Until a contingent liability is settled, cancelled or expired, a contingent liability that was recognised in the initial accounting for a business combination is measured at the higher of the amount the liability would be recognised under IAS 37 Provisions, Contingent Liabilities and Contingent Assets, and the amount less accumulated amortisation under IAS 18 Revenue.

Contingent payments to employees and shareholders

As part of a business combination, an acquirer may enter into arrangements with selling shareholders or employees. In determining whether such arrangements are part of the business combination or accounted for separately, the acquirer considers a number of factors, including whether the arrangement requires continuing employment (and if so, its term), the level or remuneration compared to other employees, whether payments to shareholder employees are incremental to non-employee shareholders, the relative number of shares owns, linkages to valuation of the acquiree, how the consideration is calculated, and other agreements and issues.

Where share-based payment arrangements of the acquiree exist and are replaced, the value of such awards must be apportioned between pre-combination and post-combination service and accounted for accordingly.

Indentification assets

Indemnification assets recognised at the acquisition date (under the exceptions to the general recognition and measurement principles noted above) are subsequently measured on the same basis of the indemnified liability or asset, subject to contractual impacts and collectibility. Indemnification assets are only derecognised when collected, sold or when rights to it are lost.

Other issues

In addition, IFRS 3 provides guidance on some specific aspects of business combinations including:

- business combinations achieved without the transfer of consideration, e.g. 'dual listed' and 'stapled' arrangements;
- reverse acquisitions;
- identifying intangible assets acquired.

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
    - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
    - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

All business combinations be accounted for by applying the acquisition method.

In addition to determining whether a transaction or other event is a business combination, four stages in the application of the acquisition method are listed:

- identifying the acquirer;
- determining the acquisition date;
- recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree; and
- recognising and measuring goodwill or a gain from a bargain purchase.

Assessment of control is, in certain cases, not straightforward but it is an important managerial decision to be taken on a case by case basis that may have relevant effects on the whole Group.

Accordingly such assessment shall be shared and agreed with Holding end evaluated case by case.

Assessing if a transaction is a Business combination or an asset acquisition is important due to the different impacts as shown in the following table:

IMPACT ON	**BUSINESS COMBINATION**	**ASSET ACQUISITION**
Goodwill	Goodwil (or a gain on a bargain purchase) may arise	No goodwill is recognised
Initial measurement of asset acquired and liabilities assumed	Fair Value	Allocated cost (on a relative fair value basis)
Directly attributable transaction costs	Expensed	May be capitalized in accordance with applicable standard
Deferred tax on initial recognition	Recognised (except for goodwill)	Not recognized
Disclosure	In accordance with IFRS 3	In accordance with applicable stantdard

However, taking all the requirements of the Standard into account, there are seven distinct steps that the Group should considered and these are listed in the following list:

- STEP 1: Detemining wheter the transaction or event is a business;
- STEP 2: Identifying the aquirer;
- STEP 3: Determining the acquisition date;
- STEP 4: Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquire;
- STEP 5: Measuring consideration and determining what is part of the business combination;
- STEP 6: Recognising and measuring goodwill or a gain from a bargain purchase;
- STEP 7: Subsequent measurement and accounting.

For further consideration about this step, see paragraph 2 of this chapter and chapter on intangible assets (intangible asset deriving from insurance contracts acquired in business combination or portfolio transfers)

3.2 Relevant topics

The post-implementation review of IFRS 3 *Business Combinations* revealed that entities have difficulties when determining whether they have acquired a business or a group of assets. As the accounting requirements for goodwill, acquisition costs and deferred tax differ on the acquisition of a business and on the acquisition of a group of assets, the IASB decided to issue narrow scope amendments aimed at resolving the difficulties that arise when an entity is determining whether it has acquired a business or a group of assets.

At the same time, the IFRS Interpretations Committee received and discussed several issues around transactions involving previously held interests in order to determine whether or not previously held interests should be remeasured. The Interpretations Committee recommended to the IASB to make certain amendments and the IASB agreed to follow the Committee's recommendation, provided the amendments were grouped with and conditional on other amendments relating to the definition of a business.

As a consequence, the IASB now issues one exposure draft addressing the definition of a business as well as the accounting for previously held interests in the assets and liabilities of a joint operation in transactions in which an investor obtains control or joint control of a joint operation that meets the definition of a business.

The amendments proposed in ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests (Proposed amendments to IFRS 3 and IFRS 11)* are:

Definition of a business (changes to the implementation guidance of IFRS 3 only)

- A business consists of inputs and processes applied to those inputs that have the ability to contribute to creating outputs, while a business need not include all of the inputs or processes that the seller used in operating that business and need not have an output. However, if there is no output, the set is a business only if it includes an organised workforce with the necessary skills, knowledge, or experience to perform an acquired substantive process that is critical to the ability to develop or convert another acquired input into output.
- If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business.
- Tangible and intangible assets, different classes of tangible assets, identifiable intangible assets in different intangible asset classes, financial assets and non-financial assets, and different classes of financial assets shall not be combined into a single asset or considered a group of similar assets.

Accounting for previously held interests (changes to IFRS 3 and the implementation guidance of IFRS 11)

- Acquisition of control over a joint operation that meets the definition of a

business is a significant economic event that warrants remeasurement of previously held interests in the assets and liabilities of the joint operation at fair value at the time an investor obtains control of the joint operation.
- Acquisition of joint control over a joint operation that meets the definition of a business is not an event that warrants remeasurement of previously held interests in the assets and liabilities of the joint operation at the time an investor obtains joint control over the joint operation.

The ED proposes that the amendments would be applied to business combinations for which the acquisition date is on or after the effective date. Earlier application would be permitted.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree (paragraph 4.1)
- Identifying and measuring consideration (paragraph 4.2)
- Recognising and measuring goodwill or a gain from a bargain purchase (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to business combinations.

4.1 Recognising and measuring the identifiable assets acquired, the liabilities assumed and any non-controlling interest in the acquiree

4.1.1 Recognition

Example 4.1.1.1

Goodwill previously recognised by the acquiree

Entity A acquires 100 per cent of Entity B for CU 100. The net assets recognised in Entity B's consolidated statement of financial position at the date of acquisition comprise goodwill of CU 20 that arose when Entity B acquired one of its subsidiaries and identifiable net assets of CU 70 (for simplicity, assume that the carrying amount of the identifiable net assets equals their fair value).

Assume that there are no assets or liabilities that are not recognised in Entity B's statement of financial position that should be recognised as part of the accounting for the business combination.

In Entity A's consolidated financial statements, should the goodwill previously recognised by Entity B be recognised separately from the goodwill arising on Entity A's acquisition of Entity B?

No. Any goodwill that is recognised in the statement of financial position of the acquiree is ignored when recognising the identifiable assets acquired and liabilities assumed by the parent. Therefore, in the circumstances described, the goodwill arising on the acquisition of Entity B is CU 30.

However, any business combination entered into by Entity B after the date of acquisition by Entity A will be a business combination from the perspective of both Entity B and Entity A and will give rise to goodwill both in the consolidated financial statements of Entity B (if consolidated financial statements are presented by Entity B) and in the consolidated financial statements of Entity A.

4.1.2 Measurement

Example 4.1.2.1

Acquisition of an intangible asset that will not be used

Company A acquires Company B. The identifiable net assets of Company B include a trademark, which is a logo previously used by Company B as a direct competitor to Company A. Company A does not intend to use this logo in the future.

Should the logo be recognised, separately from goodwill, as an identifiable intangible asset acquired as part of the business combination? If so, how should the logo be accounted for subsequent to recognition?

The logo is considered to be separable because it could, for example, be licensed to a third party. It also arises from legal rights. Therefore, the intangible asset should be recognised, separately from goodwill, as part of the accounting for the business combination.

For the purposes of impairment testing, the question of whether the logo should be allocated to existing cash-generating units of Company A or identified as a cash-generating unit by itself will depend on an assessment of specific facts and circumstances. If Company A has no intention of using the logo after acquisition and does not undertake activities aimed at transferring customers to an existing brand, the logo should be identified as a cash-generating unit by itself. Because cash inflows related to the logo are nil, fair value less costs to sell will be the recoverable amount.

However, if Company A undertakes activities to transfer value to existing brands, such that it can be demonstrated that existing cash-generating units will benefit, the logo should be allocated to those cash-generating units.

Immediately after acquisition, it would appear reasonable that the fair value less costs to sell of the logo is not significantly different from the amount recognised. Accordingly, no impairment loss is recognised immediately and the asset should be amortised over its useful life. The useful life to Company A is the length of time that holding the logo will be effective in discouraging competition, which would be a fairly short period because an unexploited logo loses value quickly. Because Company A acquired the asset with the express intention of denying others the opportunity to use the asset, it appears unlikely that the asset will be sold in the future and, accordingly, the residual value is nil. As a result, an amortisation expense for the full carrying amount of the asset is recognised over the useful life (which may be as short as a single accounting period).

Example 4.1.2.2

Potential for fair values reflecting different circumstances

Entity A acquired Entity B in two separate transactions:

- a one-third equity interest for which Entity A paid CU 10 per share, which resulted in Entity A having significant influence over Entity B; and
- a further one-third equity interest for which Entity A paid CU 15 per share, which resulted in Entity A having a controlling interest.

Based on the market prices of the remaining shares, Entity A assesses the fair value of the non-controlling interests at CU 9 per share.

In this case, it appears that three different fair values have been attributed to similar sized equity interests. However, each fair value reflects a different fact pattern and, therefore, a different market:

- CU 10 represents the fair value of an equity interest carrying significant influence in an entity where other holdings are dispersed and the holder has the potential to launch a bid for a controlling interest;
- CU 15 represents the fair value of a controlling interest, including a control premium; and
- CU 9 represents the fair value of an equity interest in an entity controlled by another party.

4.1.3 Guidance on the recognition and measurement of specific categories of assets and liabilities

Example 4.1.3.1

Acquiree has deferred rent relating to an operating lease (1)

Entity A acquires Entity B. Before the acquisition date, Entity B recognised deferred rent relating to an operating lease as a liability in its statement of financial position (because Entity B has benefited from a rent-free period under the terms of the lease agreement but is required to recognise the lease payments on a straight-line basis over the lease term in accordance with [IAS 17] *Leases*).

Should Entity A recognise the deferred rent as a liability as part of the accounting for the business combination?

No. Entity A should not recognise Entity B's deferred rent at the acquisition date because it does not meet the definition of a liability. Instead, as required by IFRS 3:B29, Entity A will recognise an intangible asset if the terms of the operating lease are favourable relative to market terms and a liability if the terms are unfavourable relative to market terms.

Entity A should, however, recognise any additional deferred rent arising in the post-combination period based on the terms of the assumed lease

Example 4.1.3.2

Acquiree has deferred rent relating to an operating lease (2)

Company A acquires Company B and assumes Company B's operating lease (as lessee). The lease has a five-year term with a rent-free period in Year 1, payments in Years 2 and 3 of CU 150, in Year 4 of CU 200 and in Year 5 of CU 250.

At the acquisition date, the lease had a remaining contractual life of three years and Company B had recognised a liability of CU 150 for deferred rent. This is calculated as the straight-line accumulated expense of CU 300 [(CU 150 + CU 150 + CU 200 + CU 250) ÷ 5 × 2] less cash payments of CU 150.

Company A does not recognise any amounts related to Company B's deferred rent liability on the acquisition date. However, the terms of the lease will give rise to deferred rent in the post-combination period. Company A will recognise a deferred rent liability of CU 50 at the end of the first year after acquisition. This is calculated as the straight-line expense of CU 200 [(CU 150 + CU 200 + CU 250) ÷ 3] less cash payments of CU 150.

Company A may also have to recognise an asset or a liability at the acquisition date to the extent that the future lease payments are favourable or unfavourable relative to market terms. For example, if market rates at the date of acquisition are CU 220 per annum, Company A will recognise an asset reflecting the fair value of the difference between this and the actual future payments, which will average CU 200 per annum.

Example 4.1.3.3

Marketing-related intangible assets

Marketing-related intangible assets are used primarily in the marketing or promotion of products or services. Examples of marketing-related intangible assets are:

Class	**Basis**
Trademarks, trade names, service marks, collective marks and certification marks	Contractual
Trade dress (unique colour, shape or package design)	Contractual
Newspaper mastheads	Contractual
Internet domain names	Contractual
Non-competition agreements	Contractual

Trademarks, trade names, service marks, collective marks and certification marks

Trademarks are words, names, symbols or other devices used in trade to indicate the source of a product and to distinguish it from the products of others. A service mark identifies and distinguishes the source of a service rather than a product. Collective marks identify the goods or services of members of a group. Certification marks certify the geographical origin or other characteristics of a good or service.

Trademarks, trade names, service marks, collective marks and certification marks may be protected legally through registration with governmental agencies, continuous use in commerce or by other means. If it is protected legally through registration or other means, a trademark or other mark acquired in a business combination is an intangible asset that meets the contractual-legal criterion.

Otherwise, a trademark or other mark acquired in a business combination can be recognised separately from goodwill if the separability criterion is met, which normally it would be.

The terms *brand* and *brand name*, often used as synonyms for trademarks and other marks, are general marketing terms that typically refer to a group of complementary assets such as a trademark (or service mark) and its related trade name, formulas, recipes and technological expertise. IFRS 3 does not preclude an entity from recognising, as a single asset separately from goodwill, a group of complementary intangible assets commonly referred to as a brand if the assets that make up that group have similar useful lives.

Internet domain names
An Internet domain name is a unique alphanumeric name that is used to identify a particular numeric Internet address. Registration of a domain name creates an association between that name and a designated computer on the Internet for the period of the registration. Those registrations are renewable. A registered domain name acquired in a business combination meets the contractual-legal criterion.

4.2 Identifying and measuring consideration

4.2.1 Contingent consideration

Example 4.2.1.1

Business acquired through exercise of a put option

On 1 July 20X5, Company A writes a put option to Company C over 100 per cent of the ordinary share capital of Company B at a fixed price of CU 150 million that is exercisable only at the date of maturity (21 December 20X5). The exercise of the put option will result in Company A gaining control over Company B. (Company A does not control Company B until the put option is exercised; Company A holds neither shares nor potential voting rights that result in its having control.) Company C pays Company A a premium of CU 10 million for the put option.

On 21 December 20X5, Company C exercises the put option. At that date, the fair value of Company B’s ordinary shares is CU 120 million and the fair value of the put option is a CU 30 million liability for Company A.
The written put option is within the scope of IFRS 9 *Financial Instruments* (or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*). It is not excluded under IFRS 9 because it is an option.

The written put option is accounted for under IFRS 9 as a derivative liability with changes in fair value recognised through profit or loss until exercise or maturity of the option:

- on 1 July 20X5, Company A recognises the liability at CU 10 million (i.e. at the amount of the premium received);
- on 21 December 20X5, Company A recognises the increase in the fair value of the derivative and a corresponding CU 20 million loss in profit or loss. This loss arising due to changes in the fair value of the put option is not reversed when accounting for the business combination;
- the payment of the purchase price of CU 150 million by Company A is treated as settlement of the written put liability of CU 30 million and the acquisition of Company B at a cost equal to the fair value of Company B’s shares (i.e. CU 120 million); and
- goodwill on the acquisition of Company B is determined by comparing the cost of acquisition of CU 120 million (not the cash amount paid of CU 150 million) with the fair value of the assets, liabilities and contingent liabilities acquired.

If instead the put option were not exercised by Company C, the lapse of the option at 21 December 20X5 would be accounted for by Company A by derecognising the liability, with a corresponding gain in profit or loss.

Example 4.2.1.2

Contingent consideration

Company A acquires Company B. The consideration is payable in three tranches:

- an immediate payment of CU 1 million;

- a further payment of CU 0.5 million after one year if profit before interest and tax for the first year following acquisition exceeds CU 200,000; and

- a further payment of CU 0.5 million after two years if profit before interest and tax for the second year following acquisition exceeds CU 220,000.

The two payments that are conditional upon reaching earnings targets are contingent consideration. At the date of acquisition, the fair value of these two payments is assessed as CU 250,000.

Consequently, on the date of acquisition, consideration of CU 1,250,000 is recognised.

Example 4.2.1.3

Outstanding contingent consideration of the acquire

Entity A acquires Entity B on 31 December 20X5.

On 31 December 20X3, Entity B had acquired Entity C. The terms of the acquisition of Entity C required Entity B to pay an additional amount of consideration in cash if specified earnings targets were met by 31 December 20X8.

How should Entity B's obligation for the contingent consideration related to the earlier acquisition of Entity C be accounted for by Entity A at the date of acquisition of Entity B?

Contingent consideration is defined in IFRS 3 as "an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met". Therefore, contingent consideration relates directly to the acquisition of control in the business combination.

In the context of Entity A's acquisition of Entity B, the only items that would be accounted for as contingent consideration are obligations as described due from Entity A to the former owners of Entity B that arise as part of the exchange of control of Entity B. From Entity A's perspective, any payments due by Entity B to the former owners of Entity C in respect of past acquisitions do not meet the definition of contingent consideration.

Entity B's obligation is a contractual obligation to deliver cash to the former owners of Entity C, which qualifies as a financial liability under IFRS 9 and should be accounted for as such by Entity A in accounting for the acquisition of Entity B. The fact that the obligation is contingent upon the occurrence or non-occurrence of uncertain future events beyond the control of both Entity B and Entity C does not prevent it from being recognised as a financial liability.

If there were no contractual obligation to deliver cash (or another financial asset or equity), the arrangement would not meet the definition of a financial liability in IAS 32 *Financial Instruments: Presentation* and, accordingly, Entity B's obligation would fall within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

4.2.2 Determining what is part of the business combination transaction

Example 4.2.2.1

Cash settlement of share-based payment awards by the acquiree

Immediately prior to its acquisition by Company A, Company B cash settles the outstanding unvested share-based payments awards held by its employees. The terms of these awards did not provide for any automatic vesting or expiry in the event of a change in control. The amount of cash paid by Company B is equal to the current fair value of the awards.

Care should be taken to determine whether the cash settlement was arranged primarily for the economic benefit of Company A or the combined entity rather than for the benefit of Company B or its former owners. Even though the form of the transaction may indicate that this is a pre-combination transaction of Company B, it may be determined that, in substance, Company A has reimbursed Company B for the cash settlement.

Company A should consider the factors set out in IFRS 3 to determine whether a portion of the consideration transferred for Company B is attributable to the settlement of the awards held by Company B's employees.

If a portion of the consideration is attributable to the settlement of the awards, Company A should apply the guidance in IFRS 3 to determine the amount considered to have been paid to the employees of Company B in consideration for pre-combination and post-combination services. The amount attributable to the post-combination service does not form part of the consideration for the business combination but is recognised as remuneration cost in the post-combination financial statements.

Example 4.2.2.2

Contingent payments to employees recognised as a liability

TC appointed a candidate as its new CEO under a ten-year contract. The contract required TC to pay the candidate CU5 million if TC is acquired before the contract expires. AC acquires TC eight years later. The CEO was still employed at the acquisition date and will receive the additional payment under the existing contract.

In this example, TC entered into the employment agreement before the negotiations of the combination began, and the purpose of the agreement was to obtain the services of the CEO. Thus, there is no evidence that the agreement was arranged primarily to provide benefits to AC or the combined entity. Therefore, the liability to pay CU5 million is included in the application of the acquisition method.

In other circumstances, TC might enter into a similar agreement with CEO at the suggestion of AC during the negotiations for the business combination. If so, the primary purpose of the agreement might be to provide severance pay to CEO, and the agreement may primarily benefit AC or the combined entity rather than TC or its former owners. In that situation, AC accounts for the liability to pay CEO in its post-combination financial statements separately from application of the acquisition method.

Example 4.2.2.3

Subsequent accounting by acquire

Entity A awarded share options to its employees, which vest if employees remain in employment for a specified number of years. Before the awards vest, Entity A is acquired by Entity B. Entity B exchanges the share options for options over shares in Entity B. The terms of the share options did not require expiry as a result of the business combination.

As required by IFRS 3, the fair values of the original acquiree share-based payment awards and the replacement awards granted by the acquirer as at the acquisition date are measured in accordance with IFRS 2.

IFRS 3 requires that, in Entity B's consolidated financial statements, the portion of the fair value of the replacement award at the acquisition date that is attributable to post-combination service should be recognised as compensation expense.

How should Entity A recognise the impact of the replacement of the awards by Entity B in its individual financial statements?

The requirements of IFRS 2 continue to apply in the individual financial statements of Entity A; the impact of the exchange should be recognised based on the principles applicable to replacements and modifications of equity awards in IFRS 2.

4.3 Recognising and measuring goodwill or a gain from a bargain purchase

4.3.1 Measuring goodwill or a gain from a bargain purchase

Example 4.3.1.1

Calculation of goodwill

Entity P acquires Entity Q in two stages.

- In 20X1, Entity P acquires a 30 per cent equity interest for cash consideration of CU 32,000 when the fair value of Entity Q's identifiable net assets is CU 100,000.
- In 20X5, Entity P acquires a further 50 per cent equity interest for cash consideration of CU 75,000. On the acquisition date, the fair value of Entity Q's identifiable net assets is CU 120,000. The fair value of Entity P's original 30 per cent holding is CU 40,000 and the fair value of the 20 per cent non-controlling interest (NCI), which represent a present ownership interest, is assessed as CU 28,000.

Goodwill is calculated, on the alternative bases that Entity P recognises components of NCI that represent present ownership interests at their proportionate share of net assets, or at fair value, as follows.

	NCI @ %of net assets	**NCI @fair value**
	CU	**CU**
Fair value of consideration	75,000	75,000
Non-controlling interests	24,000	28,000
Previously held interest	40,000	40,000
	139,000	143,000
Fair value of identifiable net assets	120,000	120,000
Goodwill	19,000	23,000

Example 4.3.1.2

Calculation of goodwill in an acquisition made by a partially-owned subsidiary

Entity P owns 80 per cent of Entity S. Entity S acquires 100 per cent of the equity shares of Entity A from an unrelated party for cash consideration of CU 100,000 when the fair value of Entity A's identifiable net assets is CU 80,000.

How should goodwill arising on the acquisition of Entity A be calculated in the consolidated financial statements of Entity P?

Goodwill should be calculated in the manner required by IFRS 3. In the circumstances described:

- no entity in Entity P's group previously held any interest in Entity A;
- no additional non-controlling interest (NCI) arises from the acquisition; and
- the full consideration for the acquisition of Entity A is payable out of assets of Entity P's group.

Therefore, goodwill will be the difference between the consideration payable by the group (for 100 per cent of Entity A's shares) and the net of the acquisition-date fair values of the identifiable assets acquired and the liabilities assumed measured in accordance with IFRS 3.

	CU
Fair value of consideration paid by Entity P's group	100,000
Less: identifiable net assets of Entity A recognised in accordance with IFRS 3	(80,000)
Goodwill	20,000

The transaction does not affect the carrying amount of NCIs because, although the shareholders owning 20 per cent of Entity S have acquired an interest of CU 20,000 in Entity A (20 per cent of the total consideration of CU 100,000), their previous interest in the net assets of Entity S has decreased by an equivalent amount (20 per cent of the cash outflow of CU 100,000).

Example 4.3.1.3

Gain on a bargain purchase

On 1 January 20X5 AC acquires 80 per cent of the equity interests of TC, a private entity, in exchange for cash of CU 150. Because the former owners of TC needed to dispose of their investments in TC by a specified date, they did not have sufficient time to market TC to multiple potential buyers. The management of AC initially measures the separately recognisable identifiable assets acquired and the liabilities assumed as of the acquisition date in accordance with the requirements of IFRS 3. The identifiable assets are measured at CU 250 and the liabilities assumed are measured at CU 50. AC engages an independent consultant, who determines that the fair value of the 20 per cent non-controlling interest in TC is CU 42.

The amount of TC's identifiable net assets (CU 200, calculated as CU 250 – CU 50) exceeds the fair value of the consideration transferred plus the fair value of the non-controlling interest in TC. Therefore, AC reviews the procedures it used to identify and measure the assets acquired and liabilities assumed and to measure the fair value of both the non-controlling interest in TC and the consideration transferred. After that review, AC decides that the procedures and resulting measures were appropriate. AC measures the gain on its purchase of the 80 per cent interest as follows:

		CU	**CU**
Amount of the identifiable net assets acquired (CU 250 – CU 50)			200
Less:	Fair value of the consideration transferred for AC's 80 per cent interest in TC; plus	150	
	Fair value of non-controlling interest in TC	42	
			192
Gain on bargain purchase of 80 per cent interest			8

AC would record its acquisition of TC in its consolidated financial statements as follows:

		CU	**CU**
Dr	Identifiable assets acquired	250	
Cr	Cash		150
Cr	Liabilities assumed		50

Cr	Gain on the bargain purchase	8
Cr	Equity-non-controlling interest in TC	42

If the acquirer chose to measure the non-controlling interest in TC on the basis of its proportionate interest in the identifiable net assets of the acquiree, the recognised amount of the non-controlling interest would be CU 40 (CU 200 × 0.20). The gain on the bargain purchase then would be CU 10 (CU 200 – (CU 150 + CU 40)).

5 PRESENTATION

5.1 Disclosure rules

Disclosure of information about current business combinations

An acquirer is required to disclose information that enables users of its financial statements to evaluate the nature and financial effect of a business combination that occurs either during the current reporting period or after the end of the period but before the financial statements are authorised for issue.

Among the disclosures required to meet the foregoing objective are the following:

- name and a description of the acquiree;
- acquisition date;
- percentage of voting equity interests acquired;
- primary reasons for the business combination and a description of how the acquirer obtained control of the acquiree;
- description of the factors that make up the goodwill recognized;
- qualitative description of the factors that make up the goodwill recognised, such as expected synergies from combining operations, intangible assets that do not qualify for separate recognition;
- acquisition-date fair value of the total consideration transferred and the acquisition-date fair value of each major class of consideration;
- details of contingent consideration arrangements and indemnification assets;
- details of acquired receivables;
- the amounts recognised as of the acquisition date for each major class of assets acquired and liabilities assumed;
- details of contingent liabilities recognised;
- total amount of goodwill that is expected to be deductible for tax purposes;
- details about any transactions that are recognised separately from the acquisition of assets and assumption of liabilities in the business

combination;
- information about a bargain purchase;
- information about the measurement of non-controlling interests;
- details about a business combination achieved in stages;
- information about the acquiree's revenue and profit or loss;
- information about a business combination whose acquisition date is after the end of the reporting period but before the financial statements are authorised for issue.

Disclosure of information about adjustments of past business combinations

An acquirer is required to disclose information that enables users of its financial statements to evaluate the financial effects of adjustments recognised in the current reporting period that relate to business combinations that occurred in the period or previous reporting periods.

Among the disclosures required to meet the foregoing objective are the following:

- details when the initial accounting for a business combination is incomplete for particular assets, liabilities, non-controlling interests or items of consideration (and the amounts recognised in the financial statements for the business combination thus have been determined only provisionally);
- follow-up information on contingent consideration;
- follow-up information about contingent liabilities recognised in a business combination;
- a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, with various details shown separately;
- the amount and an explanation of any gain or loss recognised in the current reporting period that both:
    - relates to the identifiable assets acquired or liabilities assumed in a business combination that was effected in the current or previous reporting period; and
    - is of such a size, nature or incidence that disclosure is relevant to understanding the combined entity's financial state.

IFRS Operating Manual

Chapter 4
Impairment of Assets

CHAPTER IV – IMPAIRMENT OF ASSETS **118**

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 36 – Impairment of Assets;
- a list of most recent amendment to IAS 36.

1.1 Introduction

The main standard that addresses the accounting of impairment of assets is *IAS 36.* The objective of this standard is to ensure that assets are carried at no more than their recoverable amount, and to define how recoverable amount is determined.

1.2 Overview IAS 36

IAS 36 Impairment of Assets seeks to ensure that an entity's assets are not carried at more than their recoverable amount (i.e. the higher of fair value less costs of disposal and value in use). With the exception of goodwill and certain intangible assets for which an annual impairment test is required, entities are required to conduct impairment tests where there is an indication of impairment of an asset, and the test may be conducted for a 'cash-generating unit' where an asset does not generate cash inflows that are largely independent of those from other assets.

IAS 36 was reissued in March 2004 and applies to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004, and for all other assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004.

Date	Development	Comments
29 May 2013	Amended by *Recoverable Amount Disclosures for Non-Financial Assets* (clarification of disclosures required)	Effective for annual periods beginning on or after 1 January 2014
16 April 2009	Amended by Annual	Effective for annual

	Improvements to IFRSs 2009 (units of accounting for goodwill impairment testing using segments under IFRS 8 before aggregation)	periods beginning on or after 1 January 2010
22 May 2008	Amended by *Annual Improvements to IFRSs 2007* (disclosure of estimates used to determine a recoverable amount)	Effective for annual periods beginning on or after 1 January 2009
31 March 2004	IAS 36 *Impairment of Assets* revised	Applies to goodwill and intangible assets acquired in business combinations for which the agreement date is on or after 31 March 2004, and for all other assets prospectively from the beginning of the first annual period beginning on or after 31 March 2004
June 1998	IAS 36 *Impairment of Assets*	Operative for financial statements covering periods beginning on or after 1 July 1999
May 1997	Exposure Draft E55 *Impairment of Assets*	

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 36 and from related International Financial Reporting Standards (IFRSs) that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of carrying amount
The amount at which an asset is recognised in the balance sheet after deducting accumulated depreciation and accumulated impairment losses.

Definition of cash generating unit
A cash-generating unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

Definition of impairment loss
The amount by which the carrying amount of an asset or cash-generating unit exceeds its recoverable amount.

Definition of recoverable amount
The higher of an asset's fair value less costs of disposal (sometimes called net selling price) and its value in use.

Definition of fair value
The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Definition of value in use
The present value of the future cash flows expected to be derived from an asset or cash-generating unit.

2.2 Scope of rules

IAS 36 applies to all assets except:

IAS 36.2

- inventories;
- assets arising from construction contracts;
- deferred tax assets;
- assets arising from employee benefits;
- financial assets;
- investment property carried at fair value;
- agricultural assets carried at fair value;
- insurance contract assets;
- non-current assets held for sale.

Therefore, IAS 36 applies to (among other assets):

- land;
- building;
- machinery and equipment;
- investment property carried at cost;
- intangible assets;
- goodwill;
- investments in subsidiaries, associates, and joint ventures carried at cost;
- assets carried at revalued amounts under IAS 16 and IAS 38.

2.3 Identifying an asset that may be impaired

IAS 36.9

At the end of each reporting period, an entity is required to assess whether there is any indication that an asset may be impaired (i.e. its carrying amount may be higher than its recoverable amount). IAS 36 has a list of external and internal indicators of impairment. If there is an indication that an asset may be impaired, then the asset's recoverable amount must be calculated.

IAS 36.10

The recoverable amounts of the following types of intangible assets are measured annually whether or not there is any indication that it may be impaired. In some cases, the most recent detailed calculation of recoverable amount made in a previous period may be used in the impairment test for that asset in the current period:

- an intangible asset with an indefinite useful life;
- an intangible asset not yet available for use;
- goodwill acquired in a business combination.

2.4 Indications of impairment

External sources:

IAS 36.12

- market value declines;
- negative changes in technology, markets, economy, or laws;
- increases in market interest rates;
- net assets of the company higher than market capitalization.

Internal sources:

- obsolescence or physical damage;
- asset is idle, part of a restructuring or held for disposal;
- worse economic performance than expected;
- for investments in subsidiaries, joint ventures or associates, the carrying amount is higher than the carrying amount of the investee's assets, or a dividend exceeds the total comprehensive income of the investee.

These lists are not intended to be exhaustive. Further, an indication that an asset may be impaired may indicate that the asset's useful life, depreciation method, or residual value may need to be reviewed and adjusted. **IAS 36.13-17**

2.5 Determining recoverable amount

- If fair value less costs of disposal or value in use is more than carrying amount, it is not necessary to calculate the other amount. The asset is not impaired. **IAS 36.19**
- If fair value less costs of disposal cannot be determined, then recoverable amount is value in use. **IAS 36.20**
- For assets to be disposed of, recoverable amount is fair value less costs of disposal. **IAS 36.21**

2.6 Fair value less costs of disposal

- Fair value is determined in accordance with IFRS 13 *Fair Value Measurement* **IFRS 13**

- Costs of disposal are the direct added costs only (not existing costs or overhead). **IAS 36.28**

2.7 Value in use

The calculation of value in use should reflect the following elements:

IAS 36.30

- an estimate of the future cash flows the entity expects to derive from the

asset;
- expectations about possible variations in the amount or timing of those future cash flows;
- the time value of money, represented by the current market risk-free rate of interest;
- the price for bearing the uncertainty inherent in the asset;
- other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

Estimating the value in use of an asset involves the following steps: **IAS 36.31**
- estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
- applying the appropriate discount rate to those future cash flows

Cash flow projections should be based on reasonable and supportable assumptions, the most recent budgets and forecasts, and extrapolation for periods beyond budgeted projections. IAS 36 presumes that budgets and forecasts should not go beyond five years; for periods after five years, extrapolate from the earlier budgets. Management should assess the reasonableness of its assumptions by examining the causes of differences between past cash flow projections and actual cash flows. **IAS 36.33-35**

Cash flow projections should relate to the asset in its current condition – future restructurings to which the entity is not committed and expenditures to improve or enhance the asset's performance should not be anticipated. **IAS 36.44**

Estimates of future cash flows should not include cash inflows or outflows from financing activities, or income tax receipts or payments. **IAS 36.50**

2.8 Discount rate

In measuring value in use, the discount rate used should be the pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset. **IAS 36.55**

The discount rate should not reflect risks for which future cash flows have been adjusted and should equal the rate of return that investors would require if they were to choose an investment that would generate cash flows equivalent to those expected from the asset. **IAS 36.56**

For impairment of an individual asset or portfolio of assets, the discount rate is the rate the entity would pay in a current market transaction to borrow money to buy that specific asset or portfolio.

IAS 36.57 If a market-determined asset-specific rate is not available, a surrogate must be used that reflects the time value of money over the asset's life as well as country risk, currency risk, price risk, and cash flow risk. The following would normally be considered:

- the entity's own weighted average cost of capital;
- the entity's incremental borrowing rate;
- other market borrowing rates.

2.9 Recognition of an impairment loss

IAS 36.59 An impairment loss is recognised whenever recoverable amount is below carrying amount.

IAS 36.60 The impairment loss is recognised as an expense (unless it relates to a revalued asset where the impairment loss is treated as a revaluation decrease).

IAS 36.62 When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability if, and only if, that is required by another Standard.

IAS 36.63 After the recognition of an impairment loss, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset’s revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

2.10 Cash-generating units

IAS 36.66 Recoverable amount should be determined for the individual asset, if possible.

If it is not possible to determine the recoverable amount (fair value less costs of disposal and value in use) for the individual asset, then determine recoverable amount for the asset's cash-generating unit (CGU). The CGU is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets.

2.11 Impairment of goodwill

IAS 36.96

Goodwill should be tested for impairment annually.

IAS 36.80

To test for impairment, goodwill must be allocated to each of the acquirer's cash-generating units, or groups of cash-generating units, that are expected to benefit from the synergies of the combination, irrespective of whether other assets or liabilities of the acquiree are assigned to those units or groups of units. Each unit or group of units to which the goodwill is so allocated shall:

- represent the lowest level within the entity at which the goodwill is monitored for internal management purposes; and
- not be larger than an operating segment determined in accordance with IFRS 8 *Operating Segments*.

IAS 36.84

If the initial allocation of goodwill acquired in a business combination cannot be completed before the end of the annual period in which the business combination is effected, that initial allocation shall be completed before the end of the first annual period beginning after the acquisition date.

IAS 36.85

In accordance with IFRS 3 *Business Combinations*, if the initial accounting for a business combination can be determined only provisionally by the end of the period in which the combination is effected, the acquirer:

- accounts for the combination using those provisional values; and
- recognises any adjustments to those provisional values as a result of completing the initial accounting within the measurement period, which will not exceed twelve months from the acquisition date.

IAS 36.90

A cash-generating unit to which goodwill has been allocated shall be tested for impairment at least annually by comparing the carrying amount of the unit, including the goodwill, with the recoverable amount of the unit:

- If the recoverable amount of the unit exceeds the carrying amount of the unit, the unit and the goodwill allocated to that unit is not impaired;
- If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity must recognise an impairment loss.

IAS 36.104

The impairment loss is allocated to reduce the carrying amount of the assets of the unit (group of units) in the following order:

- first, reduce the carrying amount of any goodwill allocated to the cash-generating unit (group of units); and
- then, reduce the carrying amounts of the other assets of the unit (group of units) pro rata on the basis.

IAS 36.109

The carrying amount of an asset should not be reduced below the highest of:

- its fair value less costs of disposal (if measurable);
- its value in use (if measurable);
- zero.

If the preceding rule is applied, further allocation of the impairment loss is made pro rata to the other assets of the unit (group of units).

2.12 Reversal of an impairment loss

IAS 36.110

Same approach as for the identification of impaired assets: assess at each balance sheet date whether there is an indication that an impairment loss may have decreased. If so, calculate recoverable amount.

IAS 36.116

No reversal for unwinding of discount.

IAS 36.117

The increased carrying amount due to reversal should not be more than what the depreciated historical cost would have been if the impairment had not been recognised.

IAS 36.119

Reversal of an impairment loss is recognised in the profit or loss unless it relates to a revalued asset (for example the revaluation model in IAS 16)

IAS 36.121

After a reversal of an impairment loss is recognised, the depreciation (amortisation) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.

IAS 36.124

Reversal of an impairment loss for goodwill is prohibited.

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Impairment of tangible asset

Tangible assets, including investment property, are measured at cost less any accumulated depreciation and impairment losses.

At each interim and annual reporting date, if there is an indication that an asset may be impaired the carrying amount of the asset is compared to its recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Any reduction is recognized as impairment loss in the income statement.

Therefore, in particular, the Group provides to make a valuation of their property by an external expert. The Italian entity provide to update the valuation of assets at the end of each year, as at 31st December; instead, the foreign entity make a full valuation every two years: after the first year, the foreign entity provided also to make a desktop valuation. This practice adopted by the Group is used at the end of each year like as a verification not only qualitative but more specifically quantitative, if there is any indication that an asset may be impaired.

The valuation techniques used by the Group to estimate the recoverable amount are:

- Comparative Method (or Market approach): measurements by reference to market values of properties, comparable in features for construction and location, to the asset to be valued;
- Income Method: measurements by applying to the commercial area (m2) of the property the leasing unit values found on the market, capitalizing on the potential future income (the total gross fees) to a specific market rate considered to be sufficiently profitable for the building type , location, state of preservation, necessity of extraordinary maintenance costs;
- Cost approach: reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost). This cost must be reduced considering of various factors affecting the value of the property (physical deterioration, functional obsolescence, etc .);
- Discount Cash Flow method: this method uses future free cash flow projections (net income deriving from the rental of the property) and discounts them (for a period of 10 years) to arrive at a present value estimate, which is used to evaluate the potential for investment. It is assumed that the property will be sold at at a value obtained by capitalizing the income of the last year at market rate for similar investments.

The entity has to explain which method is more appropriate and the assumptions of the evaluation.
The Group companies use the same approach agreed with the parent company: any exception adopted by may be immediately shared and agreed with the holding.

Tangible assets are tested for impairment annually (or any time there is an objective evidence of impairment): indeed, the Group provides also for the preparation of interim report to monitor the qualitative and quantitative indicators of impairment to see if there are some unexpected trigger events or other conditions that request the necessity to register an impairment loss.

If the value of a previously impaired asset increases, the impairment loss is reversed. The reversal shall not result in a carrying amount that exceeds what the asset value would have been net of accumulated depreciation less previous impairment.

Impairment of goodwill

Intangible assets include goodwill, as well as intangible assets generated during the acquisition of a business. Goodwill is the excess of the cost of the acquisition over the acquirer's interest in the fair value of the identifiable assets and liabilities acquired.

Goodwill is tested for impairment annually (or any time there is an objective evidence of impairment of goodwill): indeed, the provisions of IAS 36 require goodwill and therefore the cash generating units (CGUs) or groups of CGUs to which it was allocated, to be tested for impairment at least annually and also the qualitative and quantitative indicators of impairment to be monitored continuously to see whether the necessary conditions exist for testing goodwill for impairment more frequently. The Group, therefor, provides to analyze these indicator for the preparation of the half-year consolidated financial report under IAS 34.
It is even more important to monitor the factors which might indicate possible impairment in the current economic environment.

To that end goodwill is allocated to the cash-generating unit (CGU). If the recoverable amount of the unit is less than its carrying amount, an impairment loss is recognized. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less cost to sell and its value in use. The impairment loss on goodwill is recognized in the income statement and cannot be reversed in subsequent periods.

Goodwill recorded in the consolidated financial statements refer to the "Cash Generating Units" ("CGU") *Spain* and *Italy Life* that represent the geographic areas of control, in line with the Group's business reporting system (Segment Reporting as request by IFRS 8)

For the purpose of impairment test the Group request the assistance of a primary specialist firm. The valuations were based on cash-flow estimates derived from the Plans, approved by the Board of Directors of the Company and the Boards of Directors of the subsidiaries, and applying industry standard methods best suited for the purposes of the exercise in the specific cases, in accordance with applicable accounting standards.

The process of impairment is specifically approved by the Board of Directors.

The impairment test as at December 31 is carried out by determining the recoverable value, based on the configuration of the use value, through the application of the Dividend Discount Model ("DDM) methodology of the so-called variant of Excess Capital.
The DDM Method (in the variant of Excess Capital, commonly adopted in the banking segment) determines the value of a company as a function of the potential dividends which it is able to distribute to its stakeholders, on a

prospective basis, keeping an adequate level of capitalization in accordance with the supervisory regulations and consistent with the risk profile of the activity. The DDM adopted is based on the following formula :

$$W = \sum_{i=1}^{n} \frac{D_i}{(1+ke)^i} + \frac{TV}{(1+ke)^n}$$

The formulation od DDM is representable:

- W is the recoverable value;
- D(i) is the estimated value of next years' dividend;
- Ke: the company's cost of equity capital
- n is the explicit projection period (expressed in number of years);
- TV is the terminal value at the end of the explicit projection period

The dividend flows potentially distributable were defined based on the business plan (actually 2016-2018), in particular, considering two reference scenarios:

- Basic Scenario: developed considering the results projections in the business plan for the explicit forecast period;
- Prudential Scenario: developed by deduct from the business plan projections the income components related "institutional" treasury activities.

In both scenarios evaluation , the Group shall consider a CET 1 ratio target in line with SREP decision communicated by the ECB.

The cost of equity capital is evaluated trough the Capital Asset Pricing Model (CAPM).

The terminal value should be determined considering:

- the sustainable normalized dividend over the explicit period;
- the growth rate in the long term , assumed to be equal to 2.0% (2.0 % in 2014), in line with the growth expectations of a specific geographic area relted to the CGU identified.

This method is usually used in practice nationally and internationally for the purpose of determining the economic value of companies operating in the financial sector and subject to compliance with the minimum capitalization, and has been applied in continuity with the previous years.

Moreover, sensitivity analyses were performed in relation to possible changes in the underlying assumptions that affect the value of the assets, more specifically, the cost of own capital, long-term growth rate and by estimated net income for the strategic guidelines .

Impairment of other intangible

Intangible assets include long-term application software, as well as intangible assets generated during the acquisition of a business.

At each reporting date, if there is evidence of impairment, the recoverable amount of the asset is estimated. If the recoverable amount of the asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount.

Impairment of investments

If there is evidence that an investment may be impaired, its recoverable amount is calculated by estimating the present value of future cash flows expected to be generated by the subsidiary or associate, including the proceeds on the ultimate disposal of the investment.

If the recoverable amount is lower than the carrying amount, the resultant difference is recognized in the income statement.

If the value of a previously impaired investment increases and the increase can be objectively related to an event occurring after the impairment loss was recognized, the impairment loss is reversed and the reversal recognized in the income statement.

Equity Investments are tested for impairment annually (or any time there is an objective evidence of impairment of goodwill): indeed, the provisions of IAS 36 require equity investments to be tested for impairment at least annually and also the qualitative and quantitative indicators of impairment to be monitored continuously to see whether the necessary conditions exist to provide impairment test more frequently.

With regard to equity investments measured with the equity method, and in particular regarding Mediobanca S.p.A., the assistance of an independent expert is requested in order to ensure maintenance of the carrying amount as at December 31. The impairment test as at December 31 is carried out by determining the recoverable value, based on the configuration of the use value, through the application of the Dividend Discount Model ("DDM) methodology of the so-called variant of Excess Capital.

$$W=\sum_{i=1}^{n}\frac{D_i}{(1+ke)^i}+\frac{TV}{(1+ke)^n}$$

Moreover, sensitivity analyses were performed in relation to possible changes in the underlying assumptions that affect the value of the assets, more specifically, the cost of own capital, long-term growth rate and by estimated net income for the strategic guidelines and taking into account the Projections on the basis of the consensus analyst published in the presentation of our results as at September 30.

The values in use for equity investments were those of the corresponding values of the cash generating units (CGUs) to which the carrying amount of the equity investments held among the assets of the specific legal entity subject to impairment testing were added. The dividend currentlybeing distributed was added to the amount obtained in this manner.

3.2 Relevant topics

Given the impairment testing methodology adopted by the Group is particularly important and reflection point the effects of the evolution of the Basel 3 rules and SREP.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Measurement of recoverable amount and value in use (paragraph 4.1)
- Recognition and measurement of an impairment loss (paragraph 4.2)
- Reversals of impairment losses (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to impairment of assets.

4.1 Measurement of recoverable amount and value in use

4.1.1 Recoverable amount

Example 4.1.1.1

Measurement of recoverable amount

An entity buys a machine for CU 7 million on 1 January 20X1. The asset has a seven-year life, with nil residual value. The carrying amount at 31 December 20X3 is CU 4 million. The machine generates largely independent cash inflows and, therefore, is tested for impairment as a stand-alone asset.

Due to changes in market conditions, the entity considers that the machine may be impaired. It is determined that the asset could be sold for CU 2 million (with costs of disposal of CU 200,000). The directors have estimated that the value in use of the asset is CU 3.5 million.

First, the fair value less costs of disposal of the asset (CU 1.8 million) is compared with the estimated value in use (CU 3.5 million). The recoverable amount is the higher of these, i.e. CU 3.5 million.

The recoverable amount is then compared with the carrying amount and an impairment loss of CU 500,000 is recognised.

Recoverable amount based on fair value less cost of disposal

Entity A is reviewing all of its assets for impairment as a result of a fall in the demand for its products. One item of machinery is 10 years old and has a carrying amount of CU 80 million and a value in use of CU 75 million (calculated on the basis of revised sales estimates). The fair value of the machine is CU 82 million.

It is estimated that if the machine were to be disposed of, costs attributable to the disposal would be approximately CU 1 million. Management has no intention of selling the machine.

The fair value less costs of disposal of the machine (CU 81 million) is higher than its value in use; therefore, the fair value less costs of disposal represents the machine's recoverable amount. The carrying amount is less than the recoverable amount; consequently, no impairment loss should be recognized.

4.1.2 Value in use

Example 4.1.2.1

Assumed steady growth in cash flows to perpetuity

The calculation is based on the perpetuity formula. Cash flow is for Year 1. Thus, when the previous year's actual cash flow is used, it is first necessary to increase it to reflect growth and inflation in Year 1.

$$\text{Value in use} = CF0/d_a\,(1 + g)(1 + i)$$

Where:
CF0 = actual cash flow for previous period
i = annual inflation rate
g = annual growth rate in cash flows
d_a = nominal pre-tax discount rate adjusted to reflect inflation and growth in cash flows.

Example 4.1.2.2

Cash flows are forecast for 2 years and assumed steady growth thereafter

Assume:

Cash flow for Year 1: CU 20 million
Cash flow for Year 2: CU 24 million
Assumed steady growth thereafter: 2.5 per cent
Inflation: 2.5 per cent

Nominal pre-tax discount rate: 15 per cent
Adjusted pre-tax discount rate: 10 per cent

$$\text{Value in use} = \text{CU } 20m/1.15 + \text{CU } 24m/1.15^2 + (\text{CU } 24m \times 1.025 \times 1.025)/(0.1 \times 1.15^2) = \text{CU } 226 \text{ million}$$

4.2 Recognition and measurement of an impairment loss

4.2.1 Individual Asset

Example 4.2.1.1

Recognition of an impairment loss creates a deferred tax asset

An entity has an identifiable asset with a carrying amount of CU 1,000. Its recoverable amount is CU 650. The tax rate is 30 per cent and the tax base of the asset is CU 800. Impairment losses are not deductible for tax purposes. The effect of the impairment loss is as follows:

	Before impairment	**Effect of impairment**	**After impairment**
	CU	**CU**	**CU**
Carrying amount	1,000	(350)	650
Tax base	800	–	800
Taxable (deductible) temporary difference	200	(350)	(150)
Deferred tax liability (asset) at 30%	60	(105)	(45)

In accordance with IAS 12, the entity recognises the deferred tax asset to the extent that it is probable that taxable profit will be available against which the deductible temporary difference can be utilized.

4.2.2 Cash-Generating Unit

Example 4.2.2.1

Allocation of impairment loss within a cash-generating unit

Entity C has a soft drinks CGU which contains both goodwill and intangible assets in the form of brands with indefinite lives. Entity C tests the CGU for impairment and determines that an impairment loss has occurred. The directors attribute the impairment loss to the poor performance of a particular brand, B.

In the light of the directors' belief that the impairment is attributable to brand B, is it acceptable for Entity C to allocate the impairment loss to the carrying amount of that brand, rather than following the allocation specified in IAS 36?

No. Because it is not practicable to estimate the recoverable amount of each individual asset, the rules set out in IAS 36 result in an arbitrary allocation of any impairment loss between the assets of the unit (including brand B) other than goodwill. These reductions in carrying amounts should be dealt with in the same manner as impairment losses on individual assets.

Therefore, in the circumstances described, the impairment loss identified must first be allocated to goodwill. Following this, any excess is then available for allocation against the carrying amount of Entity C's other assets (including brand B).

Example 4.2.2.2

Two-step approach for goodwill allocated to a group of CGUs

In 20X0, Entity X acquires a business comprising three CGUs, A, B and C. The entire goodwill arising in the business combination is allocated to the three CGUs as a group. At the end of 20X5, the carrying amount of the net assets in each CGU and the associated goodwill and the value in use of each CGU is as set out below. Entity X has determined that the fair value less costs of disposal of each of the CGUs and of the business as a whole is less than the value in use of each

CGU and of the business, respectively.

Cash-generating unit	**A**	**B**	**C**	**Goodwill**	**Total**
	CU	**CU**	**CU**	**CU**	**CU**
Carrying amount	80	120	140	50	390
Value in use	100	140	120		360

Step 1

Firstly, Entity X assesses each individual CGU for impairment. This first assessment results in an impairment loss of CU 20 being recognised in respect of CGU C, thereby reducing its carrying amount from CU 140 to CU 120, and the total carrying amount of the group of CGUs (including goodwill) from CU 390 to CU 370.

Cash-generating unit	**A**	**B**	**C**	**Goodwill**	**Total**
	CU	**CU**	**CU**	**CU**	**CU**
Original carrying amount	80	120	140	50	390
Impairment recognised in Step 1	–	–	(20)	–	(20)
Carrying amount following Step 1	80	120	120	50	370
Value in use	100	140	120		360

Step 2

Secondly, the group of CGUs including the associated goodwill is tested for impairment. This second assessment gives rise to an impairment loss of CU 10 in respect of the goodwill, reducing its carrying amount from CU 50 to CU 40. The total carrying amount of the group of CGUs including goodwill is reduced to CU 360.

Cash-generating unit	**A**	**B**	**C**	**Goodwill**	**Total**
	CU	**CU**	**CU**	**CU**	**CU**
Carrying amount	80	120	140	50	390
Impairment recognised in Step 1	–	–	(20)	–	(20)
Impairment recognised in Step 2	–	–	–	(10)	(10)
Carrying amount following Step 2	80	120	120	40	360
Value in use	100	140	120		360

4.3 Reversals of impairment losses

4.3.1 General

Example 4.3.1.1

Determining whether the reversal of an impairment loss is appropriate

An acquired business produces bottled mineral water. Just before the year end, a consumer group tests the water and publicises the fact that it contains high levels of a harmful chemical. Sales of the mineral water plummet.

Situation 1

Assume that there is great uncertainty about the validity of the consumer group's claim, but it is assumed to be valid and that sales of the product will recover only after the problem has been sorted out, and the product has been re-tested and re-marketed. The future cash flows indicate that the recoverable amount of the CGU (which consists mainly of an intangible asset, being the brand of mineral water) is less than its carrying amount, so the CGU/intangible asset is written down by the entity.

However, in the next period, further tests demonstrate that the consumer group had been wrong in its claims and it retracts them publicly. Sales of the mineral water recover very quickly and soon are back to the previous level.

In this specific case, it is clear that an unforeseen change in the estimates of future cash flows used in determining the recoverable amount has resulted in the recognition of the impairment loss, and later in the reversal of that impairment loss. The CGU/intangible asset can be written back up to the value that would have been recognised had the impairment never occurred. This write-up is recognised immediately in profit or loss.

Situation 2

Assume that, by year end, the mineral water company has conducted its own tests and satisfied both itself and independent experts that the consumer group was wrong in its claims. So the entity forecasts that, although there has been a temporary reduction in sales, sales will soon recover when the consumer group retracts the claims.

The temporary reduction in sales has caused a small temporary impairment in the value of the CGU/intangible asset as measured at the end of the reporting period. The CGU/intangible asset is written down by this small amount to its recoverable amount.

In the next period, sales increase back to their previous levels in line with expectations and the value of the CGU/intangible asset recovers to its original level. But, the (small) impairment loss cannot be reversed in the financial statements. Its reversal was foreseen in the original impairment calculations and has occurred simply because of the passing of time; therefore, the reversal does not arise from a change in the estimates used in the original recoverable amount calculation.

Example 4.3.1.2

Unwinding of discounted cash flows does not reverse an impairment loss

At the beginning of 20X0, Entity X acquires a machine with an expected useful life of four years for CU 1,000. Depreciation is charged on a straight-line basis. At the end of 20X0, there is an indication that the machine may be impaired and consequently its recoverable amount is assessed by Entity X. Entity X determines that the fair value less costs of disposal is lower than the value in use of the machine. The value in use of the machine is determined using estimated future cash flows and a discount rate of 10 per cent as follows.

	20X1 **CU**	**20X2** **CU**	**20X3** **CU**	**Total** **CU**
Estimated future cash flows	250	250	300	800
Present value at 20X0	227	207	225	659

The carrying amount of the machine of CU 750 is higher than its value in use of CU 659. Therefore, Entity X should recognise an impairment loss of CU 91 to reduce the machine's carrying amount to its value in use. The revised carrying amount is then depreciated over the remaining useful life of three years. The cash flows and discount rate used in estimating the value in use of the machine do not change in subsequent years. The value in use based on the original estimated future cash flows and discount rate in each of the subsequent years is as follows.

	20X1 **CU**	**20X2** **CU**	**20X3** **CU**
Carrying amount at year end	439	220	–
Estimated future cash flows	550	300	–
Value in use at year end	475	273	–

Although the machine’s value in use exceeds its carrying amount in 20X1 and 20X2, this increase simply arises from the unwinding of the discount relating to the future cash flows. Consequently, the impairment loss of CU 91 should not be reversed.

Example 4.3.1.3

Limited reversal of impairment loss

Entity A holds a property and accounts for it under IAS 16’s cost model. The cost of the property is CU 10 million and its useful life is 20 years. Depreciation each year is, therefore, CU 0.5 million.

At the end of Year 5, the property has a carrying amount of CU 7.5 million. Due to changes in the economic environment, the directors perform a detailed impairment review and determine that the property’s recoverable amount is its value in use, which is CU 5 million. Their estimate of the remaining useful life of the asset is 10 years.

Therefore an impairment loss of CU 2.5 million is recognised in Year 5. In Years 6 and 7, the property is depreciated by CU 0.5 million per year so that its carrying amount at the end of Year 7 is CU 4 million.

Due to shortages in the supply of properties, the directors determine that the fair value less costs of disposal of the property at the end of Year 7 is CU 8 million. The recoverable amount of the asset has therefore increased to CU 8 million.

The reversal of the impairment loss is limited, however, to the amount that would restore the carrying amount to what it would have been had no impairment loss been recognised. Therefore, only CU 2 million of the impairment loss is reversed.

If the entity wishes to recognise the market value of the property in its statement of financial position, the remainder of the uplift would be treated as a revaluation movement.

5 PRESENTATION

5.1 Disclosure rules

In the financial reporting the Group is required to provide disclosure:

- by class of assets:
    - impairment losses recognised in profit or loss;
    - impairment losses reversed in profit or loss;
    - which line item(s) of the statement of comprehensive income;
    - impairment losses on revalued assets recognised in other comprehensive income;
    - impairment losses on revalued assets reversed in other comprehensive income.
- by reportable segment:
    - impairment losses recognised;
    - impairment losses reversed.

Furthermore, if an individual impairment loss (reversal) is material disclose:

- events and circumstances resulting in the impairment loss;
- amount of the loss or reversal;
- individual asset: nature and segment to which it relates;
- cash generating unit: description, amount of impairment loss (reversal) by class of assets and segment; **IAS 36.126**
- if recoverable amount is fair value less costs of disposal, the level of the fair value hierarchy within which the fair value measurement is categorised, the valuation techniques used to measure fair value less costs of disposal and the key assumptions used in the measurement of fair value measurements categorised within 'Level 2' and 'Level 3' of the fair value hierarchy;
- if recoverable amount has been determined on the basis of value in use, or on the basis of fair value less costs of disposal using a present value technique, disclose the discount rate.

If impairment losses recognised (reversed) are material in aggregate to the financial statements as a whole, disclose: **IAS 36.129**

- main classes of assets affected; **IAS 36.130**
- main events and circumstances.

If any portion of the goodwill acquired in a business combination during the period has not been allocated to a **cash-generating unit** (group of units) at the end of the reporting period, the amount of the unallocated goodwill shall be disclosed together with the reasons why that amount remains unallocated.

Disclose detailed information about the estimates used to measure recoverable amounts of cash generating units containing goodwill or intangible assets with indefinite useful lives.

5.2 Mediolanum Financial Statements disclosures

IAS 36.131

Consob and Bankit underline the importance for the preparation of financial reports of the respect of the accounting rules of IAS 36 related to the impairment test procedure adopted and the disclosure provided in the financial statement

The Italian regulator required to provide effective information on the evaluation process of the goodwill, in particular the disclosure must at least contain the following basic elements:

IAS 36.133

- *The definition of "cash generating unit" (hereinafter "CGU");*
  It's necessary that the information provided is as much as possible adhering to the operating characteristics of the company. It can not, therefore, be considered satisfactory the mere reference to the definitions provided by IAS 36.
  The identification of the CGU should be consistent with the company's strategic vision of the Board of Directors; the description of the criteria of the identification of CGU has to render understandable the features of the business and the importance of each CGU.

IAS 36.134-135

- *The allocation of goodwill to each CGU (or group of CGU);*
  In accordance with paragraph 134 of the standard, companies must disclose the carrying amount of goodwill (and intangible assets indefinite useful life) attributed to each CGU.

- *The illustration of the criteria used to estimate the recoverable value, when this is based on use value;*
  In the financial statement the Group shall explain the criteria adopted for the determining the recoverable amount (value in use and fair value less costs to sell). When the recoverable amount is based on value in use, the Group shall provide the following information:
  - description of each key assumption on which directors have founded
    Cash flow projections for the period covered by most recent budgets/ forecasts;
  - description of the approach followed to determine the values

  assigned to the assumptions of basis, explaining if these values reflect past experience, if they are consistent with the external sources of information and, if not, how and why they differ from the past experiences or from external sources of information;
  - the timing considered by the directors, based on the business plans or budgets approved by the management, for the purpose of determination of cash flows. If in relation to the estimate of the cash flows the Group uses a forward plan exceeding five years, the directors must indicate the reasons that justify the use of a more than five-year period;
  - the growth rate used to extrapolate cash flow projections beyond the period covered by the business plans or budgets, providing, where appropriate, the justification for the use of a growth rate higher than the average rate of long-term growth of production, industry, or the area of the market where the company operates;
  - the criteria used for determining the terminal value, making explicit the assumptions even if the Group uses a different approach from the present value of a perpetuity;
  - the discount rate applied to the cash flow projections. The Group should promptly provide the rate applied to each CGU to which it was allocated a significant portion of goodwill (or intangible assets with indefinite useful lives). In addition, management has to specify the input of the discount rate, if this is in line with that used in the previous year, it is gross or net of taxes.

- *The illustration of the criteria used to estimate the recoverable value, when this is based on the fair value;*
  When the recoverable amount is based on fair value, less selling costs, it draws the attention of administrators on the obligation to provide the following information:

  - explain the methodology used to estimate the fair value;
  - If the fair value is determined based on observable market prices, return the relevant sources;
  - Otherwise, directors must provide a description of each key assumption on which it was determined the fair value; must be, also, it reported a description of the approach followed to determine the values assigned to each key assumption, indicating whether these values reflect past experience, if they are consistent with external sources of information and, if not, how and because they differ from past experience or from external sources of information. For example, if you are using the multiples method should be reported on the sample selection criteria, the multiples used, how they were valued and whether they are

observable in the market.
In the event that will be adopted the method of comparable transactions, it should be indicated the number, the reference period, the market and the size of the transactions selected.

- *The description of the analysis of the sensitivity of the impairment test result compared to variations in the underlying assumptions;*
  In particular, it must indicate:
  - the recoverable amount of the CGU over book value;
  - the value assigned to the key assumption;
  - the change in the value assigned to the key assumptions that, after considering any changes induced by this change on other variables

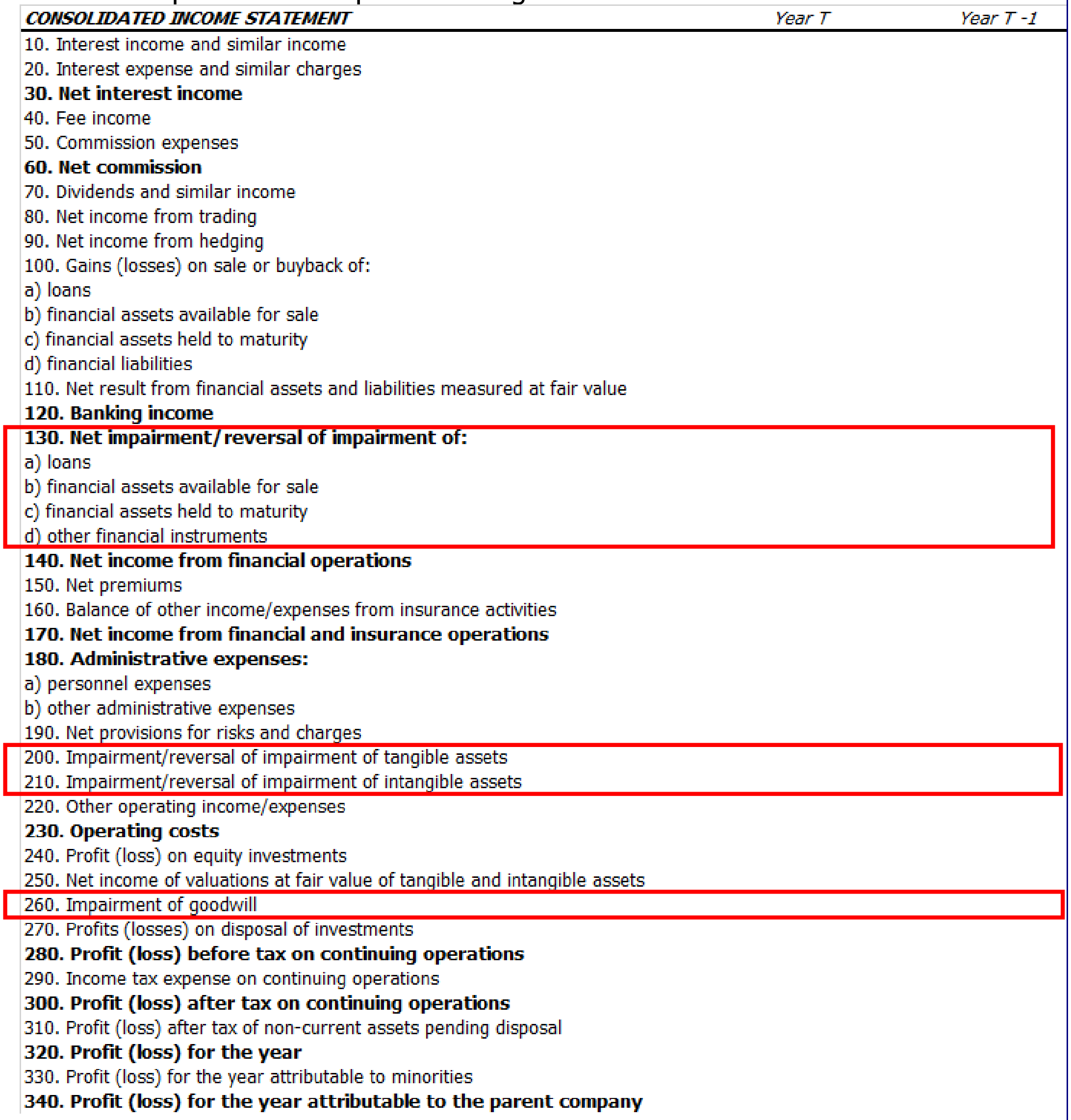
- *Comments as to the presence of external indicators of impairment in the absence the depreciation of assets following the impairment procedure.*
  It must provide a comprehensive information when, even in the presence of external indicators that signal a loss in value, the impairment procedure does not lead to make write-downs of the assets being evaluated.
  In the presence of an appreciation - by the market and external stakeholders to the company - different from what is represented by the directors, they must provide adequate information on the reasons for such differences and on the reasonableness, consistency and reliability of the evaluations carried out.

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present information on impairment of assets in the consolidated financial statements.

As required by Bank of Italy, quantitative details of impairment tests are enclosed in consolidated income statement. In particular, they are provided by:

- Caption 130 - Net impairment/reversal of impairment of (as indicated in chapter on IAS 39):
  - Loans;
  - financial assets available for sale;
  - financial assets held to maturity;
  - other financial instruments;

- Caption 200 - Impairment/reversal of impairment of tangible assets;
- Caption 210 - Impairment/reversal of impairment of intangible assets;
- Caption 260 - Impairment of goodwill.



CONSOLIDATED INCOME STATEMENT	*Year T*	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/ reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

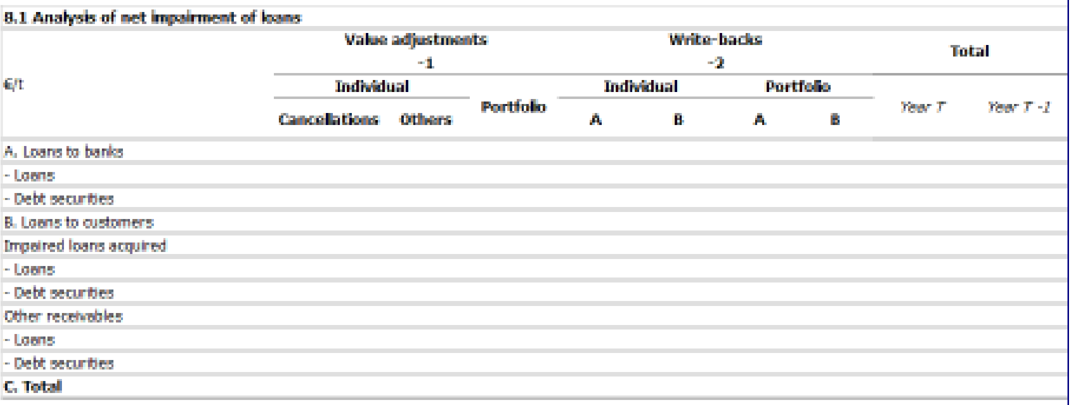
Here below, a detailed presentation of some of the items highlighted above.

Items a), b) and d) of Caption 130.

Item a) includes:

- Loans to banks:
  - Loans;
  - Debt securities.

- Loans to customers:
  Impaired loans acquired
    - Loans;
    - Debt securities.
  Other receivables
    - Loans;
    - Debt securities.

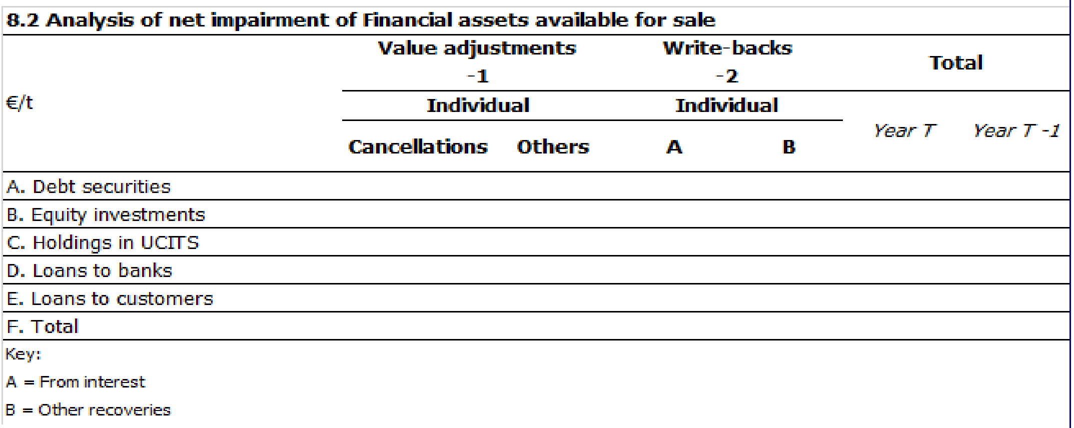


8.1 Analysis of net impairment of loans

€/t	Value adjustments -1			Write-backs -2				Total	
	Individual		Portfolio	Individual		Portfolio			
	Cancellations	Others		A	B	A	B	*Year T*	*Year T -1*
A. Loans to banks									
- Loans									
- Debt securities									
B. Loans to customers									
Impaired loans acquired									
- Loans									
- Debt securities									
Other receivables									
- Loans									
- Debt securities									
C. Total									

Item b) includes:

- Debt securities;
- Equity investments;
- Holdings in UCITS;
- Loans to banks;
- Loans to customers.



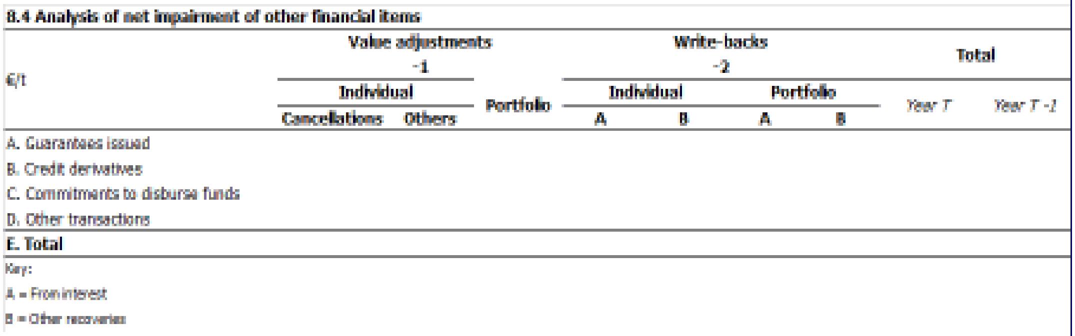
8.2 Analysis of net impairment of Financial assets available for sale

€/t	Value adjustments -1		Write-backs -2		Total	
	Individual		Individual			
	Cancellations	Others	A	B	*Year T*	*Year T -1*
A. Debt securities						
B. Equity investments						
C. Holdings in UCITS						
D. Loans to banks						
E. Loans to customers						
F. Total						

Key:
A = From interest
B = Other recoveries

And finally, Items d) includes:

- Guarantees issued;
- Credit derivatives;
- Commitments to disburse funds;
- Other transactions.



8.4 Analysis of net impairment of other financial items

€/t	Value adjustments -1			Write-backs -2				Total	
	Individual		Portfolio	Individual		Portfolio		*Year T*	*Year T -1*
	Cancellations	Others		A	B	A	B		
A. Guarantees issued									
B. Credit derivatives									
C. Commitments to disburse funds									
D. Other transactions									
E. Total									

Key:
A = From interest
B = Other recoveries

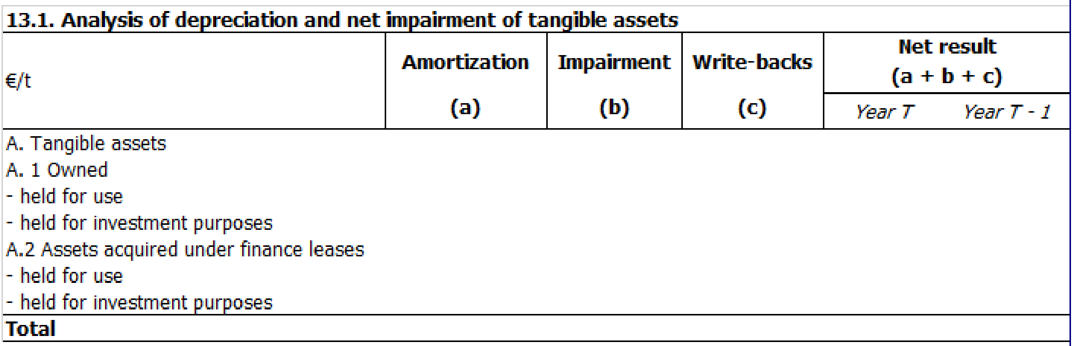
Caption 200

This caption includes the following subcategories of tangible assets:

- Owned;
- Acquired under finance leases.

Both includes the additional division among:

- asset held for use; and
- asset held for investment purpose.



13.1. Analysis of depreciation and net impairment of tangible assets

€/t	**Amortization** **(a)**	**Impairment** **(b)**	**Write-backs** **(c)**	**Net result** **(a + b + c)**	
				Year T	*Year T - 1*
A. Tangible assets					
A. 1 Owned					
- held for use					
- held for investment purposes					
A.2 Assets acquired under finance leases					
- held for use					
- held for investment purposes					
Total					

Caption 210

The same structure used for tangible assets in Caption 200 is reproduced for intangible assets in Caption 210.

14.1 Analysis of amortization and net impairment of intangible assets

€/t	Amortization (a)	Impairment (b)	Write-backs (c)	Net result (a + b + c)	
				Year T	*Year T -*
A. Intangible assets					
A.1 Owned					
- internally generated					
- other					
A.2 Assets acquired under finance leases					
Total					

IFRS Operating Manual

Chapter 5
Financial Instruments

CHAPTER V - FINANCIAL INSTRUMENTS **152**

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standards IAS 32 and IAS 39 – Financial Instruments: presentation, recognition and measurement;
- a reference to other standard strictly related to IAS 32 and IAS 39;
- a list of most recent amendment to IAS 32 and 39.

1.1 Introduction

Under IFRSs, the main standards that address the accounting of financial instruments are:

IAS 32
IAS 39
IFRS 7

- IAS 32 – *Financial Instruments: Presentation*;
- IAS 39 – *Financial Instruments: Recognition and Measurement*;
- IFRS 7 – *Financial Instruments: Disclosure.*

IFRS 9

It is due to underline that, for annual periods beginning on or after 1 January 2018, IAS 39 will be replaced by IFRS 9 - *Financial Instruments* for classification and measurement, impairment, hedge accounting and derecognition.

IFRS 13

Since these standards requires fair value measurements and disclosures about these, it is necessary to take into account IFRS 13 which:

- defines fair value;
- sets out a framework for measuring fair value; and
- requires disclosure about measurements.

1.2 Overview

IAS 16 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

IAS 32 - *Financial Instruments: Presentation* outlines the accounting requirements for the presentation of financial instruments, particularly as to the classification of such instruments into financial assets, financial liabilities and equity instruments. The standard also provide guidance on the classification of related interest, dividends and gains/losses, and when financial assets and financial liabilities can be offset.

IAS 32 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

1 January 2014	Effective date of December 2011 amendments
1 January 2013	Effective date of May 2012 amendments (*Annual Improvements 2009-2011 Cycle*)
17 May 2012	Amendments resulting from *Annual Improvements 2009-2011 Cycle* (tax effect of equity distributions)
16 December 2011	*Offsetting Financial Assets and Financial Liabilities (Amendments to IAS 32)* issued
1 February 2010	Effective date of the October 2009 amendment
8 October 2009	Amendment to IAS 32 about Classification of Rights Issues
6 August 2009	Exposure Draft *Classification of Rights Issues* proposing to amend IAS 32
1 January 2009	Effective date of amendments for puttable instruments and obligations arising on liquidation
14 February 2008	IAS 32 amended for Puttable Instruments and Obligations Arising on Liquidation
22 June 2006	Exposure Draft of proposed amendments relating to Puttable Instruments and Obligations Arising on Liquidation
18 August 2005	Disclosure provisions of IAS 32 are replaced by IFRS 7 - *Financial Instruments: Disclosures* effective 1 January 2007. Title of IAS 32 changed to *Financial Instruments: Presentation*
1 January 2005	Effective date of IAS 32 (2003)
17 December 2003	Revised version of IAS 32 issued by the IASB
December 1998	IAS 32 was revised by IAS 39, effective 1 January 2001

1 January 1996	Effective date of IAS 32 (1995)
June 1995	The disclosure and presentation portion of E48 was adopted as IAS 32 *Financial Instruments: Disclosure and Presentation*
January 1994	E40 was modified and re-exposed as Exposure Draft E48 *Financial Instruments*
September 1991	Exposure Draft E40 *Financial Instruments*

For what concerns IAS 39 - *Financial Instruments: Recognition and Measurement,* it outlines the requirements for the recognition and measurement of financial assets, financial liabilities, and some contracts to buy or sell non-financial items. Financial instruments are initially recognised when an entity becomes a party to the contractual provisions of the instrument, and are classified into various categories depending upon the type of instrument, which then determines the subsequent measurement of the instrument (typically amortised cost or fair value). Special rules apply to embedded derivatives and hedging instruments.

IAS 39 was reissued in December 2003, applies to annual periods beginning on or after 1 January 2005, and will be largely replaced by IFRS 9 Financial Instruments for annual periods beginning on or after 1 January 2018.

Date	Development	Comments
24 July 2014	IFRS 9 *Financial Instruments* issued, replacing IAS 39 requirements for classification and measurement, impairment, hedge accounting and derecognition	Effective for annual periods beginning on or after 1 January 2018#
19 November 2013	IFRS 9 *Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)* issued,	Applies when IFRS 9 is applied*

	permitting an entity to elect to continue to apply the hedge accounting requirements in IAS 39 for a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities when IFRS 9 is applied, and to extend the fair value option to certain contracts that meet the 'own use' scope exception	
27 June 2013	Amended by *Novation of Derivatives and Continuation of Hedge Accounting*	Effective for annual periods beginning on or after 1 January 2014 (earlier application permitted)
28 October 2010	IFRS 9 *Financial Instruments* reissued, incorporating new requirements on accounting for financial liabilities and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities	Original effective date 1 January 2013, later deferred and subsequently removed*
12 November 2009	IFRS 9 *Financial Instruments* issued, replacing the classification and measurement of financial assets provisions of IAS 39	Original effective date 1 January 2013, later deferred and subsequently removed*
16 April 2009	IAS 39 amended for Annual Improvements to IFRSs 2009	Effective for annual periods beginning on or after 1 January 2010

12 March 2009	Amendment to IAS 39 for embedded derivatives on reclassifications of financial assets	Effective for annual periods beginning on or after 1 July 2009
13 October 2008	Amendment to IAS 39 for reclassifications of financial assets	Effective 1 July 2008
30 July 2008	Amendment to IAS 39 for eligible hedged items	Effective for annual periods beginning on or after 1 July 2009
22 May 2008	IAS 39 amended for *Annual Improvements to IFRSs 2007*	Effective for annual periods beginning on or after 1 January 2009
18 August 2005	Amendment to IAS 39 for financial guarantee contracts	Effective for annual periods beginning on or after 1 January 2006
15 June 2005	Amendment to IAS 39 for fair value option	Effective for annual periods beginning on or after 1 January 2006
14 April 2005	Amendment issued to IAS 39 for cash flow hedges of forecast intragroup transactions	Effective for annual periods beginning on or after 1 January 2006
17 December 2004	Amendment issued to IAS 39 for transition and initial recognition of profit or loss	
31 March 2004	IAS 39 revised to reflect macro hedging	Effective for annual periods beginning on or after 1 January 2005
17 December 2003	IAS 39 *Financial*	Effective for annual

	Instruments: Recognition and Measurement (2004) issued	periods beginning on or after 1 January 2005
October 2000	Limited revisions to IAS 39	Effective date 1 January 2001
April 2000	Withdrawal of IAS 25 following the approval of IAS 40 *Investment Property*	Effective for financial statements covering periods beginning on or after 1 January 2001
December 1998	IAS 39 *Financial Instruments: Recognition and Measurement* (1998)	Effective date 1 January 2001
June 1998	Exposure Draft E62 *Financial Instruments: Recognition and Measurement* issued	Comment deadline 30 September 1998
March 1997	Discussion Paper *Accounting for Financial Assets and Financial Liabilities* issued	
June 1995	The disclosure and presentation portion of E48 was adopted as IAS 32	
January 1994	E40 was modified and re-exposed as Exposure Draft E48 *Financial Instruments*	
September 1991	Exposure Draft E40 *Financial Instruments*	
March 1986	IAS 25 *Accounting for Investments*	Operative for financial statements covering periods beginning on or after 1 January 1987

October 1984	Exposure Draft E26 *Accounting for Investments*	

* IFRS 9 (2014) supersedes IFRS 9 (2009), IFRS 9 (2010) and IFRS 9 (2013), but these standards remain available for application if the relevant date of initial application is before 1 February 2015.

When an entity first applies IFRS 9, it may choose as its accounting policy choice to continue to apply the hedge accounting requirements of IAS 39 instead of the requirements of Chapter 6 of IFRS 9. The IASB currently is undertaking a project on macro hedge accounting, which is expected to eventually replace these sections of IAS 39.

Lastly, IFRS 13 Fair Value Measurement applies to IFRSs that require or permit fair value measurements or disclosures and provides a single IFRS framework for measuring fair value and requires disclosures about fair value measurement. The Standard defines fair value on the basis of an 'exit price' notion and uses a 'fair value hierarchy', which results in a market-based, rather than entity-specific, measurement.

IFRS 13 was originally issued in May 2011 and applies to annual periods beginning on or after 1 January 2013.

Date	Development	Comments
12 December 2013	Amended by *Annual Improvements to IFRSs 2010–2012 Cycle* (short-term receivables and payables)	Amendment to the basis for conclusions only
12 December 2013	Amended by *Annual Improvements to IFRSs 2011–2013 Cycle* (scope of portfolio exception in paragraph 52)	Effective for annual period beginning on or after 1 July 2014
12 May 2011	IFRS 13 *Fair Value Measurement* issued	Effective for annual periods beginning on or after 1 January 2013

19 August 2010	Staff draft of a IFRS on fair value measurement released	
29 June 2010	Exposure Draft *Measurement Uncertainty Analysis Disclosure for Fair Value Measurements* published	Comment deadline 7 September 2010
28 May 2009	Exposure Draft *Fair Value Measurement* published	Comment deadline 28 September 2009
30 November 2006	Discussion Paper *Fair Value Measurements* published	Comment deadline 2 April 2007
September 2005	Project on fair value measurement added to the IASB's agenda	History of the project

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 32 and IAS 39 that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definitions

Financial instrument: A contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial asset: any asset that is:

IAS 32.11

- cash;
- an equity instrument of another entity;
- a contractual right
    - to receive cash or another financial asset from another entity; or
    - to exchange financial assets or financial liabilities with another entity under conditions that are potentially favourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is:
    - a non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments;
    - a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments;
    - puttable instruments classified as equity or certain liabilities arising on liquidation classified by IAS 32 as equity instruments.

Financial liability: any liability that is:

- a contractual obligation:
    - to deliver cash or another financial asset to another entity; or
    - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity; or
- a contract that will or may be settled in the entity's own equity instruments and is
    - a non-derivative for which the entity is or may be obliged to deliver a

variable number of the entity's own equity instruments;or

- a derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include: instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments; puttable instruments classified as equity or certain liabilities arising on liquidation classified by IAS 32 as equity instruments.

Equity instrument: Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

Fair value: The amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Puttable instrument: a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on occurrence of an uncertain future event or the death or retirement of the instrument holder.

The definitions used in IAS 32 are the same as IAS 39.

2.2 Scope of rules

The stated objective of IAS 32 is to establish principles for presenting financial instruments as liabilities or equity and for offsetting financial assets and liabilities. **IAS 39.8**

IAS 32 addresses this in a number of ways:

- clarifying the classification of a financial instrument issued by an entity as a liability or as equity; **IAS 32.1**
- prescribing the accounting for treasury shares (an entity's own repurchased shares);
- prescribing strict conditions under which assets and liabilities may be offset in the balance sheet.

IAS 32 applies in presenting and disclosing information about all types of financial instruments with the following exceptions:

- interests in subsidiaries, associates and joint ventures that are accounted for under IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates* or IAS 31 *Interests in Joint Ventures* (or, for annual periods beginning on or after 1 January 2013, IFRS 10 *Consolidated Financial*

Statements, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*). However, IAS 32 applies to all derivatives on interests in subsidiaries, associates, or joint ventures; **IAS 32.4**

- employers' rights and obligations under employee benefit plans;
- insurance contracts; however, IAS 32 applies to derivatives that are embedded in insurance contracts if they are required to be accounted separately by IAS 39;
- financial instruments that are within the scope of IFRS 4 because they contain a discretionary participation feature are only exempt from applying paragraphs 15-32 and AG 25-35 (analyzing debt and equity components) but are subject to all other IAS 32 requirements; **IAS 19** **IFRS 4**
- contracts and obligations under share-based payment transactions with the following exceptions:
    - this standard applies to contracts within the scope of IAS 32;
    - paragraphs 33-34 apply when accounting for treasury shares purchased, sold, issued or cancelled by employee share option plans or similar arrangements.

IAS 32 applies to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, except for contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements. **IFRS 2** **IAS 32.8-10** **IAS 32.33-34**

In addition, IAS 39 applies to all types of financial instruments except for the following, which are scoped out of IAS 39: **IAS 32.8**

- interests in subsidiaries, associates, and joint ventures accounted for under IAS 27 *Consolidated and Separate Financial Statements*, IAS 28 *Investments in Associates*, or IAS 31 *Interests in Joint Ventures* (or, for periods beginning on or after 1 January 2013, IFRS 10 *Consolidated Financial Statements*, IAS 27 *Separate Financial Statements* or IAS 28 *Investments in Associates and Joint Ventures*); however IAS 39 applies in cases where under those standards such interests are to be accounted for under IAS 39. The standard also applies to most derivatives on an interest in a subsidiary, associate, or joint venture; **IAS 32.9**
- employers' rights and obligations under employee benefit plans to which IAS 19 applies;
- forward contracts between an acquirer and selling shareholder to buy or sell an acquiree that will result in a business combination at a future acquisition date;

- rights and obligations under insurance contracts, except IAS 39 does apply to financial instruments that take the form of an insurance (or reinsurance) contract but that principally involve the transfer of financial risks and derivatives embedded in insurance contracts;

- financial instruments that meet the definition of own equity under IAS 32 *Financial Instruments: Presentation;*

- financial instruments, contracts and obligations under share-based payment transactions to which IFRS 2 *Share-based Payment* applies;

- rights to reimbursement payments to which IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* applies.

IAS 19

IAS 32

IFRS 2

Leases

IAS 39 applies to lease receivables and payables only in limited respects:

- IAS 39 applies to lease receivables with respect to the derecognition and impairment provisions

- IAS 39 applies to lease payables with respect to the derecognition provisions

- IAS 39 applies to derivatives embedded in leases.

IAS 39.2 (b)

Financial guarantees

IAS 39 applies to financial guarantee contracts issued. However, if an issuer of financial guarantee contracts has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either IAS 39 or IFRS 4 *Insurance Contracts* to such financial guarantee contracts. The issuer may make that election contract by contract, but the election for each contract is irrevocable.

Accounting by the holder is excluded from the scope of IAS 39 and IFRS 4 (unless the contract is a reinsurance contract). Therefore, paragraphs 10-12 of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* apply. Those paragraphs specify criteria to use in developing an accounting policy if no IFRS applies specifically to an item.

IAS 8

Loan commitments

Loan commitments are outside the scope of IAS 39 if they cannot be settled net in cash or another financial instrument, they are not designated as financial liabilities at fair value through profit or loss, and the entity does not have a past practice of selling the loans that resulted from the commitment shortly after origination. An issuer of a commitment to provide a loan at a below-market interest rate is required initially to recognise the commitment at its fair value; subsequently, the issuer will remeasure it at the higher of (a) the amount recognised under IAS 37 and (b) the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with IAS 18.

An issuer of loan commitments must apply IAS 37 to other loan commitments that are not within the scope of IAS 39 (that is, those made at market or above). Loan commitments are subject to the derecognition provisions of IAS 39.

Contracts to buy or sell financial items

IAS 37

Contracts to buy or sell financial items are always within the scope of IAS 39 (unless one of the other exceptions applies). **IAS 39.4**

Contracts to buy or sell non-financial items

Contracts to buy or sell non-financial items are within the scope of IAS 39 if they can be settled net in cash or another financial asset and are not entered into and held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements. Contracts to buy or sell non-financial items are inside the scope if net settlement occurs. The following situations constitute net settlement: **IAS 39.5-6**

- the terms of the contract permit either counterparty to settle net
- there is a past practice of net settling similar contracts
- there is a past practice, for similar contracts, of taking delivery of the underlying and selling it within a short period after delivery to generate a profit from short-term fluctuations in price, or from a dealer's margin, or
- the non-financial item is readily convertible to cash

Weather derivatives

Although contracts requiring payment based on climatic, geological, or other physical variable were generally excluded from the original version of IAS 39, they were added to the scope of the revised IAS 39 in December 2003 if they are not in the scope of IFRS 4.

2.3 Classification

The fundamental principle of IAS 32 is that a financial instrument should be classified as either a financial liability or an equity instrument according to the substance of the contract, not its legal form, and the definitions of financial liability and equity instrument. Two exceptions from this principle are certain puttable instruments meeting specific criteria and certain obligations arising on liquidation. The entity must make the decision at the time the instrument is initially recognised. The classification is not subsequently changed based on changed circumstances. **IAS 32.15**

A financial instrument is an equity instrument only if (a) the instrument includes no contractual obligation to deliver cash or another financial asset to another entity and (b) if the instrument will or may be settled in the issuer's own equity instruments, it is either:

- a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or **IAS 32.16**
- a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

IAS 32 also prescribes rules for the offsetting of financial assets and financial liabilities. It specifies that a financial asset and a financial liability should be offset and the net amount reported when, and only when, an entity:

- has a legally enforceable right to set off the amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously. **IAS 32.42**

IAS 32.48

Classification of financial assets

IAS 39 requires financial assets to be classified in one of the following categories:

- Financial assets at fair value through profit or loss;
- Available-for-sale financial assets;
- Loans and receivables;
- Held-to-maturity investments. **IAS 39.45**

Those categories are used to determine how a particular financial asset is recognised and measured in the financial statements.

Financial assets at fair value through profit or loss. This category has two subcategories:

- *Designated:* The first includes any financial asset that is designated on initial recognition as one to be measured at fair value with fair value changes in profit or loss.

- *Held for trading:* The second category includes financial assets that are held for trading. All derivatives (except those designated hedging instruments) and financial assets acquired or held for the purpose of selling in the short term or for which there is a recent pattern of short-term profit taking are held for trading.

Available-for-sale financial assets (AFS) are any non-derivative financial assets designated on initial recognition as available for sale or any other instruments that are not classified as as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through profit or loss. AFS assets are measured at fair value in the balance sheet. Fair value changes on AFS assets are recognised directly in equity, through the statement of changes in equity, except for interest on AFS assets (which is recognised in income on an effective yield basis), impairment losses and (for interest-bearing AFS debt instruments) foreign exchange gains or losses. The cumulative gain or loss that was recognised in equity is recognised in profit or loss when an available-for-sale financial asset is derecognised. **IAS 39.9** **IAS 39.9**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than held for trading or designated on initial recognition as assets at fair value through profit or loss or as available-for-sale. Loans and receivables for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, should be classified as available-for-sale. Loans and receivables are measured at amortised cost. **IAS 39.55 (b)** **IAS 39.9**

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments that an entity intends and is able to hold to maturity and that do not meet the definition of loans and receivables and are not designated on initial recognition as assets at fair value through profit or loss or as available for sale. Held-to-maturity investments are measured at amortised cost. If an entity sells a held-to-maturity investment other than in insignificant amounts or as a consequence of a non-recurring, isolated event beyond its control that could not be reasonably anticipated, all of its other held-to-maturity investments must be reclassified as available-for-sale for the current and next two financial reporting years. Held-to-maturity investments are measured at amortised cost. **IAS 39.46 (a)** **IAS 39.9**

Classification of financial liabilities **IAS 39.46 (b)**

IAS 39 recognises two classes of financial liabilities:

- Financial liabilities at fair value through profit or loss;

- Other financial liabilities measured at amortised cost using the effective interest method. **IAS 39.47**

The category of financial liability at fair value through profit or loss has two subcategories:

- *Designated:* A financial liability that is designated by the entity as a liability at fair value through profit or loss upon initial recognition

- *Held for trading:* A financial liability classified as held for trading, such as an obligation for securities borrowed in a short sale, which have to be returned in the future

2.4 Recognition

IAS 39 requires recognition of a financial asset or a financial liability when, and only when, the entity becomes a party to the contractual provisions of the instrument, subject to the following provisions in respect of regular way purchases.

IAS 39.14

A regular way purchase or sale of financial assets is recognised and derecognised using either trade date or settlement date accounting. The method used is to be applied consistently for all purchases and sales of financial assets that belong to the same category of financial asset as defined in IAS 39 (note that for this purpose assets held for trading form a different category from assets designated at fair value through profit or loss). The choice of method is an accounting policy. **IAS 39.38**

IAS 39 requires that all financial assets and all financial liabilities be recognised on the balance sheet. That includes all derivatives. Historically, in many parts of the world, derivatives have not been recognised on company balance sheets. The argument has been that at the time the derivative contract was entered into, there was no amount of cash or other assets paid. Zero cost justified non-recognition, notwithstanding that as time passes and the value of the underlying variable (rate, price, or index) changes, the derivative has a positive (asset) or negative (liability) value.

2.5 Measurement

Initially, financial assets and liabilities should be measured at fair value (including transaction costs, for assets and liabilities not measured at fair value through profit or loss).

IAS 39.43

Subsequently, financial assets and liabilities (including derivatives) should be measured at fair value, with the following exceptions;

- Loans and receivables, held-to-maturity investments, and non-derivative financial liabilities should be measured at amortised cost using the effective interest method; **IAS 39.46-47**

- Investments in equity instruments with no reliable fair value measurement (and derivatives indexed to such equity instruments) should be measured at cost;

- Financial assets and liabilities that are designated as a hedged item or hedging instrument are subject to measurement under the hedge accounting requirements of the IAS 39;

- Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition, or that are accounted for using the continuing-involvement method, are subject to particular measurement requirements.

IAS 39 provides a hierarchy to be used in determining the fair value for a financial instrument:

- Quoted market prices in an active market are the best evidence of fair value and should be used, where they exist, to measure the financial instrument; **IAS 39.69-82**

- If a market for a financial instrument is not active, an entity establishes fair value by using a valuation technique that makes maximum use of market inputs and includes recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis, and option pricing models. An acceptable valuation technique incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments;

- If there is no active market for an equity instrument and the range of reasonable fair values is significant and these estimates cannot be made reliably, then an entity must measure the equity instrument at cost less impairment.

IFRS 13 defines Fair value as "[t]he price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

IFRS 13 provides the guidance on the measurement of fair value:

- An entity takes into account the characteristics of the asset or liability being

measured that a market participant would take into account when pricing the asset or liability at measurement date (e.g. the condition and location of the asset and any restrictions on the sale and use of the asset) **IFRS 13:11**
- Fair value measurement assumes an orderly transaction between market participants at the measurement date under current market conditions [IFRS 13:15]
- Fair value measurement assumes a transaction taking place in the principal market for the asset or liability, or in the absence of a principal market, the most advantageous market for the asset or liability [IFRS 13:24]
- A fair value measurement of a non-financial asset takes into account its highest and best use [IFRS 13:27]
- A fair value measurement of a financial or non-financial liability or an entity's own equity instruments assumes it is transferred to a market participant at the measurement date, without settlement, extinguishment, or cancellation at the measurement date [IFRS 13:34]
- The fair value of a liability reflects non-performance risk (the risk the entity will not fulfil an obligation), including an entity's own credit risk and assuming the same non-performance risk before and after the transfer of the liability [IFRS 13:42]
- An optional exception applies for certain financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk, provided conditions are met (additional disclosure is required). [IFRS 13:48, IFRS 13:96]

Valuation techniques

An entity uses valuation techniques appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants and the measurement date under current market conditions. Three widely used valuation techniques are: **IFRS 13:61** **IFRS 13:67** **IFRS 13:62**

- **market approach** – uses prices and other relevant information generated by market transactions involving identical or comparable (similar) assets, liabilities, or a group of assets and liabilities (e.g. a business)
- **cost approach** – reflects the amount that would be required currently to replace the service capacity of an asset (current replacement cost)
- **income approach** – converts future amounts (cash flows or income and expenses) to a single current (discounted) amount, reflecting current market expectations about those future amounts.

In some cases, a single valuation technique will be appropriate, whereas in others multiple valuation techniques will be appropriate. [IFRS 13:63]

Amortised cost is calculated using the effective interest method. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or liability. Financial assets that are not carried at fair value though profit and loss are subject to an impairment test. If expected life cannot be determined reliably, then the contractual life is used.

2.6 Impairment

A financial asset or group of assets is impaired, and impairment losses are recognised, only if there is objective evidence as a result of one or more events that occurred after the initial recognition of the asset. An entity is required to assess at each balance sheet date whether there is any objective evidence of impairment. If any such evidence exists, the entity is required to do a detailed impairment calculation to determine whether an impairment loss should be recognised. The amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate. **IAS 39.58** **IAS 39.63**

Assets that are individually assessed and for which no impairment exists are grouped with financial assets with similar credit risk statistics and collectively assessed for impairment. **IAS 39.64**

If, in a subsequent period, the amount of the impairment loss relating to a financial asset carried at amortised cost or a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit or loss. Impairments relating to investments in available-for-sale equity instruments are not reversed through profit or loss. **IAS 39.65**

2.7 Financial Guarantees

A financial guarantee contract is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due.

Under IAS 39 as amended, financial guarantee contracts are recognised:

- initially at fair value. If the financial guarantee contract was issued in a stand-alone arm's length transaction to an unrelated party, its fair value at inception is likely to equal the consideration received, unless there is evidence to the contrary; **IAS 39.9**

- subsequently at the higher of (i) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*. (If specified criteria are met, the issuer may use the fair value option in IAS 39; Furthermore, different requirements continue to apply in the specialised context of a 'failed' derecognition transaction.)

Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is a credit derivative that requires payments in response to changes in a specified credit rating or credit index. These are derivatives and they must be measured at fair value under IAS 39.

2.8 Derecognition

The basic premise for the derecognition model in IAS 39 is to determine whether the asset under consideration for derecognition is:

IAS 39.15

- an asset in its entirety; or
- specifically identified cash flows from an asset; or
- a fully proportionate share of the cash flows from an asset; or
- a fully proportionate share of specifically identified cash flows from a financial asset.

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions: **IAS 39.17-19**

- the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amounts on the original asset;
- the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient);
- the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, **IAS 39.20** derecognition of the asset is precluded.

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not. If the entity does not control the asset then derecognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in the asset.

IAS 39.30

On the other hand, a financial liability should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires. Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss.

IAS 39.39

IAS 39.40-41

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
    - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
    - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

3.1.1 Classification, Measurement and Reclassification

The classification of financial instruments determines how they are subsequently measured. Mediolanum Group classified financial asset into one of four categories: fair value through profit or loss, held-to-maturity, AFS financial assets and loans and receivable.

Financial assets at fair value through profit or loss (FVTPL)
Assets classified as at FVTPL are measured at fair value. Gains and losses that arise as a result of changes in fair value are recognised in profit or loss, except for those arising on derivatives that are designated in effective cash flow hedges or hedges of a net investment in a foreign operation.
Gains and losses that arise between the end of the last annual reporting period and the date an instrument is derecognised do not constitute a separate 'profit/loss on disposal'. Such gains and losses will have arisen prior to disposal, while the item is still being measured at FVTPL, and should be recognised in profit or loss when they occur.
Transaction costs that might be incurred when the asset is disposed of in the future are *not* deducted from fair value in determining the carrying amount. Some argue that this is inconsistent with the use of exit prices (i.e. fair value) for measurement purposes,

but the Standard is clear that such costs are viewed as being related to the act of disposal and, therefore, are recognised only in the period of disposal itself.

There are many reasons why Mediolanum Group designate a financial instrument as at FVTPL:

- it eliminates an accounting mismatch;
- it allows an entity to avoid the burden of hedge accounting requirements (e.g. the requirements to designate, asses, and measure effectiveness), because designation of both items as at FVTPL achieves a similar result as if fair value hedge accounting had been applied;
- it de-emphasises interpretative issues regarding when an item is appropriately considered to be 'held for trading'; or
- when applied to hybrid instruments, it eliminates the burden of separating embedded derivatives that are not considered to be closely related to the host contract because the fair value of the whole contractual arrangement is then recognised in profit or loss.

Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity other than:

a) those that the entity upon initial recognition designates as at fair value through profit or loss;
b) those that the entity designates as available for sale; and
c) those that meet the definition of loans and receivables.

Held-to-maturity investments are measured at amortised cost using the 'effective interest method'. In particular, an asset cannot be classified as HTM if it can be contractually prepaid or otherwise extinguished by the issuer in such a way that the holder would not recover substantially all of its recorded investment (i.e. those contracts where the issuer has a right to settle at an amount significantly below amortised cost). In addition, a debt security where the issuer has a right to redeem early should be evaluated to determine whether it contains an embedded derivative that must be accounted for separately. Some host debt instruments from which an embedded derivative has been separated can be classified as HTM.

HTM investments are financial instruments with fixed or determinable payments and fixed maturity, which means that the contractual arrangement defines the amounts and dates of payments to the holder, such as interest and principal payments.
Equity instruments cannot be HTM investments either because they have an indefinite life (e.g. ordinary shares) or because the amounts the holder may receive can vary in a manner that is not predetermined (e.g. share options, warrants and similar rights).

Preference shares with fixed or determinable payments and a fixed maturity (e.g. mandatorily redeemable preference shares) determined to be financial liabilities in accordance with [IAS 32] for the issuer can be classified as HTM by the holder.

A debt instrument with a variable interest rate can satisfy the criteria for a HTM investment. The terms of the contract determine the amounts and dates of payments to the holder. An example is a five-year debt instrument which pays a variable rate of interest specified as LIBOR plus 150 basis points, with interest payments receivable semi-annually in arrears. An entity cannot classify a financial asset as HTM if the entity intends to hold the financial asset for only an undefined period. A debt security, for example, should not be classified as HTM if the entity anticipates that the security would be available to be sold in response to:

- changes in market interest rates and related changes in the investment's prepayment risk;
- liquidity needs (e.g. due to the withdrawal of deposits, increased demand for loans, surrender of insurance policies, or payment of insurance claims);
- changes in the availability of and the yield on alternative investments;
- changes in funding sources and terms; or
- changes in foreign currency risk.

In summary, classification of an investment as HTM means that the entity is indifferent to future opportunities to profit from changes in the asset's fair value.

Tainting of the HTM portfolio

"Tainting" is the term used to describe the effect of disposing of or reclassifying a HTM investment before its maturity date in situations where such disposal or reclassification disqualifies the entity from continuing to use the HTM classification for the remaining portfolio of securities held. Except for specified limited circumstances, a sale or reclassification of a HTM investment casts doubt on the entity's stated intention or ability to hold the rest of its HTM portfolio to maturity. As a consequence, when an entity has, during the current year, sold or reclassified more than an insignificant amount of HTM investments before maturity (i.e. tainting of the HTM portfolio has occurred), all of the entity's HTM investments generally must be reclassified into the available-for-sale category. Furthermore, the entity is prohibited from classifying any investments as HTM for the next two financial years.

An entity cannot create two different categories of HTM financial assets (e.g. debt securities denominated in US dollars and debt securities denominated in Euros). The 'tainting rule' applies to the portfolio of HTM investments in its entirety. If an entity has sold or reclassified more than an insignificant amount of HTM investments, it cannot classify any financial assets as HTM financial assets.

Sales or reclassifications in strictly defined and limited circumstances specified in [IAS 39] do not taint the remaining HTM portfolio. These are sales or transfers that:

- are so close to maturity or the financial asset's call date (e.g. less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair

value;
- occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments;
- are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity; or
- do not involve 'more than insignificant' amount of the entity's HTM portfolio (more than insignificant in relation to the total amount of HTM investments).

Selling an asset close enough to its maturity does not taint the remaining HTM portfolio if the effect of movements in interest rates between the repurchase date and the maturity is expected to have an insignificant impact on the fair value of the asset. For instance, if an entity sells a financial asset less than three months prior to maturity, the present value of the amount received from the sale usually will not be significantly different from the amount received at maturity. This is unlikely to be the case if the instrument's maturity is several months away.

A sale, or a transfer of a HTM investment due to one of the following isolated, non-recurring events is not considered to be inconsistent with its original classification as HTM and does not raise a question about the entity's intention to hold other investments to maturity:

a) a significant deterioration in the issuer's credit-worthiness;

b) a change in tax law that eliminates or significantly reduces the tax-exempt status of interest on the HTM investment (but not a change in tax law that revises the marginal tax rates applicable to interest income);

c) a major business combination or major disposal (such as sale of a segment) that necessitates the sale or transfer of HTM investments to maintain the entity's existing interest rate risk position or credit risk policy (although the business combination is an event within the entity's control, the changes to its investment portfolio to maintain an interest rate risk position or credit risk policy may be consequential rather than anticipated);

d) a change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of particular types of investments, thereby causing an entity to dispose of a HTM investment;

e) a significant increase in the industry's regulatory capital requirements that causes the entity to downsize by selling HTM investments; and

f) a significant increase in the risk weights of HTM investments used for regulatory risk-based capital purposes.

A sale of a HTM investment following a downgrade of the issuer's credit rating by a rating agency would not necessarily raise a question about the entity's intention to hold other investments to maturity. A downgrade indicates a decline in the issuer's creditworthiness. [IAS 39] specifies that a sale due to a significant deterioration in the issuer's creditworthiness could satisfy the condition in [IAS 39] and, therefore, not raise a question about the entity's intention to hold other investments to maturity. However, the deterioration in creditworthiness must be significant judged by reference to the credit rating at initial recognition. A credit downgrade of a notch within a class or from a rating class to the immediately lower rating class could often be regarded as reasonably anticipated. If the rating downgrade in combination with other information provides evidence of impairment, the deterioration in creditworthiness often would be regarded as significant.

A permitted (i.e. non-tainting) sale in accordance with [IAS 39:AG22(a)] should be in response to an actual deterioration rather than in advance of a deterioration in creditworthiness and should not be based on mere speculation or in response to industry statistics.

The deterioration should be supported by evidence about the issuer's creditworthiness though the entity need not await the formal notification of an actual downgrading in the issuer's published credit rating or inclusion on a 'credit-watch' list.

When an entity uses internal ratings for assessing exposures, changes in those internal ratings may help to identify issuers for which there has been a significant deterioration in creditworthiness, provided that the entity's approach to assigning internal ratings and changes in those ratings give a consistent, reliable and objective measure of the credit quality of the issuers.

If an entity does not sell a debt instrument immediately in response to a significant credit deterioration, but continues to classify the instrument in the HTM portfolio, a sale of that instrument at a future date would not satisfy the conditions for permitted sales. Because an entity is required to make an ongoing assessment of its ability and intent to hold an instrument to its maturity, by not reclassifying the instrument out of HTM when the credit deterioration occurred, the entity effectively reconfirmed its intent to hold the instrument to its maturity.
An exchange of debt securities classified as HTM pursuant to a bankruptcy generally qualifies as a permitted sale out of HTM because bankruptcy is the ultimate form of credit deterioration. However, if the investor had anticipated the bankruptcy at the acquisition date and was able to control the outcome, then such a sale would not satisfy the conditions for permitted sales due to a significant deterioration in the issuer's creditworthiness.

A disposal out of HTM is permitted if it is consequential to a major business combination or disposal of a business and affects existing interest rate risk or credit risk positions which must be maintained in accordance with risk management policies. Therefore, an entity may reassess the classification of HTM securities concurrently with or shortly after a major business combination and not necessarily call into question its intent to hold other securities to maturity in the future. As time passes, it becomes increasingly difficult to demonstrate that the business combination, and not other events or circumstances, necessitated the transfer or sale of HTM securities.

Sales in anticipation of a business combination (e.g. for the purpose of financing it) will taint the HTM category.

Sales out of the HTM category as a result of a change in senior management in connection with a restructuring of the entity will result in tainting. A change in management is not identified as an instance of sales or transfers from HTM that does not compromise the classification as HTM because a change in management or a restructuring cannot be argued to be an isolated, non-recurring event that could not have been reasonably anticipated.

In some countries, regulators of banks or other industries may set capital requirements on an *entity-specific* basis based on an assessment of the risk in that particular entity.

Sales of HTM investments in response to an unanticipated significant increase by the regulator in the *industry's* capital requirements do not taint the entity's intent to hold remaining investments to maturity. However, sales of HTM investments imposed by regulators due to a significant increase in *entity-specific* capital requirements applicable to a particular entity, but not to the industry, will generally 'taint' the entity's intent to hold other financial assets as HTM. Entity-specific capital requirements could only be disregarded in exceptional cases if it can be demonstrated that the sales result from an increase in capital requirements which is an isolated event that is beyond the entity's control and that is non-recurring and could not have been reasonably anticipated by the entity.

In consolidated financial statements, intragroup sales of HTM investments between group entities generally would not taint the HTM portfolio from a group perspective, as long as the business purpose of the transfer and the investment policies of the 'buyer' are consistent with a continued positive intention and ability to hold to maturity. The impact on each entity's stand-alone financial statements should be assessed separately; in the financial statements of the selling entity, the stated intention of holding securities to maturity will have been undermined, even though the sale was made to another entity within the consolidated group.

Note that an entity cannot apply the conditions separately to HTM financial assets held by different entities in a consolidated group, even if those group entities are in different countries with different legal or economic environments. If the consolidated entity in total across the group has sold or reclassified more than an insignificant amount of investments classified as HTM, it cannot classify any financial assets as HTM

investments in its consolidated financial statements unless such sales and transfers do not taint the HTM portfolio.
As a remedy to protect the investor from the issuer's violation of a debt covenant, a contractual right of foreclosure that was negotiated at arm's length at the issuance date would not preclude an investor classifying an investment as HTM. Similarly, the exercise of such a right or foreclosure on the violation of a substantial covenant would not taint an investor's remaining HTM portfolio.

A sale or transfer of a security classified as HTM for reasons other than those that are specifically permitted does not indicate that the previous financial statements were issued in error. Because the accounting for financial assets as HTM is based primarily on a representation of intent by management, the sale or transfer of a security classified as HTM does not represent an error of previously issued financial statements, provided that no evidence existed at the time the financial statements were issued demonstrating that the entity did not have the positive intent and ability to hold the security to maturity. However, such a sale or transfer may call into question the entity's intent to hold other debt securities to maturity in the future.

If 'tainting' of the HTM portfolio occurs in a period, resulting in reclassification of the portfolio as AFS, comparative amounts for the previous period are not restated for the reclassification because this would disguise the consequences of 'tainting.'
If an entity plans to sell a security from the HTM category in response to one of the permitted conditions that do not taint the HTM portfolio, the entity may continue to classify the security as HTM. There is no requirement in [IAS 39] for the security to be reclassified as AFS if an entity intends to sell in response to one of the permitted conditions.

Available-for-sale financial assets (AFS)

AFS financial assets are measured at fair value with fair value gains or losses recognised in other comprehensive income. On sale or impairment of the asset, the cumulative gain or loss previously recognised in other comprehensive income is reclassified to profit or loss as a reclassification adjustment.
Financial assets classified as AFS are measured at fair value. As with financial assets measured at FVTPL, no deduction is made for transaction costs that might be incurred when the asset is disposed of in the future.
Gains and losses that arise as a result of changes in fair value in AFS financial assets are recognised in other comprehensive income, with three exceptions:

i. interest, calculated using the effective interest method, is recognised in profit or loss;
ii. impairment losses are recognised in profit or loss and
iii. foreign exchange gains and losses on monetary financial assets.

When an AFS asset is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss. This reclassification of previous fair value gains and losses is frequently referred to as 'recycling'.

Impairment losses are incurred on a financial asset or a group of financial assets if, and only if, there is objective evidence of an impairment that results from one or more events that occurred after the initial recognition of the asset:

- Such loss events must have an impact on the estimated future cash flows of the asset, or group of assets, that can be reliably measured.
- An impairment may occur as the result of the combined effect of several events - it is not always possible to identify a single, discrete event that caused the impairment.
- Losses expected as a result of future events are not recognised (no matter how likely those events might be).

Equity investments

In addition to the potential loss events discussed above, further factors will apply when considering the impairment of equity investments. Information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates may constitute objective evidence of an impairment. A significant or prolonged decline in fair value is objective evidence of impairment and, therefore, will result in the fair value loss being reclassified from other comprehensive income to profit or loss. The determination of what constitutes a 'significant or prolonged' decline in fair value requires application of judgement.

In accordance with the requirements of *Presentation of Financial Statements* and IFRS 7, an entity should provide disclosures regarding the judgements it has made in determining the existence of objective evidence of impairment and the amounts of impairment losses.

When considering what is a 'significant or prolonged decline in fair value' of an equity security below cost, the investor must compare the original cost in the investor's functional currency at the date of acquisition and the fair value of the equity security (also in the investor's functional currency) on the remeasurement date. If an entity purchased a listed foreign currency denominated equity security whose fair value in local currency terms has remained relatively stable since acquisition, but the currency depreciated significantly or has been depreciating for a prolonged period, this would constitute impairment, because losses that are attributable to foreign currency losses are a portion of the overall net fair value loss of an equity security.

In July 2009, the IFRIC (now the IFRS Interpretations Committee) issued an agenda decision on [IAS 39], *Meaning of 'Significant or Prolonged'.* The IFRIC considered a number of practices and concluded as follows.

- The Standard cannot be read to require the decline in value to be both significant *and* prolonged. Thus, either a significant *or* a prolonged decline is sufficient to require the recognition of an impairment loss. The IFRIC noted that in finalising the 2003 amendments to [IAS 39], the IASB deliberately changed the word from 'and' to 'or'.

- IAS 39 requires the recognition of an impairment loss on AFS equity instruments if there is objective evidence of impairment. IAS 39 states conclusively that a significant or prolonged decline in fair value of an investment in an equity instrument below its cost is objective evidence of impairment. Consequently, when such a decline exists, recognition of an impairment loss is required.
- The fact that the decline in the value of an investment is in line with the overall level of decline in the relevant market does not mean that an entity can conclude the investment is not impaired.
- The existence of a significant or prolonged decline cannot be overcome by forecasts of an expected recovery of market values, regardless of their expected timing. Consequently, an anticipated market recovery is not relevant to the assessment of 'significant or prolonged'.
- *Impairment of Non-monetary Available-for-Sale Financial Asset* both discuss the recognition of financial instruments denominated in foreign currencies. It is inappropriate to assess 'significant or prolonged' in the foreign currency in which the equity investment is denominated. That assessment must be made in the functional currency of the entity holding the instrument because that is how any impairment loss is determined.

The Standard contains separate rules for the measurement of impairment losses to be applied to financial assets that are carried at amortised cost, carried at cost, and classified as AFS.

Loans and receivables

Loans and receivables are also measured at amortised cost using the effective interest method. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market, other than those the entity intends to sell immediately or in the short-term (which must be classified as held for trading), and those that the entity on initial recognition designates as either at FVTPL or AFS.

Note that financial assets that do not meet the definition of loans and receivables may still satisfy the criteria for classification in the HTM category because the HTM definition is different from the loans and receivables definition.

Loans and receivables are measured at amortised cost using the effective interest method. The effective interest rate is defined as the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument (or, when appropriate, a shorter period) to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity should estimate cash flows considering all contractual terms of the financial instrument (e.g. prepayment, call and similar options) but should not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity should use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

A financial asset cannot be classified as a loan and receivable if it can be contractually prepaid or otherwise extinguished by the issuer in such a way that the holder would not recover substantially all of its recorded investment, other than because of credit deterioration. Such assets are accounted for as available-for-sale or at FVTPL.

Loans and receivables are created by providing money, goods or services to a debtor. Examples are deposits held in banks, trade receivables and loan assets (including loans originated by the entity, loans acquired in a syndication, and other loans purchased in a secondary market provided that the market is not active and the loans are not quoted). Investments in debt securities that are not quoted in an active market can also be classified as loans and receivables.

When banks make term deposits with a central bank or other banks and the proof of deposit is negotiable, the deposit meets the definition of loans and receivables unless the depositor bank intends to sell the deposit immediately or in the near term, in which case the deposit must be classified as held for trading.

Financial assets purchased after origination qualify for classification as loans and receivables provided that they meet all of the criteria for loans and receivables. However, an interest in a pool of assets that are not themselves loans and receivables (e.g. an interest in a mutual fund or a similar fund) should not be classified as loans and receivables.

The principal difference between loans and receivables and HTM investments is that loans and receivables are not subject to the tainting provisions that apply to HTM investments. Loans and receivables not held for trading can be classified as such even if an entity does not have the positive intention and ability to hold them until maturity. As a consequence, the ability to measure a financial asset at amortised cost without consideration of the entity’s intention and ability to hold the asset until maturity is only appropriate when there is no active market for that asset.

Equity instruments (such as ordinary shares, share options, warrants and similar rights) should not be classified as loans and receivables because the amounts the holder may receive can vary in a manner that is not predetermined. A preference share that is a non-derivative equity instrument of the issuer with fixed or determinable payments can be classified in the loans and receivables category for the holder provided that it is not quoted in an active market. An example of such a preference share is a mandatorily redeemable preference share.

Reclassification after initial recognition

The Standard permits limited reclassifications of certain financial assets subject to meeting specified criteria. Reclassifications are not permitted for financial liabilities, derivatives or financial assets for which the fair value option has been selected.

Into FVTPL

The Group, in accordance with the Standard, does not make any reclassification of a financial instrument into the FVTPL category after initial recognition.

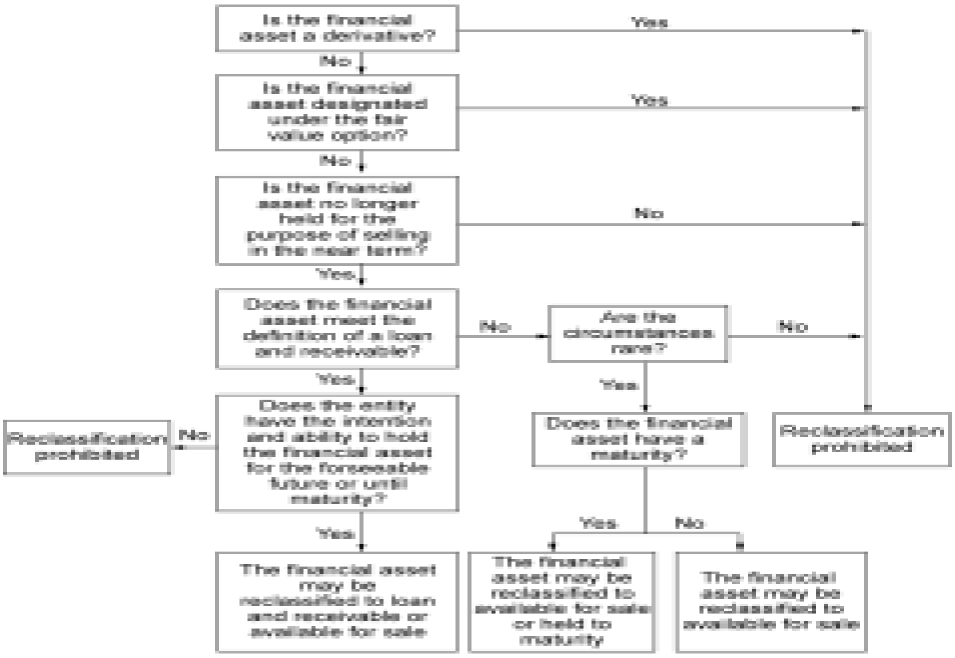
Out of FVTPL

Financial assets may be classified at initial recognition as at FVTPL if specified conditions are met. In some cases, this classification is mandatory (e.g. in the case of derivatives that are not designated as effective hedging instruments or non-derivative financial assets that are deemed held for trading). In other cases, the classification is by election (e.g. when an entity applies the fair value option). The Standard only permits reclassification out of FVTPL, subject to specified criteria, for non-derivative financial assets that were originally classified as at FVTPL because they met the definition of held for trading. Financial assets that are classified as at FVTPL because they are derivatives or because they are designated as at FVTPL under the fair value option cannot be reclassified under any circumstances.

The first condition to be met in order to reclassify a financial asset from FVTPL is that the financial asset is no longer held for the purpose of selling or repurchasing it in the near term. This criterion applies irrespective of whether the asset was initially classified as held for trading because (i) it was acquired principally for the purpose of selling in the near term or (ii) because it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.

The second condition to be considered in order to reclassify a financial asset from FVTPL is whether the financial asset meets the definition of loans and receivables. If it does, the financial asset may be reclassified out of FVTPL if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity. If it does not meet the definition of loans and receivables, it may be reclassified out of FVTPL only in rare circumstances.

The following summarises the criteria for reclassifying out of FVTPL.



The financial asset reclassified from FVTPL should be reclassified at its fair value on the date of reclassification. Any gain or loss recognised in profit or loss up until the date of reclassification should not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost (in the case of equity instruments) or amortised cost (in the case of debt instruments).

For financial assets reclassified out of FVTPL, the entity will start to apply the impairment guidance. Prior to the date of reclassification, an assessment of impairment was not required because the asset was measured at FVTPL. Because the instrument's fair value at the date of reclassification becomes its new deemed cost or deemed amortised cost, impairment losses recognised after the reclassification date may differ from the impairment losses that would have been recognised had the instrument never been previously measured at FVTPL.

A financial asset reclassified out of FVTPL is subject to extensive disclosure requirements.

Into AFS Investments

A debt or equity instrument may be reclassified out of held for trading (part of the FVTPL category) into AFS in accordance with the Standard. Because the instrument is measured at fair value both before and after reclassification, there is no gain/loss on reclassification and all amounts previously recognised in profit or loss prior to the date of reclassification are retained in profit or loss.

An entity must reclassify a debt instrument from HTM to AFS if there is no longer the intention and ability to hold the debt instrument to maturity. Also, all debt instruments must be reclassified out of HTM into AFS when there are sales or reclassifications of more than an insignificant amount of HTM investments that do not meet any of the conditions in IAS 38. At the date of reclassification, the difference between the carrying amount of such investments and their fair value should be recognised in other comprehensive income.

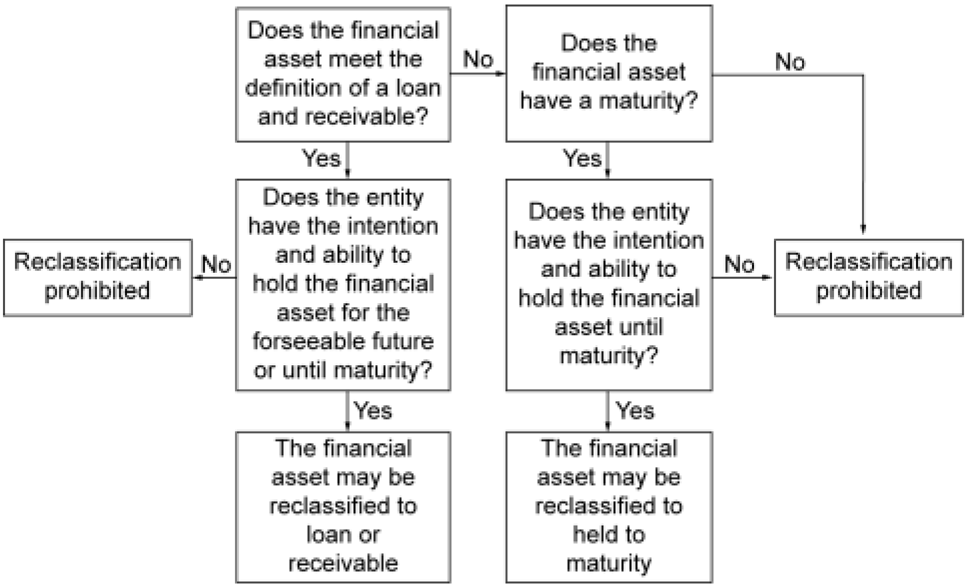
Out of AFS Investments

Investments in debt instruments may be reclassified out of AFS. Investments in equity instruments classified as AFS cannot be reclassified.

A financial asset classified as AFS may be reclassified to HTM if the entity has the intent and ability to hold the asset to maturity. The asset may be reclassified during the instrument's life except during the two-year tainting period if the entity has disposed of more than an insignificant amount of held-to-maturity assets.

A financial asset classified as AFS may be reclassified out of the AFS category to the loans and receivables category if it meets the definition of loans and receivables and the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.

The following summarises the criteria for reclassifying out of AFS.



A financial asset reclassified from AFS should be reclassified at its fair value on the date of reclassification. Any gain or loss already recognised in profit or loss should not be reversed. The fair value of the financial asset on the date of reclassification becomes its new amortised cost.

Any previous gain or loss on an AFS asset that has been recognised in other comprehensive income should be amortised to profit or loss over the remaining life of the investment using the effective interest method in the case of an instrument with a fixed maturity. Any difference between the new amortised cost (being the asset's fair value at the date of reclassification) and its maturity amount should also be amortised over the remaining life of the financial asset using the effective interest method, similar to the amortisation of a premium or a discount. In the case of a financial asset that does not have a fixed maturity (e.g. a perpetual debt instrument reclassified from AFS to loans and receivables), the gain or loss should be recognised in profit or loss when the financial asset is sold or otherwise disposed of or impaired. If the reclassified financial asset is subsequently impaired, any previous gain or loss that has been recognised in other comprehensive income is reclassified from equity to profit or loss irrespective of whether or not the asset has a fixed maturity.

Into HTM Investments

A financial asset classified as at FVTPL may be reclassified to HTM if the financial asset is no longer held for the purpose of selling or repurchasing it in the near term and it meets the definition of a HTM investment. The criteria for reclassification are described in the Paragrafh *"Out of FVTPL"*

A financial asset classified as AFS may be reclassified to HTM if the entity has the intent and ability to hold the asset to maturity. The asset may be reclassified during the instrument's life except during the two-year tainting period if the entity has disposed of more than an insignificant amount of HTM assets. When the two-year period subsequent to the period in which tainting occurred has passed, the entity is allowed to reclassify the assets back into HTM provided that it intends and is able to hold these assets to maturity. On the date of reclassification, an asset's carrying amount (i.e. its fair value at the date of reclassification) becomes the asset's new amortised cost. Any previous fair value gain or loss on the asset that has been accumulated in equity is amortised to profit or loss over the remaining life of the financial asset using the effective interest method.

Out of HTM investments

When, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as HTM, it is reclassified to AFS and remeasured at fair value. The 'tainting' provisions of IAS 39 apply not only to sales but also to reclassifications of HTM investments. Therefore, reclassifications of more than an insignificant amount of HTM investments, which do not meet any of the conditions for permitted sales, taint the HTM portfolio and all remaining HTM investments must be reclassified into AFS.
On reclassification out of HTM into the AFS category, as a consequence of tainting, any difference between an asset's carrying amount and its fair value is recognised in other comprehensive income. This difference must be disclosed in addition to the reason for reclassification.

When an entity taints its HTM portfolio in the current reporting period, and is required to reclassify all of its HTM investments into the AFS category, it does not restate its comparatives for the reporting period to reflect this change of classification, because this would conceal the impact of 'tainting' the portfolio.

Summary of Reclassification:

The summary of reclassifications below excludes investments in equity instruments (or derivatives linked to them and settled by delivery of an unquoted equity instrument) for which fair value is unreliable

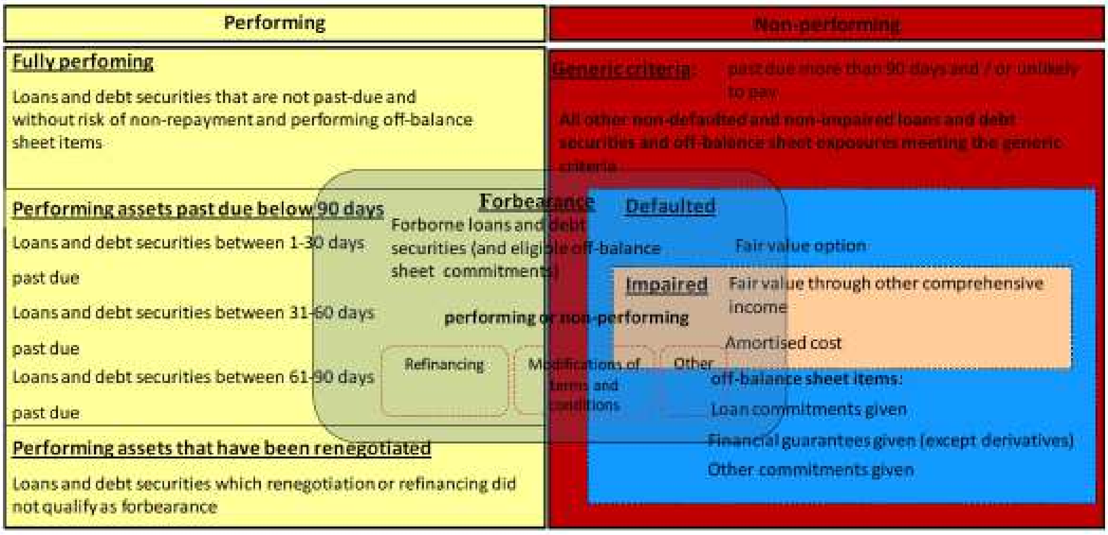
Out of	**Into**	**Criteria**	**Example**
FVTPL	L&R	Debt instrument meets the definition of L&RThe asset is no longer held for the purpose of selling in the near term and the entity has the intention and ability to hold the financial asset for the foreseeable future.	A trade receivable that at initial recognition was intended to be sold when that intent no longer applies.
FVTPL	HTM	Debt instrument does not meet the definition of loans and receivables (if the instrument met the definition of L&R it could not be reclassified to HTM because the HTM definition specifically excludes L&R)The asset is no longer held for the purpose of selling in the near term and the entity has the intention and ability to hold the financial asset until maturity (this requirement applies for all HTM assets) and the circumstances are rare.	A debt security that at initial recognition was intended to be sold in the near term and is a security that is traded in an active market (e.g. corporate debt, government bond) and where the entity now considers it has the intent and ability to hold to maturity. The circumstances for the reclassification are deemed rare.
FVTPL	AFS	Debt instrument meets the definition of L&RThe asset is no longer held for the purpose of selling in the near term and the entity has the intention and ability to hold the financial asset for the foreseeable future.	A trade receivable that at initial recognition was intended to be sold where the intent no longer applies.

FVTPL	AFS	Equity instrument or debt instrument does not meet the definition of L&RThe asset is no longer held for the purpose of selling in the near term and the circumstances are rare.	A debt security that at initial recognition was intended to be sold and is a security that is traded in an active market (e.g. corporate debt, government bond). The circumstances for the reclassification are deemed rare.
AFS	L&R	Debt instrument meets the definition of L&RThe entity has the intention and ability to hold the financial asset for the foreseeable future.	A trade receivable that at initial recognition was designated as AFS.
AFS	HTM	Debt instrument does not meet the definition of L&RThe asset is held with the intention and ability to hold to maturity.	A debt security that at initial recognition was intended to be sold prior to maturity and is a security that is traded in an active market (e.g. corporate debt, government bond) and where the entity now considers it has the intent and ability to hold to maturity.
AFS	FVTPL	Not permitted	Not permitted
HTM	AFS	Debt instrument is no longer held with the intent and ability to hold to maturity.If there are more than an insignificant amount of sales or reclassifications of HTM assets the HTM portfolio is 'tainted' and the whole portfolio must be reclassified to AFS.	A debt security that at initial recognition was considered traded in an active market (e.g. corporate debt, government bond) and the entity had the intent and ability to hold to maturity but the intent or ability no longer applies.
HTM	L&R	Not permitted	Not permitted
HTM	FVTPL	Not permitted	Not permitted
L&R	HTM	Not permitted	Not permitted
L&R	AFS	Accounting policy choice previous discussion with the Parent Company, whether to reclassify if the L&R is no longer met. This policy should be applied to all	A debt security that was not quoted in an active market becomes quoted in an active market subsequent to initial recognition, or subsequent to being reclassified to L&R.

		L&Rs.	
L&R	FVTPL	Not permitted	Not permitted

Forbearance and non-performing exposures

On 24 July 2014, to completion of a consultation process started in 2013, the European Banking Authority (EBA) published the document "Final Draft: Implementing Technical Standards on Supervisory reporting on forbearance and non-performing exposures" containing the implementing technical standards relating to the Supervisory statistical reports harmonized consolidated (FINREP), adopted by the European Commission's January 9, 2015 and thus became effective within the Union.
With effect from 1 January 2015 it was also reviewed by the Bank of Italy to the classification criteria of impaired financial assets, in order to align them to the new definitions of Non-Performing Exposures and Forbearance.
Among the main changes introduced by the ITS EBA is the creation of credit exposures subject of concessions class, exposures that fall into the categories of "Non-performing exposures with forbearance measures" and "forborne-performing exposures" as defined in ITS EBA.
The non-performing exposures include the defaulted and impaired exposures. Forborne exposures can be identified both in the performing and in the non-performing portfolios.



A concession refers to either of the following actions:

(a) a modification of the previous terms and conditions of a contract the debtor is considered unable to comply with due to its financial difficulties ("troubled debt") to

allow for sufficient debt service ability, that would not have been granted had the debtor not been in financial difficulties;
(b) a total or partial refinancing of a troubled debt contract, that would not have been granted had the debtor not been in financial difficulties.
A concession may entail a loss for the lender.

Evidence of a concession includes:
(a) a difference in favour of the debtor between the modified and the previous terms of the contract;
(b) cases where a modified contract includes more favourable terms than other debtors with a similar risk profile could have obtained from the same institution.

Forborne exposures are debt contracts in respect of which forbearance measures have been extended. Forbearance measures consist of concessions towards a debtor facing or about to face difficulties in meeting its financial commitments ("financial difficulties").

EBA identifies a number of situations directly identifiable as measures of forbearance or object rebuttable presumption. The set of the situations described above is configured as an "Entry Criteria" in forborne portfolios.
There is a rebuttable presumption that forbearance has taken place when:
(a) the modified contract was totally or partially past-due by more than 30 days (without being non-performing) at least once during the three months prior to its modification or would be more than 30 days past-due, totally or partially, without modification;
(b) simultaneously with or close in time to the concession of additional debt by the institution, the debtor made payments of principal or interest on another contract with the institution that was totally or partially 30 days past due at least once during the three months prior to its refinancing;
(c) the institution approves the use of embedded forbearance clauses for 30 days past-due debtors or debtors who would be 30 days past-due without the exercise of these clauses.

EBA also sets out the conditions that must occur in order to identify a relationship as an object of forbearance may be deemed complete ("Exit criteria").
The forbearance classification shall be discontinued when all the following conditions are met:
(a) the contract is considered as performing, including if it has been reclassified from the non-performing category after an analysis of the financial condition of the debtor showed it no longer met the conditions to be considered as nonperforming,
(b) a minimum 2 year probation period has passed from the date the forborne exposure was considered as performing;
(c) regular payments of more than an insignificant aggregate amount of principal or interest have been made during at least half of the probation period;

(d) none of the exposures to the debtor is more than 30 days past-due at the end of the probation period.

Bank of Italy has issued an update of Circular no. 272, containing a new definition of risk categories of impaired exposures, Sofferenze, Unlikely to pay, Past Due Loans, The reorganization of the risk categories has therefore resulted in the removal of the risk category "Restructured" (Ristrutturati), whose relations have been reclassified to other categories of risk (essentially UTP).

Unlikely to pay

For Unlikely to pay means the cash and "off balance sheet" at the same debtor against which the Bank considers unlikely a full compliance (principal and / or interest) pay its credit obligations without resort to actions such as realizing security.
Among the unlikely to pay are included, unless there are no grounds for their classification between the bad loans:
- The complex of exposures to borrowers who fulfill the conditions for their Classification as likely to default and who have one or more credit lines meet the definition of "Non-performing exposures with forbearance measures".
- Overall the exposure to issuers who have not honored their obligations Payment (principal and / or interest) relating to listed debt securities.

For this end it’s recognized the "grace period" stipulated in the contract or, in the absence, recognized by the stock market title.

- The overall exposures to debtors who have brought the action to the courts so called "Blank" (art. 161 of the Bankruptcy Law) from the date of submission of the application and until as it is not known the instance evolution. These exposures are classified as bad loans where it fulfills new circumstances that induce the Bank to classify the debtor in that category or if the exposure was already suffering at the time of submission of question.

In addition, they are allocated in the category of unlikely to pay on balance sheet exposures and off-balance for which, due to deterioration of the economic and financial position of the debtor, the bank agreed to modify the original contractual conditions giving rise to a loss (ex Restructured Loans). This classification is guided by the principle that, at the time of grant, is "Reset" the previous expired and the renegotiated exposure allocation between those impaired implies an assessment of the status of the debtor on the basis of infringement is unlikely principle.

Mediolanum Group’s has set management procedures based on objective and maximum timing parameters for proposed classification to unlikely to pay.

- Residential mortgage: over 3 unpaid installments (> 90 days).
- Loans: over 5 unpaid installments (> 150 days).
- Trust Ordinaries: more than 180 days of continuous encroachment.

- Overrunning of checking account without granted (uncovered): more than 180 days of continuous encroachment.

For positions classified as performing no abnormalities, a change of status of default probably it can be evaluated based on the evidence of automatic systems of detection of external faults depending on the severity of the anomaly detected.

Bad Loans

It defined the overall suffering of cash and "off balance sheet" against a person in insolvency or in similar situations regardless of any loss forecasts made by bank.
Also included are:

- Exposures to the state of financial distress in local authorities (municipalities and provinces) to the amount subject to the relevant liquidation procedure;
- Exposures to borrowers who fulfill the conditions for classification in bad loan and having one or more lines of credit that meet the definition of "Non Performing exposures with forbearance measures ".

All loans are subject to regular review by the appropriate structures within the competent units in each Group Company; checking on the progress of relations is carried out by means continuous monitoring of credit in place with particular attention on riskier positions. The intervention procedures put in place for the protection of credit are periodic reporting to the respective councils of Directors.

Past due and/or overdrawn impaired loans

They represent on-balance sheet exposures, other than those classified as non-performing or likely default which, at the reporting date, are past due or overdrawn. Past due and/or overdrawn impaired loans can be determined by reference, alternatively, to the individual debtor or to the individual transaction. Impaired past due loans and/or overdrawn loans are valued analytically, through flat-rate methods, which use flat-rate historical/statistical basis applying where available the risk detected by the appropriate risk factor used for the purposes of Regulation (EU) no. 575/2013 (CRR) related to prudential requirements for credit institutions and investment firms (LGD - Loss Given Default).

Impaired loans are individually assessed and the amount of the impairment loss is measured as the difference between the asset’s carrying amount (measured at amortized cost) at the time of assessment and the present value of estimated future cash flows discounted at the financial asset’s original effective interest rate.
Future cash flows are estimated taking into account the expected time of recovery, the realizable value of any collaterals as well as any costs of recovery which are recorded, limited to legal fees, in the risk fund. Future cash flows of receivables which are

expected to be recovered in the short term are not discounted.
The asset’s original effective interest rate remains unchanged over time also in the event of a restructuring as a result of which the interest rate changes or the loan or receivable actually carries no interest.
The amount of the impairment loss is recognized in the income statement.
If the value of a previously impaired loan or receivable increases and the increase can be objectively related to an event occurring after the impairment loss was recognized, the impairment loss is reversed and the reversal recognized in the income statement. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment loss not been recognized at the date the impairment is reversed.
Receivables for which no objective evidence of loss individually identified, usually loans not impaired, are assessed on a collective impairment. For the purpose of a collective evaluation of impairment, loans and receivables are grouped on the basis of similar credit risk characteristics and the related loss probability is estimated using historical loss rates based on observable data at the time of assessment that can reliably estimate the loss probability of each loan group. In case of significant loans not impaired, an analytical assessment can be made.
Any collectively assessed impairment loss is recognized in the income statement. At each interim and annual reporting date any additional impairment loss or reversal thereof is calculated in relation to the entire portfolio of loans not impaired on that same date.

The policy of the Mediolanum Group’s Credit Risk provides that claims in categories of impaired loans have a different approach to analytical measurement as a function of the membership class, the technical form, the value of the collateral backing the receivable, the financial and economic consistency counterparty and all information, internal and external, collected as part of the recovery process and that the management considered the most significant and indicative of the level of hazard.

Loans for which no objective evidence of impairment were detected (including loans to residents in countries at risk) they are subjected to the collective assessment.

These receivables are grouped into classes financial assets with similar risk characteristics and collectively assessed for impairment on the basis time series of internal and external elements observable at measurement date.

Generic Provisions

The process of defining groups of loans assessed collectively in accordance with the legislation IAS uses the greatest possible synergies with the approach for credit risk assessment provided by the provisions of the "New Capital Accord" known as Basel 2.

In particular, the risk parameters introduced the New Agreement, represented by the probability of default (PD) by rating category and the rate of loss in the event default (LGD) were identified as significant factors to be used in the determination of the categories homogeneous and in the calculation of accruals accounting in optics.

Mediolanum Group's implements the classification of loans subject to collective assessment on the basis of the rating and customer segment (Retail/Corporate) processed by the application Cedacri CRS (Credit Rating System).

The collective impairment provision is then determined by calculating the expected loss (hereinafter PA) of all reports belonging to a particular class of credit ratings according to the CRS processing as follows:

$$PA = Balance \times PD \times LGD$$

where:

Balance: It represents the balance of the balance for short-term credits and amortized cost for loans and financing installment repayment;
PD: likely to move from performing to default in a year for the particular rating category;
LGD: percentage of non-recovery to apply to performing loans.

The calculation model is distinguished according to the customer segment concerned:

- Private Consumers;
- PMI;
- Large Corporate;
- Real Estate;

As regards the LGD assessment, the following choices were made:

- Individuals segment. It is a model expert, in line with the market benchmark 'was applied, which assigned an LGD of 25% to mortgages and an LGD of 45% to the remaining technical forms.
- Segments Small Business, SME, Large Corporate and Real Estate. For these two segments LGD econometric models have been adopted (one for the Small Business segment and one for the SME segments, Real Estate and Large Corporate), also implemented by the outsourcer Cedacri CRS within the application.

They are based on two elements estimates:

- LGD for positions that pass directly from the state of Performing status to that non-Performing;
- calibration coefficient (cure rate), for positions that pass through other states of default before moving to bad loan.

Counterparties belonging to the residual sector are valued similarly to retail customers, using Expert Model that assigns an LGD of 25% to mortgages and an LGD of 45% to the remaining technical forms.

3.1.2 Impairment

Mediolanum's Group adopts different approaches to assessing and calculating impairment for different classification categories. The requirements to assess for impairment are summarised in the following table.

Financial Asset	Impairment assessment required?
Investment in debt instruments	
Fair Value through profit or loss	No
Held to Maturity investments	Yes
Available for sale financial assets	Yes
Loans & Receivables	Yes
Investment in equity instruments	
Fair Value through profit or loss	No
Available for sale financial assets	Yes
Unquoted equity instruments measured at cost	Yes
Derivatives instruments (included separated embedded derivatives)	
Fair Value through profit or loss	No
Derivatives that result in physical delivery of unquoted equity investments measured at cost	Yes

Impairment of equity instruments in available for sale

A significant **or** prolonged decline in the fair value of an investment in an equity instrument below its cost is an objective evidence of impairment.

As regards the impairment of equity investments classified as AFS, the Group has identified trigger for impairment in presence of negative reserve:

Category	***Significant***	***Prolonged***
Equity securities listed	FV < 1/3 book value	36 months
Equity securities unlisted	FV < 1/3 book value	36 months

The terms *significant* and *prolonged* refer respectively to the presence and the prolonged presence of a market price / lower fair value than the original cost.
If any of the above described conditions, the cumulative loss recognized in equity is reversed and recognized in the income statement.

If, however, the reduction in the fair value does not exceed these thresholds, in the presence of the listed indicators qualitative impairment, is made a "fundamental" valuation of the security, through the adoption of methodologies based on market criteria or the expected future flows, to verify if necessary to make a value adjustment.

Once an entity has recognised an impairment loss on an AFS equity investment, Mediolanum Group, in accordance with the Standard:

- does not recognise a reversal through profit or loss. Any appreciation after impairment loss is recognized in other comprehensive income.;
- reclassifies any subsequent losses from equity to profit or loss until the asset is derecognised.

Impairment measurement - debt instruments in available for sale

The impairment process , related to debt instruments , is activated by Banca Mediolanum if there is:

- event of default (as defined by international contracts ;
- admission to bankruptcy proceeding;
- or if the issuer doesn't pay interest or capital shares (except where it is contractually agreed that the issuer has the right to not pay interest shares)

In the presence of one of these conditions , due to the severity of the event, Bank Mediolanum provides directly to the recognition of impairment .The amount of the impairment loss to be recognised on an AFS debt instrument is the cumulative fair value loss that has been recognised in other comprehensive income. The whole of this amount is reclassified from equity to profit or loss. Because the impairment loss is recognised on a fair value basis, this differs from a loss on a debt instrument measured at amortised cost where the loss is determined as the difference between the asset's carrying value and its recoverable amount calculated as the sum of the estimated future recoverable cash flows discounted at the asset's original effective interest rate. The reason for this difference is that the impairment loss on an AFS debt instrument includes a market participant's view of recoverable cash flows discounted at a rate that reflects current market interest rates, adjusted for liquidity and other factors a market participant would include in determining fair value.

For all debt instruments, interest is recognised using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss. In the case of fixed rate debt instruments measured at amortised cost, the discount rate will be the original effective interest rate. For floating rate debt instruments measured at amortised cost, the discount rate will be the effective interest rate at the date of impairment. Because the impairment loss on an AFS debt instrument is equal to the fair value loss recognised in equity that is reclassified to profit or loss, the interest rate subsequent to the impairment loss is based on a market interest rate at the date of impairment. The market interest rate reflects the rate that was used in determining the asset's fair value. A further reason for applying a market interest rate for interest recognition subsequent to the date of impairment, as opposed to the original effective interest rate, is that, assuming there are no further impairment losses, or reversals of impairment losses, the amount in equity at maturity will be zero.

If, in a subsequent period, the amount of the impairment loss relating to a debt instrument carried as available-for-sale decreases due to an event occurring after the impairment was originally recognised, the previously recognised impairment loss is reversed through profit or loss: if the fair value of an AFS debt instrument increases and the increase can be related objectively to an event occurring after the impairment was recognised, then the impairment is reversed through profit or loss. It should be noted that, to qualify for recognition, a reversal does *not* need to have resulted from the same factor that caused the original impairment. The amount of the gain recognised in profit or loss on reversal of an impairment loss is unlikely to be equal to the amount of the original impairment loss recognised in profit or loss. This is because the amount of the original impairment loss and the reversal are based on the *fair value* loss and gain respectively that are recognised in other comprehensive income at the reporting date.

If an AFS debt instrument has been impaired and amounts have been reclassified from equity to profit or loss, and the asset continues to have an impaired status (i.e. the expected recoverable contractual cash flows to be received are lower than at initial recognition), further fair value losses recognised in other comprehensive income should also be reclassified from equity to profit or loss. Effectively, if an asset is impaired, IAS 39 does not distinguish between fair value losses that arise due to further declines in recoverability of cash flows, and those fair value losses that arise due to other factors (changes in risk-free interest rates, liquidity risk etc.).

Assets carried at amortised cost

Mediolanum Group classify financial assets as either loans and receivables or HTM. Once an impairment loss has been identified, its amount is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate. This amount is then recognised in profit or loss. The carrying amount of the asset is reduced, either directly or through use of an allowance account. However, as a practical expedient, the impairment loss can be measured on the basis of an asset's fair value using an observable market price.

In circumstances in which there is a range of possible amounts, a loss equal to the best estimate within that range should be recognised. When there is a continuous range of possible amounts, and each point in that range is as likely as any other, the mid-point of the range is used.

For collateralised assets, the estimated cash flows that should be used to calculate any impairment reflect the cash flows that might result from foreclosure, less the costs of obtaining and selling the collateral. Collateral should not be recognised as a separate asset before foreclosure.

If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the previously recognised impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the **financial asset** that exceeds what the **amortised cost** would have been had the impairment not been recognised at the date the impairment is reversed. The amount of the reversal shall be recognised in profit or loss.

Discount rate

In calculating an impairment loss, expected future cash flows are discounted at the original effective interest rate. As a result, *only* the effect of the reduction in cash flows is recognised as a loss - that amount is not affected by other factors (e.g. changes in the market interest rate, or the credit rating of the borrower) that might affect the fair value of the asset.

When the terms of a loan are renegotiated due to the financial difficulties of the borrower/issuer, any impairment is still measured by reference to the original effective interest rate before the modification of terms.

Two particular instances in which a different rate should be used are as follows.

For a variable rate asset, impairment should be measured using the current effective interest rate determined under the contract.

The carrying amount of an asset designated as a hedged item in a fair value hedge of interest rate risk will be adjusted for fair value changes attributable to interest rate movements. The original effective interest rate then becomes irrelevant and the rate is recalculated using the adjusted carrying amount of the loan.

3.1.3 Fair value

Valuation techniques and model

The valuation techniques that an entity can be used to measure the fair value should be based on the specific circumstances and in consideration of the adequacy of the available data.
In some cases, moreover, it may be appropriate to make use of a single evaluation technique, while in othercases it may be appropriate to apply multiple assessments to define a reasonable range of values.
The chosen technique, however, must be used steadily, unless other circumstances need to replace it with other more representative (for example, the case of new relevant and significant information, changes in market conditions or improvements in the technique estimation). The change of the valuation technique leads a change in estimate in accordance with IAS 8, and then, with effects prospective and not retroactive.
The valuation techniques therefore include the use of recent market transactions between normal parts available and aware, the reference to current fair value of another comparable instrument, the price analysis and discounted cash flow models of the options. Alternatively, if there is a valuation technique commonly used by participant to active market and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the Bank uses that technique, which can be distinguished between:

- comparable approach: measurements by reference to market values indirectly, comparable in features and risks, to the instrument to be valued;
- Mark-to-Model: valuations performed using - even partially – inputs data not identified trough observable market parameters, for which it makes use of estimates and assumptions made by evaluator.

The choice between the different methodologies is not optional, since they must be applied in hierarchical order: high priority to official prices available on active markets for assets and liabilities to be measured (Effective market quotes) or for similar assets and liabilities (comparable approach) and the lowest priority to unobservable inputs and, therefore, more judgemental (Mark-to-Model Approach).
On the use of valuation models, the Risk Management Department has to consider:

- *Model risk*: the possibility that the valuation model used does not include all Necessary elements for a correct assessment of the financial instrument, or that the parameters considered are too arbitrary;
- *liquidity risk* in the valuation of financial instruments: risk that some certain measurement parameters used in the valuation could not be liquid, then promptly available on the market;
- *the credit risk* of the counterparty.

For these reasons the group has to provide the relevant disclosure in the financial statement of the methods and assumptions used to estimate the fair value as well as of any changes in valuation techniques compared the previous period.

<u>Fair value measurement criterias</u>

The Mediolanum Group considers quoted in an active market :

- Securities traded on Italian regulated markets (eg . MTS , MOT);
- Securities traded on alternative trading systems approved or recognized by Consob (called MTF) for which has been determined the relevance of the price through procedure described in the Policy of Financial Risk.
- bonds for which securities have a quotation BGN / Bid that meet the criteria described in the policy of financial risk.

For securities listed on an active market the Group Mediolanum uses, depending on the type of financial instrument, the following criteria for determining fair value:

- For equity securities listed on Italian Stock Exchange and Foreign the closing price on the last trading day open of the reference month;
- For bonds, which have passed the test of relevance, it will be considered the Bid price(For long positions) and the Ask price (for short positions) as a source BGN

On the valuation of the end of the year or when there are particular moments of market stress could beneed to change the thresholds of relevance or the criteria prior approval by the Chief Executive Officer of Banca Mediolanum and subsequent disclosure to the Board of Directors.

For securities not listed on an active market, Mediolanum Group has defined these evaluation techniques:

- Market price of a single eligible counterparties, which according to the principle of *arm's length transaction*, they can be considered as independent sources and operating in conditions of complete freedom. Furthermore, these prices must be updated and executable by size comparable with those in the portfolio of property. Such listing will be provided by the operator, accompanied by appropriatesupporting documentation, and validated by the Risk Management function;
- Price arising from a recent transaction on the same instrument with a counterparty, independent and voluntary. On that price should be applied, if necessary, adjustments to incorporate the changes in market conditions. This price will be provided by the operator, adequately documented and validated by the Risk Management function;
- Calculating the present value of expected cash flows and discount factors (expressed by depo / swap curveprovided by Bloomberg at the reporting date). On the price of the securities resulting from the application of this methodology is adjusted by the "credit spread"corresponding to the credit risk of the the issuer; for liquidity risk will be applied a further adjustment based on emission breadth, nature of the bond and current market conditions. This price will be provided by Risk Management.

Hierarchy of fair value

The table below provides the breakdown of financial instrument into the three level of fair value:

Level of fair value	Type of financial instruments
Level 1	• Equity investments/debt instruments of listed company traded in an active market, • shares of listed funds/OICR
Level 2	• Hedge Funds, • debt instruments of companies not listed for which inputs are derived principally from or corroborated by observable market data by correlation or other means ('market-corroborated inputs'). • Zero swap, • Debt securities issued • Reverse Floater • Call Spread certificates on a single index
Level 3	• Investments in private equity • Equity Swap • Bond not listed for which price is based on internal model • Real Estate Funds • ABS without contributors of an active market • Options (no plain vanilla) • Certificates (except for tare included in level 2)

3.2 Relevant topics

On 12 November 2009, the IASB issued IFRS 9 Financial Instruments as the first step in its project to replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 introduced new requirements for classifying and measuring financial assets that had to be applied starting 1 January 2013, with early adoption permitted.

On 28 October 2010, the IASB reissued IFRS 9, incorporating new requirements on accounting for financial liabilities, and carrying over from IAS 39 the requirements for derecognition of financial assets and financial liabilities.

On 16 December 2011, the IASB issued Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7), which amended the effective date of IFRS 9 to annual periods beginning on or after 1 January 2015, and modified the relief from restating comparative periods and the associated disclosures in IFRS 7.

On 19 November 2013, the IASB issued IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) amending IFRS 9 to include the new general hedge accounting model, allow early adoption of the treatment of fair value changes due to own credit on liabilities designated at fair value through profit or loss and remove the 1 January 2015 effective date.

On 24 July 2014, the IASB issued the final version of IFRS 9 incorporating a new expected loss impairment model and introducing limited amendments to the classification and measurement requirements for financial assets. This version supersedes all previous versions and is mandatorily effective for periods beginning on or after 1 January 2018 with early adoption permitted (subject to local endorsement requirements). For a limited period, previous versions of IFRS 9 may be adopted early if not already done so provided the relevant date of initial application is before 1 February 2015.

3.2.1 Potential impacts related to IFRS 9

Initial measurement of financial instruments

All financial instruments are initially measured at fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs.

Subsequent measurement of financial assets

IFRS 9 divides all financial assets that are currently in the scope of IAS 39 into two classifications - those measured at amortised cost and those measured at fair value.

Where assets are measured at fair value, gains and losses are either recognised entirely in profit or loss (fair value through profit or loss, FVTPL), or recognised in other comprehensive income (fair value through other comprehensive income, FVTOCI).

For debt instruments the FVTOCI classification is mandatory for certain assets unless the fair value option is elected. Whilst for equity investments, the FVTOCI classification is an election. Furthermore, the requirements for reclassifying gains or losses recognised in other comprehensive income are different for debt instruments and equity investments.

The classification of a financial asset is made at the time it is initially recognised, namely when the entity becomes a party to the contractual provisions of the instrument. If certain conditions are met, the classification of an asset may subsequently need to be reclassified.

Debt instruments

A debt instrument that meets the following two conditions must be measured at amortised cost (net of any write down for impairment) unless the asset is designated at FVTPL under the fair value option:

- Business model test: The objective of the entity's business model is to hold the financial asset to collect the contractual cash flows (rather than to sell the instrument prior to its contractual maturity to realise its fair value changes).
- Cash flow characteristics test: The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

A debt instrument that meets the following two conditions must be measured at FVTOCI unless the asset is designated at FVTPL under the fair value option:

- Business model test: The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.
- Cash flow characteristics test: The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

All other debt instruments must be measured at fair value through profit or loss.

Fair value option

Even if an instrument meets the two requirements to be measured at amortised cost or FVTOCI, IFRS 9 contains an option to designate, at initial recognition, a financial asset as measured at FVTPL if doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases.

Equity instruments

All equity investments in scope of IFRS 9 are to be measured at fair value in the statement of financial position, with value changes recognised in profit or loss, except for those equity investments for which the entity has elected to present value changes in 'other comprehensive income'. There is no 'cost exception' for unquoted equities.

'Other comprehensive income' option

If an equity investment is not held for trading, an entity can make an irrevocable election at initial recognition to measure it at FVTOCI with only dividend income recognised in profit or loss.

Measurement guidance

Despite the fair value requirement for all equity investments, IFRS 9 contains guidance on when cost may be the best estimate of fair value and also when it might not be representative of fair value.

Subsequent measurement of financial liabilities

IFRS 9 doesn't change the basic accounting model for financial liabilities under IAS 39. Two measurement categories continue to exist: FVTPL and amortised cost. Financial liabilities held for trading are measured at FVTPL, and all other financial liabilities are measured at amortised cost unless the fair value option is applied.

Fair value option

IFRS 9 contains an option to designate a financial liability as measured at FVTPL if:

- doing so eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as an 'accounting mismatch') that would otherwise arise from measuring assets or liabilities or recognising the gains and losses on them on different bases; or
- the liability is part or a group of financial liabilities or financial assets and financial liabilities that is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel.

A financial liability which does not meet any of these criteria may still be designated as measured at FVTPL when it contains one or more embedded derivatives that sufficiently modify the cash flows of the liability and are not clearly closely related.

IFRS 9 requires gains and losses on financial liabilities designated as at FVTPL to be split into the amount of change in fair value attributable to changes in credit risk of the liability, presented in other comprehensive income, and the remaining amount presented in profit or loss. The new guidance allows the recognition of the full amount of change in the fair value in profit or loss only if the presentation of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. That determination is made at initial recognition and is not reassessed.

Amounts presented in other comprehensive income shall not be subsequently transferred to profit or loss, the entity may only transfer the cumulative gain or loss within equity.

Derecognition of financial assets

The basic premise for the derecognition model in IFRS 9 (carried over from IAS 39) is to determine whether the asset under consideration for derecognition is:

- an asset in its entirety; or
- specifically identified cash flows from an asset (or a group of similar financial assets); or
- a fully proportionate (pro rata) share of the cash flows from an asset (or a group of similar financial assets); or
- a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets).

Once the asset under consideration for derecognition has been determined, an assessment is made as to whether the asset has been transferred, and if so, whether the transfer of that asset is subsequently eligible for derecognition.

An asset is transferred if either the entity has transferred the contractual rights to receive the cash flows, or the entity has retained the contractual rights to receive the cash flows from the asset, but has assumed a contractual obligation to pass those cash flows on under an arrangement that meets the following three conditions:

- the entity has no obligation to pay amounts to the eventual recipient unless it collects equivalent amounts on the original asset;
- the entity is prohibited from selling or pledging the original asset (other than as security to the eventual recipient);
- the entity has an obligation to remit those cash flows without material delay.

Once an entity has determined that the asset has been transferred, it then determines whether or not it has transferred substantially all of the risks and rewards of ownership of the asset. If substantially all the risks and rewards have been transferred, the asset is derecognised. If substantially all the risks and rewards have been retained, derecognition of the asset is precluded.

If the entity has neither retained nor transferred substantially all of the risks and rewards of the asset, then the entity must assess whether it has relinquished control of the asset or not. If the entity does not control the asset then derecognition is appropriate; however if the entity has retained control of the asset, then the entity continues to recognise the asset to the extent to which it has a continuing involvement in the asset.

Derecognition of financial liabilities

A financial liability should be removed from the balance sheet when, and only when, it is extinguished, that is, when the obligation specified in the contract is either discharged or cancelled or expires. Where there has been an exchange between an existing borrower and lender of debt instruments with substantially different terms, or there has been a substantial modification of the terms of an existing financial liability, this transaction is accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. A gain or loss from extinguishment of the original financial liability is recognised in profit or loss.

Reclassification

For financial assets, reclassification is required between FVTPL, FVTOCI and amortised cost, if and only if the entity's business model objective for its financial assets changes so its previous model assessment would no longer apply.

If reclassification is appropriate, it must be done prospectively from the reclassification date which is defined as the first day of the first reporting period following the change in business model. An entity does not restate any previously recognised gains, losses, or interest.

IFRS 9 does not allow reclassification:

- for equity investments measured at FVTOCI, or
- where the fair value option has been exercised in any circumstance for a financial assets or financial liability.

Impairment

The impairment model in IFRS 9 is based on the premise of providing for expected losses.

Scope

IFRS 9 requires that the same impairment model apply to all of the following:
- Financial assets measured at amortised cost;
- Financial assets mandatorily measured at FVTOCI;
- Loan commitments when there is a present obligation to extend credit (except

where these are measured at FVTPL):

  - Financial guarantee contracts to which IFRS 9 is applied (except those measured at FVTPL);
  - Lease receivables within the scope of IAS 17 *Leases*; and
  - Contract assets within the scope of IFRS 15 *Revenue from Contracts with Customers* (i.e. rights to consideration following transfer of goods or services).

General approach

With the exception of purchased or originated credit impaired financial assets (see below), expected credit losses are required to be measured through a loss allowance at an amount equal to:

- the 12-month expected credit losses (expected credit losses that result from those default events on the financial instrument that are possible within 12 months after the reporting date); or
- full lifetime expected credit losses (expected credit losses that result from all possible default events over the life of the financial instrument).

A loss allowance for full lifetime expected credit losses is required for a financial instrument if the credit risk of that financial instrument has increased significantly since initial recognition, as well as to contract assets or trade receivables that do not constitute a financing transaction in accordance with IFRS 15.

Additionally, entities can elect an accounting policy to recognise full lifetime expected losses for all contract assets and/or all trade receivables that do constitute a financing transaction in accordance with IFRS 15. The same election is also separately permitted for lease receivables.

For all other financial instruments, expected credit losses are measured at an amount equal to the 12-month expected credit losses.

Presentation

Whilst interest revenue is always required to be presented as a separate line item, it is calculated differently according to the status of the asset with regard to credit impairment. In the case of a financial asset that is not a purchased or originated credit-impaired financial asset and for which there is no objective evidence of impairment at the reporting date, interest revenue is calculated by applying the effective interest rate method to the gross carrying amount.

In the case of a financial asset that is not a purchased or originated credit-impaired financial asset but subsequently has become credit-impaired, interest revenue is calculated by applying the effective interest rate to the amortised cost balance, which comprises the gross carrying amount adjusted for any loss allowance.

In the case of purchased or originated credit-impaired financial assets, interest revenue is always recognised by applying the credit-adjusted effective interest rate to the amortised cost carrying amount. The credit-adjusted effective interest rate is the rate that discounts the cash flows expected on initial recognition (explicitly taking account of expected credit losses as well as contractual terms of the instrument) back to the amortised cost at initial recognition.

Consequential amendments of IFRS 9 to IAS 1 require that impairment losses, including reversals of impairment losses and impairment gains (in the case of purchased or originated credit-impaired financial assets), are presented in a separate line item in the statement of profit or loss and other comprehensive income.

Disclosures

IFRS 9 amends some of the requirements of IFRS 7 *Financial Instruments: Disclosures* including adding disclosures about investments in equity instruments designated as at FVTOCI, disclosures on risk management activities and hedge accounting and disclosures on credit risk management and impairment.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognition (paragraph 4.1)
- Measurement (paragraph 4.2)
- Derecognition (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to financial instruments.

4.1 Recognition

4.1.1 Initial Recognition

Example 4.1.1.1

Initial recognition following modification

An entity had previously issued a perpetual instrument with an issuer option to redeem after 15 years. Under the terms of the instrument, the entity was entitled to defer interest payments indefinitely, except upon liquidation of the entity. The instrument met the definition of an equity instrument and was presented as equity at its net proceeds.

During the current reporting period, the entity and the holder of the instrument agree to modify the terms of the instrument so that, if a prescribed contingent event occurs any time after the date of modification, the entity will be required to pay all deferred interest and lose the right to defer future interest. This newly created contingent settlement provision is considered to be 'genuine' in accordance with IAS 32; consequently, after this modification, in accordance with IAS 32 the instrument is classified as a financial liability. The modification involves no compensation payment to the holders of the instrument and no change in the expected cash flows, and no fees in respect of the modification are paid.

All financial instruments are measured at fair value at initial recognition. In this example, the initial recognition date for the financial liability is the date of the modification because, at that date, the original equity instrument is derecognised and a new financial liability is recognised. Therefore, the entity must recognise the financial liability at its fair value, which will incorporate expectations of cash flows and market interest rates at the date of the modification. Any difference between the previous carrying amount recognised in equity and the fair value of the financial liability is recognised as an adjustment within equity.

If the entity does not designate the financial liability as at FVTPL, after initial recognition the liability is measured at amortised cost which will include any directly attributable transaction costs.

4.1.2 Trade date and settlement date accounting

Example 4.1.2.1

Trade and settlement date accounting for a purchase of an asset

The following example illustrates the amounts to be recognised for a purchase of a financial asset.

The dates and fair values that are relevant to the example are:

- trade date: 29 December 20X1 (fair value of asset 1,000);
- period end date: 31 December 20X1 (fair value of asset 1,002); and
- settlement date: 4 January 20X2 (fair value of asset 1,003).

The contracted price of the asset is set as the trade date fair value of 1,000.

TRADE DATE ACCOUNTING			
Journal entries	**Debt instrument measured at amortised cost (HTM, L&R)**	**AFS asset**	**FVTPL**
29/12/20X1			
	Dr Asset 1,000	Dr Asset 1,000	Dr Asset 1,000
	Cr Liability 1,000	Cr Liability 1,000	Cr Liability 1,000
Description	*To recognise the asset and payable.*	*To recognise the asset and payable.*	*To recognise the asset and payable.*
31/12/20X1			
	-	Dr Asset 2	Dr Asset 2
	-	Cr OCI 2	Cr Profit or loss

			2
Description		*To recognise the increase in fair value to date.*	*To recognise the increase in fair value to date.*
04/01/20X2			
	-	Dr Asset 1	Dr Asset 1
	-	Cr OCI 1	Cr Profit or loss 1
Description		*To recognise the increase in fair value to date.*	*To recognise the increase in fair value to date.*
	Dr Liability 1,000	Dr Liability 1,000	Dr Liability 1,000
	Cr Cash 1,000	Cr Cash 1,000	Cr Cash 1,000
Description	*To record the payment for the asset at the contracted amount.*	*To record the payment for the asset at the contracted amount.*	*To record the payment for the asset at the contracted amount.*
SETTLEMENT DATE ACCOUNTING			
Journal entries	**Debt instrument measured at amortised cost (HTM, L&R)**	**AFS asset**	**FVTPL**
29/12/20X1			
	-	-	-
	-	-	-
31/12/20X1			
	-	Dr Receivable 2	Dr Receivable 2
	-	Cr OCI 2	Cr Profit or loss 2
Description		*To recognise the increase in fair value to date.*	*To recognise the increase in fair value to date.*
04/01/20X2			
	-	Dr Receivable 1	Dr Receivable 1

	-	Cr OCI 1	Cr Profit or loss 1
Description		*To recognise the increase in fair value to date.*	*To recognise the increase in fair value to date.*
	Dr Asset 1,000	Dr Asset 1,003	Dr Asset 1,003
	Cr Cash 1,000	Cr Cash 1,000	Cr Cash 1,000
	-	Cr Receivable 3	Cr Receivable 3
Description	*To recognise the asset and payment for the asset at the contracted amount.*	*To recognise the asset and payment for the asset at the contracted amount and its change in fair value since trade asset.*	*To recognise the asset and payment for the asset at the contracted amount and its change in fair value since trade asset.*

Example 4.1.2.2

<u>Application of trade and settlement date accounting for different categories of financial asset</u>

Entity P has an accounting policy of settlement date accounting for loans and receivables and trade date accounting for AFS financial assets. Entity P enters into a regular way transaction whereby it will sell a loan in exchange for an AFS equity instrument. At the date of entering into the arrangement, 30 March 20X8, both assets have the same fair value. The settlement date is 2 April 20X8. Entity P's reporting date is 31 March20X8.

	Amortised cost	**Fair value**
	CU	**CU**
30 March 20X8		
Loans and receivables	10,000	
AFS asset		10,400
31 March 20X8		
Loans and receivables	10,005	
AFS asset		10,350

2 April 20X8		
Loans and receivables	10,015	
AFS asset		10,352
30 March 20X8	**CU**	**CU**
Dr AFS asset	10,400	
Cr Financial liability		10,400
To recognise the AFS asset at trade date.		
31 March 20X8	**CU**	**CU**
Dr Other comprehensive income (equity)	50	
Cr AFS asset		50
To recognise the change in fair value of the AFS equity instrument.		
	CU	**CU**
Dr Loans and receivables	5	
Cr Interest income		5
To recognise the interest earned on an effective interest rate basis.		
2 April 20X8	**CU**	**CU**
Dr Loans and receivables	10	
Cr Interest income		10
To recognise the interest earned on an effective interest rate basis.		
	CU	**CU**
Dr Other comprehensive income (equity)	25	
Cr AFS asset		25
To recognise the		

change in fair value of the AFS equity instrument.		
	CU	**CU**
Dr Financial liability	10,400	
Cr Loans and receivables		10,015
Cr Profit or loss		385

Example 4.1.2.3

Settlement date accounting: exchange of non-cash financial assets

On 29 December 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is carried at amortised cost, in exchange for Bond B, which will be classified as held for trading and measured at fair value. Both assets have a fair value of CU1,010 on 29 December, while the amortised cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for loans and receivables and trade date accounting for assets held for trading. On 31 December 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On 4 January 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

31 December 20X2	
Dr Bond B	CU 1,010
Cr Payable	CU 1,010
31 December 20X2	
Dr Trading loss	CU 1
Cr Bond B	CU 1
4 January 20X3	
Dr Payable	CU 1,010
Dr Trading loss	CU 2
Cr Note Receivable	CU 1,000
Cr Bond B	CU 2
Cr Realisation gain	CU 10

4.2 Measurement

4.2.1 Financial Assets

Example 4.2.1.1

Available-for-sale debt instrument

A zero coupon bond is acquired for its fair value of CU95 on 1 January 20X0 and classified as AFS. Transaction costs arising on acquisition are CU5. The bond is due to be redeemed for CU130 on 31 December 20X4. On 31 December 20X0, the bond's fair value is CU103. On 31 December 20X1, the entity sells the bond for its fair value of CU108. In 20X0, the entity records the following entries.

1.Initial recognition (at fair value, including transaction costs)

	CU	**CU**
Dr Asset	100	
Cr Cash		100

To recognise the zero coupon bond.

2.Interest income (calculated under the effective interest method)

	CU	**CU**
Dr Asset	5.39	
Cr Interest Income		5.39

To recognise the interest income.

3.Fair value adjustment (such that the asset is stated at its fair value of CU103)

	CU	**CU**
Dr OCI	2.39	
Cr Asset		2.39

To record the remeasurement of the asset to fair value.

In 20X1, the entity records the following entries.

1.Interest income (calculated under the effective interest method)

	CU	**CU**
Dr Asset	5.68	
Cr Interest Income		5.68

To recognise the interest income.

2.Fair value adjustment (such that the asset is stated at its fair value of CU108)

	CU	**CU**
Dr OCI	0.68	
Cr Asset		0.68

To record the remeasurement of the asset to fair value.

3.Sale of asset

	CU	**CU**
Dr Cash	108	
Cr Asset		108

To record the disposal of the asset.

4.Reclassification to profit or loss of fair value losses previously recognised in other comprehensive income and accumulated in equity

	CU	**CU**
Dr Profit or Loss	3.07	
Cr OCI		3.07

To reclassify losses previously recognised in other comprehensive income and accumulated in equity.

Example 4.2.1.2

<u>Dividends on available-for-sale equity instruments</u>

On 1 January 20X0, Entity X acquires an equity instrument of Entity Y for its fair value of CU100; the instrument is classified as an AFS financial asset. Entity Y immediately declares a dividend of CU10 and, consequently, the fair value of the equity instrument in Entity Y decreases to CU90. Entity X records the following entries.

1.Initial recognition

	CU	**CU**
Dr Asset	100	
Cr Cash		100

To recognise the equity instrument.

2.Dividend income

	CU	**CU**
Dr Cash	10	
Cr Dividend Income		10

To recognise the dividend income.

2.Fair value adjustment (such that the asset is stated at its fair value of CU90)

	CU	CU
Dr OCI	10	
Cr Asset		10

To record the remeasurement of the equity instrument.

4.2.2 Foreign Currency

Example 4.2.2.1

Available-for-sale financial assets: separation of currency component

For an available-for-sale monetary financial asset, the entity recognises changes in the carrying amount relating to changes in foreign exchange rates in profit or loss in accordance with IAS 21 and other changes in the carrying amount in other comprehensive income in accordance with IAS 39. How is the cumulative gain or loss that is recognised in other comprehensive income determined? It is the difference between the amortised cost (adjusted for impairment, if any) and fair value of the available-for-sale monetary financial asset in the functional currency of the reporting entity. For the purpose of applying IAS 21 the asset is treated as an asset measured at amortised cost in the foreign currency.

To illustrate: on 31 December 20X1 Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC1,000. The bond has five years remaining to maturity and a principal amount of FC1,250, carries fixed interest of 4.7 per cent that is paid annually (FC1,250 × 4.7 per cent = FC59 per year), and has an effective interest rate of 10 per cent. Entity A classifies the bond as available for sale, and thus recognises gains and losses in other comprehensive income. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1.5 and the carrying amount of the bond is LC1,500 (= FC1,000 × 1.5).

Dr Bond	LC1,500
Cr Asset	LC1,500

On 31 December 20X2, the foreign currency has appreciated and the exchange rate is FC1 to LC2. The fair value of the bond is FC1,060 and thus the carrying amount is LC2,120 (=FC1,060 × 2). The amortised cost is FC1,041 (= LC2,082). In this case, the cumulative gain or loss to be recognised in other comprehensive income and accumulated in equity is the difference between the fair value and the amortised cost

on 31 December 20X2, i.e. LC38 (= LC2,120 – LC2,082). Interest received on the bond on 31 December 20X2 is FC59 (= LC118). Interest income determined in accordance with the effective interest method is FC100 (=1,000 × 10 per cent). The average exchange rate during the year is FC1 to LC1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest income during the year IAS 21. Thus, reported interest income is LC175 (= FC100 × 1.75) including accretion of the initial discount of LC72 (= [FC100 – FC59] × 1.75). Accordingly, the exchange difference on the bond that is recognised in profit or loss is LC510 (= LC2,082 – LC1,500 – LC72). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.00 – 1.75]).

Dr	Bond	LC 620
Dr	Cash	LC 118
Cr	Interest Income	LC 175
Cr	Exchange Gain	LC 525
Cr	Fair value income in OCI	LC 38

On 31 December 20X3, the foreign currency has appreciated further and the exchange rate is FC1 to LC2.50. The fair value of the bond is FC1,070 and thus the carrying amount is LC2,675 (= FC1,070 × 2.50). The amortised cost is FC1,086 (= LC2,715). The cumulative gain or loss to be accumulated in equity is the difference between the fair value and the amortised cost on 31 December 20X3, i.e. negative LC40 (= LC2,675 – LC2,715). Thus, the amount recognised in other comprehensive income equals the change in the difference during 20X3 of LC78 (= LC40 + LC38). Interest received on the bond on 31 December 20X3 is FC59 (= LC148). Interest income determined in accordance with the effective interest method is FC104 (= FC1,041 × 10 per cent). The average exchange rate during the year is FC1 to LC2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest income during the year. Thus, recognised interest income is LC234 (= FC104 × 2.25) including accretion of the initial discount of LC101 (= [FC104 – FC59] × 2.25). Accordingly, the exchange difference on the bond that is recognised in profit or loss is LC532 (= LC2,715 – LC2,082 – LC101). Also, there is an exchange gain on the interest receivable for the year of LC15 (= FC59 × [2.50 – 2.25]).

Dr	Bond	LC 555
Dr	Cash	LC 148
Cr	Interest Income	LC 234
Cr	Exchange Gain	LC 547
Dr	Fair value income in OCI	LC 78

4.2.3 Amortized Cost

Example 4.2.3.1

Calculating amortised cost using IAS 39 for a financial asset

Entity A lends CU1,000 for five years. The instrument has a principal amount of CU1,250 and carries fixed interest of 4.7 per cent that is paid annually (CU1,250 × 4.7 per cent = CU59 per year). The contract also specifies that the borrower has an option to prepay the instrument at the end of every year at an amount equal to the amount advanced plus accrued interest at 10 per cent less interest paid to date, plus a penalty of CU30. There are no transaction costs. At inception, the entity expects the borrower not to prepay and the prepayment feature is considered a closely related embedded derivative as the amount prepayable is approximately equal to the financial asset's amortised cost.

The table below provides information about the amortised cost, interest income and cash flows of the debt instrument in each reporting period.

Year	(a) Amortised cost at the beginning of the year	(b = a x 10%) Interest income	(c) Cash flows	(d = a + b+ c) Amortised cost at the end of the year
20X0	1,000	100	(59)	1,041
20X1	1,041	104	(59)	1,086
20X2	1,086	109	(59)	1,136
20X3	1,136	113	(59)	1,19
20X4	1,190	119	(1,250 + 59)	–

On the first day of 20X2 the entity revises its estimate of cash flows. It now expects that 50 per cent of the instrument will be prepaid at the end of 20X2 and the remaining 50 per cent at the end of 20X4. In accordance with IAS 39, the opening balance of the debt instrument in 20X2 is adjusted. The adjusted amount is calculated by discounting the amount the entity expects to receive in 20X2 being the prepayable amount ((CU1,136 * 50 per cent) + CU30 = CU598) plus interest of CU59 for the year, with the due interest in years 20X3 and 20X4 (CU59 * 50 per cent = CU30) and the remaining principal due in 20X4 (CU1,250 * 50 per cent), using the original effective interest rate (10 per cent). This results in the new opening balance in 20X2 of CU1,114. The adjustment is a gain of CU28 (CU1,114 – CU1,086) and is recorded in profit or loss in 20X2.

The table below provides information about the amortised cost, interest income and cash flows as they would be adjusted taking into account the change in estimate.

Year	(a) Amortised cost at the beginning of the year	(b = a x 10%) Interest income	(c) Cash flows	(d = a + b+ c) Amortised cost at the end of the year
20X0	1,000	100	(59)	1,041
20X1	1,041	104	(59)	1,086
20X2	1,086+28	111	(568+30+59)	568
20X3	568,000	57	(30)	595
20X4	595,000	60	(625 + 30)	–

Example 4.2.3.2

Calculating amortised cost: debt instruments with stepped interest payments

On 1 January 20X0, Entity A issues a debt instrument for a price of CU1,250. The principal amount is CU1,250 and the debt instrument is repayable on 31 December 20X4. The rate of interest is specified in the debt agreement as a percentage of the principal amount as follows: 6.0 per cent in 20X0 (CU75), 8.0 per cent in 20X1 (CU100), 10.0 per cent in 20X2 (CU125), 12.0 per cent in 20X3 (CU150), and 16.4 per cent in 20X4 (CU205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is 10 per cent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining amortised cost in each period. In each period, the amortised cost at the beginning of the period is multiplied by the effective interest rate of 10 per cent and added to the amortised cost. Any cash payments in the period are deducted from the resulting number. Accordingly, the amortised cost in each period is as follows:

Year	(a) Amortised cost at the beginning of the year	(b = a x 10%) Interest income	(c) Cash flows	(d = a + b+ c) Amortised cost at the end of the year
20X0	1,250	125	75	1,300
20X1	1,300	130	100	1,330
20X2	1,330	133	125	1,338
20X3	1,338	134	150	1,322
20X4	1,322	133	1,250 + 205	–

4.2.4 Impairment

Example 4.2.4.1

Determining the amount of impairment for a loan

On 1 January 20X0, an entity originates a loan of CU100 that is measured at amortised cost. The loan attracts five annual repayments of CU25 on 31 December 20X0 to 31 December 20X4. Ignoring future credit losses, it is expected that all contractual cash flows will be received; therefore, the effective interest rate is 7.93 per cent and the following entries are recorded in 20X0.

1.Initial recognition

	CU	**CU**
Dr Asset	100	
Cr Cash		100

To recognise the loan.

2.Interest income

	CU	**CU**
Dr Asset	7.93	
Cr Interest Income		7.93

To recognise the interest income.

3.Repayment

	CU	**CU**
Dr Cash	25	
Cr Asset		25

To record the repayment of the loan.

The carrying amount of the loan as at 31 December 20X0 is therefore CU82.93. On 1 January 20X1, the entity receives information regarding the future prospects of the sector in which the borrower operates. This information coincides with a downgrading of the borrower's credit rating. Together, these two occurrences are deemed to constitute a loss event and it is now expected that the 20X3 and 20X4 repayments will not be received. The revised carrying amount of the loan is calculated by discounting the expected future cash flows (i.e. the 20X1 and 20X2 repayments) at the original effective interest rate: CU25/1.0793 + CU25/1.07932 = CU44.62. Therefore, an impairment loss of CU38.31 (i.e. CU82.93 – CU44.62) is recognised, as follows.

	CU	**CU**

Dr Profit or Loss	38.31	
Cr Asset		38.31

To recognize an impairment loss.

Example 4.2.4.2

Interaction of impairment and interim financial reporting

On 1 January 20X1, Entity A and Entity B each buy small shareholdings of equity instruments of Entity X for CU100. Both entities classify their investments in the quoted equity instruments as AFS. Accordingly, IAS 39 requires gains and losses to be recognised initially in other comprehensive income except for impairment losses, which are recognised in profit or loss.

Entity A is listed on its national stock exchange which requires interim reports in accordance with IFRSs on a semi-annual basis. Entity B is required to prepare IFRS financial statements on an annual basis for statutory purposes. On 30 June 20X1, Entity X shows signs of severe financial difficulties with the share price declined to CU80. While preparing its interim report, Entity A concludes that its investment in Entity X is impaired and recognises an impairment loss of CU20 in profit or loss. Because Entity B is not required to prepare a semi-annual report, it does not review its equity instruments for evidence of impairment at that point in time.
On 31 December 20X1, the financial condition of Entity X has fully recovered due to a successful debt restructuring with the share price having risen to CU120. Both Entity A and Entity B conclude that the original cost of the investment is recoverable. However, while Entity B does not recognise an impairment loss in its annual IFRS financial statements, Entity A is prohibited from reversing the impairment loss recognised in its interim report. The result is that Entity A and Entity B have different results for exactly the same equity instrument.

Example 4.2.4.3

Fair value losses subsequent to impairment – debt instruments

Entity Q acquires an investment in an AFS debt instrument at 1/1/X1. Entity D has a calendar year end.

At 31/12/X3, Entity Q determines that there is objective evidence of impairment and the fair value loss previously recognised in other comprehensive income is reclassified from equity to profit or loss in accordance with IAS 39.

At 31/12/X4, a further fair value loss is recognised in other comprehensive income and Entity Q estimates the recoverable cash flows remaining due are lower than at 1/1/X1, i.e. the asset continues to be impaired. The fair value loss recognised initially in other comprehensive income in the period must be reclassified from equity to profit or loss.

Example 4.2.4.4

Impairment reversals – debt instruments

Entity D acquires an investment in an AFS debt instrument at 1/1/X1. Entity D has a calendar year end.

At 31/12/X3, Entity D determines that there is objective evidence of impairment and the fair value loss recognised in other comprehensive income is reclassified from equity to profit or loss in accordance with IAS 39.

At 31/12/X4, there is objective evidence that the impairment loss has reversed and, therefore, the gain recognised in other comprehensive income is reclassified from equity to profit or loss. The amount of the gain recognised in profit or loss will not necessarily equal the amount of loss recognised in profit or loss at 31/12/X3.

4.3 Derecognition

4.3.1 Financial Assets

Example 4.3.1.1

Determining the part of a financial asset subject to transfer

Entity X, the transferor, transfers the right to the first CU90 of cash flows that are derived from a debt instrument; the fair value of the asset is CU100 on the date of transfer. The transferor cannot apply the derecognition model to part of the asset because the transferor has neither transferred specifically identifiable cash flows nor a fully proportionate share of all or part of the cash flows. The transferor would apply the derecognition model to the asset in its entirety. The transferor effectively agrees to absorb the first CU10 of losses from the transferred asset. It should be noted, however, that if the transferor had transferred a 90 per cent pro rata share of all cash flows from the asset, then the derecognition model could be applied to the part of the asset that has been transferred, i.e. 90 per cent. In that case, the transferor and the transferee would have agreed to participate in a fully proportionate share of losses.

Example 4.3.1.2

Application of the pass-through test to an asset in the scope of IAS 39 that is settled by the receipt of a non-financial item

Entity A has an existing offtake agreement to purchase crude oil from an oil producer, Entity B, in the future. Under this arrangement, Entity A advances to Entity B cash of CU100 million and in return Entity B is obliged to deliver to Entity A on specified dates a variable amount of oil until Entity B has delivered oil equal in value to the amount of the advance (CU100 million) plus interest accrued at a rate of 10 per cent per annum. The value of the oil is determined based on the spot price at the date of delivery.

Entity A does not intend to use the oil as part of its usage requirements; it will either sell the oil spot on receipt, or forward in the future, or retain the physical oil for speculative purposes. Consequently, the advance does not qualify for the 'own use' exemption in IAS 39; even though it is settled with the receipt of a non-financial item, it is an asset in the scope of IAS 39.

Entity A enters into a separate agreement with Bank C under which it 'sells' its economic interest in the asset for CU100 million. This is achieved by Entity A assuming a contractual obligation to deliver to Bank C cash equivalent to the value of oil that it receives from Entity B. Entity A retains the contractual right to receive oil. When title to oil passes from Entity B to Entity A, this immediately triggers a cash payment from Entity A to Bank C (e.g. if Entity A receives CU12 million worth of oil on a specific date, Entity A is required to pay CU12 million in cash to Bank C on the same date).

The exposure to variability in timing of delivery of oil by Entity B is passed to Bank C because Entity A's obligation to pay Bank C is not triggered until Entity A receives oil from Entity B.

The arrangement with Bank C does result in a transfer by Entity A of its asset from Entity B under the 'pass-through' requirement of IAS 39. Under IAS 39, a transfer arises if an entity both retains the contractual rights to receive the cash flows of the asset and assumes a contractual obligation to pay the cash flows to one or more eventual recipients. Because Entity A's asset due from Entity B is exclusively physically settled in oil, the 'cash flows' for the purposes of applying IAS 39 are the contractual rights to receive oil. Therefore, in order to meet the second condition in IAS 39, it is necessary for Entity A to assume an obligation to pay to Bank C the same 'cash flows' (i.e. an equivalent physical amount of oil). However, the arrangements are such that Entity A receives physical oil from Entity B but pays cash to Bank C. The difference in the physical nature between receiving oil and paying cash means that the criteria for 'pass-through' in IAS 39 are not satisfied.

Entity A should instead recognise the cash proceeds from Bank C of CU100 million as a financial liability.

Example 4.3.1.3

Interaction of pass-through tests and risk and reward tests

Entity A originates a portfolio of five-year interest-bearing loans of CU10,000. Entity A enters into an agreement with Entity C whereby, in exchange for a cash payment of CU9,000, Entity A agrees to pay to Entity C the first CU9,000 (plus interest) of cash collected from the loan portfolio. Entity A retains rights to the last CU1,000 (plus interest), i.e. it retains a subordinated residual interest. If Entity A collects, say, only CU8,000 of its loans of CU10,000 because some debtors default, Entity A would pass on to Entity C all of the CU8,000 collected and Entity A keeps nothing. If Entity A collects CU9,500, it passes CU9,000 to Entity C and retains CU500. Expected losses are CU500.

Even though all cash flows that derive from the portfolio of assets are passed onto Entity C up to a maximum of CU9,000, Entity A has not transferred substantially all the risks and rewards of ownership because of the subordinated retained interest. The residual interest absorbs the likely variability in net cash flows, i.e. the expected losses.

4.3.2 Transfers

Example 4.3.2.1

Allocating consideration received between sold and retained interests

Entity A owns loans with a face amount of CU1 million that contractually yield 10 per cent interest over their life. The carrying amount of these loans after recognising impairment of CU20,000 is CU980,000. Entity A sells 90 per cent of the principal, plus the right to receive interest income of 8 per cent, without recourse to an investor for CU900,000 in cash. The part of the asset that has been transferred meets all the criteria for derecognition.

Entity A retains the right to service these loans, and the servicing contract stipulates a 1 per cent fee as compensation for performing the servicing. Entity A also retains an interest only strip for the portion of the interest coupon not sold (1 per cent). At the date of transfer, the fair value of the retained 10 per cent of the loan is CU100,000, the fair value of the servicing asset is CU15,000, and the fair value of the interest only strip is CU35,000.

The following table demonstrates the allocation of the carrying amount of the loans between the sold and retained interests assuming the entity has already determined that it has transferred substantially all the risks and rewards of ownership of the transferred assets (e.g. substantially all the credit losses and the majority of interest rate risk on the loans transferred).

Interest	**Fair Value**	**Percentage of total fair value**	**Allocated carrying amount (1)**	**Sold interests**	**Retained interests**
	CU	**%**	**CU**	**CU**	**CU**
Loans sold	900,000	85,71	840,000	840,000	–
Loans retained	100,000	9,53	93,333	–	93,333
IO strip	35,000	3,33	32,667	–	32,667
Servicing asset	15,000	1,43	14,000	–	14,000
Total	1,050,000	100,00	980,000	840,000	140,000

Footnote: *(1) The allocated carrying amount is calculated as the percentage of total fair value multiplied by the aggregate carrying amount prior to the transfer (CU980,000).*

Example 4.3.2.2

Transfer of receivables with credit guarantee

Entity X transfers short-term receivables to Entity Y and provides a credit guarantee to Entity Y over the expected losses of those receivables.

Entity X continues to recognise the receivables in its statement of financial position because it has retained substantially all the risks and rewards of ownership of the receivables. Entity X will recognise a financial liability for the proceeds received. The substance of the arrangement is that of a secured borrowing (i.e. short-term receivables provide security for the cash advanced by Entity Y).

4.3.3 Financial Liabilities

Example 4.3.3.1

Extinguishment of financial liabilities

Situations may arise where a liability is considered unlikely to result in an outflow of economic resources. The following examples illustrate three scenarios in which a liability might never be extinguished absent a statute of limitation in the applicable jurisdiction:

Unredeemed travellers' cheques
Entity A is in the business of issuing travellers' cheques to customers. Historical statistical analysis indicates that five per cent of travellers' cheques will never be redeemed. Travellers' cheques do not have an expiry date.

Because travellers' cheques do not have an expiry date, the entity is obliged to honour the redemption of travellers' cheques on demand. The financial liability will be measured at the amount Entity A can be required to pay on demand. This obligation may carry on indefinitely into the future unless the jurisdiction allows for legal release from that obligation when a specified period of time has passed.

Goods received but not invoiced

Entity B is a media-buying entity that purchases advertising space in newspapers, television and radio on behalf of its customers, thereby incurring a liability to pay for that advertising space. Historical analysis shows that invoices have never been received by Entity B in respect of five per cent of the advertising space purchased. The jurisdiction of Entity B contains a 'statute of limitations' under which the counterparty is no longer able legally to enforce payment if it does not claim payment from Entity B within a period of six years from the date the goods or services are provided.

Until six years have expired since the transaction, Entity B is legally obligated to pay the counterparty if a claim is made. The financial liability will be measured at the amount the Entity B can be required to pay on demand. At the end of six years, Entity B should derecognise the financial liability.

Dormant bank accounts
Bank C cannot locate all its customers that deposit cash with the bank. The depositor may have moved from his or her home without notifying the bank and there have been no transactions on the account for a considerable period of time (the account is dormant). However, the depositor or its legal representatives, including the depositor's executor of the estate, have the right to claim the deposited amounts indefinitely. Historically, five per cent of dormant accounts held with the bank are never reclaimed.

In the absence of a statute of limitation in Bank C's jurisdiction, Bank C will continue to recognise the financial liability to return the cash to the depositor at the amount repayable on demand. In other jurisdictions, the law may allow the bank, or the bank may be forced, to transfer the deposit to a third party (e.g. a government body), after a specified period of time. The legal release on transfer to the government body is a legal release for the bank if the depositor has no recourse to the bank.

Example 4.3.3.2

Debt modification: change in interest and term

Entity A borrowed CU1 million on 1 January 20X0, at a fixed rate of 9 per cent per annum for 10 years. Entity A incurred issue costs of CU50,000. Interest on the loan is payable annually in arrears. The original effective interest rate (EIR) is 9.807 per cent. During 20X5, Entity A approached the lender for a modification of the terms of the debt (this modification could have been as a result of a deteriorating financial condition of the borrower or because of a fall in interest rates). The following modified terms were agreed with effect from 1 January 20X6:

- interest rate to be reduced to 7.5 per cent payable yearly in arrears; and
- the original amount, payable on maturity, to remain unchanged but the maturity of the loan to be extended by two years to 31 December 20Y1.

No fees are payable for renegotiating the finance.

	Opening CU	**Interest CU**	**Payments CU**	**Closing CU**
		(EIR of 9,807%)	(950,000)	
31 Dec 20X0	950,000	93,166	90,000	953,166
31 Dec 20X1	953,166	93,477	90,000	956,643
31 Dec 20X2	956,643	93,818	90,000	960,461
31 Dec 20X3	960,461	94,192	90,000	964,653
31 Dec 20X4	964,653	94,604	90,000	969,257
31 Dec 20X5	969,257	95,055	90,000	974,312
31 Dec 20X6	974,312	95,551	90,000	979,863
31 Dec 20X7	979,863	96,095	90,000	985,958
31 Dec 20X8	985,958	96,693	90,000	992,651
31 Dec 20X9	992,651	97,349	1,090,000	0

The present value of the modified debt at the original effective interest rate is calculated as follows.

	Payments CU
31 Dec 20X6	75,000
31 Dec 20X7	75,000
31 Dec 20X8	75,000
31 Dec 20X9	75,000

31 Dec 20Y0	75,000
31 Dec 20Y1	1,075,000
Present value at 1 January 20X6 discounting at original EIR of 9.807 %	898,954

The entity must determine whether the modification is considered to be an extinguishment of the original debt. Because the difference between the amortised cost of the debt instrument at the date of modification and the present value of the new debt instrument, discounted by the original effective interest rate, is less than 10 per cent, the modification is not considered an extinguishment of the original debt. The difference (CU75,358) will be recognised in profit or loss in future periods through the revised effective interest rate.

For the avoidance of doubt, at the date of modification only, the issuer should not apply IAS 39, because this will result in an immediate gain/loss in profit or loss on modification which is contrary to the issuer not achieving derecognition. The issuer will apply IAS 39 following the date of modification if the estimates of future cash flows change. The revised cash flows must be discounted at the revised effective interest rate that was determined at the date of modification.

5 PRESENTATION

5.1 Overview of IFRS 7

IFRS 7 *Financial Instruments: Disclosures* requires disclosure of information about the significance of financial instruments to an entity, and the nature and extent of risks arising from those financial instruments, both in qualitative and quantitative terms. Specific disclosures are required in relation to transferred financial assets and a number of other matters.

IFRS 7 was originally issued in August 2005 and applies to annual periods beginning on or after 1 January 2007.

Date	Development	Comments
25 September 2014	Amended by *Improvements to IFRSs 2014* (servicing contracts and applicability of the amendments to IFRS 7 to condensed interim financial statements)	Effective for annual periods beginning on or after 1 January 2016
19 November 2013	*IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39)* issued, implementing additional disclosures (and consequential amendments) resulting from the introduction of the hedge accounting chapter in IFRS 9	Applies when IFRS 9 is applied*
16 December 2011	*Mandatory Effective Date and Transition Disclosures (Amendments to IFRS 9 and IFRS 7)* issued	Effective for annual periods beginning on or after 1 January 2015 (or otherwise when IFRS 9 is first applied)*
16 December 2011	*Disclosures — Offsetting*	Effective for annual

	Financial Assets and Financial Liabilities (Amendments to IFRS 7) issued	periods beginning on or after 1 January 2013
7 October 2010	*Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)* issued	Effective for annual periods beginning on or after 1 July 2011
6 May 2010	Amended by *Improvements to IFRSs* (clarification of disclosures)	Effective for annual periods beginning on or after 1 January 2011
5 March 2009	*Improving Disclosures about Financial Instruments (Amendments to IFRS 7)* issued	Effective for annual periods beginning on or after 1 January 2009
23 December 2008	Exposure Draft *Investments in Debt Instruments (Proposed Amendments to IFRS 7)* published	Comment deadline 15 January 2009 (Project subsequently abandoned in January 2009)
13 October 2008	*Reclassification of Financial Assets (Amendments to IAS 39 and IFRS 7)* issued	Effective 1 July 2008
22 May 2008	Amended by *Improvements to IFRSs* (required disclosures when interests in jointly controlled entities are accounted for at fair value through profit or loss, presentation of finance costs)	Effective for annual periods beginning on or after 1 January 2009
18 August 2005	IFRS 7 *Financial Instruments: Disclosures* issued	Effective for annual periods beginning on or after 1 January 2007

IFRS 7.6

22 July 2004	Exposure Draft ED 7 *Financial Instruments: Disclosures* published	Comment deadline 14 September 2009

IFRS 7.7-8

* The release of IFRS 9 *Financial Instruments* (2013) on 19 November 2013 contained no stated effective date and contained consequential amendments which removed the mandatory effective date of IFRS 9 (2010) and IFRS 9 (2009), leaving the effective date open but leaving each standard available for application. Accordingly, these amendments apply when IFRS 9 is applied.

5.2 Disclosure rules

IFRS requires certain disclosures to be presented by category of instrument based on the IAS 39 measurement categories. Certain other disclosures are required by class of financial instrument. For those disclosures an entity must group its financial instruments into classes of similar instruments as appropriate to the nature of the information presented. **IFRS 7.9-19**

The two main categories of disclosures required by IFRS 7 are:

1. information about the significance of financial instruments.
2. information about the nature and extent of risks arising from financial instruments

Information about the significance of financial instruments

Statement of financial position

- Disclose the significance of financial instruments for an entity's financial position and performance. This includes disclosures for each of the following categories: **IFRS 7.20 (a)**
    - financial assets measured at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition;
    - held-to-maturity investments;
    - loans and receivables;
    - available-for-sale assets;
    - financial liabilities at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition;
    - financial liabilities measured at amortised cost.

- Other balance sheet-related disclosures: **IFRS 7.20 (b)–(e)**

  - special disclosures about financial assets and financial liabilities designated to be measured at fair value through profit and loss, including disclosures about credit risk and market risk, changes in fair values attributable to these risks and the methods of measurement;
  - reclassifications of financial instruments from one category to another (e.g. from fair value to amortised cost or vice versa);
  - information about financial assets pledged as collateral and about financial or non-financial assets held as collateral;
  - reconciliation of the allowance account for credit losses (bad debts) by class of financial assets;
  - information about compound financial instruments with multiple embedded derivatives; **IFRS 7.21-23**
  - breaches of terms of loan agreements.

Statement of comprehensive income

- Items of income, expense, gains, and losses, with separate disclosure of gains and losses from:

  - financial assets measured at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition;
  - held-to-maturity investments;
  - loans and receivables;
  - available-for-sale assets;
  - financial liabilities measured at fair value through profit and loss, showing separately those held for trading and those designated at initial recognition;
  - financial liabilities measured at amortised cost.

- Other income statement-related disclosures:

  - total interest income and total interest expense for those financial instruments that are not measured at fair value through profit and loss;
  - fee income and expense; **IFRS 7.24 (a)**
  - amount of impairment losses by class of financial assets; **IFRS 7.24 (B)-(C)**
  - interest income on impaired financial assets.

IFRS 7.25-30

Other disclosures

- Accounting policies for financial instruments;
- Information about hedge accounting, including:

  - description of each hedge, hedging instrument, and fair values of those instruments, and nature of risks being hedged;
  - for cash flow hedges, the periods in which the cash flows are expected to occur, when they are expected to enter into the determination of profit or loss, and a description of any forecast transaction for which hedge accounting had previously been used but which is no longer expected to occur;
  - if a gain or loss on a hedging instrument in a cash flow hedge has been recognised in other comprehensive income, an entity should disclose the following:

IFRS 7.27 (A)-(B)

  - the amount that was so recognised in other comprehensive income during the period

  - the amount that was removed from equity and included in profit or loss for the period

  - the amount that was removed from equity during the period and included in the initial measurement of the acquisition cost or other carrying amount of a non-financial asset or non- financial liability in a hedged highly probable forecast transaction.

IFRS 13:72

- For fair value hedges, information about the fair value changes of the hedging instrument and the hedged item;
- Hedge ineffectiveness recognised in profit and loss (separately for cash flow hedges and hedges of a net investment in a foreign operation);
- Information about the fair values of each class of financial asset and financial liability, along with:
  - comparable carrying amounts;
  - description of how fair value was determined;
  - the level of inputs used in determining fair value;
  - reconciliations of movements between levels of fair value measurement hierarchy additional disclosures for financial instruments whose fair value is determined using level 3 inputs including impacts on profit and loss, other comprehensive income and sensitivity analysis;
  - information if fair value cannot be reliably measured.

IFRS 13:73

IFRS 13:76

IFRS 13:77

The fair value hierarchy introduces 3 levels of inputs based on the lowest level of input significant to the overall fair value:

IFRS 13:80

- Level 1 – quoted prices for similar instruments;
- Level 2 – directly observable market inputs other than Level 1 inputs;
- Level 3 – inputs not based on observable market data.

Note that disclosure of fair values is not required when the carrying amount is a reasonable approximation of fair value, such as short-term trade receivables and payables, or for instruments whose fair value cannot be measured reliably.

IFRS 13:81

Fair value Hierarchy

IFRS 13 seeks to increase consistency and comparability in fair value measurements and related disclosures through a 'fair value hierarchy'. The hierarchy categorises the inputs used in valuation techniques into three levels. The hierarchy gives the highest priority to (unadjusted) quoted prices in active markets for identical assets or liabilities and the lowest priority to unobservable inputs.

If the inputs used to measure fair value are categorised into different levels of the fair value hierarchy, the fair value measurement is categorised in its entirety in the level of the lowest level input that is significant to the entire measurement (based on the application of judgement).

Level 1 inputs

IFRS 13:86

Level 1 inputs are quoted prices in active markets for identical assets or liabilities that the entity can access at the measurement date.

IFRS 13:87-89

A quoted market price in an active market provides the most reliable evidence of fair value and is used without adjustment to measure fair value whenever available, with limited exceptions.

If an entity holds a position in a single asset or liability and the asset or liability is traded in an active market, the fair value of the asset or liability is measured within Level 1 as the product of the quoted price for the individual asset or liability and the quantity held by the entity, even if the market's normal daily trading volume is not sufficient to absorb the quantity held and placing orders to sell the position in a single transaction might affect the quoted price.

IFRS 7.29

Level 2 inputs

Level 2 inputs are inputs other than quoted market prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
Level 2 inputs include:

IFRS 7.33

- quoted prices for similar assets or liabilities in active markets
- quoted prices for identical or similar assets or liabilities in markets that are not active
- inputs other than quoted prices that are observable for the asset or liability, for example
    - interest rates and yield curves observable at commonly quoted intervals
    - implied volatilities
    - credit spreads
- inputs that are derived principally from or corroborated by observable market

data by correlation or other means ('market-corroborated inputs').

IFRS 7.34

Level 3 inputs

Level 3 inputs inputs are unobservable inputs for the asset or liability.

IFRS 7.36-38

Unobservable inputs are used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date. An entity develops unobservable inputs using the best information available in the circumstances, which might include the entity's own data, taking into account all information about market participant assumptions that is reasonably available.

Nature and extent of exposure to risks arising from financial instruments

Qualitative disclosures

IFRS 7.39

- The qualitative disclosures describe:
  - risk exposures for each type of financial instrument;
  - management's objectives, policies, and processes for managing those risks;
  - changes from the prior period.

IFRS 7.40-42

Quantitative disclosures

- The quantitative disclosures provide information about the extent to which the entity is exposed to risk, based on information provided internally to the entity's key management personnel.

  These disclosures include:
  - summary quantitative data about exposure to each risk at the reporting date;
  - disclosures about credit risk, liquidity risk, and market risk and how these risks are managed as further described below;
  - concentrations of risk.

Credit risk

- Credit risk is the risk that one party to a financial instrument will cause a loss for the other party by failing to pay for its obligation.
- Disclosures about credit risk include:
  - maximum amount of exposure (before deducting the value of collateral), description of collateral, information about credit quality of financial assets that are neither past due nor impaired, and information about credit quality of financial assets whose terms have been renegotiated;
  - for financial assets that are past due or impaired, analytical disclosures are required;
  - information about collateral or other credit enhancements obtained or called.

Liquidity risk

- Liquidity risk is the risk that an entity will have difficulties in paying its financial liabilities.
- Disclosures about liquidity risk include:
    - a maturity analysis of financial liabilities;
    - description of approach to risk management;

Market risk

- Market risk is the risk that the fair value or cash flows of a financial instrument will fluctuate due to changes in market prices. Market risk reflects interest rate risk, currency risk and other price risks.
- Disclosures about market risk include:
    - a sensitivity analysis of each type of market risk to which the entity is exposed;
    - additional information if the sensitivity analysis is not representative of the entity's risk exposure (for example because exposures during the year were different to exposures at year-end);

    - IFRS 7 provides that if an entity prepares a sensitivity analysis such as value-at-risk for management purposes that reflects interdependencies of more than one component of market risk (for instance, interest risk and foreign currency risk combined), it may disclose that analysis instead of a separate sensitivity analysis for each type of market risk.

5.3 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present financial instruments in the consolidated financial statements.

As required by Bank of Italy, financial instruments under IAS 32/IAS 39 are enclosed among the assets and the liabilities of balance sheet, respectively in captions 20, 30, 40, 50, 60, 70 and in captions 40 and 50.

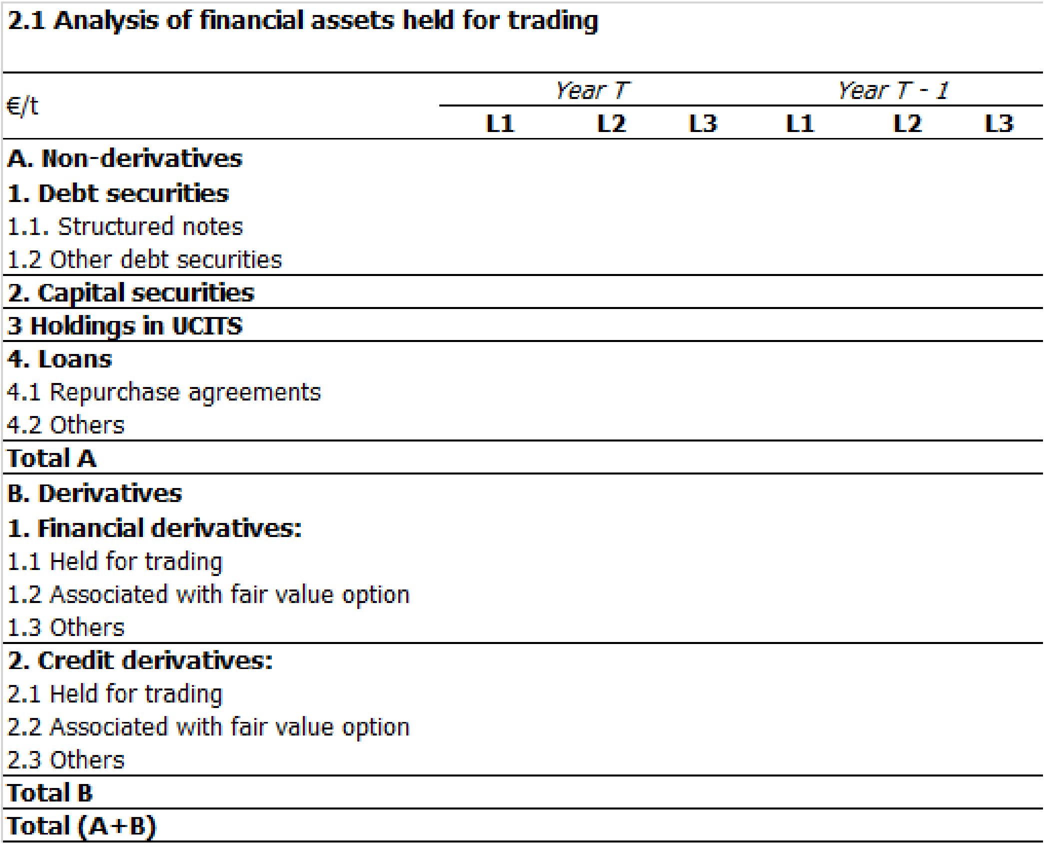
STATEMENT OF FINANCIAL POSITION - ASSETS		*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			

STATEMENT OF FINANCIAL POSITION - LIABILITIES	*Year T*	*Year T - 1*
10. Amounts due to banks		
20. Payables due to customers		
30. Securities issued		
40. Financial liabilities held for trading		
50. Financial liabilities measured at fair value		
60. Hedge derivatives		
70. Value adjustment of financial liabilities backed by generic hedges (+/-)		
80. Tax liabilities		
a) current		
b) deferred		
90. Liabilities associated with assets held for sale		
100. Other liabilities		
110. Employee completion-of-service entitlements		
120. Provisions for risks and charges:		
a) severance benefits and similar obligations		
b) other provisions		
130. Technical reserves		
140. Valuation reserves		
150. Redeemable shares		
160. Capital instruments		
170. Reserves		
175. Interim dividend (-)		
180. Share premium reserve		
190. Share capital		
200. Treasury shares (-)		
210. Shareholders' equity attributable to minority interest (+/-)		
220. Net profit (loss) for the year (+/-)		
Total liabilities and shareholders' equity		

Here below, a detailed analysis of all the captions mentioned above:

ASSET

Caption 20



2.1 Analysis of financial assets held for trading

€/t	*Year T*			*Year T - 1*		
	L1	**L2**	**L3**	**L1**	**L2**	**L3**
A. Non-derivatives						
1. Debt securities						
1.1. Structured notes						
1.2 Other debt securities						
2. Capital securities						
3 Holdings in UCITS						
4. Loans						
4.1 Repurchase agreements						
4.2 Others						
Total A						
B. Derivatives						
1. Financial derivatives:						
1.1 Held for trading						
1.2 Associated with fair value option						
1.3 Others						
2. Credit derivatives:						
2.1 Held for trading						
2.2 Associated with fair value option						
2.3 Others						
Total B						
Total (A+B)						

Caption 30

3.1. Analysis of financial assets measured at fair value:

€/t	Year T			Year T - 1		
	L1	**L2**	**L3**	**L1**	**L2**	**L3**
1. Debt securities						
1.1. Structured notes						
1.2 Other debt securities						
2. Equity investments						
3. Holdings in UCITS						
4. Loans						
4.1 Structured						
4.2 Others						
Total						
Cost						

Caption 40

4.1 Analysis of financial assets available for sale

€/t	Year T			Year T - 1		
	L1	**L2**	**L3**	**L1**	**L2**	**L3**
1. Debt securities						
1.1. Structured notes						
1.2 Other debt securities						
2. Equity investments						
2.1 Measured at fair value						
2.2 Measured at cost						
3. Holdings in UCITS						
4. Loans						
Total						

Caption 50

5.1 Analysis of financial assets held to maturity

€/t	Year T				Year T - 1			
	BV	**Fair Value**			**BV**	**Fair Value**		
		Level 1	**Level 2**	**Level 3**		**Level 1**	**Level 2**	**Level 3**
1. Debt securities								
- structured								
- others								
2. Loans								
Total								

Key: BV = book value

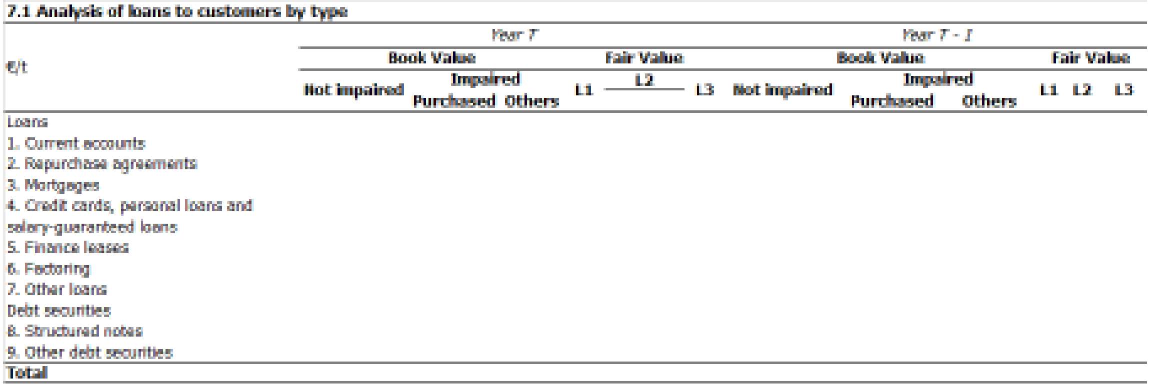
Caption 60

6.1 Analysis of loans to banks

€/t	*Year T*				*Year T - 1*			
	BV	***Fair Value***			**BV**	***Fair Value***		
		Level 1	**Level 2**	**Level 3**		**Level 1**	**Level 2**	**Level 3**
A. Loans to Central Banks								
1. Time deposits								
2. Reserve requirements								
3. Repurchase agreements								
4. Others								
B. Loans to banks								
1. Loans								
1.1 Current accounts and demand deposits								
1.2 Time deposits								
1.3 Other loans:								
- Repurchase agreements								
- Finance leases								
- Others								
2. Debt securities								
2.1. Structured notes								
2.2 Other debt securities								
Total								

Key: BV = book value

Caption 70



7.1 Analysis of loans to customers by type

€/t	*Year T*						*Year T - 1*					
	Book Value			**Fair Value**			**Book Value**			**Fair Value**		
		Impaired						**Impaired**				
	Not impaired	**Purchased**	**Others**	**L1**	**L2**	**L3**	**Not impaired**	**Purchased**	**Others**	**L1**	**L2**	**L3**
Loans												
1. Current accounts												
2. Repurchase agreements												
3. Mortgages												
4. Credit cards, personal loans and salary-guaranteed loans												
5. Finance leases												
6. Factoring												
7. Other loans												
Debt securities												
8. Structured notes												
9. Other debt securities												
Total												

LIABILITIES

Caption 40

4.1 Analysis of financial liabilities held for trading

	Year T					*Year T - 1*				
€/t	**NV**	**FV**			**FV***	**NV**	**FV**			**FV***
		L1	**L2**	**L3**			**L1**	**L2**	**L3**	
A. Non-derivatives liabilities										
1. Amounts due to banks										
2. Payables due to customers										
3. Debt securities										
3.1 Bonds										
3.1.1 Structured										
3.1.2 Other bonds										
3.2 Other securities										
3.2.1 Structured										
3.2.2 Others										
Total A										
B. Derivatives										
1. Financial derivatives										
1.1 For trading										
1.2 Associated with fair value option										
1.3 Others										
2. Credit derivatives										
2.1 For trading										
2.2 Associated with fair value option										
2.3 Others										
Total B										
Total A+B										

Key
FV = fair value
FV* = fair value calculated excluding any changes in value due to changes in the credit standing of the issuer over the date of issue
NV = nominal or notional value
L1 = Level 1
L2 = Level 2
L3 = Level 3

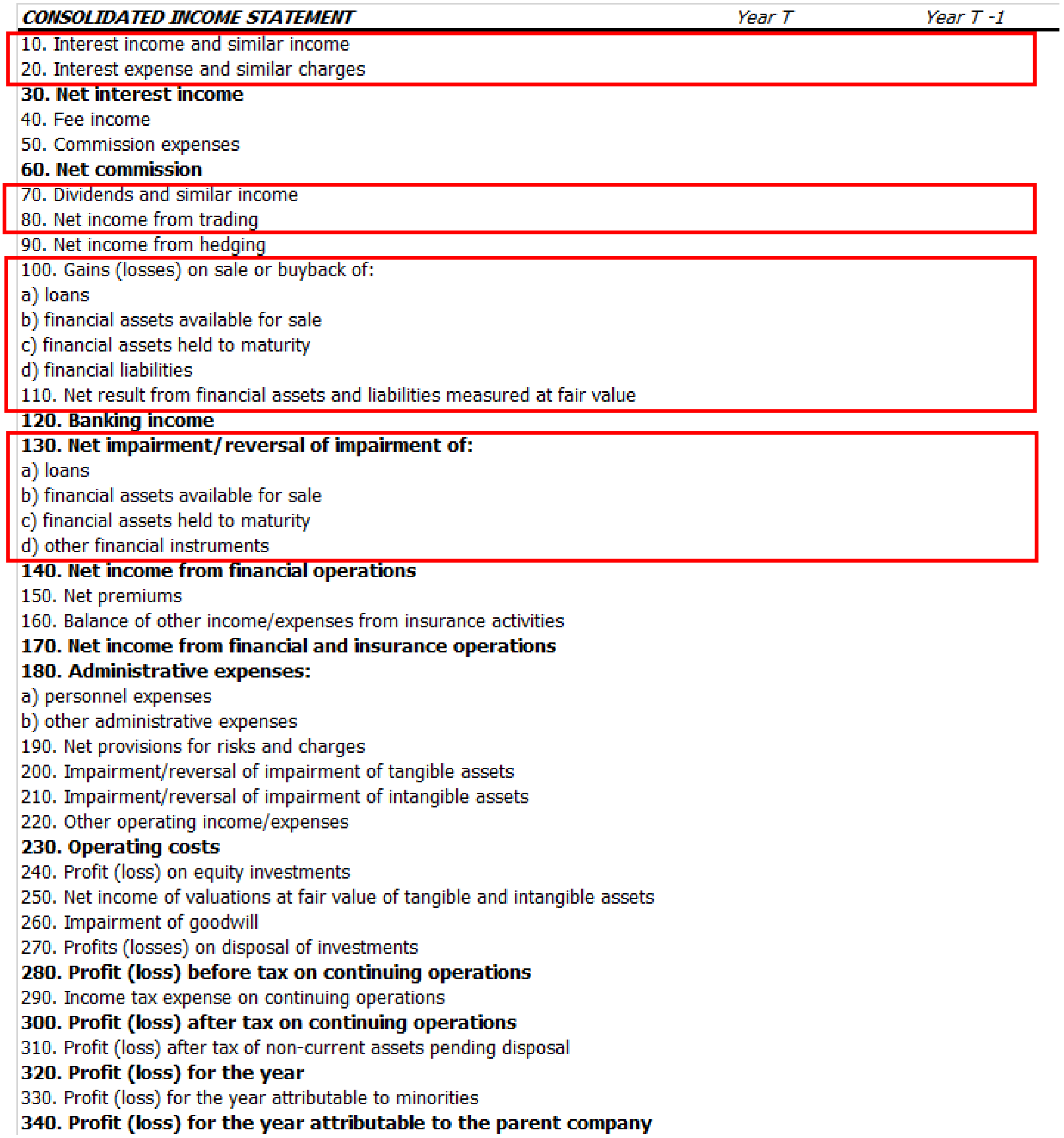
Caption 50

5.1. Analysis of financial liabilities measured at fair value

	Year T					*Year T - 1*				
€/t	**NV**	**FV**			**FV***	**NV**	**FV**			**FV***
		L1	**L2**	**L3**			**L1**	**L2**	**L3**	
1. Amounts due to banks										
1.1 Structured										
1.2 Others										
2. Payables due to customers										
2.1 Structured										
2.2 Others										
3. Debt securities										
3.1 Structured										
3.2 Others										
Total										

Key
FV = fair value
FV* = fair value calculated excluding any changes in value due to changes in the credit standing of the issuer over the date of issue
NV = nominal or notional value
L1 = Level 1
L2 = Level 2
L3 = Level 3

As required by Bank of Italy, items strictly related to financial instruments are enclosed in captions 10, 20, 70, 80, 100, 110, 130 of consolidated income statements.



CONSOLIDATED INCOME STATEMENT	*Year T*	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

Here below, a detailed analysis of the items highlighted:

Caption 10

1.1 Analysis of interest income and similar income

	Debt securities	Loans	Other transactions	*Year T*	*Year T-1*
1. Financial assets held for trading					
2. Financial assets available for sale					
3. Financial assets held to maturity					
4. Loans to banks					
5. Loans to customers					
6. Financial assets measured at fair value					
7. Hedge derivatives					
8. Other assets					
Total					

Caption 20

1.4 Analysis of Interest expense and similar charges

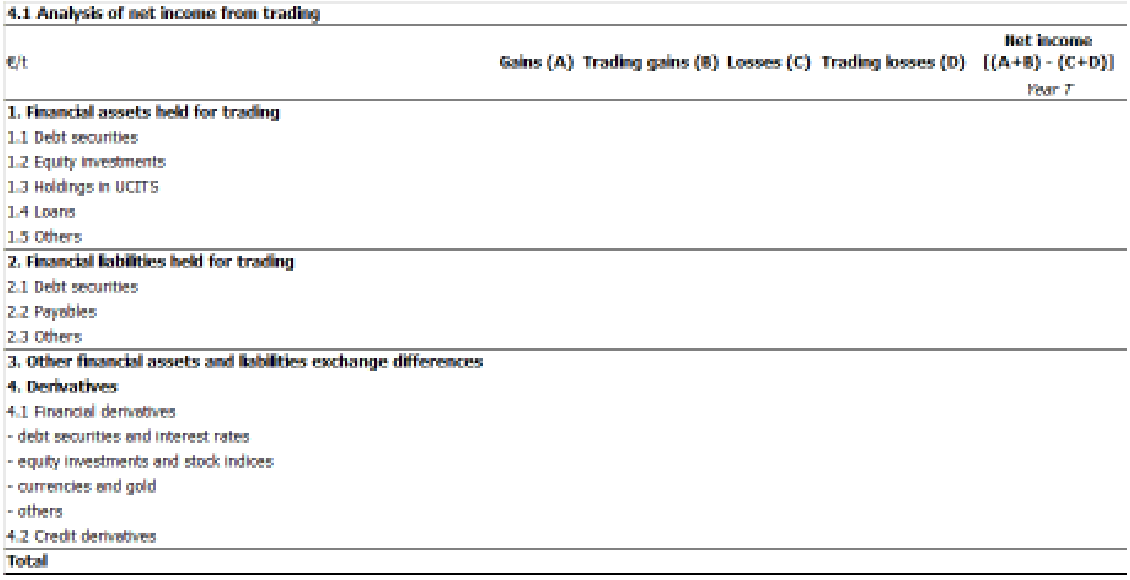
€/t	Payables	Securities	Other transactions	*Year T*	*Year T -1*
1. Amounts due to central banks					
2. Amounts due to banks					
3. Payables due to customers					
4. Securities issued					
5. Financial liabilities held for trading					
6. Financial liabilities measured at fair value					
7. Other liabilities and funds					
8. Hedge derivatives					
Total					

Caption 70

3.1 Dividends and similar income

	Year T		*Year T-1*	
	Dividends	Income from holdings in UCITS	Dividends	Income from holdings in UCITS
A. Financial assets held for trading				
B. Financial assets available for sale				
C. Financial assets measured at fair value				
D. Equity investments				
Total				

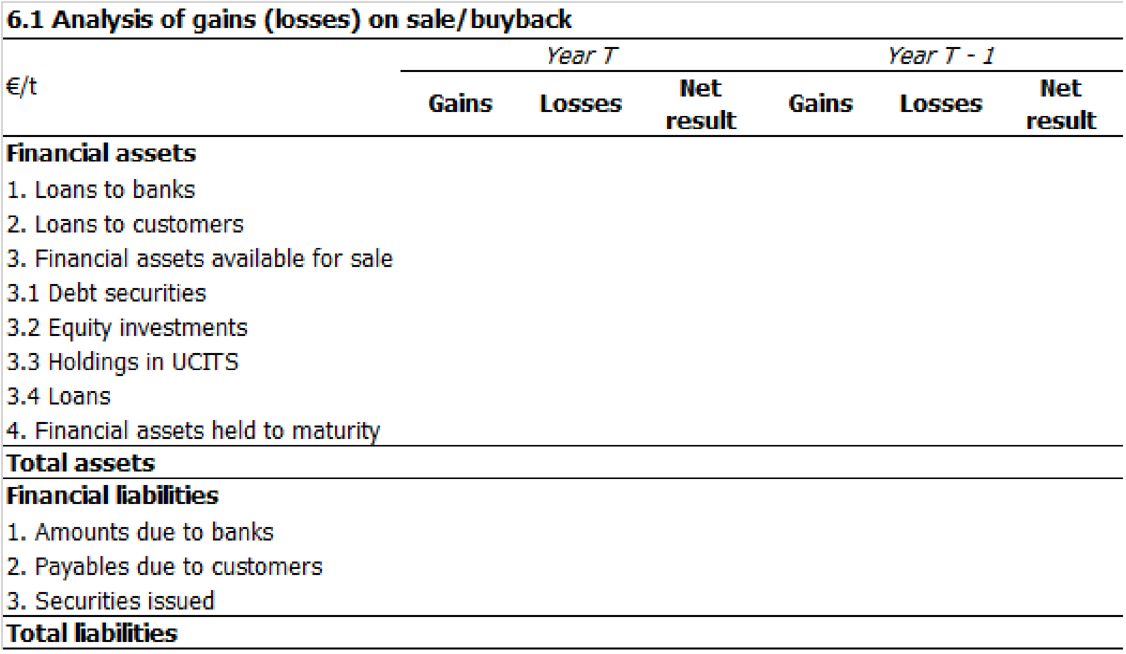
Caption 80



4.1 Analysis of net income from trading

€/t	Gains (A)	Trading gains (B)	Losses (C)	Trading losses (D)	Net income [(A+B) - (C+D)] *Year T*
1. Financial assets held for trading					
1.1 Debt securities					
1.2 Equity investments					
1.3 Holdings in UCITS					
1.4 Loans					
1.5 Others					
2. Financial liabilities held for trading					
2.1 Debt securities					
2.2 Payables					
2.3 Others					
3. Other financial assets and liabilities exchange differences					
4. Derivatives					
4.1 Financial derivatives					
- debt securities and interest rates					
- equity investments and stock indices					
- currencies and gold					
- others					
4.2 Credit derivatives					
Total					

Caption 100



6.1 Analysis of gains (losses) on sale/buyback

€/t	*Year T*			*Year T - 1*		
	Gains	**Losses**	**Net result**	**Gains**	**Losses**	**Net result**
Financial assets						
1. Loans to banks						
2. Loans to customers						
3. Financial assets available for sale						
3.1 Debt securities						
3.2 Equity investments						
3.3 Holdings in UCITS						
3.4 Loans						
4. Financial assets held to maturity						
Total assets						
Financial liabilities						
1. Amounts due to banks						
2. Payables due to customers						
3. Securities issued						
Total liabilities						

Caption 110

7.1 Analysis of net change in value of financial assets and liabilities measured at fair value

€/t	Gains (A)	Gains on disposal (B)	Losses (C)	Losses on (D)	Net result [(A+B) – (C+D)] *Year T*
1. Financial assets					
1.1 Debt securities					
1.2 Equity investments					
1.3 Holdings in UCITS					
1.4 Loans					
2. Financial liabilities					
2.1 Debt securities					
2.2 Amounts due to banks					
2.3 Due to customers					
3. Financial assets and liabilities: exchange differences					
4.Credit and financial derivatives					
Total					

Caption 130

8.2 Analysis of net impairment of Financial assets available for sale

€/t	**Value adjustments -1**		**Write-backs -2**		**Total**	
	Individual		**Individual**			
	Cancellations	**Others**	**A**	**B**	*Year T*	*Year T - 1*
A. Debt securities						
B. Equity investments						
C. Holdings in UCITS						
D. Loans to banks						
E. Loans to customers						
F. Total						

Key:
A = From interest
B = Other recoveries

IFRS Operating Manual

Chapter 6
Derivatives and Hedge Accounting

Chapter 7 Insu

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter introduces the standards that provide for derivative instruments accounting treatment and hedge accounting procedure.

1.1 Introduction

The main standards that address the accounting of derivatives and disciplines the hedge accounting technique are *IAS 32, IAS 39, IFRS 7 and IFRS 13*

As for other financial instruments,

- IAS 32 outlines the accounting requirements for the presentation of derivative instruments;
- IAS 39 provides the requirements for their recognition and measurement; and
- IFRS 7 deals with the main disclosure requirements.

For a complete overview of these standards and a list of their recent amendments, see Chapter 5 – *Financial Instruments.*

As already mentioned in the previous Chapter, for annual periods beginning on or after 1 January 2018, IAS 39 will be replaced by IFRS 9 - *Financial Instruments* for classification and measurement, impairment, hedge accounting and derecognition.

Since these standards requires fair value measurements and disclosures about these, it is necessary to take into account IFRS 13 which:

- defines fair value;
- sets out a framework for measuring fair value; and
- requires disclosure about measurements.

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 32, IAS 39 and IFRS 7 that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Derivative

A derivative is a financial instrument:

IAS 39.9

- whose value changes in response to the change in an underlying variable such as an interest rate, commodity or security price, or index;
- that requires no initial investment, or one that is smaller than would be required for a contract with similar response to changes in market factors; and
- that is settled at a future date.

Forwards

Contracts to purchase or sell a specific quantity of a financial instrument, a commodity, or a foreign currency at a specified price determined at the outset, with delivery or settlement at a specified future date. Settlement is at maturity by actual delivery of the item specified in the contract, or by a net cash settlement.

Interest rate swaps and forward rate agreements

Contracts to exchange cash flows as of a specified date or a series of specified dates based on a notional amount and fixed and floating rates.

Futures

Contracts similar to forwards but with the following differences: futures are generic exchange-traded, whereas forwards are individually tailored. Futures are generally settled through an offsetting (reversing) trade, whereas forwards are generally settled by delivery of the underlying item or cash settlement.

Options

Contracts that give the purchaser the right, but not the obligation, to buy (call option) or sell (put option) a specified quantity of a particular financial instrument, commodity, or foreign currency, at a specified price (strike price), during or at a specified period of time. These can be individually written or exchange-traded. The purchaser of the option pays the seller (writer) of the option a fee (premium) to compensate the seller for the risk of payments under the option.

Caps and floors

These are contracts sometimes referred to as interest rate options. An interest rate cap will compensate the purchaser of the cap if interest rates rise above a predetermined rate (strike rate) while an interest rate floor will compensate the purchaser if rates fall below a predetermined rate.

Embedded derivatives

Some contracts that themselves are not financial instruments may nonetheless have financial instruments embedded in them. For example, a contract to purchase a commodity at a fixed price for delivery at a future date has embedded in it a derivative that is indexed to the price of the commodity.

IAS 39.11

An embedded derivative is a feature within a contract, such that the cash flows associated with that feature behave in a similar fashion to a stand-alone derivative. In the same way that derivatives must be accounted for at fair value on the balance sheet with changes recognised in the income statement, so must some embedded derivatives. IAS 39 requires that an embedded derivative be separated from its host contract and accounted for as a derivative when:

- the economic risks and characteristics of the embedded derivative are not closely related to those of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the entire instrument is not measured at fair value with changes in fair value recognised in the income statement.

If an embedded derivative is separated, the host contract is accounted for under the appropriate standard. Appendix A to IAS 39 provides examples of embedded derivatives that are closely related to their hosts, and of those that are not.

IAS 39.AG30

Examples of embedded derivatives that are not closely related to their hosts (and therefore must be separately accounted for) include:

- the equity conversion option in debt convertible to ordinary shares (from the perspective of the holder only);
- commodity indexed interest or principal payments in host debt contracts;
- cap and floor options in host debt contracts that are in-the-money when the instrument was issued;
- leveraged inflation adjustments to lease payments;
- currency derivatives in purchase or sale contracts for non-financial items where the foreign currency is not that of either counterparty to the contract, is not the currency in which the related good or service is routinely denominated in commercial transactions around the world, and is not the currency that is commonly used in such contracts in the economic environment in which the transaction takes place.

IAS 39.12

If IAS 39 requires that an embedded derivative be separated from its host contract, but the entity is unable to measure the embedded derivative separately, the entire combined contract must be designated as a financial asset as at fair value through profit or loss.

For the general rules about classification, recognition, measurement, derecognition and impairment of financial instruments, see Chapter 5 – *Financial Instruments*. Here below, the specific requirements related to derivatives and hedge accounting.

2.2 IAS 39 fair value option

IAS 39 permits entities to designate, at the time of acquisition or issuance, any financial asset or financial liability to be measured at fair value, with value changes recognised in profit or loss. This option is available even if the financial asset or financial liability would ordinarily, by its nature, be measured at amortised cost – but only if fair value can be reliably measured.

In June 2005 the IASB issued its amendment to IAS 39 to restrict the use of the option to designate any financial asset or any financial liability to be measured at fair value through profit and loss (the fair value option). The revisions limit the use of the option to those financial instruments that meet certain conditions:

IAS 39.9

- the fair value option designation eliminates or significantly reduces an accounting mismatch, or
- a group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis by entity's management.

Once an instrument is put in the fair-value-through-profit-and-loss category, it cannot be reclassified out with some exceptions. In October 2008, the IASB issued amendments to IAS 39. The amendments permit reclassification of some financial instruments out of the fair-value-through-profit-or-loss category (FVTPL) and out of the available-for-sale category. In the event of reclassification, additional disclosures are required under IFRS 7 *Financial Instruments: Disclosures*. In March 2009 the IASB clarified that reclassifications of financial assets under the October 2008 amendments: on reclassification of a financial asset out of the 'fair value through profit or loss' category, all embedded derivatives have to be (re)assessed and, if necessary, separately accounted for in financial statements. **IAS 39.50**

2.3 Hedge accounting

IAS 39 permits hedge accounting under certain circumstances provided that the hedging relationship is:

- formally designated and documented, including the entity's risk management objective and strategy for undertaking the hedge, identification of the hedging instrument, the hedged item, the nature of the risk being hedged, and how the entity will assess the hedging instrument's effectiveness and
- expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk as designated and documented, and effectiveness can be reliably measured and
- assessed on an ongoing basis and determined to have been highly effective. **IAS 39.88**

Hedging instruments

Hedging instrument is an instrument whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item.

All derivative contracts with an external counterparty may be designated as hedging instruments except for some written options. A non-derivative financial asset or liability may not be designated as a hedging instrument except as a hedge of foreign currency risk.

For hedge accounting purposes, only instruments that involve a party external to the reporting entity can be designated as a hedging instrument. This applies to intragroup transactions as well (with the exception of certain foreign currency hedges of forecast intragroup transactions – see below). However, they may qualify for hedge accounting in individual financial statements. **IAS 39.9**

IAS 39.72

Hedged items

Hedged item is an item that exposes the entity to risk of changes in fair value or future cash flows and is designated as being hedged.

IAS 39.73

A hedged item can be:

- a single recognised asset or liability, firm commitment, highly probable transaction or a net investment in a foreign operation;
- a group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics;
- a held-to-maturity investment for foreign currency or credit risk (but not for interest risk or prepayment risk);
- a portion of the cash flows or fair value of a financial asset or financial liability; or **IAS 39.9**
- a non-financial item for foreign currency risk only for all risks of the entire item; **IAS 39.78-82**
- in a portfolio hedge of interest rate risk (Macro Hedge) only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged.

In April 2005, the IASB amended IAS 39 to permit the foreign currency risk of a highly probable intragroup forecast transaction to qualify as the hedged item in a cash flow hedge in consolidated financial statements – provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated financial statements.

In 30 July 2008, the IASB amended IAS 39 to clarify two hedge accounting issues:

- inflation in a financial hedged item; **IAS 39.80**
- a one-sided risk in a hedged item.

Effectiveness

IAS 39 requires hedge effectiveness to be assessed both prospectively and retrospectively. To qualify for hedge accounting at the inception of a hedge and, at a minimum, at each reporting date, the changes in the fair value or cash flows of the hedged item attributable to the hedged risk must be expected to be highly effective in offsetting the changes in the fair value or cash flows of the hedging instrument on a prospective basis, and on a retrospective basis where actual results are within a range of 80% to 125%.

All hedge ineffectiveness is recognised immediately in profit or loss (including ineffectiveness within the 80% to 125% window).

2.4 Categories of hedges

A **fair value hedge** is a hedge of the exposure to changes in fair value of a recognised asset or liability or a previously unrecognised firm commitment or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss. The gain or loss from the change in fair value of the hedging instrument is recognised immediately in profit or loss. At the same time the carrying amount of the hedged item is adjusted for the corresponding gain or loss with respect to the hedged risk, which is also recognised immediately in net profit or loss.

A **cash flow hedge** is a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect profit or loss. The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in other comprehensive income.

IAS 39.86

IAS 39.89

If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, any gain or loss on the hedging instrument that was previously recognised directly in equity is 'recycled' into profit or loss in the same period(s) in which the financial asset or liability affects profit or loss.

IAS 39.86

If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or non-financial liability, then the entity has an accounting policy option that must be applied to all such hedges of forecast transactions:

IAS 39.95

- Same accounting as for recognition of a financial asset or financial liability – any gain or loss on the hedging instrument that was previously recognised in other comprehensive income is 'recycled' into profit or loss in the same period(s) in which the non-financial asset or liability affects profit or loss;
- 'Basis adjustment' of the acquired non-financial asset or liability – the gain or loss on the hedging instrument that was previously recognised in other comprehensive income is removed from equity and is included in the initial cost or other carrying amount of the acquired non-financial asset or liability.

IAS 39.97

IAS 39.98

A hedge of a net investment in a foreign operation as defined in IAS 21 *The Effects of Changes in Foreign Exchange Rates* is accounted for similarly to a cash flow hedge.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

2.5 Discontinuation of hedge accounting

Hedge accounting must be discontinued prospectively if:

- the hedging instrument expires or is sold, terminated, or exercised; **IAS 39.102**
- the hedge no longer meets the hedge accounting criteria – for example it is no longer effective;
- for cash flow hedges the forecast transaction is no longer expected to occur; or
- the entity revokes the hedge designation.

In June 2013, the IASB amended IAS 39 to make it clear that there is no need to discontinue hedge accounting if a hedging derivative is novated, provided certain criteria are met. **IAS 39.91-101**

For the purpose of measuring the carrying amount of the hedged item when fair value hedge accounting ceases, a revised effective interest rate is calculated.

If hedge accounting ceases for a cash flow hedge relationship because the forecast transaction is no longer expected to occur, gains and losses deferred in other comprehensive income must be taken to profit or loss immediately. If the transaction is still expected to occur and the hedge relationship ceases, the amounts accumulated in equity will be retained in equity until the hedged item affects profit or loss.

If a hedged financial instrument that is measured at amortised cost has been adjusted for the gain or loss attributable to the hedged risk in a fair value hedge, this adjustment is amortised to profit or loss based on a recalculated effective interest rate on this date such that the adjustment is fully amortised by the maturity of the instrument. Amortisation may begin as soon as an adjustment exists and must begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risks being hedged. **IAS 39.101**

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Derivatives: Definition

IAS 39 defines a derivative as a financial instrument or other contract within the scope of the Standard with all three of the following characteristics:

- its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the 'underlying');
- it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- it is settled at a future date.

The definition of a derivative is important because it is used in determining the classification and measurement of financial instruments. Those instruments that meet the definition of a derivative are required to be classified as at FVTPL unless the instrument is designated and is highly effective as a hedging instrument. The definition of a derivative is also relevant in accounting for embedded derivatives in contractual arrangements and hedge accounting, because financial assets and liabilities are only permitted to be designated as hedging instruments in hedging risks other than foreign currency risk if they meet the definition of a derivative.

The Underlying

An underlying is a variable that, along with either a notional amount or a payment provision, determines the settlement amount of a derivative.
Examples of underlyings include:

- a security price or security price index;
- a commodity price or commodity price index;
- an interest rate or interest rate index;
- a credit rating or credit index;
- a foreign exchange rate or foreign exchange rate index;
- an insurance index or catastrophe loss index;
- a climatic or geological condition (e.g. temperature, earthquake severity or rainfall), another physical variable, or a related index;
- or another variable (e.g. volume of sales).

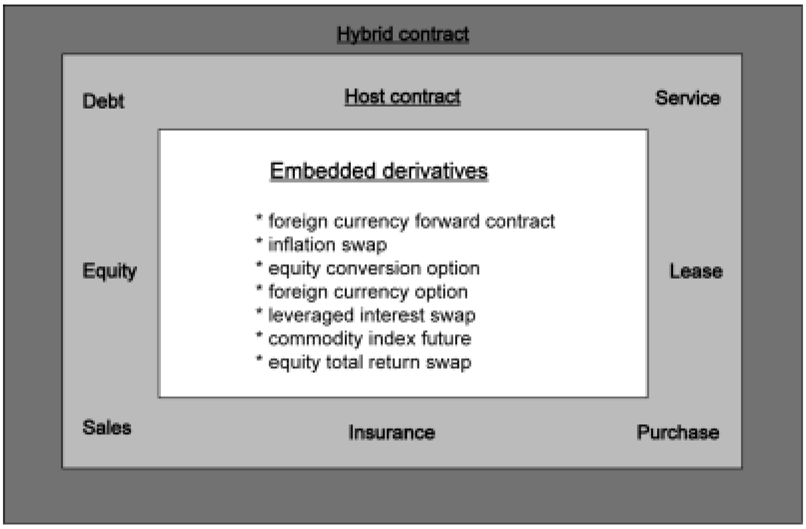
Derivatives Held for Trading

Financial assets held for trading consist mainly of debt securities, equities and trading derivatives with positive fair value.
Derivatives are initially recognized on the trade date.
On initial recognition, financial assets held for trading are measured at cost, i.e. the fair value of the instrument, without adding directly attributable transaction costs or income.
After initial recognition, financial assets held for trading are measured at their fair value.
The fair value of a financial instrument quoted in an active market is determined using its market quotation (bid/ask or average price). If the market for a financial instrument is not active, fair value is determined using estimation and valuation techniques which measure all instrument-related risks and use market data, e.g. the quoted price of instruments with similar characteristics, discounted cash flow analysis, option pricing models, recent comparable transactions.
Reclassification to other categories of financial assets is not allowed except for rare circumstances which are unlikely to occur again in the near term.
The existence of any embedded derivative contracts that require unbundling is assessed upon reclassification.
Financial assets are derecognized when the contractual rights to the cash flows from the financial asset expire or the financial asset and substantially all the risks and rewards of ownership thereof are transferred.

Embedded Derivatives

[IAS 39] defines an embedded derivative as a component of a hybrid (combined) instrument that also includes a non-derivative host contract – with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates or other variable (provided in the case of a non-financial variable that the variable is not specific to a party to the contract.
The hybrid contract is the entire contract, within which there is an embedded derivative. The host contract is the main body of the contract, excluding the embedded derivative.

The diagram and examples below illustrate the application of these terms by Mediolanum Group.



Not all embedded derivatives should be separated from their host contracts. An embedded derivative is separated from its host contract and accounted for separately as a stand-alone derivative when all of the following criteria, defined by the Group in accordance with the Standard, are met:

- the economic characteristics and risks of the embedded derivative are not closely related to the economic risks and characteristics of the host contract;
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid instrument is not measured at fair value with changes in fair value recognised in profit or loss (i.e. a derivative that is embedded in a

financial liability at fair value through profit or loss is not separated).

Condition (b) above means that an embedded feature should only be separated from its host contract if it meets the definition of a derivative, i.e.:

- it has an underlying;
- it involves no initial net investment (or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors);
- and it is settled at a future date.

The condition means that any financial asset or financial liability that is held at fair value with changes in fair value recognised through profit or loss should not be assessed to see if it contains any embedded derivatives. Any embedded derivative that is not closely related to its host and meets definition of a derivative will be accounted for as if it were a stand-alone derivative – i.e. measured at fair value, with changes in fair value recognised in profit or loss. If the entire contract is currently accounted for at fair value, the embedded derivative is automatically accounted for at fair value and, therefore, it is not required to be separated.

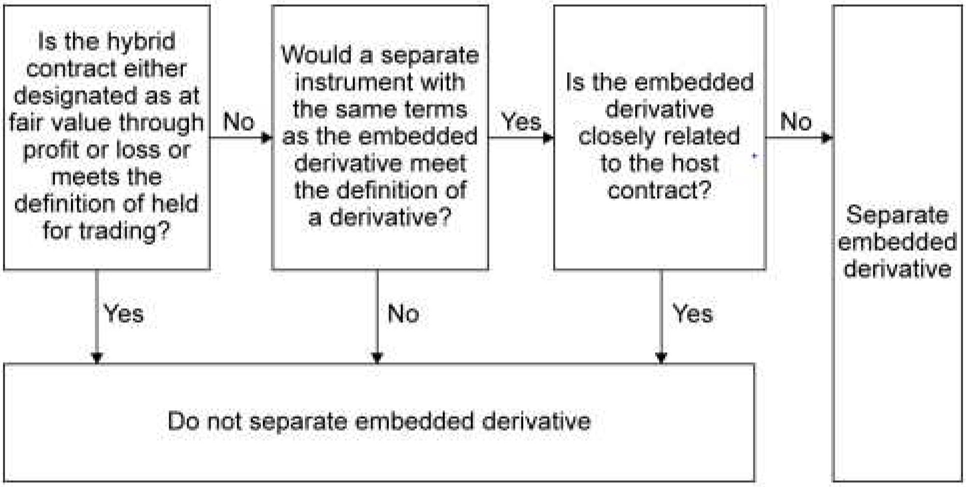
An entity can elect to designate a hybrid instrument in the scope of [IAS 39] as at FVTPL at initial recognition even though the instrument would not meet the definition of held for trading. This option is available when the financial instrument is a hybrid contract containing one or more embedded derivatives, unless

- the embedded derivative does not significantly modify the cash flows that otherwise would be required by the contract; or
- it is clear with little or no analysis when a similar hybrid instrument is first considered that separation of the embedded derivative is prohibited, as in the case of a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortised cost.

Designating a hybrid instrument as at FVTPL may provide benefit to entities with more complex instruments where the search for and analysis of embedded derivatives significantly increases the cost of compliance with the Standard. This approach will also benefit entities that issue structured products or acquire structured products (e.g. equity-linked notes or callable range-accrual notes) which may contain more than one embedded derivative that is not closely related to the host contract. For issuers of these instruments, who normally invest in derivatives as an economic hedge of the issued notes, fair valuing the hybrid instrument reduces the accounting mismatch that would have resulted had the host contract been measured at amortised cost. Furthermore, for these more complex instruments, the fair value of the combined contract may be significantly easier to measure and, therefore, provide more reliable information than the fair value of only those embedded derivatives that are required to be separated.

When an embedded derivative is not included in one of these two lists, a significant degree of judgement will be required and conclusions may need to be drawn by analogy to the specific examples given. Ultimately, the conclusion reached should be consistent with the underlying principle that an embedded derivative should be separated from its host contract when its economic characteristics and risks differ from those of the host contract.

In summary, the following decision tree can be used to determine whether an embedded derivative needs to be separated from its host contract:



If it is determined that an embedded derivative is closely related to the host contract, it should not be separated from the host contract because the entire hybrid contract is accounted for in accordance with the relevant Standard that deals with the host contract.

If an identified embedded derivative is not closely related to the host contract, then it must be separately accounted for as if it were a free-standing derivative.

IFRIC Interpretation 9 [IFRIC 9] *Reassessment of Embedded Derivatives* provides guidance on whether an entity should assess whether embedded derivatives are closely related at the time the entity first becomes a party to the contract or on an ongoing basis. The Interpretation clarifies the following.

- An entity is generally prohibited from reassessing its conclusion as to whether an embedded derivative needs to be separated from the hybrid contract after it is initially recognised.
- An entity is required to revisit its assessment if there is a change in the terms of the contract that significantly modifies the cash flows that would otherwise be required under the (original) contract. The significance of the change in cash flows is evaluated by considering the extent of the change in the cash flows of the embedded derivative, the host contract or both, and whether these changes are significant relative to the previously expected

cash flows of the contract.
- An entity is required to revisit is assessment when a financial asset is reclassified out of the FVTPL category.

The Interpretation does not apply to embedded derivatives acquired in:
- a business combination (as defined in [IFRS 3] *Business Combinations*);
- a combination of entities or businesses under common control; or
- the formation of a joint venture as defined in [IAS 31] *Interests in Joint Ventures* and joint arrangement as defined in [IFRS 11] Joint Arrangements or their possible reassessment at the date of acquisition.

The table below provides further examples of derivative instruments embedded in debt host contracts:

Type of instrument	**Economic characteristics**	**Embedded derivative**	**Closely related**
Inverse floater	Bond accrues interest at 5.25 per cent for three months to July 20X4; thereafter, at 10.75 per cent less 6-month LIBOR to January 20X5.	Forward starting fixed-to-floating rate interest rate swap	No. [IAS 39:AG33(a)]
Leveraged inverse floater	Bond accrues interest at 6 per cent to June 20X5; thereafter, at 14.55 per cent – (2.5 × 3-month LIBOR).	Forward starting leveraged interest rate swap	No. [IAS 39:AG33(a)]
Ratchet floater	Bond accrues interest at 3-month LIBOR + 50 basis points. In addition to having a lifetime cap of 7.25 per cent, the coupon will be collared each period between the previous coupon and the previous coupon plus 25 basis points. 3-month LIBOR at inception is 4 per cent.	Combinations of purchased and written options that create changing caps and floors	Yes. [IAS 39:AG33(b)]
Fixed-to-floating note	A bond that pays a varying coupon (first-year coupon is fixed; second- and thirdyear coupons are based on LIBOR).	Forward-starting interest-rate swap	Yes. [IAS 39:AG33(a)]
Equity-indexed note	A bond for which the return of interest, principal, or both is tied to a specified equity security or index (e.g. the	Forward exchange contracts or option contracts	No. [IAS 39:AG30(d)]

	Standard and Poor's 500 (S&P 500) index). This instrument may contain a fixed or varying coupon rate and may place all, or a portion, of principal at risk.		
Variable principal redemption bond	A supplemental principal payment will be paid to the investor, at maturity, if the final S&P 500 closing value (determined at a specified date) is less than its initial value at date of issuance and the 10-year constant maturity treasuries (CMT) is greater than 2 per cent as of a specified date. In all cases, the minimum principal redemption will be 100 per cent of face amount.	Option contract	No. [IAS 39:AG30(d)]
Crude-oil knockin note	A bond that has a 1 per cent coupon and guarantees repayment of principal with upside potential based on the strength of the oil market.	Option contract	No. [IAS 39:AG30(e)]
Gold-linked bull note	A bond that has a fixed 3 per cent coupon and guarantees repayment of principal with upside potential if the price of gold increases.	Option contract	No. IAS 39:AG30 (e) [IAS 39:AG33]
Step-up bond	A bond that provides an introductory above-market yield that is less than twice the market rate at inception and steps up to a new coupon, which will be below then-current market rates or, alternatively, the bond may be called, at an amount that approximates the amortised cost of the debt instrument, in lieu of the step-up in the coupon rate.	Interest rate swap and call option	Yes. [IAS 39:AG30(g)] and [IAS 39:AG33(a)]

Credit-sensitive bond	A bond that has a coupon rate of interest that resets based on changes in the issuer's credit rating.	Conditional exchange contract or option	Yes. [IAS 39:AG33(a)]
Inflation bond	A bond with a contractual principal amount that is indexed to the nonleveraged inflation rate of the economic environment of the issuer, but cannot decrease below par; the coupon rate is below that of traditional bonds of a similar maturity.	Inflation-linked swap with embedded floor	Yes. [IAS 39:AG33](a) and (f)(i)
Specific equitylinked bond	A bond that pays a coupon slightly below that of traditional bonds of similar maturity; however, the principal amount is linked to the stock market performance of an equity investee of the issuer.	Series of forward contracts or option contracts	No. [IAS 39:AG30(d)]
Dual currency bond	A bond providing for repayment of principal in one currency (e.g. Euro) and periodic interest payments denominated in a different currency (e.g. Yen).	Foreign currency Forward	Yes. [IAS 39:AG33(c)]
Short-term loan with foreign currency option	A US lender issues a loan at an above-market interest rate. The loan is made in US dollars, the borrower's functional currency, and the borrower has the option to repay the loan early in US dollars or in a fixed amount of a specified foreign currency.	Foreign currency option	No. [IAS 39:AG30(g)]

Embedded derivatives are not limited to debt hosts; they can also be embedded in equity host contracts. From the perspective of the holder of a hybrid instrument, judgement is required in determining whether the put feature in puttable shares is closely related to the equity host contract when the host contract is classified as an AFS asset in the scope of [IAS 39]. (If the hybrid instrument is classified as at FVTPL, the embedded derivative guidance is not applicable because the whole instrument is fair valued through earnings.)

For the particular type of Embedded derivatives in insurance contracts see the paragraph 3.2 Relevant Issues

Measurement of embedded derivatives at initial recognition
If an embedded derivative is separated from its host contract (because it is not closely related to the host), then it must be accounted for as if it were a free-standing derivative. The embedded derivative should be recognised in the statement of financial position at fair value, with changes in fair value recognised in profit or loss as they arise, unless it is designated as an effective hedging instrument in a cash flow or a net investment hedge.
The host contract is accounted for under [IAS 39] if it is a financial instrument within the scope of the Standard; otherwise it is accounted for under the appropriate Standard.

Measurement
Assets, in particular derivatives, classified as at FVTPL are measured at fair value. Gains and losses that arise as a result of changes in fair value are recognised in profit or loss, except for those arising on derivatives that are designated in effective cash flow hedges or hedges of a net investment in a foreign operation. Gains and losses that arise between the end of the last reporting period and the date an instrument is derecognised do not constitute a separate 'profit/loss on disposal'. Such gains and losses will have arisen prior to disposal, while the item is still being measured at FVTPL, and should be recognised in profit or loss when they occur.
Transaction costs that might be incurred when the asset is disposed of in the future are *not* deducted from fair value in determining the carrying amount. Some argue that this is inconsistent with the use of exit prices (i.e. fair value) for measurement purposes, but the Standard is clear that such costs are viewed as being related to the act of disposal and, therefore, are recognised only in the period of disposal itself

Financial liabilities at FVTPL, which include those classified as held for trading and derivative liabilities that are not designated as effective hedging instruments, and those designated as at FVTPL, are measured at their fair value with gains and losses recognised in profit or loss. However, a derivative liability that is linked to, and must be settled by delivery of, an unquoted equity instrument whose fair value cannot be reliably measured is measured at cost.
A consequence of including a financial liability in this category is that the effect of an entity's own credit risk will be reflected in profit or loss. For example, if an entity that has elected to measure its issued debt at fair value experiences financial difficulties, it is likely to recognise a gain in profit or loss reflecting the instrument's worsening creditworthiness.

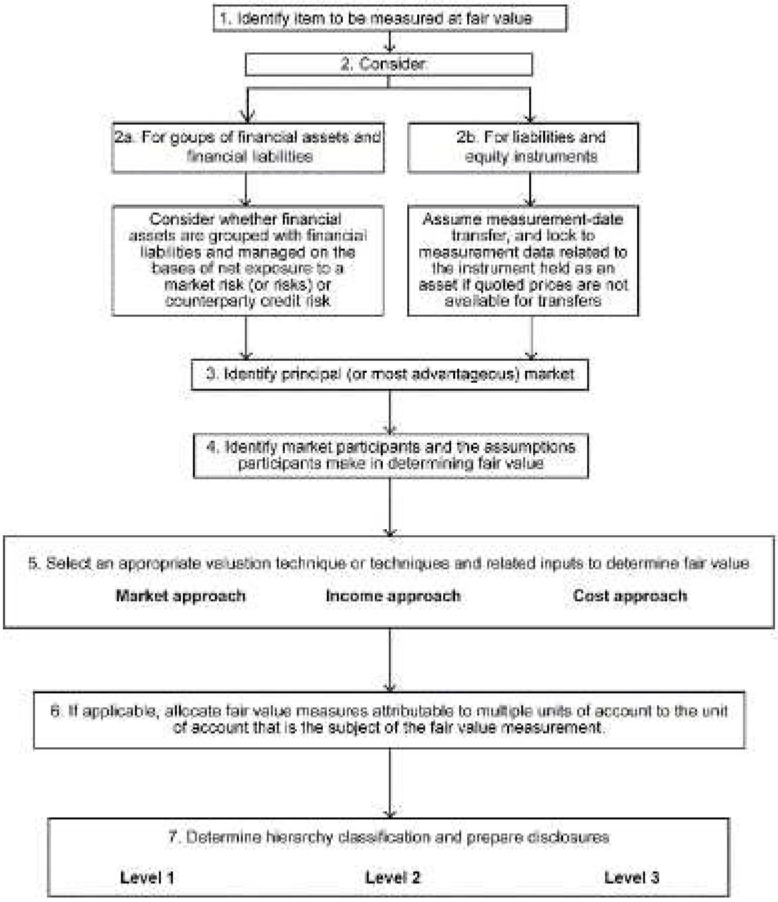
Fair value measurement of financial instruments derivatives

Fair value is defined as "[t]he price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date".

A fair value measurement requires an entity to determine all of the following:

- the particular asset or liability that is the subject of the measurement (consistently with its unit of account);
- the principal (or most advantageous) market for the asset or liability; and
- the valuation technique(s) appropriate for the measurement, considering the availability of data with which inputs that represent the assumptions market participants would use when pricing the asset or liability and the level of the fair value hierarchy within which the inputs are categorised.

The table and flow chart below set out a step-by-step approach to applying the basic measurement principles of [IFRS 13] to financial instruments, adopted by Mediolanum Group:



The guidelines for the valuation of financial instruments defined by the Mediolanum Group provide, in accordance with the IAS / IFRS accounting principles, the distinction between:

- derivative financial instrument for which the price is available on an active market (such as futures). In these cases the fair value is the official price Closing (Level 1 of the fair value hierarchy);
- non-contributed all derivatives that do not fall into the category defined above (Level 2 or Level 3 of the fair value hierarchy).

In general, and thus also in the case of derivative financial instruments traded on an active market, the existence of a in prices is the best evidence of fair value, as in an active marke prices typically reflect normal market transactions that took place over a certain period of reference; fair value is the price on the principal or most advantageous market for the derivatives in question (or the market prices of the parts that are included into the financial instrument if the instrument as a whole is not listed, but so are its components).
Prices must be significant, as well as readily and regularly available from official lists of stock exchange, dealer, broker, industry group, pricing services or regulatory agency (the contributors).

For non -listed derivative financial instruments in an active market , the fair value should instead be quantified on the basis of valuation models: these models, in line with best market practice , taking into account all relevant parameters available in the markets .

In the case of financial instruments quoted on an active market (eg . Italian Derivative Market or London Stock Exchange) , the fair value is determined using the official closing price on the day in which the valuation refers.

Related to derivatives "over the counter" (OTC), Mediolanum Group estimates their fair value on the basis of techniques assessment which consider all the risk factors that could affect the value of the instrument Financial to evaluate, using observable market parameters that, being precisely representative of market situations, need corrective components that include the credit risk of the specific counterparty.
The inputs used for the valuation are:

- levels of interest rate;
- levels of credit spreads;
- levels of volatilities of interest rate.

In this case, the chosen valuation model by the Group shall:

- be in accordance with the market practice;
- include the risk of the counterparty (CVA, Credit Value Adjustment) and their risk of Credit (DVA, Debt Value Adjustment).

The value of the discount factor will be obtained considering the collateralisation, and therefore it will be used the interbank deposit rates, futures on Euribor , the overnight interest swaps, interest rate swaps and basis swaps curve on Euribor.
The volatilities shall be related to cap contracts of same strike and duration.
For the evaluation of derivatives not collateralised, the fair value of the flows will be adjusted to reflect the credit spread ,deducted from the 5-year CDS spreads of the issuer .

Hedge Accounting

IAS 39 recognises three types of hedge accounting depending on the nature of the risk exposure:

- a fair value hedge;
- a cash flow hedge; and
- a hedge of a net investment in a foreign operation (net investment hedge).

Fair value Hedge

A fair value hedge is a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect profit or loss.
Fair value exposures arise from existing assets and liabilities, including firm commitments. Fixed rate financial assets and liabilities, for example, have a fair value exposure to changes in market rates of interest and changes in credit quality. Non-financial assets have a fair value exposure to changes in their market price (e.g. a commodity price). Some assets and liabilities have fair value exposures arising from more than one type of risk (e.g. interest rate, credit, foreign currency risk).
The following assets and liabilities are commonly fair value hedged:

- fixed rate liabilities such as loans;
- fixed rate assets such as investments in bonds;
- investments in equity securities classified as AFS under [IAS 39]; and

firm commitments to buy/sell non-financial items at a fixed price.

Examples of fair value hedges include:

- a hedge of exposure to changes in the fair value of fixed rate debt as a result of changes in market interest rates (such a hedge could be entered into either by the issuer or by the holder);
- a hedge of the foreign currency risk of an unrecognised contractual commitment by an airline to purchase an aircraft for a fixed amount of a

foreign currency at a future date; and
- a hedge of the change in fuel price relating to an unrecognised contractual commitment by an electricity utility to purchase fuel at a fixed price at a specified date, with payment in its functional currency.

A fair value hedge that meets all of the hedge accounting criteria is accounted for as follows:

- the gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount (for a non-derivative hedging instrument) is recognised immediately in profit or loss; and
- the carrying amount of the hedged item is adjusted through profit or loss for the gain or loss on the hedged item attributable to the hedged risk. This applies even if the hedged item is an AFS financial asset measured at fair value with changes in fair value recognised in other comprehensive income. This also applies if the hedged item is otherwise measured at cost.

Hedged items

A hedged item is defined as a recognised asset, liability, unrecognised firm commitment, highly probable forecast transaction or net investment in a foreign operation that:

- exposes the entity to risk of changes in fair value or future cash flows; and
- is designated as being hedged.

A hedged item can be:

- a single asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation
- a group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics; or
- in a portfolio hedge of interest rate risk only, a portion of the portfolio of financial assets/liabilities that share the risk being hedged

The following examples of hedge accounting relationship are commonly in place in Mediolanum Group:

- Fair value hedge of a variable rate capped portfolio mortgages with an Interest Rate Option (IRO)
- Fair value hedge of a fixed rate portfolio mortgages with an Interest Rate Swap (IRS)

The mortgages portfolio at variable rate with cap has been designated to be covered by an IRO that would hedge the asset fair value by an increase in the interest rate greater than the cap (option in the money).

At the initial recognition the company records an amount (Asset) related to the option premium that represents the fair value of the transaction and in the same moment designs the hedge relationship with the mortgages portfolio.

In the subsequent measurements, the company assume that the fair value of the financial instrument is consistent with the decrease of the fair value option because of the reduction of the time to maturity. Then the company would record in P&L the change in fair value splitted between pro rata amortization of the premium and change in fair value due to the probability of the strike (the sum of the two components is equal to the change in fair value of the option).

The hedged item fair value, related to interest rate risk, is determined starting from the designation date of the hedging relationship and any change in fair value is accounted as a variation of the mortgages portfolio against a change in P&L.

The fixed rate mortgage portfolio been designated to be covered by an IRS that would hedge the asset fair value by an increase in the interest rate.

At the initial recognition the company records an amount (Asset) related to the IRS that represents the fair value of the transaction and in the same moment designs the hedge relationship with the mortgages portfolio.

In the subsequent measurements, the company determine the fair value of the hedging instrument (IRS) and of the hedged item (mortgages portfolio) and would record in P&L the change in fair value related to interest rate risk.

The hedged item fair value, related to interest rate risk, is determined starting from the designation date of the hedging relationship and any change in fair value is accounted as a variation of the mortgages portfolio against a change in P&L.

Discontinuance of fair value hedge accounting

An entity of Mediolanum Group must discontinue prospectively fair value hedge accounting if:

- the hedging instrument expires or it is sold, terminated or exercised. For this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy (for a discussion of rollover hedging strategies. Additionally, for this purpose there is not an expiration or termination of the hedging instrument if
    - as a consequence of laws or regulations or the introduction of laws or regulations, the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties. For this purpose, a clearing counterparty is a central counterparty

  (sometimes called a 'clearing organisation' or 'clearing agency') or an entity or entities, for example, a clearing member of a clearing organisation or a client of a clearing member of a clearing organisation, that are acting as counterparty in order to effect clearing by a central counterparty. However, when the parties to the hedging instrument replace their original counterparties with different counterparties this paragraph shall apply only if each of those parties effects clearing with the same central counterparty.
  - other changes, if any, to the hedging instrument are limited to those that are necessary to effect such a replacement of the counterparty. Such changes are limited to those that are consistent with the terms that would be expected if the hedging instrument were originally cleared with the clearing counterparty. These changes include changes in the collateral requirements, rights to offset receivables and payables balances, and charges levied.
- the hedge no longer meets the hedge accounting criteria (e.g. it is no longer highly effective or its effectiveness is no longer measurable); or
- the entity of the Group de-designates the hedge relationship.

Any adjustment to the carrying amount of the hedged item for the designated risk for interest-bearing financial instruments is amortised to profit or loss, with amortisation commencing no later than when the hedged item ceases to be adjusted. The amortisation is based on a recalculated effective interest rate at the date amortisation commences such that the adjustment is fully amortised by maturity.

If amortisation begins as soon as a fair value adjustment exists, the adjustment to the carrying amount affects the effective interest rate calculation for the hedged item. In practice, to ease the administrative burden of amortising the adjustment while the hedged item continues to be adjusted for changes in fair value attributable to the hedged risk, it may be easier to defer amortising the adjustment until the hedged item ceases to be adjusted for the designated hedged risk. This is particularly true when the life of the hedge is the same as that of the hedged item. For example, if a fixed rate loan is issued at par and redeems at par, its fair value will move away from par over its life in response to changes in interest rates but it will be pulled back to par on maturity. Therefore, any fair value adjustments to the carrying amount of the loan under a fair value hedge for interest rate risk will be reversed by the end of the hedge and will not require amortisation.

However, if an interest-bearing instrument is hedged for only a portion of its term to maturity (for a discussion of partial term hedging), deferring amortisation until cessation of the hedge relationship will result in a skewed effective interest rate in the remaining years to the maturity of the hedged item.

An entity must apply the same amortisation policy for all of its debt instruments (i.e. it cannot defer amortising fair value adjustments on some items and not on others).

Cash flow Hedge

A cash flow hedge is a hedge of the exposure to variability in cash flows that:

- is attributable to a particular risk associated with a recognised asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction; and
- could affect profit or loss.

Assets and liabilities and forecast transactions that are commonly cash flow hedged include:

- variable rate liabilities such as loans;
- variable rate assets such as investments in bonds;
- a highly probable future issuance of fixed rate debt;
- forecast reinvestment of interest and principal received on fixed rate assets; and
- highly probable forecast sales and purchases.

An example of a cash flow hedge is a hedge of variable rate debt with a floating to fixed interest rate swap. The variability in cash flow arises due to the reset of interest rates. The cash flow hedge reduces future variability of interest cash flows on the debt. Another example of a cash flow hedge is a hedge of anticipated reinvestment of cash inflows and the anticipated refinancing or rollover of a financial liability. A hedging instrument that swaps one variable rate for another (e.g. LIBOR for EURIBOR) would not qualify in a cash flow hedge relationship because it does not reduce cash flow variability; it merely swaps the debt's existing cash flow variability for cash flow variability determined on a different basis.

Hedge effectiveness

[IAS 39] requires a hedge to be 'highly effective', prospectively and retrospectively, for it to qualify for hedge accounting. Highly effective refers to the degree to which the hedge relationship is assessed as having a high level of hedge effectiveness. If hedge accounting is applied in the period, any ineffectiveness is required to be measured and recognised immediately in profit or loss.

The Standard does not prescribe a specific method for assessing hedge effectiveness. However, it requires an entity to specify at inception of the hedge relationship the method it will apply to assess hedge effectiveness, and to apply that method consistently for the duration of the hedging relationship. The method specified must be consistent with management's risk management strategy and objective. A method of assessing hedge effectiveness must be applied consistently to all similar hedges unless different methods are explicitly justified.

Several mathematical techniques are be used to assess hedge effectiveness, including ratio analysis and various statistical methods like regression analysis. The appropriateness of a given method will depend on the nature of the risk being hedged and the type of hedging instrument used.

A hedge is regarded as highly effective by Mediolanum Group only if both of the following conditions are met:

- at the inception of the hedge, and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge; and
- the actual results of the hedge are within a range of 80-125 per cent.

When actual results are within a range of 80-125 per cent, but not 100 per cent exactly, any deviation from 100 per cent means that the hedge relationship is partly ineffective and ineffectiveness must be recognised in profit or loss.

Hedge ineffectiveness arises in a fair value hedge when the change in the fair value of the hedging instrument differs from that of the hedged risk of the hedged item. Because changes in the fair value of the hedging instrument are recognised in profit or loss so as to offset changes in the fair value due to the hedged risk on the hedged item, all hedge ineffectiveness is automatically recognised in profit or loss in the period. Hedge ineffectiveness is recognised in profit or loss for both under- and over-hedges, i.e. ineffectiveness is recognised when the fair value of the hedging instrument changes, either to a lesser or greater extent respectively when compared to the changes in the fair value of the hedged item.

In a cash flow hedge, the portion of the hedging instrument that is considered to be effective (and, therefore, is recognised in other comprehensive income) is the lesser of:

- the cumulative gain or loss on the hedging instrument from inception of the hedge; an
- the cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge.

In an over-hedge, when the change in fair value of the hedging instrument is greater than the change in fair value of the expected future cash flows on the hedged item, the difference is recognised in profit or loss as hedge ineffectiveness.

However, when the change in the fair value of the hedging instrument is less than the change in the fair value of expected future cash flows on the hedged item, the entire change in the fair value of the hedging instrument is recognised in other comprehensive income, i.e. no ineffectiveness arises in an under-hedge unless the hedge is determined no longer to be highly effective.

[IAS 39] permits the assessment of hedge effectiveness either on a period-by-period basis or cumulatively over the life of the hedging relationship, provided that the approach to be taken is documented formally at inception of the hedge relationship.

If hedge effectiveness is assessed on a cumulative basis and the hedge is not expected to be highly effective in a particular period, hedge accounting is not precluded if effectiveness is expected to remain sufficiently high over the life of the hedging relationship. The entity is still required to recognise any ineffectiveness in profit or loss as it occurs.

Effectiveness outside the range of 80 - 125 per cent at any measurement period may preclude hedge accounting not only in the period but also for future periods if it is an indication of further expected ineffectiveness.

A hedge relationship must be discontinued for the period in which the hedge fails to meet the effectiveness criteria. Issue (i) states that "if there is a hedge effectiveness failure, the ineffective portion of the gain or loss on the derivative instrument is recognised immediately in profit or loss and hedge accounting based on the previous designation of the hedge relationship cannot be continued. In this case, the derivative instrument may be redesignated prospectively as a hedging instrument in a new hedging relationship provided this hedging relationship satisfies the necessary conditions". Generally, hedge accounting will be discontinued from the previous effectiveness testing date, though when it is possible to identify the event that caused the hedging relationship to fail the effectiveness test and to demonstrate that the hedge was effective before the event occurred, hedge accounting will be discontinued from the date the event occurred.

When hedge effectiveness is outside the 80 - 125 per cent range, hedge accounting in subsequent periods would only be appropriate if a strong historical relationship exists and there is an expectation that the hedge will be highly effective in future periods. The same hedge relationship can be redesignated for hedge accounting prospectively provided that the entity can demonstrate that the new hedge relationship is expected to be highly effective in the future. An entity may wish to change the hedge ratio of the existing hedged item and hedging instrument, designate a new hedging instrument, or utilise the hedging instrument in hedging a different hedged item in order to improve effectiveness.

Where a hedge is redesignated after an effectiveness failure, the previous hedge relationship is considered to be extinguished and a new hedge relationship created. Accordingly, subsequent retrospective effectiveness testing will only assess hedge effectiveness from the date of the new hedge designation and will not be tainted by the poor historical performance. Prospective tests will, nevertheless, be affected where the entity's chosen method of prospective effectiveness testing incorporates historical performance data.

At the inception of the hedge Mediolanum have to improve formal designation and documentation of:

- the hedging relationship; and
- the entity's risk management objective and strategy for undertaking the hedge.

That documentation should include identification of:

- the hedging instrument;
- the hedged item or transaction;
- the nature of the risk being hedged; and
- how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.

Broadly, the documentation requirements fall into two categories:

- specific documentation for every hedge entered into. This will give details of the hedged item, hedged risk, hedging instrument, how effectiveness will be assessed prospectively and retrospectively, and how effectiveness will be measured retrospectively; and
- overall risk management objectives and strategies.

Hedging a portfolio of items

The Standard allows similar assets or similar liabilities to be aggregated and hedged as a group only if the individual assets or individual liabilities in the group share the risk exposure that is designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group must be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items. Because the individual hedged items are expected to behave differently in so far as they may prepay at different times, the change in the fair value of each hedged item cannot be expected to be proportional to the change in the fair value of the portfolio.

The general requirement is modified for a hedge of a portfolio for interest rate risk only. The items in the hedged portfolio must be items whose fair value changes in response to the hedged interest rate and must be items that could have qualified for fair value hedge accounting had they been designated individually. However, an entity is not required to demonstrate that the change in fair value of the individual hedged items is approximately proportional to the overall change in fair value of the portfolio due to interest rate risk. For this type of hedge, the designated hedged item is expressed as an 'amount of currency' rather than as individual assets or liabilities.

[IAS 39] requires that in an effective fair value hedge relationship the hedged item is adjusted by the change in its fair value due to the hedged risk. The adjustment to the hedged item may be amortised to profit or loss as soon as the adjustment exists, but should begin no later than when the item ceases to be adjusted for the hedged risk. For a portfolio hedge, this would require an adjustment to many items, as well as tracking the amortisation of the resultant adjustment to profit or loss. In most cases complex systems solutions would be required.

[IAS 39] is modified to permit the adjustment to the hedged items for a portfolio hedge of interest rate risk to be recognised in two separate line items within assets or liabilities for those repricing time periods for which the hedged item is an asset or liability respectively. This adjustment should be presented next to financial assets or financial liabilities. Furthermore, that adjustment may be amortised to profit or loss using a straight line method when amortisation using a recalculated effective interest rate is not practicable. The adjustment should also be amortised to profit or loss by the expiry of the relevant repricing time period.

3.2 Relevant topics

Embedded derivatives in insurance contracts

IFRS 9.4

Derivatives embedded in insurance contracts are within the scope of [IAS 39] if they require separation in accordance with [IAS 39], except if a derivative embedded in an insurance contract is itself an insurance contract. An insurance contract is a contract under which one party (the policyholder) accepts significant insurance risk from another party by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder.

As an exception to [IAS 39], an insurer is not required to separate and measure at fair value a policyholder's option to surrender an insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if the exercise price differs from the carrying amount of the host insurance liability. However, the requirement in [IAS 39] does apply to a put option or cash surrender option embedded in an insurance contract if the surrender value varies in response to the change in a financial variable (such as an equity or commodity price or index), or a non-financial variable that is not specific to a party to the contract.

Furthermore, this requirement also applies if the holder's ability to exercise a put option or cash surrender option is triggered by a change in such a variable (e.g. a put option that can be exercised if a stock market index reaches a specified level). This applies equally to options to surrender a financial instrument containing a discretionary participation feature. [IFRS 4:8] & [IFRS 4:9]
This is a complex area, and must be considered in conjunction with [IFRS 4] *Insurance Contracts*

For the general consideration about the potential impact of the introduction of IFRS 9, see Chapter 5.

3.2.1 Potential impacts related to IFRS 9

Derivatives

IFRS 9.6

All derivatives in scope of IFRS 9, including those linked to unquoted equity investments, are measured at fair value. Value changes are recognised in profit or loss unless the entity has elected to apply hedge accounting by designating the derivative as a hedging instrument in an eligible hedging relationship.

Embedded derivatives

An embedded derivative is a component of a hybrid contract that also includes a non-derivative host, with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument.

The embedded derivative concept that existed in IAS 39 has been included in IFRS 9 to apply only to hosts that are not financial assets within the scope of the Standard. Consequently, embedded derivatives that under IAS 39 would have been separately accounted for at FVTPL because they were not closely related to the host financial asset will no longer be separated. Instead, the contractual cash flows of the financial asset are assessed in their entirety, and the asset as a whole is measured at FVTPL if the contractual cash flow characteristics test is not passed.
The embedded derivative guidance that existed in IAS 39 is included in IFRS 9 to help preparers identify when an embedded derivative is closely related to a financial liability host contract or a host contract not within the scope of the Standard (e.g. leasing contracts, insurance contracts, contracts for the purchase or sale of a non-financial items).

Hedge accounting

The hedge accounting requirements in IFRS 9 are optional. If certain eligibility and qualification criteria are met, hedge accounting allows an entity to reflect risk management activities in the financial statements by matching gains or losses on financial hedging instruments with losses or gains on the risk exposures they hedge.

The hedge accounting model in IFRS 9 is not designed to accommodate hedging of open, dynamic portfolios. As a result, for a fair value hedge of interest rate risk of a portfolio of financial assets or liabilities an entity can apply the hedge accounting requirements in IAS 39 instead of those in IFRS 9.

In addition when an entity first applies IFRS 9, it may choose as its accounting policy choice to continue to apply the hedge accounting requirements of IAS 39.

Qualifying criteria for hedge accounting

A hedging relationship qualifies for hedge accounting only if all of the following criteria are met:

- the hedging relationship consists only of eligible hedging instruments and eligible hedged items;
- at the inception of the hedging relationship there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge;
- the hedging relationship meets all of the hedge effectiveness requirements.

Hedging instruments

Only contracts with a party external to the reporting entity may be designated as hedging instruments.

A hedging instrument may be a derivative (except for some written options) or non-derivative financial instrument measured at FVTPL unless it is a financial liability designated as at FVTPL for which changes due to credit risk are presented in OCI. For a hedge of foreign currency risk, the foreign currency risk component of a non-derivative financial instrument, except equity investments designated as FVTOCI, may be designated as the hedging instrument.

IFRS 9 allows a proportion (e.g. 60%) but not a time portion (eg the first 6 years of cash flows of a 10 year instrument) of a hedging instrument to be designated as the hedging instrument. IFRS 9 also allows only the intrinsic value of an option, or the spot element of a forward to be designated as the hedging instrument. An entity may also exclude the foreign currency basis spread from a designated hedging instrument.

IFRS 9 allows combinations of derivatives and non-derivatives to be designated as the hedging instrument.

Combinations of purchased and written options do not qualify if they amount to a net written option at the date of designation.

Hedged items

A hedged item can be a recognised asset or liability, an unrecognised firm commitment, a highly probable forecast transaction or a net investment in a foreign operation and must be reliably measurable.

An aggregated exposure that is a combination of an eligible hedged item as described above and a derivative may be designated as a hedged item.

The hedged item must generally be with a party external to the reporting entity, however, as an exception the foreign currency risk of an intragroup monetary item may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation. In addition, the foreign currency risk of a highly probable forecast intragroup transaction may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated profit or loss.

An entity may designate an item in its entirety or a component of an item as the hedged item. The component may be a risk component that is separately identifiable and reliably measurable; one or more selected contractual cash flows; or components of a nominal amount.

A group of items including net positions is an eligible hedged item only if:

- it consists of items individually, eligible hedged items;
- the items in the group are managed together on a group basis for risk management purposes; and
- in the case of a cash flow hedge of a group of items whose variabilities in cash flows are not expected to be approximately proportional to the overall variability in cash flows of the group:
    - it is a hedge of foreign currency risk; and
    - the designation of that net position specifies the reporting period in

which the forecast transactions are expected to affect profit or loss, as well as their nature and volume.

For a hedge of a net position whose hedged risk affects different line items in the statement of profit or loss and other comprehensive income, any hedging gains or losses in that statement are presented in a separate line from those affected by the hedged items.

Accounting for qualifying hedging relationships

There are three types of hedging relationships:

1. Fair value hedge: a hedge of the exposure to changes in fair value of a recognised asset or liability or an unrecognised firm commitment, or a component of any such item, that is attributable to a particular risk and could affect profit or loss (or OCI in the case of an equity instrument designated as at FVTOCI).

   For a fair value hedge, the gain or loss on the hedging instrument is recognised in profit or loss (or OCI, if hedging an equity instrument at FVTOCI and the hedging gain or loss on the hedged item adjusts the carrying amount of the hedged item and is recognised in profit or loss. However, if the hedged item is an equity instrument at FVTOCI, those amounts remain in OCI. When a hedged item is an unrecognised firm commitment the cumulative hedging gain or loss is recognised as an asset or a liability with a corresponding gain or loss recognised in profit or loss.

   If the hedged item is a debt instrument measured at amortised cost or FVTOCI any hedge adjustment is amortised to profit or loss based on a recalculated effective interest rate. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for hedging gains and losses.

2. Cash flow hedge: a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with all, or a component of, a recognised asset or liability (such as all or some future interest payments on variable-rate debt) or a highly probable forecast transaction, and could affect profit or loss. For a cash flow hedge the cash flow hedge reserve in equity is adjusted to the lower of the following (in absolute amounts):

- the cumulative gain or loss on the hedging instrument from inception of the hedge; and
- the cumulative change in fair value of the hedged item from inception of the hedge.

The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in OCI and any remaining gain or loss is hedge ineffectiveness that is recognised in profit or loss.

If a hedged forecast transaction subsequently results in the recognition of a non-financial item or becomes a firm commitment for which fair value hedge accounting is applied, the amount that has been accumulated in the cash flow hedge reserve is removed and included directly in the initial cost or other carrying amount of the asset or the liability. In other cases the amount that has been accumulated in the cash flow hedge reserve is reclassified to profit or loss in the same period(s) as the hedged cash flows affect profit or loss.

When an entity discontinues hedge accounting for a cash flow hedge, if the hedged future cash flows are still expected to occur, the amount that has been accumulated in the cash flow hedge reserve remains there until the future cash flows occur; if the hedged future cash flows are no longer expected to occur, that amount is immediately reclassified to profit or loss.

A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or a cash flow hedge.

3. <u>Hedge of a net investment in a foreign operation</u> (as defined in IAS 21), including a hedge of a monetary item that is accounted for as part of the net investment, is accounted for similarly to cash flow hedges:
   - the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in OCI; and
   - the ineffective portion is recognised in profit or loss.

   The cumulative gain or loss on the hedging instrument relating to the effective portion of the hedge is reclassified to profit or loss on the disposal or partial disposal of the foreign operation.

Hedge effectiveness requirements

In order to qualify for hedge accounting, the hedge relationship must meet the following effectiveness criteria at the beginning of each hedged period:

- there is an economic relationship between the hedged item and the hedging instrument;
- the effect of credit risk does not dominate the value changes that result from that economic relationship; and

- the hedge ratio of the hedging relationship is the same as that actually used in the economic hedge.

Rebalancing and discontinuation

If a hedging relationship ceases to meet the hedge effectiveness requirement relating to the hedge ratio but the risk management objective for that designated hedging relationship remains the same, an entity adjusts the hedge ratio of the hedging relationship (i.e. rebalances the hedge) so that it meets the qualifying criteria again.

An entity discontinues hedge accounting prospectively only when the hedging relationship (or a part of a hedging relationship) ceases to meet the qualifying criteria (after any rebalancing). This includes instances when the hedging instrument expires or is sold, terminated or exercised. Discontinuing hedge accounting can either affect a hedging relationship in its entirety or only a part of it (in which case hedge accounting continues for the remainder of the hedging relationship).

Time value of options

When an entity separates the intrinsic value and time value of an option contract and designates as the hedging instrument only the change in intrinsic value of the option, it recognises some or all of the change in the time value in OCI which is later removed or reclassified from equity as a single amount or on an amortised basis (depending on the nature of the hedged item) and ultimately recognised in profit or loss. This reduces profit or loss volatility compared to recognising the change in value of time value directly in profit or loss.

Forward points and foreign currency basis spreads

When an entity separates the forward points and the spot element of a forward contract and designates as the hedging instrument only the change in the value of the spot element, or when an entity excludes the foreign currency basis spread from a hedge the entity may recognise the change in value of the excluded portion in OCI to be later removed or reclassified from equity as a single amount or on an amortised basis (depending on the nature of the hedged item) and ultimately recognised in profit or loss. This reduces profit or loss volatility compared to recognising the change in value of forward points or currency basis spreads directly in profit or loss.

Credit exposures designated at FVTPL

If an entity uses a credit derivative measured at FVTPL to manage the credit risk of a financial instrument (credit exposure) it may designate all or a proportion of that financial instrument as measured at FVTPL if:

- the name of the credit exposure matches the reference entity of the credit derivative ('name matching'); and
- the seniority of the financial instrument matches that of the instruments that can be delivered in accordance with the credit derivative.

An entity may make this designation irrespective of whether the financial instrument that is managed for credit risk is within the scope of IFRS 9 (for example, it can apply to loan commitments that are outside the scope of IFRS 9). The entity may designate that financial instrument at, or subsequent to, initial recognition, or while it is unrecognised and shall document the designation concurrently.

If designated after initial recognition, any difference in the previous carrying amount and fair value is recognised immediately in profit or loss.

An entity discontinues measuring the financial instrument that gave rise to the credit risk at FVTPL if the qualifying criteria are no longer met and the instrument is not otherwise required to be measured at FVTPL. The fair value at discontinuation becomes its new carrying amount.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following specific topics:

- Embedded Derivatives (paragraph 4.1)
- Hedge Accounting (paragraph 4.2)

that could be considered by Group Component to make decisions on accounting issues related to these topics.

4.1 Embedded Derivatives

4.1.1 Presentation

Example 4.1.1.1

Presentation of embedded derivative in the statement of financial position

Consider the application of the two policies described immediately above in the following five examples in which the embedded derivative would be separately accounted for under IAS 39.

Scenario 1

Issued debt with maturity in five years with a separated embedded put option that allows the holder to put the debt instrument back to the issuer every six months' time at an amount not approximately equal to the debt host contract's amortised cost.

Scenario 2

Same as Scenario 1 except that the issuer has a call option (rather than the holder having a put option). The issuer does not expect the call to be exercised in the next 12 months.

Scenario 3

Issued debt with maturity in five years with no put or call options but principal payment depends on the performance of a specified equity index.

Scenario 4

An executory contract to buy a non-financial item in five years when the price paid is based on a non-closely related foreign currency. The non-financial host contract is treated as an executory contract outside the scope of IAS 39. The embedded non-closely related foreign currency derivative is separately recognised at fair value through profit or loss.

Scenario 5

An operating lease with five years to maturity with a non-closely related embedded inflation derivative (e.g. the lease rentals are linked to leveraged inflation).

Depending on the entity's accounting policy, the presentation options are as follows.

	Policy 1	**Policy 2**
Scenario	Separate presentation of host contract and derivative, but assessment of current/non-current based on the whole hybrid arrangement because the embedded cannot be settled separately from the host contract.	No separate presentation of host contract and embedded, and assessment of current/non-current based on the whole hybrid arrangement because the embedded cannot be settled separately from the host contract.
1 Debt with written put	Derivative (D): current liability; Host (H): current liability	Whole instrument: current liability
2 Debt with purchased call	D: non-current asset*; H: non-current liability	Whole instrument: non-current liability*
3 Debt linked to equity index	D: non-current asset/liability; H: non-current liability	Whole instrument: non-current liability
4 Executory contract with foreign currency derivative	D: non-current asset/liability; H: not recognised	D: non-current asset/liability; H: not recognised
5 Operating lease with inflation derivative	D: non-current asset/liability; H: not recognised	D: non-current asset/liability; H: not recognised

The list of scenarios above is not intended to be exhaustive.

* Because the issuer does not expect to call the debt in the 12 months after the reporting date, the derivative and host contract are both non-current. If the issuer expected to call the debt in the 12 months following the reporting date the derivative and host contract would be both presented as current in the statement of financial position.

4.1.2 Measurement

Example 4.1.2.1

Accounting for foreign currency derivative embedded in executory contract

Entity A, a UK-based entity with Sterling as its functional currency, enters into a contract to purchase cocoa from a local supplier, Entity B, in six months for a fixed amount of US dollars. The US dollar is not the functional currency of either party to the transaction. The cocoa will be delivered and used over a reasonable period in the normal course of business.

Because the cocoa will be physically delivered and is for use in the normal course of business, the contract qualifies for the purchase requirements scope exception and therefore is not wholly in the scope of IAS 39. This means that the entire contract is not a derivative recognised in the statement of financial position at fair value with changes in fair value recognised in profit or loss.

The contract still needs to be assessed for embedded derivatives. The contract contains an embedded foreign currency forward that is not closely related because the contract will be settled in US dollars and US dollars is neither the functional currency of either counterparty to the contract nor the currency in which the price of cocoa is routinely denominated in commercial transactions throughout the world. It is also not the currency commonly used in contracts to purchase or sell non-financial items in the UK. This embedded derivative must be separated from the host purchase contract and accounted for in the statement of financial position at fair value. Changes in fair value (arising from changes in the Sterling/US dollar exchange rate) will be recognised in profit or loss.

Assume the contract is entered into on 1 January 20X5. The contract is over a specified amount of cocoa for US$150,000. The 6-month forward exchange rate is US$1.5:£1. The 3-month forward exchange rate on 31 March 20X5 (Entity A's year end) is US$1.2:£1, and the spot exchange rate on 30 June 20X5 (when the cocoa is delivered) is US$1.25:£1. From the point of view of Entity A, the contract will be accounted for as a foreign currency forward contract to sell US dollars and buy Sterling, and an unrecognised executory contract to sell Sterling and buy inventories.

There are no entries on 1 January because the embedded derivative is a non-optional derivative with a fair value of zero at inception. At 31 March, the forward exchange rate has moved and so Entity A now expects US$150,000 to be equivalent to £125,000, rather than £100,000. There is a fair value loss on the forward contract, so the entry is as follows.

		£	£
Dr	Profit or loss	25,000	
Cr	Forward liability		25,000

To record the remeasurement of the forward liability.

On 30 June, the forward liability has decreased in value, because US$150,000 will cost £120,000. The entry is as follows.

		£	£
Dr	Forward liability	5,000	
Cr	Profit or loss		5,000

To record the remeasurement of the forward liability.

Entity A now pays US$150,000 to buy the cocoa under the purchase contract.

		£	£
Dr	Inventories	120,000	
Cr	Cash		120,000

To record the purchase of cocoa.

Entity A must also remove the embedded derivative from its statement of financial position.

		£	£
Dr	Forward liability	20,000	
Cr	Inventories		20,000

To eliminate the embedded derivative.

The inventories are recognised in the statement of financial position at £100,000. This is US$150,000 translated at the forward rate contracted on 1 January. When the inventories are sold, the cost of sales will be £20,000 lower than expected (based on cash paid on 30 June). This is because a £20,000 loss has already been recognised in profit or loss as a result of fair valuing the embedded derivative.

Note: for illustrative purposes only, this example ignores the time value of money for the purpose of valuing the forward contract.

Example 4.1.2.2

Allocating the proceeds to the embedded derivative

Entity A invests CU1 million in a convertible bond. The bond has a coupon of 6 per cent, a maturity of five years, and is convertible into a fixed number of equity shares at maturity of the bond. Using a Black-Scholes model, it is determined that the fair value of the conversion option is CU100,000. Assuming that the entire bond is not carried at FVTPL, separation of the embedded derivative is necessary. The amount assigned to the bond is determined by subtracting the fair value of the option from the consideration paid to purchase the bond. The entry on purchasing the asset is as follows.

		CU	**CU**
Dr	Bond	900,000	
Dr	Equity conversion option	100,000	
Cr	Cash		1,000,000

To record the purchase of the convertible bond

4.2 Hedge Accounting

4.2.1 Fair value hedge

Example 4.2.1.1

Fair value hedging fixed rate debt

On 1 January 20X0, Entity C issued £100 million of five-year 8 per cent fixed rate debt. Entity C has a BBB credit rating at the issuance date. The fixed interest rate on the debt is 150 basis points higher than the five-year swap rate. Interest on the debt is payable semi-annually. Entity C’s interest rate risk policy requires that all debt is at variable rates which is achieved either through issuing variable rate debt or by issuing fixed rate debt and swapping it into variable.

In order to maintain compliance with this policy Entity C entered into an interest rate swap on 1 January 20X0 to 'convert' the debt from fixed rate to variable and designated the swap (identifying and documenting all critical terms) as a fair value hedge of interest rate risk on the fixed rate debt (credit spreads are purposely not hedged). The swap is a five-year pay 6-month LIBOR, receive 6.50 per cent fixed interest rate swap.

Entity C satisfies the hedge accounting criteria:

- The fair value of Entity C's issued fixed rate debt will vary with changes in market interest rates. Such changes could have an impact in profit or loss if the debt is extinguished early. Hence, the debt qualifies for fair value hedge accounting (it is not a non-qualifying exposure).
- Entity C has formally documented the hedging relationship from inception, identifying all critical terms.
- The hedge is consistent with Entity C's risk management policy for that hedging relationship.
- Entity C expects its hedge to be highly effective and has documented this assessment. The primary potential source of ineffectiveness in a fair value hedge of fixed rate debt is credit risk. Entity C is using an interest rate swap to hedge interest rate risk only. Hence, changes in credit spreads between Entity C's BBB rate and swap rates will not generate hedge ineffectiveness.

Note that the principal terms of the hedged item and the hedging instrument match. IAS 39 recognises that if the principal terms of the hedging instrument and the hedged item are the same, then the changes in fair value attributable to the risk being hedged may be likely to offset each other fully, both at inception and afterwards. Entity C is required, however to assess effectiveness on an ongoing basis.

The fair value of the swap and the carrying amount of the debt following the adjustment for changes in fair value attributable to the hedged risk are as follows. Note that the journal entries to recognise interest on the hedged item and the net interest settlements are not presented in this example.

	1/1/20X0	**30/6/20X0**	**31/12/20X0**
Issued debt	£(100,000,000)	£(105,000,000)	£(102,000,000)
Swap	£nil	£4,800,000	£1,900,000

The required entries are as follows.

1 January 20X0

		£	£
Dr	Cash	100,000,000	
Cr	Debt		100,000,000

To recognise the issuance of debt.

No entries are required in respect of the swap because it was entered into at the money when the fair value was zero.

30 June 20X0

		£	£
Dr	Profit or loss	5,000,000	
Cr	Debt		5,000,000
Dr	Swap	4,800,000	
Cr	Profit or loss		4,800,000

To recognise changes in the fair value of the debt and of the swap.

The net impact in profit or loss of £200,000 reflects that the changes in fair value of the swap do not fully offset the changes in the fair value of the debt for the designated risk. The difference is due to credit risk of the counterparty bank which is not present in the hedged item.

31 December 20X0

		£	£
Dr	Debt	3,000,000	
Cr	Profit or loss		3,000,000
Dr	Profit or loss	2,900,000	
Cr	Swap		2,900,000

To recognise changes in the fair value of the debt and of the swap.

The net impact in profit or loss of £100,000 reflects that the changes in fair value of the swap do not fully offset the changes in the fair value of the debt for the designated risk.

Note that the carrying amount of the debt in the statement of financial position will not represent its full fair value but will be a hybrid of amortised cost and an element of its fair value which is due to movements in interest rates since the inception of the hedging relationship. Other factors, such as changes in the entity's credit spread, could impact the fair value of the debt, but the hedged item is not adjusted for movements in that risk.

Example 4.2.1.2

Hedging a firm commitment with a non-derivative

On 1 January 20X4, Entity B has a firm commitment to purchase equipment (a non-financial asset) from Entity M, a French entity. Entity B's functional currency is Sterling and Entity M's is Euro. The firm commitment requires B to pay €30 million for the equipment for delivery on 1 January 20X5. Entity B has a 31 March year-end.

Entity B currently has €30 million on deposit with a European bank maturing on 1 January 20X5 on which it currently recognises in profit or loss foreign exchange gains and losses at the end of each reporting period. Entity B would like to use its Euro deposit balance as a hedge of its commitment to purchase the equipment.

Entity B can designate the cash deposit as a hedging instrument in either a cash flow or a fair value hedge of the spot foreign currency risk of the firm commitment. The spot foreign exchange rates are as follows.

Date	Exchange rate	Sterling equivalent of €30m	Movement
1 January 20X4	1.4321	20,948,257	
31 March 20X4	1.4282	21,005,461	57,204
1 January 20X5	1.4511	20,673,971	(331,490)

The entries below do not consider the accounting for the deposit before 1 January 20X4. Up to this date, the monetary asset will have been reported at the spot rate at the end of each reporting period, with exchange gains and losses recognised in profit or loss.

Entity B designates the hedge as a *fair value hedge* of the spot foreign currency risk of the firm commitment.

1 January 20X4

There are no entries. The firm commitment has a fair value of zero.

31 March 20X4

		£	£
Dr	Deposit	57,204	
Cr	Profit or loss		57,204

To recognise the foreign exchange gain on remeasurement of the deposit.

		£	£
Dr	Profit or loss	57,204	
Cr	Firm commitment		57,204

To recognise the change in fair value of the firm commitment relating to the hedged risk (foreign currency spot movements).

1 January 20X5

		£	£
Dr	Profit or loss	331,490	
Cr	Deposit		331,490

To recognise the foreign currency exchange loss on remeasurement of the deposit.

		£	£
Dr	Firm commitment	331,490	
Cr	Profit or loss		331,490

To recognise the change in fair value of the firm commitment relating to the hedged risk (foreign currency spot movements).

		£	£
Dr	Property, plant, equipment	20,948,257	
Cr	Firm commitment		274,286
Cr	Cash		20,673,971

To recognise the acquisition of the asset and derecognition of the firm commitment that has now been extinguished. The carrying amount of the *non-financial asset is the Sterling equivalent of €30 million, translated at the spot rate when the hedge was entered into.*

		£	£
Dr	Cash	20,673,971	
Cr	Deposit		20,673,971

To recognise the repayment of the deposit upon its maturity on 1 January 20X5.

Entity B designates the hedge as a *cash flow hedge* of the spot foreign currency risk of the firm commitment.

If Entity B has an accounting policy not to apply basis adjustments to non-financial items in cash flow hedges, the amount recognised in other comprehensive income will be retained in equity at the acquisition date of the equipment and will be reclassified from equity to profit or loss in future periods when the depreciation of the equipment will impact profit or loss. In this case, the carrying amount of the equipment would be £20,673,971.

4.2.2 Cash flow hedge

Example 4.2.2.1

Forecast sale of a non-financial item

On 4 January 20X0 Entity B has a forecast sale of 500 tonnes of wheat expected to occur on or about 31 December 20X0.

On 4 January 20X0 Entity B designates the cash flows of the forecasted sale as a hedged item and enters into a wheat futures contract to sell 500 tonnes at US$1.1 million on 31 December 20X0.

At inception of the hedge, the derivative is at-the-money (fair value is zero). The terms of the forecast sale and the derivative match. On 31 December 20X0, the wheat futures contract has a fair value of US$25,000 and is closed out. Entity B sells the inventory with a cost of US$1,000,000 for US$1,075,000.

The required entries are as follows.

31 December 20X0

		US$	US$
Dr	Wheat futures contract	25,000	
Cr	Other comprehensive income		25,000

To recognise the wheat futures contract at fair value (note that the changes in fair value of the derivative are recognised in other comprehensive income until the hedged forecast sale occurs).

31 December 20X0

		US$	US$
Dr	Cash	25,000	
Cr	Wheat futures contract		25,000

To recognise the settlement of the wheat futures contract.

		US$	US$
Dr	Cash	1,075,000	
Dr	Cost of goods sold	1,000,000	
Cr	Revenue		1,075,000
Cr	Inventories		1,000,000

To recognise the sale of inventories with a cost of US$1,000,000.

		US$	US$

Dr	Other comprehensive income	25,000	
Cr	Revenue		25,000

To recognise the reclassification of the gain on the hedging instrument from other comprehensive income to revenue.

Revenue of US$1,100,000 is recognised. This represents US$1,075,000 from the sale of wheat at spot prices, plus the gain on the derivative. The sum of the two equals the sale of wheat at the hedged rate.

Example 4.2.2.2

Cash flow hedging the foreign currency risk of a forecast sale of a non-financial item

On 4 January 20X2, Entity D has a forecast sale of €4,000,000 of confectionery on or about 31 December 20X2 to a German retail outlet (Entity AG). Entity D has a Sterling functional currency, and Entity AG has a Euro functional currency. On 4 January 20X2, Entity D designates the cash flow of the forecast sale as a hedged item and enters into a currency forward to sell €4 million based on the forecast receipt. The forward contract locks in the value of the Euros to be received at a rate of €1.5:£. At inception of the hedge, the derivative is on-market (i.e. fair value is zero). The terms of the currency forward and the forecast sale match each other. The entity designates the forward foreign exchange risk as the hedged risk.

Potential sources of ineffectiveness include non-occurrence of the forecast transaction and changes in the date of sale. Any ineffectiveness will be recognised in profit or loss.

On 30 June 20X2, the fair value of the currency forward is negative £100,000 because the forward rate has changed, reflecting the fact that the Euro has strengthened against Sterling.

On 31 December 20X2, the transaction occurred as expected. The fair value of the forward is negative £111,111 because the Euro continued to strengthen against Sterling.

The required entries are as follows.

4 January 20X2

No entries are required because the forward was entered into 'on-market', and therefore had a fair value of zero at inception. Normally, there will be margin to be posted, associated with trading on a currency exchange, but this has been ignored for illustration purposes only. There may also be fees if the foreign exchange contract is an over-the-counter (OTC) transaction.

30 June 20X2

		£	**£**
Dr	Other comprehensive income	100,000	
Cr	Forward		100,000

To recognise the forward contract at fair value, reflecting that the forward contract is fully effective in hedging the forward rate of the forecast transaction.

31 December 20X2

		£	**£**
Dr	Other comprehensive income	11,111	
Cr	Forward		11,111

To recognise the change in fair value of the forward contract. The forward contract remains fully effective in hedging the forward rate of the forecast transaction.

		£	**£**
Dr	Forward	111,111	
Cr	Cash		111,111

To recognise the cash paid in settling the forward contract.

£	**£**

Dr	Cash	2,777,778	
Cr	Sales		2,777,778

To recognise the receipt of €4m from the sale of confectionery translated at the spot rate of €1.44:£.

		£	£
Dr	Sales	111,111	
Cr	Other comprehensive income		111,111

To recognise the cumulative effective portion of the hedging instrument included in other comprehensive income that is reclassified from equity to profit or loss when the sale occurs.

The net effect of reclassifying the amount from equity to profit or loss when the sale occurred is equivalent to recognising in profit or loss the sale translated at the contracted rate inherent in the forward (i.e. €4,000,000/€1.5:£).

Translation of sale at spot rate at 31 December 20X2	£2,777,778
Reclassified from equity to profit or loss at 31 December 20X2	(£111,111)
	£2,666,667

4.2.3 Net investment hedges

Example 4.2.3.1

Net investment hedging the spot foreign currency rate

On 1 November 20X1, Entity XYZ enters into a forward contract to sell US$1,000,000 and buy Sterling at a fixed rate of US$1.57:£1 on 30 January 20X2. Group XYZ has a 31 December year end and is headed by Entity XYZ, which has a Sterling functional currency. The forward contract is entered into to hedge the foreign exchange translation risk associated with movements in the spot rate relating to its investment in its US subsidiary with a US dollar functional currency, Entity ABC, which has net assets of US$1,000,000 in Group XYZ's consolidated financial statements.

The forward and spot US$/£ translation rates are as follows.

	1/11/X1	**31/12/X1**	**30/1/X2**
Spot	1.55	1.59	1.61
Forward (to 30/1/X2)	1.57	1.60	n/a

On 30 January 20X2, Entity XYZ closes out the forward contract, and also sells Entity ABC for US$1,200,000 which is equal to £745,342 translated at US$1.61:£1.

Translating US$1,000,000 at the above rates gives the following Sterling amounts.

	1/11/X1	**31/12/X1**	**30/1/X2**
Spot	1.55	1.59	1.61
Sterling amount	£645,161	£628,931	£621,118
Forward (to 30/1/X2)	1.57	1.60	n/a
Sterling amount	£636,943	£625,000	

Therefore, the value of the derivative is as follows (for purposes of illustration, ignoring the time value of money).

Date	**Derivative value**	**How calculated**
31/12/X1	£11,943	£636,943 – £625,000
30/1/X2	£15,825	£636,943 – £621,118

Movements in the fair value of the premium (or discount) implicitly inherent in the fair value of the forward contract will not give rise to hedge ineffectiveness, because the designated hedged risk is movements in spot rate only and, therefore, those movements are excluded from the designated hedging relationship. However, movements in the fair value of these forward points will give rise to volatility in profit or loss.

The entries are as follows.

31 December 20X1

		£	**£**
Dr	Other comprehensive income	16,230	
Cr	Net assets		16,230

To recognise the foreign exchange difference on translation of the net assets at the spot rate (i.e. translating the investment at 1.59 rather than 1.55).

		£	**£**
Dr	Derivative	11,943	
Dr	Profit or loss	4,287*	
Cr	Other comprehensive income		16,230

To recognise the change in the fair value of the derivative, the effective portion in other comprehensive income and the undesignated portion in profit or loss.

30 January 20X2

		£	**£**
Dr	Other comprehensive income	7,813	
Cr	Net assets		7,813

To recognise the foreign exchange difference on translation of the net assets at the spot rate (i.e. translating the investment at 1.61 rather than 1.59).

		£	£
Dr	Derivative	3,882	
Dr	Profit or loss	3,931*	
Cr	Other comprehensive income		7,813

To recognise the change in the fair value of the derivative, the effective portion in other comprehensive income and the undesignated portion in profit or loss.

		£	£
Dr	Cash	15,825	
Cr	Derivative		15,825

To recognise the cash settlement of the derivative at its maturity.

		£	£
Dr	Cash	745,342	
Cr	Profit or loss		100,181
Cr	Net assets		621,118
Cr	Other comprehensive income		24,043

To recognise the sale proceeds and profit on disposal.

		£	£

Dr	Other comprehensive income	24,043	
Cr	Profit or loss		24,043

To recognise the reclassification of the hedging gains and losses from equity to profit or loss.

The total, post hedge, profit on disposal is £124,224 (£100,181 + £24,043).

It is assumed for illustrative purposes only that the total net assets of the foreign operation are unaffected by the application of [IFRS 5] *Non-current Assets Held for Sale and Discontinued Operations* to the disposal group, i.e. the carrying amount of the net assets is lower than the fair value less costs to sell.

* relates to forward point

Example 4.2.3.2

Net investment hedging the forward foreign currency rate

Movements in the fair value of the premium (or discount) implicit in the forward contract, the forward points, will now be recognised in other comprehensive income (rather than in profit or loss) and will therefore give rise to equity volatility. These amounts will be reclassified from equity to profit or loss when the subsidiary is sold.

The required entries are as follows.

31 December 20X1

		£	£
Dr	Other comprehensive income	16,230	
Cr	Net assets		16,230

To recognise the foreign exchange difference on translation of the net assets at the spot rate (i.e. translating the investment at 1.59).

		£	£

Dr	Derivative	11,943	
Cr	Other comprehensive income		11,943

To recognise the change in the fair value of the derivative that is fully effective.

30 January 20X2

		£	£
Dr	Other comprehensive income	7,813	
Cr	Net assets		7,813

To recognise the movements in the investment relating to the spot rate movement (i.e. translating the investment at 1.61).

		£	£
Dr	Derivative	3,882	
Cr	Other comprehensive income		3,882

To recognise the change in the fair value of the derivative that is fully effective.

		£	£
Dr	Cash	15,825	
Cr	Derivative		15,825

To recognise the cash settlement of the derivative at its maturity.

		£	£
Dr	Cash	745,342	

Cr	Profit or loss		100,181
Cr	Net assets		621,118
Cr	Other comprehensive income		24,043

To recognise the sale proceeds and the profit on disposal.

		£	£
Dr	Other comprehensive income	15,825	
Cr	Profit or loss		15,825

To recognise the reclassification of the hedging gains and losses from equity to profit or loss.

The total, post hedge, profit on disposal is £116,006 (£100,181 + £15,825).

Compared to example 4.2.3.1, the profit on disposal is £8,218 lower because in the previous example the fair value of the forward points was recognised in profit or loss throughout the life of the hedge relationship.

It is assumed for illustrative purposes only that the total net assets of the foreign operation are unaffected by the application IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* to the disposal group, i.e. the net assets are lower than the fair value less costs to sell.

5 PRESENTATION

5.1 Disclosures Rules

As mentioned before, disclosure rules for financial instruments are provided by IFRS 7, IFRS 13 and IAS 32. For a complete overview of the standard, see Chapter 5 – *Financial Instruments*.

Presentation of derivatives

Current versus non-current

Where assets and liabilities are not presented in the statement of financial position in order of liquidity, derivatives will need to be presented as current and non-current assets, and current and non-current liabilities in accordance with [IAS 1] *Presentation of Financial Statements*.

A derivative that has a maturity of less than 12 months from the end of the reporting period or has a maturity greater than 12 months but is expected to be settled within 12 months should be presented as a current asset or liability in the statement of financial position. A derivative that has a maturity of more than 12 months from the end of the reporting period and is not intended to be settled within 12 months will be presented as a non-current asset or liability.

Prior to the issue of *Improvements to IFRSs* in May 2008, there was ambiguity as to whether derivatives with a maturity greater than 12 months that are not intended to be settled within 12 months and were not part of a designated and effective hedge accounting relationship could be presented as non-current because these instruments also met the definition of held for trading in IAS 39.9. An amendment to IAS 1 included as part of *Improvements to IFRSs* clarified that, in such instances, the derivatives should be presented as non-current because the derivative is not held primarily for trading purposes.

Presentation in profit or loss

Fair value gains and losses on derivatives in hedge accounting relationships

IAS 39 provides limited guidance on the appropriate presentation in profit or loss of gains and losses on derivatives in highly effective hedge accounting relationships. However, an analogy can be drawn with the principle in IAS 39:IG.G.2 that describes how cash flows arising from hedging instruments should be classified in statements of cash flows. The implementation guidance states that cash flows arising from hedging instruments are classified as operating, investing or financing activities on the basis of the classification of the cash flows arising from the hedged item. Therefore, it appears appropriate that gains and losses in highly effective hedge accounting relationships are presented in the same line in the statement of comprehensive income as the hedged item affects profit or loss. If gains and losses are material, separate presentation of those gains and losses in profit or loss would be required. An item that is not sufficiently material to warrant separate presentation on the face of the statement of comprehensive income may nevertheless be sufficiently material for it to be presented separately in the notes.

Fair value gains and losses on derivatives that are economic hedges

IAS 39 requires gains and losses on derivatives to be reported in profit or loss when hedge accounting is not applied. However, the Standard does not specify where such gains and losses would be presented within profit or loss.

Presentation of embedded derivatives

IFRSs do not provide specific guidance on the presentation of embedded derivatives in the statement of financial position or in profit or loss. IAS 39.11 has an explicit statement articulating that IFRSs do not address whether an embedded derivative should be presented separately in the statement of financial position.

It seems appropriate for an entity to choose as an accounting policy whether it presents a hybrid contract in its statement of financial position as a single contractual arrangement or non-closely related embedded derivatives as separate financial assets or liabilities. The policy should be applied consistently to all hybrid contracts.

If an entity chooses to present the embedded derivative(s) and the host contract as a single contractual arrangement, it must still comply with IFRS 7.8 and IFRS 7.20(a), which require an analysis of the carrying amounts of financial instruments, and of gains or losses in the period, by IAS 39 classification category. Irrespective of the policy adopted for presentation (as discussed in the previous paragraph), the embedded derivative component will always be classified as at FVTPL for measurement purposes (except if it is designated in a qualifying and effective hedge relationship); the host contract, if it is a financial instrument in the scope of [IAS 39], will be in a different category, such as loans and receivables, AFS or HTM.

In addition, an entity must determine if the embedded derivative is current or non-current under [IAS 1] *Presentation of Financial Statements* when an entity does not present assets and liabilities in order of liquidity. Two accounting policies are considered acceptable, as set out below.

Policy 1

Separate presentation of the host and the embedded derivative, but assessment regarding classification as current or non-current based on the cash flows of the whole hybrid arrangement because embedded derivatives cannot be settled separately from the host contract.

Policy 2
No separate presentation of the host and the embedded derivative, and assessment regarding classification as current or non-current based on the cash flows of the whole hybrid arrangement because embedded derivatives cannot be settled separately from the host contract.

Offsetting a financial asset and a financial liabilities

A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

- currently has a legally enforceable right to set off the recognized amounts; and
- intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IAS 39, paragraph 36).

This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.

Offsetting a recognised financial asset and a recognised financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognised item from the statement of financial position but also may result in recognition of a gain or loss.

A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.

The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk.

However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 36 of IFRS 7.

Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organised financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realisation of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.

Fair value hierarchy

To increase consistency and comparability in fair value measurements and related disclosures, [IFRS 13] establishes a fair value hierarchy that categorises into three levels the inputs to valuation techniques used to measure fair value, as follows:

- Level 1 inputs comprise unadjusted quoted prices in active markets for identical assets and liabilities that the entity can access at the measurement date;

- Level 2 inputs comprise other observable inputs not included within Level 1 of the fair value hierarchy; and
- Level 3 inputs comprise unobservable inputs (including the entity's own data, which are adjusted, if necessary, to reflect the assumptions market participants would use in the circumstances)

Observable inputs are defined as "[i]nputs that are developed using market data, such as publicly available information about actual events or transactions, and that reflect the assumptions that market participants would use when pricing the asset or liability".

Unobservable inputs are defined as "[i]nputs for which market data are not available and that are developed using the best information available about the assumptions that market participants would use when pricing the asset or liability".
The fair value hierarchy gives the highest priority to Level 1 inputs and the lowest priority to Level 3 inputs.

For example, if a fair value measurement for an asset is based on an unadjusted quoted price in an active market for an identical asset that the entity can access at the measurement date, this is categorised within 'Level 1' of the fair value hierarchy. In contrast, a valuation based on unobservable inputs would be categorised within 'Level 3'.

When an entity approaches the measurement of an asset, or a liability, or an entity's own equity instrument, at fair value, it looks at the available valuation techniques and at the inputs available for those techniques. When selecting the techniques and inputs to be used, the entity is required to maximise the use of observable inputs and minimise the use of unobservable inputs. Once the selection has been made, each of the inputs is categorised within the fair value hierarchy outlined above; When an entity has determined the appropriate categorisation of the inputs into a fair value measurement, and has arrived at a measure of fair value using those inputs, it is then necessary to determine the appropriate categorisation of the fair value measurement in its entirety.

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
A quoted price for an identical asset or liability in an active market provides the most reliable evidence of fair value and should be used without adjustment to measure fair value whenever available, An active market is defined as "[a] market in which transactions for the asset or liability take place with sufficient frequency and volume to provide pricing information on an ongoing basis".

Level 2 inputs are inputs other than quoted prices included within Level 1 that are

observable for the asset or liability, either directly or indirectly.
Level 2 inputs include the following:

- quoted prices for similar assets or liabilities in active markets.
- quoted prices for identical or similar assets or liabilities in markets that are not active.
- inputs other than quoted prices that are observable for the asset or liability, for example:
- interest rates and yield curves observable at commonly quoted intervals;
- implied volatilities; and
- credit spreads.

inputs that are derived principally from or corroborated by observable market data by correlation or other means (market-corroborated inputs)

Level 3 inputs are unobservable inputs for the asset or liability.

Unobservable inputs should be used to measure fair value to the extent that relevant observable inputs are not available (e.g. when there is little, if any, market activity for the asset or liability at the measurement date). However unobservable inputs should reflect the assumptions that market participants would use when pricing the asset or liability, so as to achieve the general fair value measurement objective (i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability).

Unobservable inputs should reflect, among others, assumptions that market participants would make about risk. Assumptions about risk include the risk inherent in a particular valuation technique used to measure fair value (such as a pricing model) and the risk inherent in the inputs to the valuation technique. A measurement that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one when pricing the asset or liability. For example, it might be necessary to include a risk adjustment when there is significant measurement uncertainty (e.g. when there has been a significant decrease in the volume or level of activity when compared with normal market activity for the asset or liability (or similar assets or liabilities) and the entity has determined that the transaction price or quoted price does not represent fair value).

Unobservable inputs should be developed using the best information available in the circumstances, which might include an entity's own data. In developing unobservable inputs, an entity's own data, should be adjusted if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (e.g. an entity-specific synergy). [IFRS 13] does not require an entity to undertake exhaustive efforts to obtain information about market

participant assumptions. However, the entity is required to take into account all information about market participant assumptions that is reasonably available.
Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement.

[IFRS 13] provides the following examples of Level 3 inputs for particular assets and liabilities.

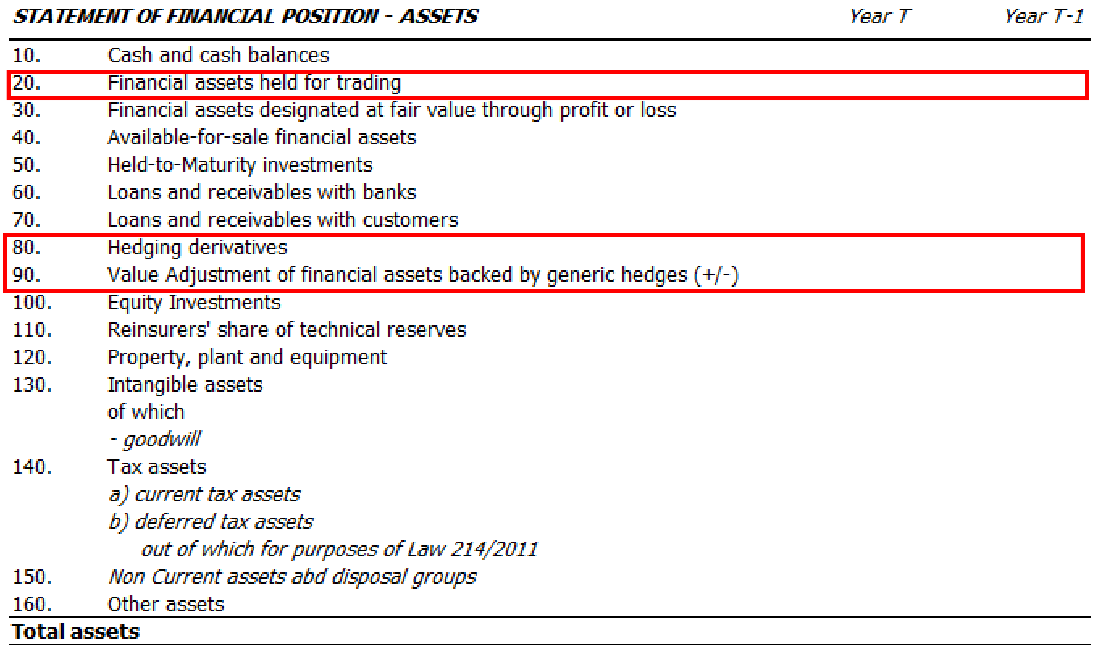
- **Long-dated currency swap** A Level 3 input would be an interest rate in a specified currency that is not observable and cannot be corroborated by observable market data at commonly quoted intervals or otherwise for substantially the full term of the currency swap. The interest rates in a currency swap are the swap rates calculated from the respective countries' yield curves.
- **Three-year option on exchange-traded shares** A Level 3 input would be historical volatility, i.e. the volatility for the shares derived from the shares' historical prices. Historical volatility typically does not represent current market participant expectations about future volatility, even if it is the only information available to price an option.
- **Interest rate swap** A Level 3 input would be an adjustment to a mid-market consensus (non-binding) price for the swap developed using data that are not directly observable and cannot otherwise be corroborated by observable market data.

5.2 Mediolanum Financial Statements disclosures

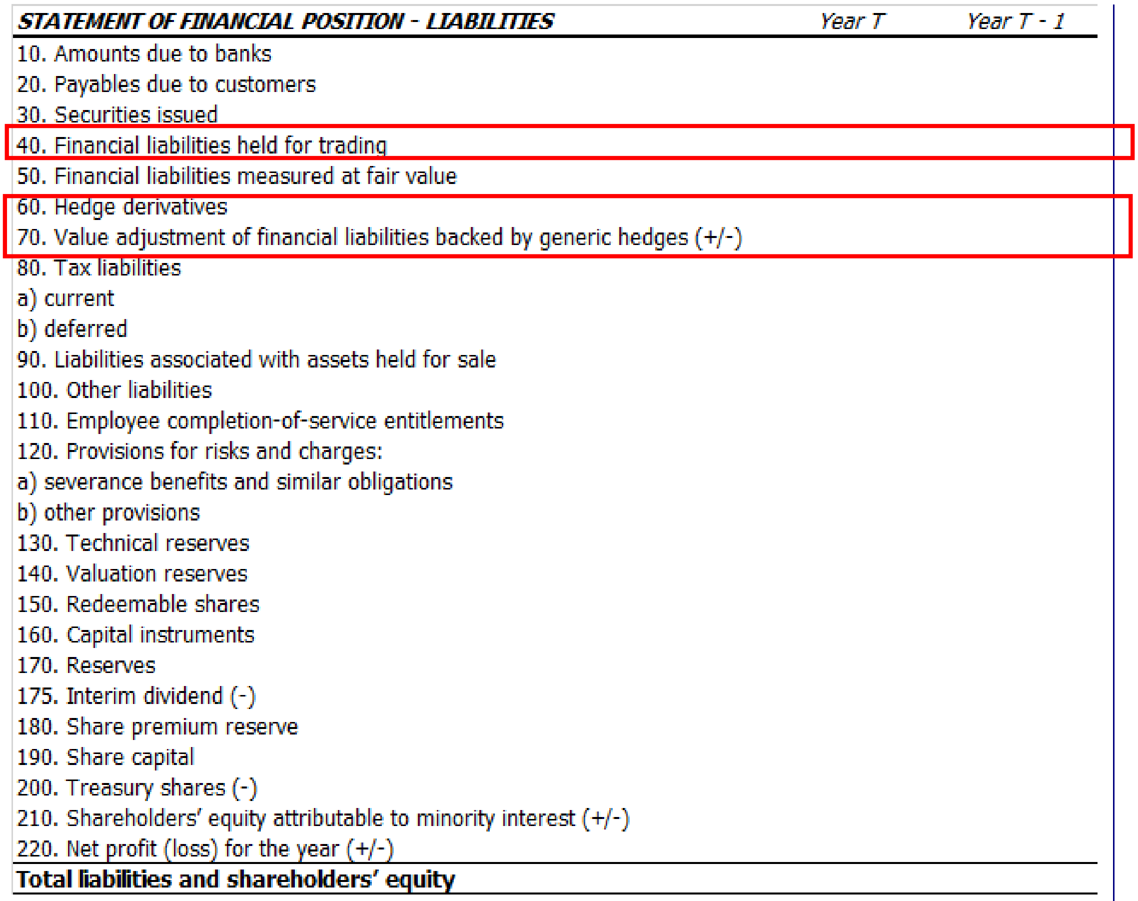
In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present derivatives in the consolidated financial statements.

As required by Bank of Italy, hedging derivatives under IAS 32/39 are enclosed among the assets and the liabilities of balance sheet, respectively in captions 80 and 60. In captions 90 and 70, is registered the positive or negative value adjustment of financial assets backed by generic hedges.

In relation to derivatives held for trading, that financial instruments are enclosed among the assets and the liabilities of balance sheet, respectively in captions 20 and 40.



STATEMENT OF FINANCIAL POSITION - ASSETS		*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			



STATEMENT OF FINANCIAL POSITION - LIABILITIES	*Year T*	*Year T - 1*
10. Amounts due to banks		
20. Payables due to customers		
30. Securities issued		
40. Financial liabilities held for trading		
50. Financial liabilities measured at fair value		
60. Hedge derivatives		
70. Value adjustment of financial liabilities backed by generic hedges (+/-)		
80. Tax liabilities		
a) current		
b) deferred		
90. Liabilities associated with assets held for sale		
100. Other liabilities		
110. Employee completion-of-service entitlements		
120. Provisions for risks and charges:		
a) severance benefits and similar obligations		
b) other provisions		
130. Technical reserves		
140. Valuation reserves		
150. Redeemable shares		
160. Capital instruments		
170. Reserves		
175. Interim dividend (-)		
180. Share premium reserve		
190. Share capital		
200. Treasury shares (-)		
210. Shareholders' equity attributable to minority interest (+/-)		
220. Net profit (loss) for the year (+/-)		
Total liabilities and shareholders' equity		

Here below, a deeper analysis of captions 80 and 60. Both the sections includes the following subcategories of derivative instruments:

a) *Financial derivatives*: fair value, cash flows, foreign investments;
b) *Credit derivatives*: fair value, cash flows.

Caption 80

8.1 Analysis of hedging derivatives by type of hedge and fair value hierarchy								
	Year T				Year T - 1			
€/t	FV				FV			
	L1	**L2**	**L3**	**NV**	**L1**	**L2**	**L3**	**NV**
A) Financial derivatives								
1) Fair value								
2) Cash flows								
3) Foreign investments								
B) Credit derivatives								
1) Fair value								
2) Cash flows								
Total								

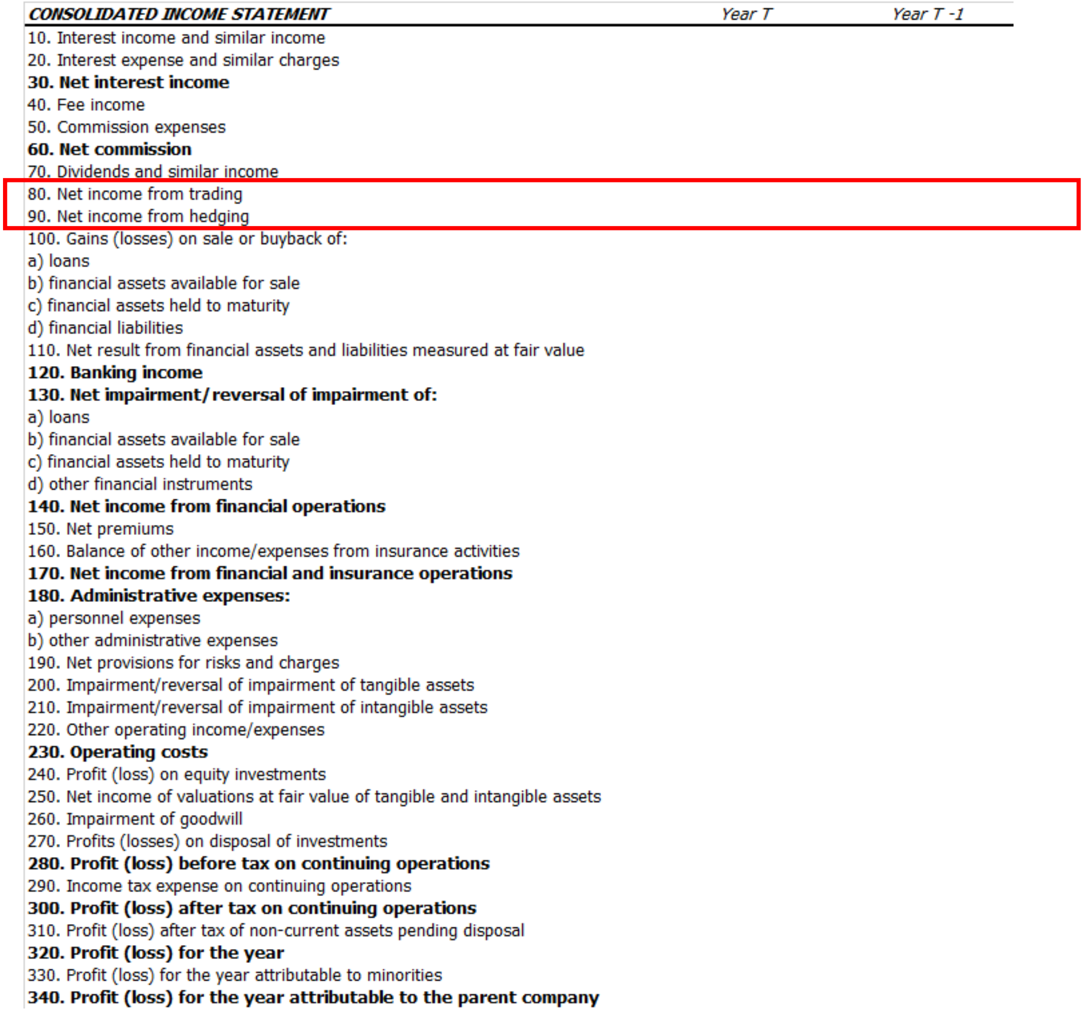
Key:
FV = fair value
NV = notional value

Caption 60

6.1 Analysis of hedging derivatives by type of hedge and fair value hierarchy								
	Year T				*Year T - 1*			
€/t	***Fair Value***			**NV**	***Fair Value***			**NV**
	L1	**L2**	**L3**		**L1**	**L2**	**L3**	
A. Financial derivatives								
1) Fair value								
2) Cash flows								
3) Foreign investments								
B. Credit derivatives								
1) Fair value								
2) Cash flows								
Total								

Key:
NV = nominal value
L1 = Level 1
L2 = Level 2
L3 = Level 3

For the general requirements of financial instruments relatively to consolidated income statement, see Chapter 5 – *Financial Instruments.*
In caption 80, are enclosed the economic effect (fair value or gains/losses on derivatives held for trading)
Here below, an analysis of caption 90, an additional item particularly involed with the topics treated in this chapter.

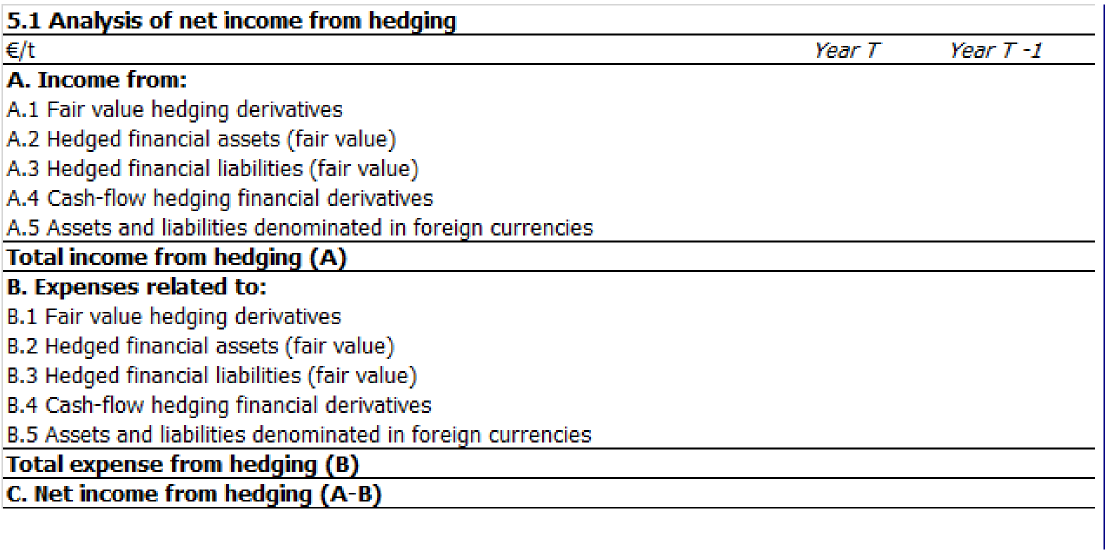


CONSOLIDATED INCOME STATEMENT	*Year T*	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

Caption 90

This section includes the following subcategories of income/expenses:

- Fair value hedging derivatives;
- Hedged financial assets (fair value);
- Hedged financial liabilities (fair value);
- Cash-flow hedging financial derivatives;
- Assets and liabilities denominated in foreign currencies.



5.1 Analysis of net income from hedging

€/t	*Year T*	*Year T -1*
A. Income from:		
A.1 Fair value hedging derivatives		
A.2 Hedged financial assets (fair value)		
A.3 Hedged financial liabilities (fair value)		
A.4 Cash-flow hedging financial derivatives		
A.5 Assets and liabilities denominated in foreign currencies		
Total income from hedging (A)		
B. Expenses related to:		
B.1 Fair value hedging derivatives		
B.2 Hedged financial assets (fair value)		
B.3 Hedged financial liabilities (fair value)		
B.4 Cash-flow hedging financial derivatives		
B.5 Assets and liabilities denominated in foreign currencies		
Total expense from hedging (B)		
C. Net income from hedging (A-B)		

IFRS Operating Manual

Chapter 7
Insurance Contracts

Chapter 8 Provisions

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides an overview of the International Accounting Standard IFRS 4, whose major impacts will be declined into three macro-areas: *Deposit Accounting, Shadow Accounting* and *Liability Adequacy Test*.

1.1 Introduction

IFRS 4 is the first guidance from the IASB on accounting for insurance contracts, although a more comprehensive project on insurance contracts is under way. IFRS 4 applies to virtually all insurance contracts (including reinsurance contracts) that an entity issues and to reinsurance contracts that it holds. It does not apply to other assets and liabilities of an insurer, such as financial assets and financial liabilities within the scope of IAS 39 Financial Instruments: *Recognition and Measurement*.

IFRS 4.2

IFRS 4.3

As mentioned above, this IFRS is a stepping stone to phase II of this project and has the aim of:

- Making limited improvements to accounting for insurance contracts until the Board complete the second phase of the project on insurance contracts.
- Requiring any entity issuing insurance contracts (an insurer) to disclose information about those contracts.

The IFRS exempts an insurer temporarily (ie during Phase I of this project) from some requirements of other IFRSs, including the requirement to consider the Framework in selecting accounting policies for insurance contracts.

IFRS 4-BC6

1.2 Overview of IFRS 4

As stated above, the current phase is a stepping stone for the completion of a wider project, Phase II, the outlines of which shall be:

- the application of an asset-and-liability approach that requires an entity to identity and measure directly the contractual rights and obligations arising from insurance contracts when preparing its financial statements;
- the measurement of assets and liabilities arising from insurance contracts at their fair value, considering the intrinsic limits associated with the lack of an active market for insurance liabilities;
- the measurement of all contractual rights and obligations associated with the book of insurance contracts including the future premiums specified in the contracts, claims, benefits, expenses and
- other additional cash flows resulting from those premiums;
- the recognition of acquisition costs as they are incurred.

IFRS 4.22

In general, IFRS 4 Phase I:

- prohibits provisions for possible claims under contracts that are not in existence at the end of the reporting period (such as catastrophe and equalisation provisions).
- requires a test for the adequacy of recognised insurance liabilities and an impairment test for reinsurance assets.
- requires an insurer to keep insurance liabilities in its statement of financial position until they are discharged or cancelled, or expire, and to present insurance liabilities without offsetting them against related reinsurance assets.

The IFRS permits an insurer to change its accounting policies for insurance contracts only if, as a result, its financial statements present information that is more relevant and no less reliable, or more reliable and no less relevant.

Moreover, the IFRS Phase I:

- clarifies that an insurer need not account for an embedded derivative separately at fair value if the embedded derivative meets the definition of an insurance contract.
- requires an insurer to unbundle (ie account separately for) deposit components of some insurance contracts, to avoid the omission of assets and liabilities from its statement of financial position.
- clarifies the applicability of the practice sometimes known as 'shadow accounting'.
- permits an expanded presentation for insurance contracts acquired in a business combination or portfolio transfer.
- addresses limited aspects of discretionary participation features contained in insurance contracts or financial instruments.

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IFRS 4 that Legal Entities have to follow for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs), not applicable for Italian insurance Companies that prepare their individual financial statements under local GAAP;
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

The paragraph describes the main improvements of IFRS 4 declining them into *Deposit Accoun*t, *Shadow Accounting* and *Liability Adequacy Tes*t.

2.1 Deposit Accounting

The following are guidelines for the classification of insurance contracts with a focus on the accounting practice known as deposit accounting.

According to IFRS 4, a contract is an insurance contract[2] if it involves the transfer of a *significant insurance risk*. Insurance risk is significant if an insured event could cause a significant decrease in the present value of the net cash flows from the contract for the Insurer. Events that consist of a change in one or more of the following factors may not be considered insured events because they are expressions of financial and not insurance risk: an interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable. **IFRS 4.6**
During Phase I of IFRS 4, contracts that qualify as insurance contracts may be accounted for according to local accounting standards.
Contracts that do not qualify as insurance contracts due to their intrinsic characteristics are considered:

- *financial financial instruments* if financial assets or liabilities arise from the contract. Such instruments must be accounted for in accordance with IAS 39. This accounting practice is referred to as "deposit accounting."
- *service contracts* that do not create financial assets or liabilities. Such contracts must be accounted for in accordance with IAS 18.

IFRS 4-B20

2.1.1 Relevant Definitions

IFRS 4-B21

2.1.1.1 Definition of an insurance contract

Insurance contract: a contract under which one party (the insurer) accepts significant

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[2] The National Association of Actuaries and the National Council of Actuaries: Guidelines for the classification of contracts issued by insurance companies in accordance with IFRS.

insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or another beneficiary if a specified uncertain future event adversely affects the policyholder.

Accordingly, the basic elements that identify a contract as an insurance contract are as follows:

- uncertainty;
- insurable interest;
- insurance risk;
- significance;
- changes in the level of insurance risk.

Uncertainty
Uncertainty (or risk) is the essence of an insurance contract. Accordingly, at least one of the following is uncertain at the inception of an insurance contract:

- whether an insured event will occur;
- when it will occur;
- how much the insurer will need to pay if it occurs.

IFRS 4 Appendix B, B 2, 4

Insurablee interest
The definition of an insurance contract refers to an insurable interest in the form of an adverse effect on the policyholder as a precondition for the identification of the benefits to be considered when assessing the existence of insurance risk.

IFRS 4- BC25, 29

The primary purpose of this arrangement was to exclude from the definition of insurance contract items such as gambling. Indeed, while policyholders buy insurance to reduce risk, gamblers increase their exposure to individual risk.

In general, contracts that require payment if a specified uncertain event occurs, but do not require an adverse effect on the policyholder or other beneficiary as a precondition for payment, are not insurance contracts even if the holder uses the contract to mitigate an underlying risk exposure.

Insurance risk
Insurance risk is defined as risk other than financial risk transferred from the holder of a contract to the issuer. The Standard does not therefore supply a direct, exhaustive definition, but rather identifies insurance risk by distinguishing it from financial risk, which is in turn defined as the risk of a possible future change:

IFRS 4- BC21, 23
IFRS 4, Appendix A

- in one or more specified interest rates;
- a financial instrument price;
- a commodity price;
- a foreign exchange rate;
- an index of prices or rates;
- a credit rating or credit index or other variable.

Accordingly, a contract that contains solely financial risk may not be classified as an insurance contract. However, a contract that contains both significant insurance risk and financial risk is still classified as an insurance contract.

The definition of financial risk includes a list of financial and non-financial variables. This list comprises non- financial variables that are not specific to a party to the contract, such as an index of earthquake losses in a particular region or an index of temperatures in a particular city. It excludes non-financial variables that are specific to a party to the contract, such as the occurrence or non-occurrence of a fire that damages or destroys an asset of that party. Furthermore, the risk of changes in the fair value of a non-financial asset is not financial risk if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of a specific non-financial asset held by a party to a contract (a non-financial variable).

IFRS 4-B9

The definition of insurance risk refers to the risk that an insurer accepts from a policyholder: this implies that the insurance risk must be pre-existing. Accordingly, a risk that is created by the contract itself cannot be considered an insurance risk for an insurer.

Significance

Insurance risk is significant if, and only if, an insured event could cause an insurer to pay significant additional benefits, excluding scenarios that lack commercial substance.

If the insured event is extremely unlikely, insurance risk is still significant if the significant additional benefits would be payable by the insurer and the event has commercial substance.

IFRS 4, Appendix B, B22, B28, BC30, 37

An insurer shall assess the significance of insurance risk contract by contract. Thus, insurance risk may be significant even if there is a minimal probability of material losses for a whole book of contracts.

However, if a book of contracts is known to consist of insurance contracts, the Insurer need not examine each contract within that book to identify a few contracts that transfer insignificant insurance risk.

IFRS 4 does not provide a quantitative parameter for significance in order to avoid introducing thresholds that might encourage the use of arbitrary devices aimed at ensuring that a contract may qualify as an insurance contract rather than an investment contract. Insurers are therefore responsible for making this decision.

Changes in the level of insurance risk

Some contracts do not transfer any insurance risk to the issuer at inception, although they do transfer insurance risk at a later time.

For example, consider a contract that provides a specified investment return and includes an option for the policyholder to use the proceeds of the investment at maturity to buy a life-contingent annuity at the current annuity rates charged by the insurer to other new annuitants when the policyholder exercises the option. The contract transfers no insurance risk to the issuer until the option is exercised, because the insurer remains free to price the annuity on a basis that reflects the insurance risk transferred to the insurer at that time.

IFRS 4, Appendix B, B29, B30

The IASB has maintained that a contract that qualifies as an insurance contract at inception remains an insurance contract until all rights and obligations are extinguished or expire. However, if a contract that did not qualify as an insurance contract at inception is amended so as to transfer significant insurance risk, the contract is then reclassified as an insurance contract and the provisions of IFRS 4 shall apply.

2.1.2 Scope

The "deposit accounting" method applies to the treatment of premiums, benefits and other technical captions pertinent to investment contracts.

In detail, the principle accounts for:

- premiums, benefits and changes in technical reserves as financial liabilities;
- fee and commission income, loading fees, and management fees as revenue;
- expenses, fee and commission expense, and acquisition fees as expenses.

2.1.3 Classification of contracts

2.1.3.1 Identification of insurance risk

When classifying a contract to a book of insurance contracts, service contracts, or investment contracts with or without discretionary participation features, an entity shall identify the transferred insurance risk, i.e. the risk related to the fact that at least one of the following events is uncertain at the inception of the insurance contract:

IFRS 4-B2

- whether an insured event will occur;
- when it will occur;
- how much the insurer will need to pay if it occurs.

The following are examples of insurance contracts:

- non-life contracts under which it is uncertain how much the benefits will be, whether the event will occur, and when the benefits will be paid;
- temporary life insurance under which the amount of the benefits is certain, but it is uncertain when death will occur and when the benefits will be paid;
- full-life or mixed life insurance under which the benefits and payment of benefits are certain (if the contract remains in force), but it is uncertain when the benefits will be paid;

- term-life insurance, under which the benefits and moment of payment are certain but it is uncertain whether the benefits will be paid, because this depends on the survival of the policyholder.

In order for a contract to qualify as an insurance contract, the uncertainty must arise from a risk other than financial risk, lapse or persistency risk (the risk that the counterparty will cancel the contract earlier or later than the issuer had expected), and the risk of changes in the administrative costs associated with the servicing of a contract. The above risks are not insurance risks because the payment to the counterparty does not depend on an uncertain future event with an adverse effect on the counterparty. Accordingly, a contract that exposes the issuer to these risks is not an insurance contract unless it also exposes the issuer to additional significant insurance risk. **IFRS 4-B15**

The significant risk that qualifies a contract as an insurance contract must be a pre-existing risk that is transferred by the policyholder to the insurer and its existence must therefore be independent of that of the contract. A risk created by a contract, such as, for example, the non-application of a surrender penalty in case of decease, is not an insurance risk.
As mentioned above, contracts that expose an insurer to both financial risk and significant insurance risk are considered insurance contracts. For example, life insurance contracts that both guarantee a minimum rate of return (creating financial risk) and promise additional death benefits (creating insurance risk) fall into this category.

IFRS 4-B10

2.1.3.2 Significance of insurance risk

After identifying the insurance risk transferred by the policyholder to the insurer, an entity shall assess whether this risk is significant. IFRS 4 does not set quantitative thresholds for determining whether insurance risk is significant.

This evaluation shall be conducted by considering all possible scenarios, excluding only those that lack commercial substance. An insured event has commercial substance if it produces a discernible effect on the economics of the transaction (for example, a request to pay a specific premium for coverage of the risk). **IFRS 4-B23** The guarantee that qualifies the contract must also be effectively discernible from a commercial standpoint. If this guarantee is represented by a contractual option, the exercise of this option must be plausible and reasonable. **IFRS 4-B23**

IFRS 4 also states that insurance risk may also be significant even if the insured event is extremely unlikely (for example, a catastrophe) or if the expected present value of the cash flows from the insured event is a small proportion of the expected present value of all the remaining contractual cash flows, provided that the scenario in question has commercial substance. This implies that significance may be determined for scenarios that have not been weighted by probability with respect to the entire range of possible benefits.

IFRS 4-B23

2.1.3.3 Changes in the level of insurance risk

An insurance contract is classified when the contract is issued, except for those products for which a change in the level of insurance risk is possible.

If the insurance risk contained in a contract that previously was not considered an insurance contract for any reason subsequently becomes significant, the contract is reclassified as an insurance contract.
However, an entity need not review the book of contracts in order to conduct this assessment because the initial evaluation should have incorporated all future scenarios that had commercial substance at inception.
If a contract allows one of the parties to exercise options that are not binding on the other party, insurance risk is not considered to exist from inception and the contract only becomes an insurance contract after the option is exercised (for example, a contract may grant the right to purchase insurance contracts). Since this option is not an obligation for the other party to the contract, it cannot have any effect on the assessment of the insurance risk in the original contract.
On the other hand, where there are obligations upon the counterparty on the basis of the economic conditions set at issue, insurance risk is present from inception. In this latter case, it must be determined whether the risk is significant in order to classify the contract as an insurance contract. For example, if the policyholder has entered into a contract under which it may convert the principal into an annuity, but the conversion rate is not established at inception, the policyholder's option right may be voided by the insurer's ability, at its discretion, to make the policyholder pay a very high price at the moment of exercise. Thus, the contract should not be classified as an insurance contract until the binding conversion rate for the insurer is determined.

In any event, a contract that qualifies as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire. For example, a life-contingent annuity with a certain payment period should not change classification when the insured dies but rather when payments are complete. Thus, under IFRS the contract continues to be classified as an insurance contract until the above payments have been completed. The right to choose an annuity at a future date using the sums set aside under the contract does not add insurance risk if the annuity rates are to be freely negotiated between the parties. If the right to determine the annuity rates is limited by contractual conditions that impose the use, when the right is exercised, of conditions applicable by the insurer to new immediate life annuities, this right does not add insurance risk to the contract. Accordingly, in such cases the potential risk of survival that could arise from the future choice of an annuity need not be considered when determining the contract's insurance risk.

IFRS 4-B30
IFRS 4-B29

2.1.3.4 Embedded derivatives

Derivatives embedded in an insurance contract are separated from the host contract and measured at fair value in accordance with IAS 39, unless the embedded derivatives are themselves insurance contracts.

IFRS 4 does not require an entity to separate and measure at fair value an embedded derivative if: **IFRS 4.7**

- interdependence with the host contract does not permit the derivative to be measured separately;
- the policyholder has an option to surrender the insurance contract for a fixed amount (or for an amount based on a fixed amount and an interest rate), even if this amount differs from the carrying amount of the liability.

IFRS 4-BC194
IFRS 4.8

The following are some examples of how to account for derivatives embedded in insurance or investment contracts:

Description of embedded	Accounting for a derivative embedded in an	Accounting for a derivative embedded
Death benefits based on an index of prices (valid only where there is a claim).	This option transfers both a financial risk and an insurance risk. If quantitatively significant, the option is an insurance contract because the occurrence of the adverse event (death) significantly changes the cash flows from the contract. The entire contract should be accounted for under local standards. Thus, IFRS 4 does not require that such contracts be measured at their fair value, but it does	The entire contract may be classified as an insurance contract because there is a high degree of interdependence between the option (considered an insurance option) and the investment contract.
Benefits linked to an index of prices (valid for surrender, maturity and claim).	Even if quantitatively significant, the option does not constitute an insurance contract because the cash flows do not change if an adverse event occurs. Furthermore, the option is not closely linked to the insurance contract. The	This option is not considered an insurance contract. The derivative must be separated from the investment contract and measured at fair value.

Surrender clauses that call for payments according to a predetermined plan.	The predetermined surrender value is considered as the deposit component of an insurance contract. Separation of the deposit element follows the rules specified in Paragraph 13.1.5.1 Unbundling.	The surrender option is closely interdependent on the host contract and does not require separation if the surrender value approximates the carrying amount of the financial liability. If

Contracts must be classified when issued, except for those products for which a change in the level of insurance risk is possible.

The elements that may indicate that a contract, in its legal form, contains many types of guarantees to be separated for accounting purposes include, for example:

- the various components are handled separately in order to monitor risk;
- the various components are treated differently with respect to the rules of participation or adjustment of the premium;
- components may be transferred or cancelled separately;
- the components have different counterparties;
- there is no common commercial strategy.

2.1.4 Accounting treatment

The following paragraphs include the accounting treatment for investment and service contracts while the contracts with significant insurance risk are accounted in line with local GAAP requirements.

2.1.4.1 Accounting for investment contracts: deposit accounting

2.1.4.1.1 Unbundling

Various components may coexist in a contract. A component of a contract is defined as the smallest part that contains an identifiable, separable characteristic and comprises all economic aspects required to form the equivalent of an independent contract. After unbundling, the remaining portion of the contract must also be capable of forming an independent contract.

A contract may contain both a financial component (deposit) and an insurance component. IFRS 4 states that virtually all insurance contracts have a deposit component, because the policyholder is required to pay premiums before the period of risk. **IFRS 4-BC40**

An insurer is required to unbundle the deposit component from the insurance component if both of the following conditions are met:

- the insurer can measure the deposit component (including any embedded surrender options) separately;
- the insurer's accounting policies do not otherwise require it to recognise all obligations and rights arising from the deposit component.

IFRS 4.10

Unbundling is permitted, but not required, if the insurer can measure the deposit component separately but its accounting policies require it to recognise all obligations and rights arising from the deposit component, regardless of the basis used to measure those rights and obligations.

Unbundling is prohibited if an insurer cannot measure the deposit component separately.

If an insurance contract is unbundled into a deposit component and an insurance component, the significance of insurance risk transfer is assessed by reference to the insurance component.

The significance of insurance risk transferred by an embedded derivative is assessed by reference to the embedded derivative. On this subject, see paragraph on Embedded derivatives.

IFRS 4-B28

2.1.4.1.2 Issue of premium and subsequent measurement

An insurer shall apply deposit accounting:

- to contracts that do not transfer significant insurance risk and give rise to financial assets or liabilities (investment contracts);
- to the deposit component of unbundled contracts.

Under this accounting method, the premium collected is recognised as a liability and not as revenue. The liability is commensurate to the pure premium.

For further information on the accounting treatment of loading fees, see Accounting for the service components of investment contracts

2.1.4.1.3 Payment of benefits

The accounting of the payment of benefits provides that the obligation is extinguished through an outlay.

2.1.4.1.4 Accounting for insurance contracts with discretionary participation features

Some contracts include discretionary participation features. For the definition of a contract with a discretionary participation feature, refer to Paragraph on Shadow Accounting. Both insurance and investment contracts may contain such features.

According to IFRS 4, in the case of insurance contracts that contain a discretionary participation feature:

- may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it shall classify the whole contract as a liability. If the issuer classifies them separately, it shall classify the guaranteed element as a liability and the discretionary participation feature as a liability or a separate component of equity; **IFRS 4.34**
- may recognise all premiums received as revenue 3 without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part or all of the discretionary participation feature is classified in equity, the portion of profit or loss attributable to that feature is recognised as an allocation of profit or loss, not as expense or income;
- shall apply IAS 19 to embedded derivatives in accordance with Paragraph 13.1.3.4 Embedded derivatives

According to IFRS 4, the requirements in the foregoing paragraph also apply to financial contracts that contain a discretionary participation feature. In addition:

- the issuer shall apply the Liability Adequacy Test described in Paragraph 2.2, if the entire discretionary participation feature is classified as a liability;
- the liability recognised for the whole contract shall not be less than the amount that would result from applying IAS 39 to the guaranteed element; **IFRS 4.35**
- the issuer may recognise the premiums as revenue and the resulting increase in the carrying amount and the claims of the liability as expenses.

2.1.4.1.5 Costs of acquisition and collection of an insurance contract

According to IFRS 4, the acquisition costs of an insurance contract are accounted for under local accounting standards, and thus may be capitalised or directly recorded in profit or loss. The accounting for the acquisition costs of an insurance contract may therefore differ from the accounting of the acquisition costs of an investment contract. **IFRS 4- BC116**

2.1.4.2 Accounting for service contracts

A non-insurance contract (or a contractual component) that does not generate financial assets or liabilities and calls for the rendering of services is governed by IAS 18 as a service contract.

Examples of such contracts or contractual components are agreements to render investment management services or administrative services such as collecting premiums, paying for services, keeping accounting records and managing a contract portfolio.

For further information on accounting for service contracts, see Chapter X - Costs and revenue recognition

The service components of insurance contracts are not unbundled.

2.1.4.2.1 Accounting for the service components of investment contracts

In accordance with IAS 18, the service components of investment contracts are accounted for separately.

IAS 18 distinguishes between the following types of revenue under investment contracts:

- origination fees;
- fees that are earned on the execution of an act (agency fees, etc.);
- investment management fees.

IAS 18, Appendix 14

Origination fees are:

- included in the calculation of the internal rate of return for liabilities measured at amortised cost;
- recognised in the profit or loss when the financial liability is measured at fair value (because IAS 39 does not allow the capitalisation of transaction costs for this category of liability).

Fees earned on the execution of an act are recognised as revenue when the act is completed.
Investment management fees are recognised as revenue as the services are provided (deferred income reserve or DIR).

IAS 18 clarifies that the direct costs (deferred acquisition costs or DAC) of contracts may be recognised as an increase in the value of an asset where:

- they may be separated and measured separately from the investment contract;
- it is probable that they will be recovered.

These costs represent the expense incurred by the issuer correlated with contract management fees. The amortisation criterion must follow the accrual of the associated revenue.

2.2 Shadow Accounting

The following are guidelines for the application of the accounting practice known as "shadow accounting."

The Italian accounting model calls for gains and losses realised on an insurer's assets to have a direct effect on the measurement of insurance liabilities. This rule applies primarily to insurance contracts in the life- insurance business the return on which is linked to separate management (contracts with discretionary participation features). However, unrealised gains (and some losses) on assets are not recognised in the separate financial statements of insurers in accordance with local accounting standards 4.
Insurers apply IAS-IFRS solely for consolidation reporting purposes while separate financial statements follow local GAAP rules. Accordingly, for these purposes, the measurement of the fair value of financial assets pursuant to IAS 39 is not correlated to the value of insurance liabilities, which in accordance with IFRS 4 are measured under local standards.

It is in this context that the practice of shadow accounting is employed. The purpose of this method is to correlate the amount of the technical reserve for contracts with discretionary participation features (which, as mentioned above, are measured at cost) and the amount of the associated assets (measured at fair value in accordance with IAS 39).

2.2.1 Relevant Definitions

2.2.1.1 Definition of an insurance contract

For further information on the definition of an insurance contract, see Section "Relevant Definitions", Paragraph "Deposit Accounting".

2.2.1.2 Definition of contract with discretionary participation features

Contract with discretionary participation features: a contract that contains a guaranteed element and a discretionary participation feature determined at the insurer's discretion, although subject to contractual, legal or competitive constraints. In detail, such additional benefits must:

- represent a significant proportion of the total contractual benefits;
- be at the issuer's discretion in terms of amount and timing;
- be contractually defined in relation to:
  - the benefits of a specific group of contracts or a specific type of contract;
  - the realised and/or unrealised return on investment on a specific group of assets managed
  - by the issuer;
  - the profit or loss of the entity, fund or other issuer of the contract.

IFRS 4.34, 25, BC154, 165

2.2.1.3 Other definitions

Other definitions are relevant to the shadow accounting method. In further detail:

- Separate management: the portfolio of investments managed separately from the assets held by the entity, the return on which is used to determine the level of benefits provided under the associated contracts. This portfolio requires the use of measurement rules that differ from those that the insurer uses in its own financial statements.
- Guaranteed interest rate: the return guaranteed by the contract and provided directly by the insurer.
- Technical reserve: the reserve that reflects the insurer's obligations to policyholders (in the life-insurance business).

IVASS Provision 22

IVASS Provision 22
IVASS Provision 21

2.2.2 Scope

In accordance with paragraph 30 of IFRS 4, an insurer has the option of correlating the value of its mathematical reserves (and of the intangible assets recognised under business combinations or deferred acquisition costs) with unrealised gains or losses on the financial instruments that the insurer has recognised pursuant to IAS 39 as if these components had been realised. The related adjustment is recognised in equity if, and only if, the unrealised gains or losses are recognised directly in equity; otherwise, it is recognised in profit or loss. This practice is known as "shadow accounting."

2.2.3 Classification of outstanding contracts for the application of shadow accounting

Shadow accounting applies to insurance or investment contracts with discretionary participation features.
In order to determine the shadow accounting reserve, outstanding contracts must be classified in order to identify the contracts that fall into the category in question.

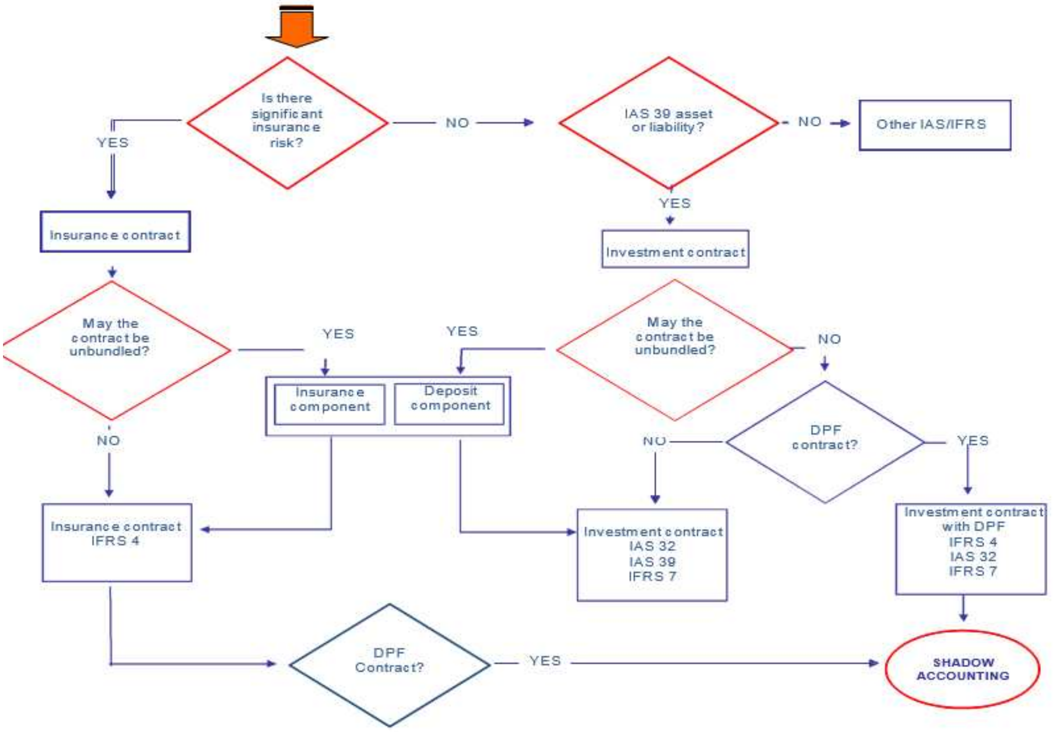
In detail, the following must be identified:

- insurance contracts
  - with discretionary participation features;
  - without discretionary participation features;
- investment contracts
  - with discretionary participation features;
  - without discretionary participation features;
- service contracts.

For further information on the classification of contracts to the foregoing categories, see Paragraph "Deposit Accounting"

2.2.4 Decision tree for defining an insurance or investment contract that falls within the scope of IFRS 4

The following decision tree depicts the process of identifying the contracts that fall within the scope of the shadow accounting method.



2.2.5 Contracts with DPF clauses: contracts the return on which is linked to separate managements

Contracts the return on which is linked to a separate managements rate meet the definition of DPF because:

- these benefits represent a significant proportion of total benefits;
- given a defined set of assets and contracts, there is no certainty as to the effective amount and timing of the benefits because they depend on the extent of the gains or losses realised during each period;
- there are also discretionary features to the extent of the retrocession rate;

- there is a mismatch of the "distributable surplus" due to the different accounting for separate managements in accordance with applicable standards and IFRS.

The presence of contractual constraints on the allocation of the revaluation does not mean that the contract in question may not be considered to show substantial discretionary features in the determination of the "additional benefits".

The rules for the measurement of separate management assets are set forth in IVASS Circular 38. In detail, the following are relevant to the computation of the separate management return:

- gross coupons return;
- amortising cost;
- realised gains and losses;
- transaction costs associated with the purchase and sale of assets;
- realised and unrealised exchange gains and losses;
- certification costs.

IFRS 4- BC154

Unrealised gains or losses and withholding taxes accrued are not considered in the computation of separate managements returns.

Only the carrying amount of the securities, gross of any impairment or recoveries recognised in the insurer's financial statements, are considered when computing average invested capital.

Unrealised gains or losses are considered for Supervisory purposes related to the determination of the minimum amount of assets covering the technical reserves for separate management.

2.2.6 Determination of shadow accounting

2.2.6.1 Assumptions and simplifications of the empirical method

As mentioned above, IFRS 4 does not require that entities develop a system for the application of shadow accounting but suggest an empirical founded upon the following assumptions and simplifications:

IVASS Circular 38

- timing of the realisation of unrealised gains or losses. Immediate realisation of all unrealised gains or losses (the liquidation approach), multi- year approach or going-concern approach ;
- determination of a guaranteed minimum average rate.
- the rates of retrocession to policyholders of separate management returns.

2.2.6.2 Application of shadow accounting

The application of shadow accounting is divided into the following steps:

- identification of unrealised gains or losses on financial instruments included in separate managements. This process involves comparing the carrying amount of the securities in separate managements with the fair value at the reporting date. unrealised gains or losses are divided into:
    - those recognised in profit or loss on securities classified as held for trading or for which the fair value option has been exercised;
    - those recognised in profit or loss on securities classified as available for sale that have become impaired or have been hedged. Hedged securities are those for which the hedge is considered effective both prospectively and retroactively, and changes in the fair value of these securities are covered by fair value hedge accounting;
    - those recognised in equity for investments classified as available for sale.
- determination of the rate of return on the separate management according to the ratio of separate management income and average invested capital computed in accordance with IVASS Circular 38;
- redetermination of separate management income by adding realised income and the previously computed unrealised gains or losses;
- redetermination of the separate management rate of return computed on the basis of the new income and average invested capital.

The rates of return thus computed may present values:
- higher than the guaranteed average interest rate;
- equal to or lower than the guaranteed average interest rate.

Where the rate of return exceeds the guaranteed minimum rate for the separate management in question, gains and losses may be distributed to policyholders within the limit of the average retrocession rates.
Where the rate of return is equal to or lower than the guaranteed minimum rate, unrealised gains and losses may be attributed to policyholders on the basis of the respective average retrocession rates within the limits of the guaranteed minimum.

2.2.6.3 Determination of the balancing entry for shadow accounting

Once the retrocession percentage for unrealised gains or losses has been determined for a separate management, a balancing entry is recognised:
- in equity where the unrealised gains or losses are recognised directly in equity (i.e. on available for sale securities). In this case the reserve is recognised under the caption required by Bank of Italy Circular 262/2005, “140. Valuation reserves: 1) available for sale”;
- in profit or loss where the unrealised gains or losses are recognised in profit or loss (for securities classified as held for trading, securities designated at fair value, and hedged available for sale securities). In this case, the gain or loss is recognised in the caption required by Bank of Italy Circular 262, “160.

Other net insurance income (expense)".

2.2.6.4 Shadow accounting: flows and the stock accounting method

There are two option for the bookkeeping of shadow accounting: i) "flows" method and ii) "stock" methods.

The "flows" method permits to recognize the effects of shadow accounting matching the fair value movements of the underlying investments of the period.

This "stock" method permits to recognize the effects of shadow accounting considering the fair value valuation of the underlying investments at the end of reporting period. In particular such method requires the following steps: i) to reverse the sums recognized at the end of the previous period as "shadow accounting" ii) to estimate the effects of shadow accounting on underealized gains/losses at the reporting date. The difference between the opening and closing balances represents the impact on the period.

2.2.6.5 Taxes and shadow accounting

The taxable income of insurers is determined on the basis of their income statement and balance sheet prepared in accordance with local standards.

For further information on the recognition of deferred tax associated with all adjustments of accounting balances for the purposes of the application of IFRS, see

In detail, the difference generated due to the effect of shadow accounting between the value of the mathematical reserves in separate financial statements (which normally corresponds to the value for tax purposes) and the value of these reserves as recomputed in accordance with IFRS 4 is recognised:

- in equity if the balancing entry for shadow accounting is an equity reserve;
- in profit or loss if the balancing entry for shadow accounting is to profit or loss.

2.2.6.6 Impairment and recoveries of financial instruments in separate management: effects of shadow accounting

As discussed in further detail in the relevant Chapter, IAS 39 states that an asset is impaired and an impairment loss incurred if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset that has a negative impact on estimated future cash flows. Of course, it may be that the combined effects of several events, rather than a single event, have caused the impairment of the financial instrument.

In this respect, an entity shall assess at each balance sheet date whether there is any objective evidence that a financial asset or group of financial assets is impaired.

Objective evidence that a security is impaired is primarily related to the following loss events:

- significant financial difficulty of the issuer;
- a breach of contract such as a default or delinquency in interest or principal payments;
- the lender, for economic or legal reasons relating to the borrower's financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
- it becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- the disappearance of an active market for that financial asset because of financial difficulties.

IAS 39.58, 59

For the purposes of shadow accounting, the detection of objective evidence of an impairment loss on an available for sale asset included in a separate management (with the resulting recognition of the available for sale reserve in profit or loss) entails that the asset in question be accounted for in the same way as an asset with changes of fair value detected through profit or loss.

Any recoveries after the impairment loss on available for sale instruments included in a separate management are:

- reversed from profit or loss if associated with debt instruments;
- recognised in equity if associated with equities instruments

2.2.6.7 Accounting for the reclassification of financial instruments between different categories for the purposes of shadow accounting

An insurer may exercise the option of reclassifying financial instruments included in its portfolio according to the conditions set forth in paragraphs 50 et seq. of IAS 39.

As described in Chapter 5 "Financial Instruments" of this document, when a financial asset is transferred from held for trading, it is recognised in the new category (loans and receivables, held to maturity5 or available for sale) at its fair value on the date of reclassification. Any gain or loss already recognised in profit or loss, and thus any gains or losses on valuation, are not reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortised cost and the effective rate of return to be employed to recognise interest in profit and loss is also determined from said date. The impairment rules for the new category apply to the reclassified instruments.

Where an item is transferred from available for sale to loans and receivables or held to maturity6 , the gains or losses previously recognised to the available for sale reserve, if they pertain to an instrument with a fixed maturity, are amortised over the residual life of the investment according to the amortised cost method, whereas those that pertain to instruments without a fixed maturity continue to be carried in the reserve until the item is sold or extinguished (derecognition).

Where a financial asset is reclassified from available for sale to loans and receivables, if the asset in question later becomes "impaired", the gains or losses previously recognised to the available for sale valuation reserve are reversed and recognised in profit or loss.

By its nature, shadow accounting aims to limit mismatches between the effects of the measurement of assets and mathematical reserves for products with DPF clauses. Where a security was initially recognised as held for trading and then transferred to available for sale, the balancing entry for shadow accounting is to profit or loss over the period in which the unrealised gains or losses were recognised in profit or loss and to an equity reserve for unrealised gains or losses recognised in equity.

Shadow accounting ceases to generate effects if securities are transferred to categories not measured at fair value (loans and receivables and held to maturity).
The balancing entry for shadow accounting associated with securities that have undergone recoveries is accounted for in a similar manner.

2.3 Liability Adequacy Test

The following are the guidelines for the application of the Liability Adequacy Test (LAT).

The purpose of the LAT is to verify the adequacy of the liabilities recognised in the financial statements. This is done by comparing the insurance liabilities with the present estimates of the future cash flows from the insurance contracts.

Some accounting systems already call for an assessment of the adequacy of insurance liabilities. The IASB does not require an additional assessment of the adequacy of insurance liabilities if the test complies with the minimum requirements established by IFRS 4 (the international accounting standard applicable to insurance contracts).

In phase I of IFRS 4, the IASB does not aim to create a detailed accounting regime for insurance contracts. Therefore, the following are not specified:

- what criteria determine the date of conclusion and beginning of insurance contracts;
- whether or how the cash flows are discounted to reflect the time value of money and adjusted for risk and uncertainty factors;
- whether the LAT should consider both the time value and the intrinsic value of embedded options and guarantees;

- whether any underestimates of insurance liabilities recognised because of the LAT are to be recorded by increasing the carrying amount of the insurance liabilities themselves or by decreasing the related acquisition costs.

In the Italian system, there are rules established by IVASS (also referred to hereinafter as the Supervisory Authority) that implicitly regulate the testing of insurance liabilities.

In the non-life insurance business, the computation of the current risk reserve (a component of the premiums reserve) and the criterion of the "final cost", aimed at allocating claims reserves, ensure the adequacy of reserves in local standards

2.3.1 Relevant Definitions

2.3.1.1 Definitions of adequacy tests provided in Italian accounting standards

IFRS 4-BC101

The following are the definitions of certain types of technical reserves provided in the Italian accounting system.

Additional reserve for financial risk (life-insurance business)
The additional reserve for financial risk is a reserve aimed at supplementing technical reserves where the current or foreseeable return on the assets that cover the technical reserves is less than the commitment to policyholders in terms of the guaranteed minimum rate.

Additional reserve for demographic risk (life-insurance business)
The additional reserve for demographic risk is a reserve aimed at supplementing the technical reserves for insurance annuity contracts and life contracts that may be converted to an annuity (contractually guaranteed)
where there is an unfavourable mismatch between the demographic assumptions used and the results of direct experience with the portfolio.

Expense reserve (life-insurance business)
The expense reserve is a reserve allocated on the basis of the present value of the positive balances of administrative expense plus the contract management fees to be incurred less the loading fees included in
any future premiums to be collected and future financial income arising from the investment of the premiums that is not retroceded to the contracts and allocated to fund the management costs of the contracts.

IVASS Reg 21 art. 36

Current risk reserve (non-life insurance business)
The reserve for current risks is the reserve to be allocated to cover incumbent risks after year-end in order to pay all indemnities and expenses arising from insurance contracts entered into prior to that date, to the extent
that the expected cost of these risks exceeds that of the pro-rata temporis premiums

IVASS Reg 21 art. 50

reserve.

Claims reserves (non-life insurance business)

IVASS Reg 31 art. 49

The claims reserve is the reserve recognised to account for each claim incurred and reported, the settlement process for which has yet to be completed at year-end or for which compensation for damages, direct expenses and settlement expenses have not yet been paid in full. The claims reserve is measured at its final cost, which represents the cost of the claim considering all foreseeable future expenses.

IVASS Reg 16 art. 9

When determining the amount of the claims reserve, insurers may not consider the present value of the foreseeable amount of the future settlement of the claim or make any other form of deduction or discount. Insurers determine the claims reserve on the basis of a separate analytical assessment of each reported claim that has not been fully settled according to the inventory method. When determining the final cost of claims in sectors characterised by slow settlement processes or in which analytical assessment does not allow all foreseeable future expenses to be considered, insurers are required to apply statistical and actuarial methods or cost projection systems. In addition to the reserve for occurred and reported claims, insurers must allocate a reserve for occured but unreported claims. The latter includes the total amount that, according to a conservative estimate, will be required to make payment on the claims that have been occurred during the present or previous periods but have yet to be reported at the date of assessment and to discharge the associated settlement expenses.

IVASS Reg 16 art. 26-27-39

2.3.2 Scope

IFRS 4 states that an insurer shall conduct a liability adequacy test.

If this test meets the minimum requirements specified by IFRS 4, no further requirements are imposed.

If the liability adequacy test is not carried out or does not meet the minimum requirements of IFRS 4, the insurer shall compare:

- the carrying amount of the insurance liabilities (less any related deferred acquisition costs and any related intangible assets acquired in a business combination);
- the carrying amount of the above liability that would be required if the relevant insurance liabilities were within the scope of IAS 37 "Provisions, Contingent Liabilities and Contingent Assets".

If this comparison indicates that the recognised insurance liability is underestimated, the difference is recognised in profit or loss.

2.3.3 Scope of application

The adequacy of insurance liabilities is tested both for contracts classified as insurance contracts and investment contracts with discretionary participation features (DPF).

The application of the LAT to contracts classified as insurance contracts is detailed in paragraphs 2.3.5 *et seq*.

The application of the LAT to investment contracts with discretionary participation features depends on the methods of recognition of the DPF component. The DPF may be recognised either as an insurance liability or a component of equity.
Insurers conduct liability adequacy tests for investment contracts with DPF clauses recognised entirely as liabilities according to the same methods as for the test applied to contracts classified as insurance contracts.

The liabilities to be recognised for total investment contract containing DPF clauses that are partially or entirely recognised as a component of equity may not be less than the amount of the guaranteed elements measured in accordance with IAS 39. This measurement includes the intrinsic value of the surrender option but does not include the time value of money because the option is beyond the scope of fair value in accordance with IAS 39.

2.3.4 Frequency and precision of testing

IFRS 4 requires that the LAT be performed at each balance sheet date, i.e. when the annual financial statements and half-yearly report are prepared.

IFRS 4.8-9

The detail and precision of calculation of the LAT must allow an opinion of the adequacy of the reserves allocated in the financial statements to be expressed. In theory, the precision and analytics of the test could vary according to the extent that the net technical reserve exceeds the reserve determined according to the LAT (adequacy margin). If a large adequacy margin is detected and proven to exist, the level of precision of the test could also be diminished. If the margin is limited in extent, it is advisable to plan to conduct a precise, detailed test.

2.3.5 Assessment of compliance with minimum LAT requirements according to local accounting standards

As mentioned above, some accounting systems call for insurance liability adequacy tests. IFRS 4 specifies that if these tests meet minimum requirements, no further tests are necessary.

These minimum requirements are:

- the test considers current estimates of all contractual cash flows and of related cash flows such as claims handling costs, as well as cash flows resulting from embedded options and guarantees;
- if the test shows that the liability is inadequate, the entire deficiency is recognised in profit or loss.

In order to verify that the insurance liability adequacy test performed under local accounting standards complies with the minimum requirements established by IFRS 4, the test shall:

IFRS 4.16

- determine the current amount of all expected future cash flows, using updated assumptions when measuring these cash flows. IFRS 4 does not specify whether the assumptions to be adopted must be adjusted for risk and uncertainty. The minimum requirements established by IFRS 4 for tests already required by local standards may be satisfied by the use of updated assumptions not adjusted for risk and uncertainty;
- carry out a projection of cash flows for the entire life of the contract. The cash flows from life insurance contracts must be projected through the maturity of the contract. For contracts that do not have a predetermined maturity, but for which an effective maximum duration may be estimated, this duration may be used as the projection period. Alternatively, the duration deriving from the portfolio's historical experience may be used if this duration is borne out by reliable statistics;
- include the following in the measurement of future cash flows:
  - future premium receipts for annual or recurring premium tariffs;
  - claims handling expenses (comprising direct costs, administrative expense and claims settlement expenses);
- consider the cash flows from embedded options and guarantees: the IFRS 4 guidelines do not specify which embedded options and guarantees should be considered, but they state that the measurement of these options and guarantees may not be neglected in a insurance liability adequacy test. Embedded options and guarantees may be calculated by:
  - estimating the future cash flows from embedded options and guarantees, regardless of whether the options and guarantees are "in the money" or "out of the money";
  - estimating the cash flows from the embedded options and guarantees by extending the projection period so as to cover all flows produced from these options and guarantees;
  - conducting a stochastic measurement of the cost of the embedded options and guarantees.

2.3.6 Insurance liability adequacy tests in the Italian accounting system

Italian law provides for various types of analysis of the assessment of the adequacy of technical reserves. The following is a summary of the main types of analysis.

2.3.6.1 LAT in the life-insurance business

LAT in the life-insurance business allows for the adequacy of reserves to be tested separately on the basis of the type of cash flow and type of underlying risk.
In particular, IVASS Regulation 21 calls for the allocation of reserves to account for demographic risk, interest-rate risk and economic risk.

- Demographic risk (additional reserve for demographic bases). Annuity contracts or life contracts with an annuity option establish an annuity conversion rate at the date of payment of the annuity. If these guaranteed conversion rates are determined on the basis of demographic tables predating those currently in use, insurers must supplement technical reserves to make good this shortfall. In substance, when the contract was entered into, an annuity was guaranteed on the basis of demographic tables that foresaw a shorter life expectancy than that in force when the annuity is paid.

- Interest-rate risk (additional reserve for a guaranteed interest rate). Products associated with separate managements (DPF contracts) call for policyholders to be allocated an annual appreciation of the invested premium in the amount of the greater of a guaranteed minimum rate and a retrocession percentage of the income generated by the separate management. It may occur that the commitments to policyholders (in terms of guaranteed minimum rates) exceed the income that the insurer will earn in the future. IVASS requires that insurers account for this risk by determining a vector for foreseeable returns for the following four years 7 (on the basis of the assets) and verify that this vector matches their commitment structure. If there is a shortfall, insurers are required to supplement their reserves8 .

- Risks other than financial and demographic risks (expense risk). Insurers must test the adequacy of the implicit and explicit loading fees in their fee schedules with respect to the structure of the handling and settlement costs incurred. This test allows insurers to assess the reliability of the assumptions underlying the structure of their loading fees over time. If there is a mismatch, insurers are required to make an additional allocation to cover future contract handling expenses

The adequacy tests for the life-insurance business do not satisfy the overall minimum LAT requirements (i.e., the cash flows are not projected to maturity). Given the foregoing, the adequacy of reserves must be tested according to a process compliant with the provisions of IAS 37.

2.3.6.2 LAT in the non-life insurance business

IVASS 16 calls for the conduct of adequacy tests for the premiums reserve in the non-life insurance business.

In detail, IVASS requires that the reserve for current risks (a component of the premiums reserve) be tested for adequacy. This test allows for an estimate of the expected costs of the risks incumbent after year-end in order to account for all indemnities and expenses arising from the insurance contracts that have given rise to the allocation of the pro-rata temporis premiums reserve , to the extent that the total amount of the presumed cost of the expected claims exceeds the amount of the pro-rata temporis premiums reserve and the premiums due under these contracts.

The methods of determination of the claims reserve set forth in IVASS Regulation 16 call for an analytical inventory of claims according to a conservative estimation of damages on a final-cost basis (without contemplating any discounting effect). These estimates must cover commitments to pay claims and the associated direct and indirect settlement expenses.

This method is based on the ratio of claims to net earned premiums for the testing period and contemplates the values of this ratio over a retroactive period of observation and additional objective elements pertaining to the performance of the expected cost of risks incumbent after year-end.

When determining the final cost of claims in sectors characterised by slow settlement processes, insurers are required to use statistical and actuarial methods or cost forecasting systems.

The foregoing analysis of the adequacy tests for the non-life insurance business indicates that these tests meet the minimum LAT requirements for the current risk reserve. In addition, it is also believed that the current methods of determination of the claims reserve on the basis of the final cost criterion are methodologically suitable to representing the future cash flows from the book of outstanding contracts.

Given the foregoing, in these cases IFRS 4 does not require additional tests.

2.3.7 Non-compliance with minimum requirements according to local accounting standards

If the insurance liability adequacy testing method does not satisfy all of the minimum LAT requirements, IFRS 4 states that insurers shall determine the adequacy of technical reserves according to the criteria of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

In detail, an insurer must:

- determine the carrying amount of technical reserves less deferred acquisition costs and intangible assets acquired in business combinations;
- compare this carrying amount with the amount determined in accordance with IAS 37.

IAS 37 states that the amount recognised as a reserve shall be the best estimate of the expenditure required to settle the insurer's present obligation at the balance sheet date. The "best estimate" is the amount that an entity would rationally pay to settle the obligation or to transfer it to a third party. This amount corresponds to the estimate of the technical reserves prepared by the insurer's management, supplemented by experience of similar transactions and, in some cases, reports from independent experts. **IFRS 4.17**

If the assessment of technical reserves involves uncertainties (for example, the assessment of commitments under an insurance contract or an investment contract with DPF), the reserve is calculated by weighting all possible outcomes by their associated probabilities.

IAS 37 calls for:

- risks and uncertainties to be taken into account: such factors, which clearly characterise most of the captions to be measured, must be thoroughly taken into consideration in the process of assessing assumptions in reaching the best estimate of reserves; **IAS 37.36-38**

- the overstatement of reserves to be avoided: adjustment for risk and uncertainty inevitably increases the amount of a reserve but caution is needed to ensure that such increases do not result in overstatement. Accordingly, IAS 37 expressly advises insurers to act with care and caution in adjusting assumptions for risk and uncertainty. **IAS 37.43-43**

2.3.8 Insurance liability adequacy tests: assumptions

2.3.8.1 Discount rate and benefit appreciation rate

IAS 37 discusses the issue of the discounting factor to be used to discount cash flows. The "pre-tax discount rate" is defined as a discount rate, gross of taxes, that reflects current market assessments of the "time value" of money according to current market conditions. The discount rate shall not reflect risks for which future cash flow estimates have been adjusted.

Paragraph 19 of IFRS 4 also specifies that reserves measured in accordance with IAS 37 shall reflect future interest margins if, and only if, the net reserves to compare also reflect those margins.

One issue to be taken into due consideration when choosing a benefit appreciation rate is the constraint imposed by IAS 37 concerning the "expected disposal of assets", which states that gains from the expected disposal of assets shall not be taken into account in measuring a provision.

IAS 37.45-47

The solutions applicable to benefit appreciation are:

- appreciation of benefits at the guaranteed minimum rate. This approach allows an insurer to estimate the minimum amount of the reserve to be allocated to pay out the guaranteed minimum benefits to the policyholder. It has the advantage of being a simple, objective approach that in some cases ensures that the net reserves allocated in the financial statements are adequate. In detail, where there is no reserve deficit for a guarantee type, it may be concluded that the reserves are sufficient to guarantee the commitments to the policyholder. On the other hand, where there is a deficit with respect to high guaranteed return levels, offsetting against low guaranteed return levels could lead to an incorrect determination of adequacy. This approach has the disadvantage of not taking account of market conditions and the presumed rates at which benefits will appreciate.

IAS 37.51-52

- appreciation of benefits according to a risk-free curve. This approach allows benefits to be adjusted to the higher of the guaranteed annual return and the return obtained by applying the retrocession rate or minimum withholding percentage to the market risk-free interest rate curve. This is an objective method that follows market rates. However, it does not contemplate the assets held by the insurer. In this scenario, the offsetting of various guarantee types is plausible because it prevents the understatement of benefits for fee structures with low guaranteed returns since the financial assumption used for the appreciation of benefits is defined according to the risk-free rate curve.

- appreciation of benefits according to a rate vector estimated by using the "cash-flow matching" technique. Under this approach, benefits appreciate according to returns estimated according to the "cash-flow matching" technique. In other words, an insurer estimates the returns on a synthetic portfolio capable of recreating reserve profiles on the basis of the market values of the risk-free curve with a spread that ensures that the value of the mirror portfolio is the same as that of the securities portfolio effectively held by the insurer. This is an objective approach the structure of which allows various guarantee types to be offset within a special management.

- appreciation of benefits according to a "best estimate" rate vector. This approach allows benefits to be adjusted to the higher of the guaranteed annual return and the return obtained by applying the retrocession rate or minimum withholding percentage to the "best estimate" rate curve. The "best estimate" return vector is defined on the basis of the returns on the assets underlying the reserves, which are estimated through a consolidated company procedure that permits an objective assessment of these returns.

In this scenario, as in the foregoing case, there do not appear to be any problems with offsetting the various types of guarantees because the adjustment of benefits is calculated on the basis of the "best estimate" return curve.

2.3.8.2 The estimation of cash flows

As discussed in Paragraph "Assessment of compliance with minimum LAT requirements according to local accounting standards", to comply with IFRS 4, a test on liability adequacy must consider all contracts that are in existence at the end of the reporting period and must carry out a projection of cash flows for the entire life of the contract. Given these conditions, there are different aspects a Company must consider when performing the LAT.

2.3.8.2.1 Level of aggregation

IFRS 4, paragraph 18, specifies the level of aggregation to be used to test the adequacy of reserves.

If an insurer uses an already existing adequacy test for its reserves that meets the minimum requirements of
IFRS 4, paragraph 16, the test is applied at the level of aggregation specified in that test.

If the amount of future cash flows is calculated in accordance with IAS 37, the test shall be made at the level of a portfolio of contracts that are subject to broadly similar risks and managed together as a single portfolio. The choice of the level of aggregation for appreciable products depends on the financial assumptions adopted to appreciate the benefits and discount the cash flows, as well as from the assessment of the homogeneity of special managements. In determining whether guarantee types may be used as the level of aggregation, an insurer shall consider the financial assumptions used for appreciation and discounting used in computing the cash flows.

2.3.8.2.2 Future Events

IAS 37, paragraph 48, states that future events shall be reflected in the computation of reserves for LAT where there is sufficient objective evidence that the events will occur. Future events such as cost reductions, improved mortality trends, and other transactions or behavioural factors that may influence future cash flows should only be considered in the process of determining the cash flows if there is objective evidence that these events will occur.

2.3.8.2.3 Reimbursements

IAS 37 states that where some or all of the expenditure required to settle an obligation is reimbursed by another party, the measurement of that obligation is not affected by the reimbursements provided by other parties; instead, these reimbursements are accounted as an asset amount.
The expense relating to a obligation may be presented net of the amount recognised for a reimbursement.

2.3.8.2.4 Sensitivity Analysis

IAS 37 supports a multi-scenario model based on the measurement of future cash flows that is capable of reflecting the possible outcomes of uncertainties.

2.3.8.2.5 Accounting for LAT deficits

IFRS 4 does not specify which captions are adjusted to supplement reserves to correct a deficit detected in a LAT. A reserve deficit may therefore be accounted for by increasing a reserve or decreasing the relevant intangible asset by an amount equal to the entire deficit.

2.3.9 Relationship between LAT and shadow accounting

IFRS 4 does not clarify whether the LAT should or should not contemplate "shadow liabilities". However, paragraph 15 of the Standard contains the general provision that an insurer shall assess the adequacy of its recognised insurance liabilities.
Including the "shadow liability" ensures greater financial consistency between the amounts to be compared given the provisions governing the discount rate to be used in performing LAT.
Where an insurer recognises in its financial statements a portion of net losses attributable to policyholders, this component shall be deducted when calculating the net reserve. **IFRS 4-BC104**
Although IFRS 4 states that deficits are recognised in profit or loss, where an insurer recognises a reserve deficit that arose, for example, from the recognition in equity of unrealised gains, such a deficit is recognized in equity in accordance with the "Shadow Accounting" provisions of IFRS 4, paragraph 30.

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
    - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs), which is not applicable for Italian insurance Companies that prepare their individual financial statements under local GAAP;
    - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

3.1.1 Deposit Accounting

3.1.1.1. Classification of contracts

3.1.1.1.1 Identification of insurance risk

The Mediolanum Group has identified some key features to classify contracts as insurance contracts, based on the type of product:

- Unit Linked Products - the presence of death benefits, based on the relevance this feature has in the composition of the product;
- Traditional Products – the presence of an annuity or DPF as features of the contract.

3.1.1.1.2 Significance of insurance risk

The Mediolanum Group has set the quantitative threshold for defining an insurance risk as significant at 5%. Thus, where the benefits payable upon the occurrence of the adverse event exceed 5% of those benefits payable if the event does not occur, the

contract is considered an insurance contract.
As stated in Paragraph "Significance of insurance risk", Section "Accounting Rules", an insurer shall assess the significance of insurance risk contract by contractual types (products) on the basis of the economic and commercial substance of each contract rather than its legal form. The Group has decided to conduct an analysis aggregating contracts by tariffs. These aggregates only include either insurance or investment contracts, because products within the same tariff have the same characteristics.

3.1.1.1.3 Changes in the level of insurance risk

The Mediolanum Group considers insurance risk to be significant also if:

- the quantitative level of insurance risk does not qualify it as significant at inception, but the insurance risk is susceptible to becoming significant thereafter in the ordinary course of events or as the result of the exercise of a party's rights;
- the scenario that gave rise to the insurance risk shows commercial substance in a period subsequent to issue.

When the Group changes the features of a tariff and these changes alter the tariff risk level, it has to reclassify all the products subjected to the new risk.

3.1.1.2 Accounting for investment contracts

3.1.1.2.1 Unbundling

The Mediolanum Group does not apply the unbundling method, as permitted by IFRS 4.

3.1.1.2.2 Embedded Derivatives

The Mediolanum Group distinguishes products that present many types of guarantees that may qualify the entire contract as an insurance contract from commercial packages, in which guarantees are treated separately.

3.1.1.2.3 Costs of acquisition and collection of an insurance contract

The Mediolanum Group recognises all acquisition costs of insurance contracts in profit or loss on an accruals basis.

3.1.2 Shadow Accounting

3.1.2.1 Determination of Shadow Accounting

The Mediolanum Group has elected to apply an empirical method founded upon the following assumptions and simplifications:

- timing of the realisation of unrealised gains or losses. The Group has adopted assumptions concerning the immediate realisation of all unrealised gains or losses (the liquidation approach) instead of the multi-year approach or going-concern approach because this arrangement is most closely compliant with the provisions of paragraph 30 of IFRS 4;
- determination of a guaranteed minimum average rate. The Group recognizes unrealized losses to the policyholders only up to the minimum guaranteed rate determined for each separate management
- the rates of retrocession to policyholders of separate management returns. An average retrocession rate is determined for each separate management according to retrocession clauses and the differing financial guarantees provided.

3.1.3 Liability Adequacy Test

3.1.3.1 LAT in the Italian accounting system

3.1.3.1.1 LAT in the non-life insurance business

As mentioned in Paragraph "LAT in the non-life insurance business", Section "Accounting Rules", The methods established by IVASS (empirical method for unearned premium reserve and ultimate cost for claims reserve already complies with IFRS 4 minimum LAT requirements.

3.1.3.1.2 LAT in life business

As mentioned in Paragraph "LAT in the life insurance business", Section "Accounting Rules", the methods established by IVASS for testing the technical reserves adequacy in the life-insurance business do not fully comply with IFRS 4 requirements, primarily because IVASS does not require to project all the cash flows to maturity. For this reason, Companies are required to perform additional testing.

In detail, the Mediolanum Group includes the following in the financial statement reserves to be tested:

- the mathematical reserve;
- the additional interest-rate reserve;
- the additional reserve for demographic bases;
- the expense reserve;

by comparing these amounts, less deferred acquisition costs and any intangible assets arising from business combinations, with the expected future cash flows10 consisting of:

- contract-related benefits to be paid (claims, surrenders, expiries, etc.);
- premiums to be collected under annual and recurring premium tariffs (net of the associated fees);
- handling and settlement expenses.

Since Unit Linked products are already fair-valued, therefore liabilities already equal assets, it is not necessary for those products to perform the LAT. Moreover, the other technical reserves related to those products are plenty covered by fees and loadings charged to policyholders.

As for Traditional Products, the Group only tests the adequacy of reserves as required by IFRS 4 for Medinvest since the Freedom separate management does not guarantee any minimum rate to policyholders therefore no additional reserve is required.

3.1.3.2 Insurance liability adequacy tests: assumptions

3.1.3.2.1 Discount rate and benefit appreciation rate

The Mediolanum Group has opted to use the Eur Italy Sovereign curve to determine the time value of money, as its discount rate. This approach is in line with paragraph X of IAS 37, which states that Companies can adopt a discount rate in line with the rate of assets.

In constructing its LAT model, the Mediolanum Group opted to appreciate benefits at the guaranteed minimum rate, which is the first of the solutions described in *par 2.3.8.1* The appreciation of benefits at the guaranteed minimum rate easily and objectively guarantees that net reserves are adequately assessed, if no line of guarantee records losses. If this is the case, though, this approach brings to compensation among different levels of guarantees leading to inaccurate adequacy conclusions. Moreover, this approach has the downside of not taking in consideration market conditions and presumable rates to which assets will adjust in the foreseeable future.

3.1.3.2.2 The estimation of cash flows

When estimating future cash flows, the Mediolanum Group considers:

- the benefits to be provided on the basis of the existing book, taking account of the estimated termination frequencies set forth in the foregoing paragraph and appreciation assumptions. This computation contemplates all contract-related clauses (surrender penalties, bonuses, etc.);

- future receipts related to premiums under annual or recurring premium tariffs according to assumptions regarding the stability/disruption of the relevant payments. Commission flows to be paid to the sales network are also considered when reaching this estimate;
- costs incurred to acquire, manage or settle policies in determining an average unit cost. In detail, the general costs allocated to the four categories (acquisition, management, settlement and funding) according to internal statistics are considered along with all directly attributable costs.

These amounts are projected according to the assumptions the Company defined concerning termination frequencies, which are outlined below. In this projection, costs are adjusted for inflation according to inflation expectations available from the market at the date of assessment.

Type	Assumption
Contracts that reach maturity	The date of maturity is taken as the term of the projection period for contracts with
Contracts terminated before maturity - Surrenders	The probability of surrender is computed as a function of the past period since the contract underwriting as a ratio of the number of outgoing policies each year to
Contracts terminated before maturity - Claims	Mortality analysis is based on a survey of the frequency of decease among classes of individuals with similar risk of decease (classes of policyholders with temporary life insurance policies, life annuitants, etc.). This analysis is compared with

3.1.3.2.3 Level of aggregation

The Mediolanum Group tests the adequacy of its insurance liabilities by identifying each individual tariff type for separate managements and projecting the closed portfolio on the basis of the elements characteristic of each tariff. The most relevant feature for identifying homogenous aggregates for projection is the guaranteed minimum rate that, as stated above, is used as appreciation rate.

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The Mediolanum Group sets the level of aggregation by summarising the portfolio of contracts into "model points" representative of the near entirety of the book related to separate managements. The "model points" aggregation criterion ensures that a high level of information concerning liabilities is available.

In detail these are the assumptions used:

- *Level of aggregation*: the Group identifies homogeneous groups of DPF contracts based on the minimum guaranteed rate: 2%, 3% and 4%.

- *Model*: The recurrent method adopted by the Company relies on the following assumptions:

  - *Premiums growth rate*: the Company applies to premiums a decay rate based on existing knowledge,
  - *Cancellations growth rate*: the Company applies to cancellations a decay rate based on existing knowledge
  - *Deadline payments growth rate*: the Group estimates deadline payments based on deadlines of existing contracts
  - Appreciation rate: the Group appreciate benefits at the minimum guaranteed rate.
  - Discount rate: The Group adopted a discount rate equal to the Eur Italy Sovereign curve

3.1.3.2.4 Future Events

The Mediolanum Group does not consider future events in its liability adequacy testing because it does not believe that there is objective evidence that they will occur.

3.1.3.2.5 Sensitivity Analysis

The Mediolanum Group tests the adequacy of its insurance liabilities by drawing on the information and methodological support currently used and developed by the Group to measure the intrinsic value. More specifically, the Company performed a Sensitivity Analysis increasing by one percentage point the decay rate of redemptions. Performing this test the Company did not incur in any insufficiency.

3.1.3.2.6 Accounting for LAT deficits

The Mediolanum Group recognises any reserve deficit by increasing the reserve in question by an amount equal to the entire deficit. The reserve deficit is recognised in its entirety in profit and loss when it is detected.

3.1.3.3 Relationship between LAT and shadow accounting

On the basis of IFRS 4, paragraph 30 ("Shadow Accounting"), the Mediolanum Group has opted to test reserves also considering, among net reserves, the "shadow liability" associated with the policyholders recognised in the financial statements.

4. ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Deposit Accounting
- Shadow Accounting
- Liability Adequacy Test

that could be considered by Group Component to make decisions on accounting issues related to Insurance Contracts.

4.1 Deposit Accounting

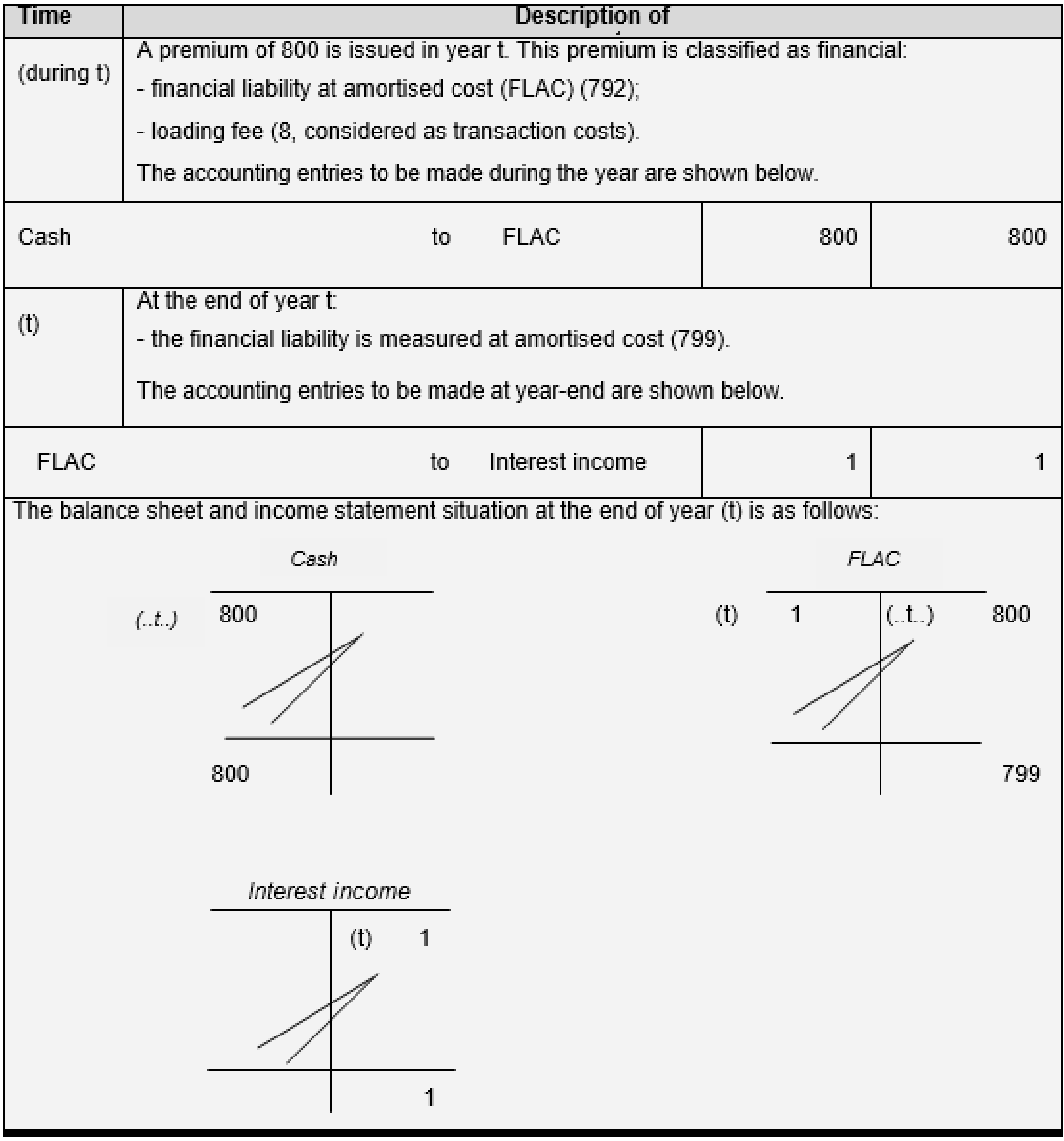
4.1.1 Accounting for investment contracts: deposit accounting

Example 4.1.1.1

The following is an example of the application of deposit accounting in which:

- the contract does not transfer significant insurance risk but creates a financial liability. This financial liability is measured at amortised cost
- the initial loading fees are considered transaction costs, not management fees.

If the liability is measured at amortised cost, the loading fee is included in the carrying amount of the liability and recognised as a component of the effective rate of return. The accounting entry will therefore be as follows:



Time	Description of		
(during t)	A premium of 800 is issued in year t. This premium is classified as financial: - financial liability at amortised cost (FLAC) (792); - loading fee (8, considered as transaction costs). The accounting entries to be made during the year are shown below.		
Cash	to FLAC	800	800
(t)	At the end of year t: - the financial liability is measured at amortised cost (799). The accounting entries to be made at year-end are shown below.		
FLAC	to Interest income	1	1

The balance sheet and income statement situation at the end of year (t) is as follows:

Cash

	Debit	Credit
(..t..)	800	
	800	

FLAC

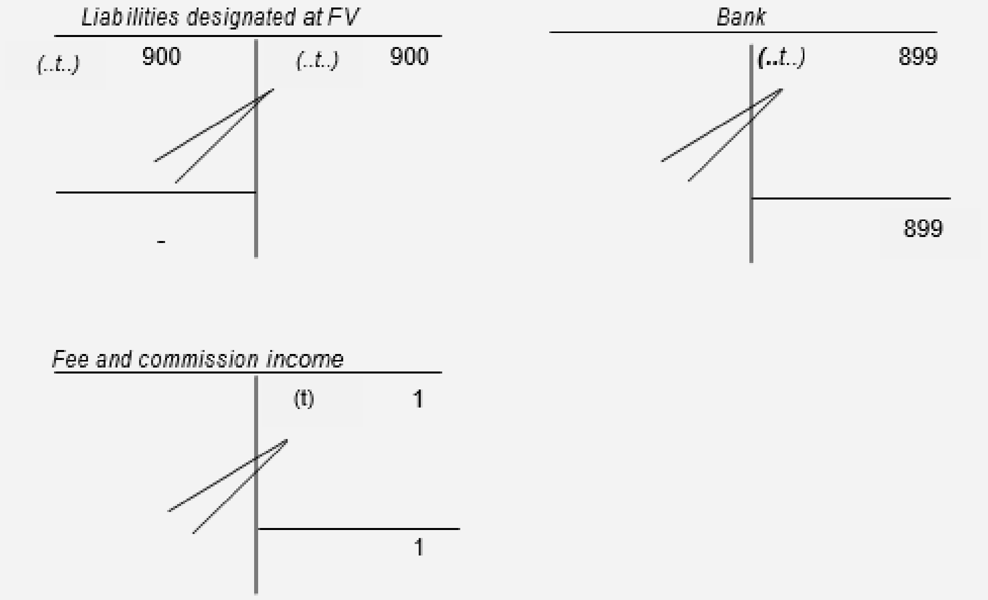
	Debit		Credit
(t)	1	(..t..)	800
			799

Interest income

Debit		Credit
	(t)	1
		1

Example 4.1.1.2

The following is an example of the entries for the transfer of financial liabilities with the application of a surrender penalty.

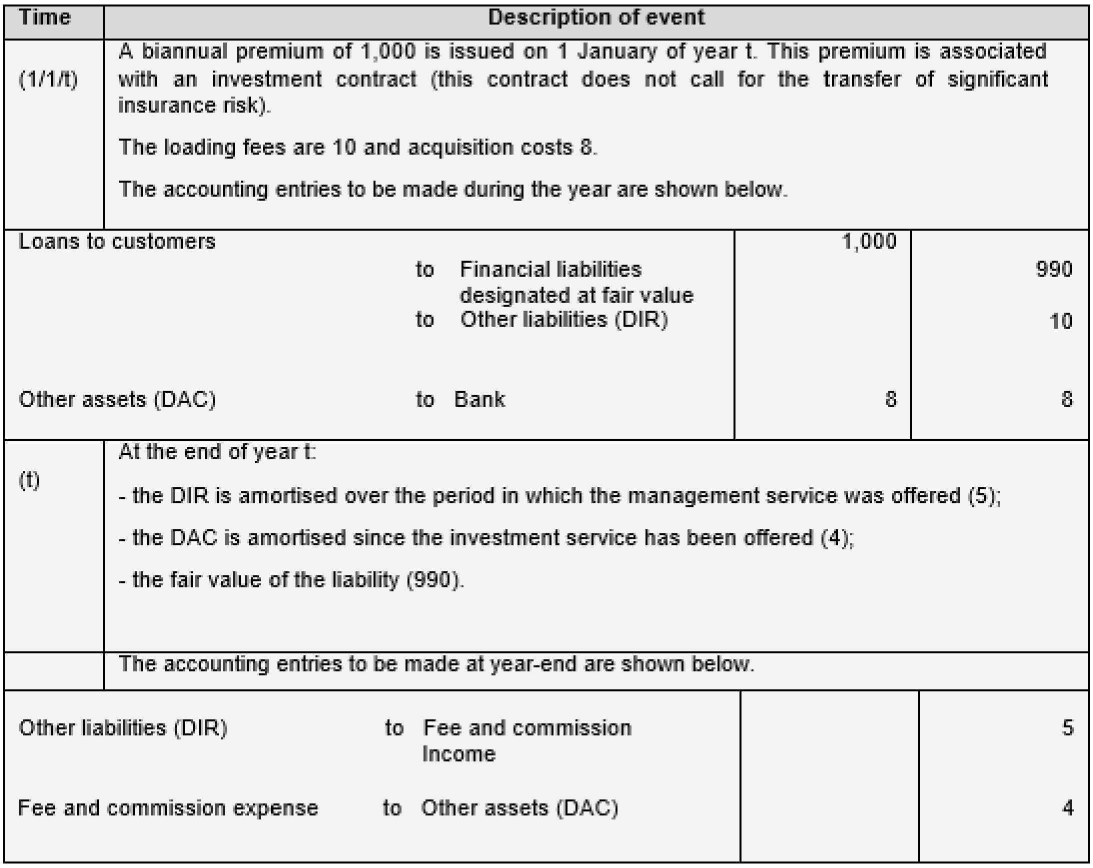
<table>
<tr><th>Time</th><th colspan="3">Description of</th></tr>
<tr><td>(during t)</td><td colspan="3">During t, a policyholder elects to surrender an insurance contract.
This contract calls for:
- a fair value of the liability (990);
- a surrender penalty (1).
The accounting entries are shown below.</td></tr>
<tr><td colspan="2">Financial liabilities designated at FV
to Bank
to Fee and commission income</td><td>990</td><td>989
1</td></tr>
<tr><td colspan="4">The balance sheet and income statement situation at the end of year (t) is as follows:
 </td></tr>
</table>

4.1.2 Accounting for service contracts

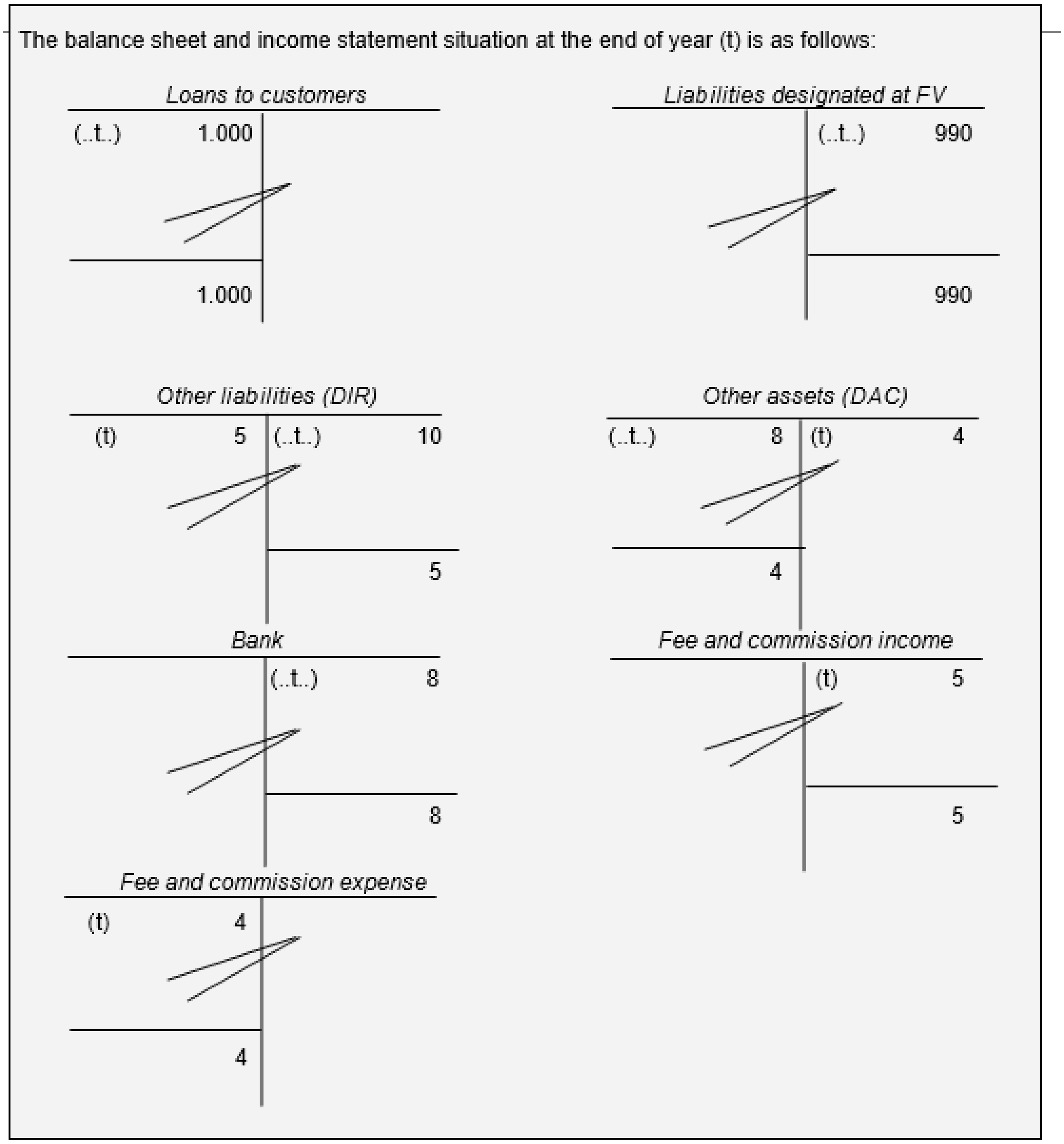
4.1.2.1 Accounting for the service components of investment contracts

Example 4.1.2.1.1

The following is an example of the application of deposit accounting in which the loading fees are considered management fees and the acquisition costs direct costs.



Time	Description of event		
(1/1/t)	A biannual premium of 1,000 is issued on 1 January of year t. This premium is associated with an investment contract (this contract does not call for the transfer of significant insurance risk). The loading fees are 10 and acquisition costs 8. The accounting entries to be made during the year are shown below.		
Loans to customers	to Financial liabilities designated at fair value to Other liabilities (DIR)	1,000	990 10
Other assets (DAC)	to Bank	8	8
(t)	At the end of year t: - the DIR is amortised over the period in which the management service was offered (5); - the DAC is amortised since the investment service has been offered (4); - the fair value of the liability (990).		
	The accounting entries to be made at year-end are shown below.		
Other liabilities (DIR)	to Fee and commission Income		5
Fee and commission expense	to Other assets (DAC)		4



The balance sheet and income statement situation at the end of year (t) is as follows:

Loans to customers

(..t..)	1.000		
	1.000		

Liabilities designated at FV

		(..t..)	990
			990

Other liabilities (DIR)

(t)	5	(..t..)	10
			5

Other assets (DAC)

(..t..)	8	(t)	4
	4		

Bank

		(..t..)	8
			8

Fee and commission income

		(t)	5
			5

Fee and commission expense

(t)	4		
	4		

4.2 Shadow Accounting

4.2.1 Application of shadow accounting

Example 4.2.1.1

The following is an example of the application of the shadow accounting method to a separate management according to two assumptions:

- a guaranteed minimum average rate of 3,5% (case 1);
- a guaranteed minimum average rate of 2% (case 2).

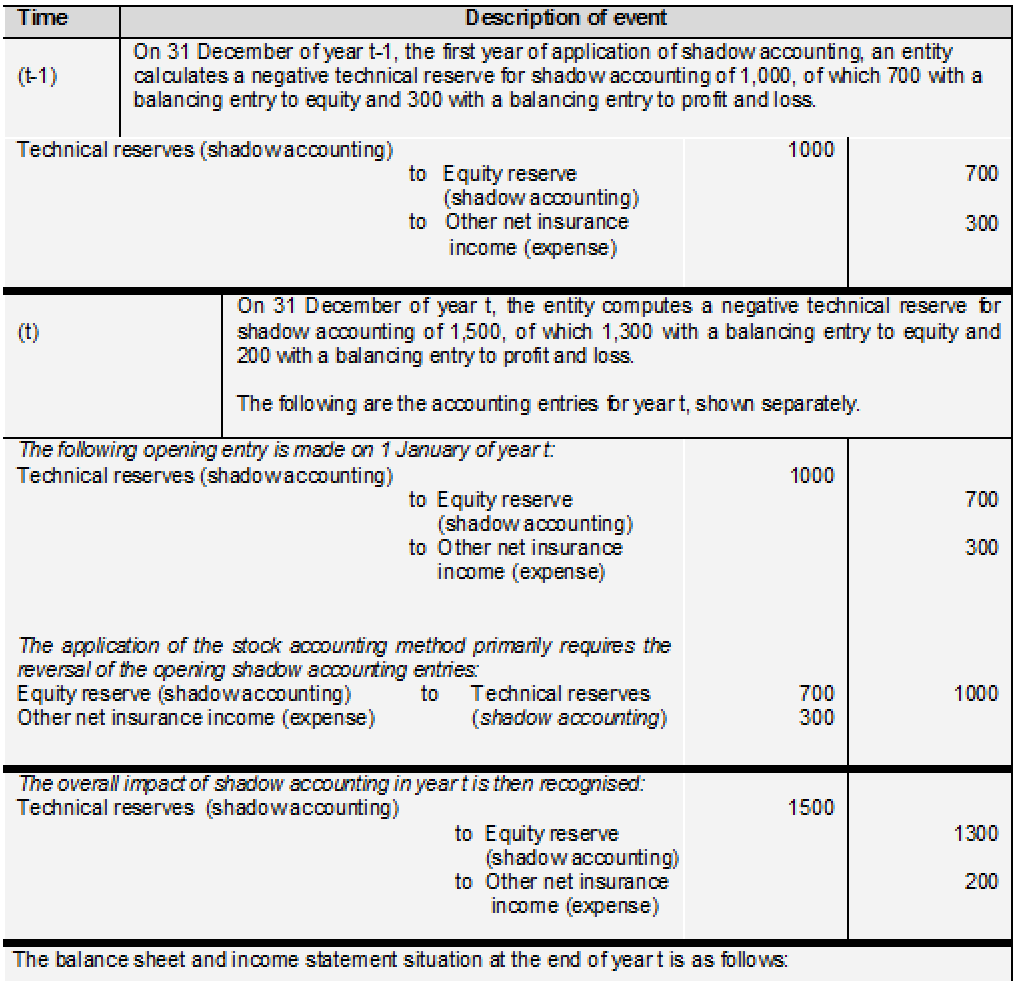
Average invested capital is assumed to coincide with the technical reserve

Column	Description	Amount
A	Unrealised gains/losses through profit or loss	- 1,
B	Unrealised gains/losses through equity	- 3,
C=A+B	Total unrealised gains/losses	- 4,
D	Separate management income	10,
E	Average capital invested in separate management	200,
F= D/E	Separate management return	
G=C+D	New separate management income	6,
H= G/E	New separate management return	
I	Average retrocession rate	9
Case 1	**Guaranteed minimum average rate**	**3.5**
L1	Unrealised losses for retrocession to policyholders	- 2,
M1=L1/C	% retrocession of unrealised gains/losses	5
N1=M1*B	Impact on profit or loss	-
O1=M1*C	Impact on equity	-1,
Case 2	**Guaranteed minimum average rate**	**2.0**
L2	Loss for retrocession to policyholders	- 3,
M2=L2/C	% retrocession of unrealised gains/losses	9
N2=M2*B	Impact on profit or loss	- 9
O2=M2*C	Impact on equity	- 2,
	Unrealised losses for retrocession to policyholders are equal to the difference between the income subject to retrocession before the recognition of unrealised gains/losses (D*I) and the income computed as the product of average invested capital (E) and the greater of the new separate management return and guaranteed minimum rate (G*max(case X;H*I)).	

4.2.2 Application of the Stock Accounting Method

Example 4.2.2.1

The following is an example of the stock accounting method (gross of the tax effect).



Time	Description of event		
(t-1)	On 31 December of year t-1, the first year of application of shadow accounting, an entity calculates a negative technical reserve for shadow accounting of 1,000, of which 700 with a balancing entry to equity and 300 with a balancing entry to profit and loss.		
	Technical reserves (shadow accounting)	1000	
	to Equity reserve (shadow accounting)		700
	to Other net insurance income (expense)		300
(t)	On 31 December of year t, the entity computes a negative technical reserve for shadow accounting of 1,500, of which 1,300 with a balancing entry to equity and 200 with a balancing entry to profit and loss. The following are the accounting entries for year t, shown separately.		
	The following opening entry is made on 1 January of year t:		
	Technical reserves (shadow accounting)	1000	
	to Equity reserve (shadow accounting)		700
	to Other net insurance income (expense)		300
	The application of the stock accounting method primarily requires the reversal of the opening shadow accounting entries:		
	Equity reserve (shadow accounting)	700	
	Other net insurance income (expense)	300	
	to Technical reserves (*shadow accounting*)		1000
	The overall impact of shadow accounting in year t is then recognised:		
	Technical reserves (shadow accounting)	1500	
	to Equity reserve (shadow accounting)		1300
	to Other net insurance income (expense)		200
	The balance sheet and income statement situation at the end of year t is as follows:		

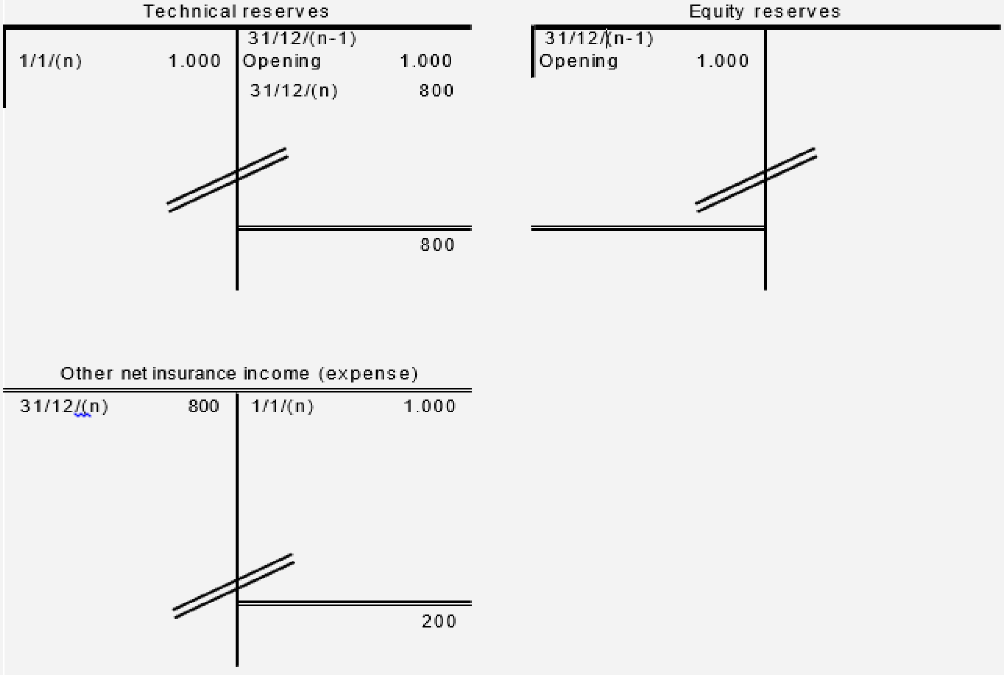
4.3 Liability Adequacy Test

4.3.1 Accounting for LAT Deficits

The following is an example of the treatment of a deficit detected in a LAT through the application of the stock method.

Time	Description of event		
(t-1)	A deficit of 1,000 in technical reserves is detected at 31 December of year (t-1)[11].		
Other net insurance income (expense) to Technical reserves		1,000	1,000
(t)	A new LAT is performed on 31 December of year (t), resulting in a deficit of 800.		
The following opening entry is made on 1 January of year t: Equity reserve to Technical reserves		1,000	1,000
The application of the stock accounting method first requires the reversal of the opening LAT entries: Technical reserves to Other net insurance income (expense)		1,000	1,000
The overall impact of the LAT in year (t) is then recognized: Other net insurance income (expense) to Technical reserves		800	800

The balance sheet and income statement situation at the end of year (t)t is as follows:

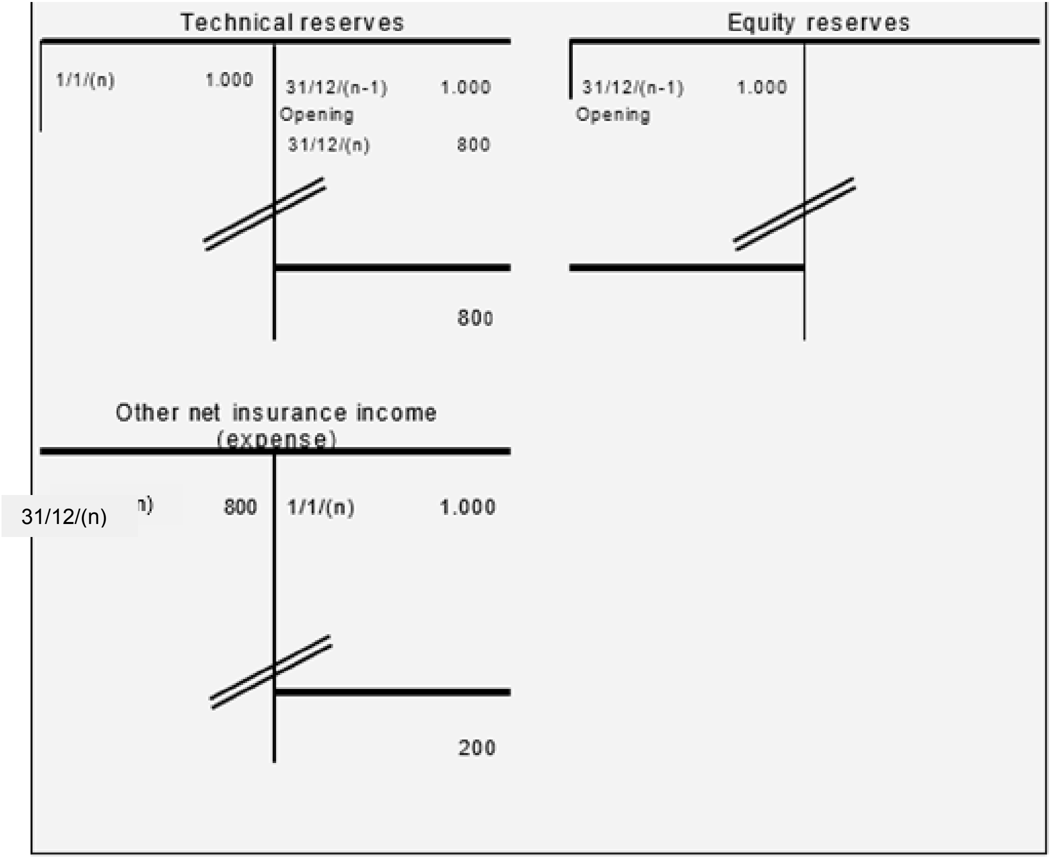


4.3.2 Relationship between LAT and shadow accounting

Example 4.3.2.1

The following is an example of accounting for a reserve deficit due to a LAT performed after recognizing Shadow Accounting (in equity):

Time	Description of event		
(t)	On 31 December of year (t) the application of shadow accounting resulted in the recognition of a reduction of 100 in the reserve due to losses reversible to policyholders.[12]		
Technical reserves	to Equity reserves (shadow accounting)	800	800
(t)	A LAT is performed on 31 December of year (t), resulting in a deficit of 1000.		
The effect of shadow accounting is first reversed Equity reserves (shadow accounting)	to Technical reserves	800	800
The excess of the effect with respect to shadow accounting is recognised in the income statement Other net insurance income (expense)	to Technical reserves	200	200



5 PRESENTATION

5.1 Disclosure rules

Phase I of IFRS 4 requires limited improvements to accounting criteria for insurance contracts by requiring extended disclosure that helps users understand the amount, timing and uncertainty of future cash flows from insurance contracts.

IFRS 4 establishes a flexible, principle-based disclosure system instead of a detailed list of requirements, because the IASB believes that this approach:

- makes it easier for insurers to understand the rationale for the requirements, which promote a more proactive role of insurance companies;
- avoids a mechanical approach to IFRS and encourages insurers to research and experimentation of new disclosure techniques;
- reduces superfluous disclosures by focusing attention in material information;
- gives insurers flexibility to decide on an appropriate level of aggregation that they believe will enable users to have a better understanding of disclosures.

The IASB also wished to ensure that IFRS 4 and IFRS 7 were consistent in order to:

- avoid excessive effort by insurers that issue both insurance and investment contracts (disclosure of insurance contracts in accordance with IFRS 4 differing from the disclosure of investment contracts in accordance with IFRS 7);
- simplify the preparation of disclosures since IFRS 7 required less extensive disclosures than the previous version of IFRS 4.

The disclosure required by IFRS 4 in phase I should remain substantially unchanged in phase II of the project, except for amendments to incorporate the new accounting criteria for insurance contracts.

5.1.1 Explanations of recognized amounts

The minimum information to be disclosed concerning the amounts recognised in financial statements arising from insurance contracts are:

- the accounting policies adopted for insurance contracts (and the related assets, liabilities, income and expense);
- the recognised assets, liabilities, income and expense arising from insurance contracts. If the insurer is a cedant, it shall disclose:

- gains and losses recognised in profit or loss on buying reinsurance; and
- if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period.

- the process used to determine the assumptions that have the greatest effect on the measurement of recognised insurance balances. When practicable, an insurer shall also give quantified disclosure of
- those assumptions;
- the effect of changes in assumptions used to measure insurance assets and liabilities, showing separately the effect of each change that has a material effect on the financial statements;
- the reconciliation of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs.

5.1.1.1 Accounting policies adopted

The accounting policies for insurance contracts should address the treatment of (if applicable):

- premiums (and the premiums reserve);
- commissions and loading fees;
- acquisition costs;
- claims incurred (both reported and not reported), and claims handling costs13 ;
- embedded options and guarantees;
- discretionary participation features;
- franchise, salvage, subrogation or other recoveries from policyholders and third parties;
- reinsurance held;

Insurers should also disclose considerations concerning the methods of determination of insurance liabilities in order to account for risk and uncertainty and the significant assumptions underlying the recognition of insurance balances (i.e., assumptions regarding the classification of contracts with discretionary participation features).

Circular 262/05 of the Bank of Italy states that accounting policies shall be disclosed in section A. 2 – Main financial statement captions, under point 17 Insurance assets and liabilities.

5.1.1.2 Recognised assets, liabilities, income and expense arising from insurance contracts

The level of aggregation for insurance captions suggested by IFRS 4 is as follows:

- insurance and reinsurance liabilities (indirect business), specifically indicating:

  - the premiums reserve;
  - the claims reserve and the incurred but not reported (IBNR) claims reserve;
  - the provisions arising from liability adequacy tests;
  - any components of equity arising from contracts with discretionary participation features;
  - receivables and payables related to insurance contracts.

- insurance and reinsurance assets (indirect business), specifically indicating:
  - deferred acquisition costs;
  - recognised intangible assets arising from business combinations;
  - transferred reinsurance assets (ceded business).

The following are the main tables on insurance assets and liabilities that Bank of Italy Circular 262/05 requires be included in the Notes to the financial statements:

Table_ Technical reserves: breakdown

	Direct work	**Indirect work**	**Total (T)**	**Total (T-1)**
A. Non-life business				
A1. Premiums reserves				
A2. Claims reserves				
A3. Other reserves				
B. Life business				
B1. Mathematical reserves				
B2. Reserves for amounts to be used				
B3. Other reserves				
C. Technical reserves for investment risks to be borne by the insured				
C1. Reserves for contracts with disbursements connected with investment funds and market indices				
C2. Reserves from pension fund management				
D. Total technical reserves				

IFRS 4-IG17

Table: Technical reserves reinsured with third parties: breakdown

	Total T	**Total (T-1)**
A. Non-life business		
A1. Premiums reserves		
A2. Claims reserves		
A3. Other reserves		
B. Life business		
B1. Mathematical reserves		
B2. Reserves for amounts to be disbursed		
B3. Other reserves		
C. Technical reserves for investment risks to be borne by the insured		
C1. Reserves for contracts with disbursements connected with investment funds and market indices		
C2. Reserves from pension fund management		
D. Total technical reserves reinsured with third parties		

IFRS 4-IG22

"Other reserves" item must include:

- the reserves allocated as a result of the application of liability adequacy tests;
- the reserves arising from shadow accounting;
- additional reserves other than reserves for financial risk, as defined by IVASS Regulation 21;
- all reserves other than the premiums reserve or claims reserve.

IFRS 4-IG23

C1 and C2 contain the technical reserves for insurance contracts allocated to cover commitments calculated on the basis of investments or indices for products having the characteristics set forth in article 41 of Legislative Decree 209/2005.

Circular 262/05 requires that insurers provide the details of deferred acquisition costs (where material) in section 16 Other assets, caption 160.

Insurers shall disclose the following information on income statement, in addition to indicating premiums, transferred premiums, claims, claims recovered from reinsurers and other technical items 14 :

- acquisition costs (indicating deferred acquisition costs and costs recognised directly in the income statement);
- the effects of any change in assumptions and estimates;
- insurance liabilities, if discounted, in terms of:
    - impacts on the income statement due to the passage of time;
    - impacts on the income statement due to changes in the discount

rate;
- impacts on accounting for contracts with discretionary participation features.

The following are the main tables that Circular 262/05 requires insurers include in the Notes to the financial statements concerning the income and expenses arising from insurance contracts:

Table_ Net premiums: breakdown

Premiums deriving from insurance business	**Direct business**	**Indirect business**	**Total (T)**	**Total (T-1)**
A. Life business				
A.1 Gross accounted premiums (+)				
A.2 Premiums ceded for reinsurance				
A.3 Total				

Premiums deriving from insurance business	**Direct business**	**Indirect business**	**Total (T)**	**Total (T-1)**
B. Non-life business				
B.1 Gross accounted premiums (+)				
B.2 Premiums ceded for reinsurance				
B.3 Change in gross amount of the premiums reserve (+/-)				
B.4 Change in the premiums reserve reinsured with third parties (-/+)				
B.5 Total				
C. Total net premiums				

The foregoing table includes direct premiums, indirect premiums (premiums received for reinsurance given) and ceded premiums (premiums transferred for reinsurance received) arising from contracts classified as insurance contracts.

Table_Other net insurance income (expense): breakdown

Captions	**Total (T)**	**Total (T-1)**
1. Net change in technical reserves		
2. Claims accrued and paid during the year		
3. Other net insurance income (expense)		
Total		

The foregoing table includes changes in technical reserves, paid claims on accrual basis and other insurance income and expenses, as specified in the following tables.

IVASS Reg 21 art 49

Table_ Breakdown of Net change in technical reserves

Net change in technical reserves	**Total (T)**	**Total (T-1)**
1. Life business		
A. Mathematical reserves		
A.1 Gross annual amount		
A.2 Amount reinsured with third parties (-)		
B. Other technical reserves		
B.1 Gross annual amount		
B.2 Amount reinsured with third parties (-)		
C. Technical reserves for investment risks to be borne by the insured		
C.1 Gross annual amount		
C.2 Amount reinsured with third parties (-)		
Total life business reserves		
2. Non-life business		
Change in other technical reserves for non-life business other than the claims reserve, net of ceded reinsurance		

IFRS 4-IG243

The foregoing table includes the details of changes in technical reserves before and after the impact of reinsurance

Table_ Breakdown of Claims accrued during the year

Charges associated with claims	**Total (T)**	**Total (T-1)**
Life business: charges associated with claims, net of reinsurance ceded		
A. Amounts paid		
A.1 Gross annual amount		
A.2 Amount reinsured with third parties (-)		
B. Change in reserve for sums to be disbursed		
B.1 Gross annual amount		
B.2 Amount reinsured with third parties (-)		
Total life business claims		
Non-life business: charges associated with claims, net of recoveries and reinsurance ceded		
C. Amounts paid:		
C.1 Gross annual amount		
C.2 Amount reinsured with third parties (-)		
D. Change in recoveries, net of quotas insured with third parties		
E. Change in the claims reserve		
E.1 Gross annual amount		
E.2 Amount reinsured with third parties (-)		
Total non-life business claims		

The foregoing table includes the details of claims paid, gross and net of claims recovered from reinsurers.

Section 10.4 "Other income/expenses arising from insurance business" of Bank of Italy Circular 262/05 does not supply a standard model for the table to be used to present the composition of the caption. It should be noted that this caption consists primarily of other technical income and expenses, as defined in IVASS Regulation 22.

Section 2 "Net fee and commission income" of Bank of Italy Circular 262/05 does not supply a standard model for the table to be used to present the breakdown of fees and commissions of the insurance business.

Fees income and commissions on investment contracts or contracts without discretionary participation features should be included in h) Other services.

Acquisition costs for contracts classified as investment contracts should be included in e) Other services of commission expenses.

5.1.1.3 Process used to determine assumptions and estimates

The description of the process that IFRS 4 suggests for determining assumptions includes:

- the objective of the assumptions (i.e., whether the assumptions are intended to be neutral estimates or best estimates, etc.);
- the source of data used as inputs for the assumptions that have the greatest effect (e.g. internal, external, or a mixture of the two, etc.);
- the extent to which the assumptions are consistent with observable market prices or other published information;
- a description of how past experience, current conditions and other relevant benchmarks are taken into account in developing assumptions;
- a description of how the insurer developed assumptions (about changes in mortality, etc.);
- an explanation of how the insurer identifies correlations between different assumptions;
- the insurer's policy in making allocations or distributions for contracts with discretionary participation features;
- the nature and extent of any uncertainties affecting assumptions.
- Bank of Italy Circular 262/05 requires that the process of determining assumptions and estimates be described in Section 18 "Other information".

5.1.1.4 Changes in assumptions and estimates

IFRS 4 requires an insurer to disclose the effect of changes in assumptions and estimates in accordance with IAS 8.

Assumptions are often interdependent. When this is the case, analysis of changes by assumption may depend on the order in which the analysis is performed and may be arbitrary to some extent. Therefore, IFRS 4 does not specify a rigid pattern for the analysis of changes in assumptions and estimates. This allows insurers to analyse the effects of changes by disclosing

- the impact of changes in different assumptions (beneficial and adverse effects that do not offset one another);
- a description of the impact of interdependencies and the resulting limitations of any analysis.

An insurer discloses the effects of changes in assumptions both before and after reinsurance held, especially in situation where the change of assumptions has relevance in relation to accounting for reinsurance or in situation in which an analysis before reinsurance is relevant for highlight the credit risk arising from the same reinsurance.

5.1.1.5 Changes in insurance liabilities or reinsurance assets

IFRS 4 requires an insurer to disclose changes in insurance liabilities or reinsurance assets, including:

- the carrying amount at the beginning and end of the period;
- increases in reserves recognised during the period;
- cash paid;
- income and expense included in profit or loss;
- reserves acquired from, or transferred to, other insurers;
- recognised net exchange differences.

The above disclosure shall be provided for all prior periods for which comparative information was reported.

Section 13.2 "Technical reserves: annual changes" of Bank of Italy Circular 262/05 does not provide a standard model of the table in which changes in technical reserves during the period are to be presented.

IFRS 4 requires an insurer to disclose the following information about deferred acquisition costs:

- the carrying amount at the beginning and end of the period;
- the amounts incurred during the period;
- the amortisation for the period;
- impairment losses recognised during the period;
- other changes.

Section 16 "Other assets" of Bank of Italy Circular 262/05 does not provide a standard model of the table in which changes in deferred acquisition during the period are to be presented. The following table may be used where the caption in question is material:

16.2 Acquisitions Cost

	31/12/XX	31/12/X-1
Initial amounts		
Capitalisations		
Amortisation		
Impairment losses		
Other changes		
Closing amounts		

The disclosures required by IAS 38 Intangible Assets are sufficient for assets acquired in a business combination.

5.1.2 Disclosure about nature and extent of risks arising from insurance contracts

IFRS 4 requires an insurer to disclose the following information concerning the nature and extent of risks arising from insurance contracts:

- its objectives, policies, and processes for managing risks;
- information about insurance risk (both before and after reinsurance), including information about:
    - sensitivity analyses;
    - concentrations of insurance risk;
    - actual claims compared with previous estimates (i.e., the use of the claims reserve).

- information about credit risk, liquidity risk and market risk that would be required by IFRS 7, considering that:
    - an insurer need not provide the maturity analysis required by IFRS 7 if it discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities. This may take the form of an analysis, by estimated timing, of the amounts recognised in the balance sheet;
    - if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may use that sensitivity analysis to meet the requirements of IFRS 7.
- information about exposures to market risk arising from embedded derivatives

contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value

5.1.2.1 Risk management objectives, policies, processes and methods

IFRS 4 requires an insurer to disclose its objectives, policies, processes and methods for managing risks, including information about:

- the structure and organisation of the insurer's risk management function;
- the scope and nature of the insurer's risk reporting system (measurement models, sensitivity analyses, stress testing, etc.). This disclosure might include a summary description of the approah used, associated assumptions and parameters;
- the insurer's process of accepting, measuring, monitoring and controlling insurance risks and underwriting strategies;
    - the level of aggregation of the insurance risk managed by the insurer;
    - the risk mitigation methods employed by the insurer (acquisition of reinsurance, etc.);
    - asset-and-liability management techniques;
    - capital management techniques.

This information should be provided both at the level of individual risks and the Group's overall exposure in both qualitative and quantitative form.

5.1.2.2 Insurance risk

On the subject of disclosure about insurance risk, IFRS 4 requires:

- information to be consistent with that used by the management to manage risk;
- such information to be provided before and after the impact of reinsurance;
- quantitative information to be accompanied by a description of the methods and assumptions underlying its determination;
- such quantitative information to be presented in matrix form if risks are classified by extent;
- disclosure to be provided if the risk exposure at the end of the reporting period is unrepresentative of its exposure during the period;
- sensitivity analyses to be provided;
- the level of risk concentration to be disclosed;
- the use of reserves to be disclosed.

IFRS 4 also requires:

- a description of the nature of risks covered;
- a description of discretionary participation features;
- a description of any obligation or contingent obligation arising from the contracts

5.1.2.3 Sensitivity analysis

IFRS 4 requires that sensitivity analyses focus on profit or loss and equity. In detail, IFRS 4 allows insurers to disclose, at their discretion:

- quantitative information about the sensitivity of their profit or loss and equity. If this analysis does not show significant correlations between the key variables, an explanation should be provided;
- qualitative information about sensitivity and information about the terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of cash flows. IFRS 4 states
- that each insurer shall decide the level of aggregation most appropriate to presenting the results of its sensitivity analyses.

5.1.2.4 Concentration of insurance risk

IFRS 4 requires that an insurer disclose concentrations of insurance risk. Insurers shall disclose a description of the characteristics of each concentration and possible exposure before and after the effect of reinsurance.

The following are examples of the concentration of insurance risk:

a single insurance contract, or a small number of related contracts, when an insurance contract overs low-frequency, high-severity risks (such as earthquakes);

- single incidents that expose an insurer to multiple risks;
- exposure to unexpected changes in trends (unexpected changes in the mortality rate, etc.);
- exposure to possible major changes in financial market conditions (for example, when interest rates decline significantly, policies with guaranteed minimum rates may result in significant losses).

Catastrophe and equalisation reserves are recognised in individual financial statements prepared in accordance with local accounting standards. These reserves are derecognised when preparing financial statements in accordance with IFRS because they are considered components of equity. IAS 1 requires an entity to disclose the following information concerning these reserves:

- a description of the nature and purpose of each reserve within equity;
- the entity’s objectives, policies and processes for managing capital;
- the nature of any minimum capital requirements.

5.1.2.5 Claims development

IFRS 4 requires disclosure of claims development information. The disclosure about claims development shall go back to the period when the earliest material claim arose for which there is still uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. An insurer need not disclose this information for claims for which uncertainty about the amount and timing of claims payments is typically resolved within one year. Informative disclosure should reconcile this information to amounts reported in the balance sheet.

5.1.2.6 Credit risk, liquidity risk and market risk

IFRS 4 requires an insurer to disclose information about credit risk, liquidity risk and market risk that would be required if insurance contracts were within the scope of IFRS 7.

Such disclosure includes:

- information about the extent of clauses that mitigate or compound those risks;
- a summary of guarantees that could alter the insurer’s cash flows;
- the basis for determining the technical interest owed to policyholders (fixed rate, rate linked to the return on allocated assets).

The credit risk of an insurance contract is related to the risk of default of a reinsurer or the risk that premiums may not be remitted by intermediaries.

IFRS 7 requires an entity to disclose a maturity analysis of insurance liabilities. The estimated date of the outflow is used as the maturity. IFRS 4 states that an insurer need not provide this maturity analysis if it discloses an analysis, by estimated timing, of the insurance liabilities recognised in the financial statements as at the balance sheet date. An insurer should provide a description of how the maturity analysis could change if the policyholders exercised surrender options in different ways.

5.1.3 Disclosure of exposure to market risk due to derivatives embedded in an insurance contract

IFRS 4 requires an insurer to disclose information concerning the exposure to market risk associated with an embedded derivative that has not been separated from its host contract and measured at fair value.

This disclosure shall include:

- a sensitivity analysis;
- information concerning exposures with a material impact on cash flows;
- the fair value of embedded derivatives

5.2 Mediolanum Financial Statement disclosure

When Bank of Italy Circular 262/05 does not provide a standard model of a table but requires disclosure, the Company can adopt tables of its own choice.

5.2.1 Recognised assets, liabilities, income and expense arising from insurance contracts

Table_Other income/expenses arising from insurance business

	31/12/XX	**31/12/X-1**
Life		
A. Income - Other technical income, net of reinsurance - Unrealized income and gains related to investments for the benefit of - policyholders who bear the risk - Change in commissions and other acquisition costs to be amortized - Commissions and investments in profits received from - Other income reinsurers		
	31/12/XX	**31/12/X-1**
A. Expenses - Other technical expenses, net of reinsurance - Unrealized expenses and losses related to investments for the benefit of - policyholders who bear the risk - Acquisition commissions - Other acquisition costs - Collection commissions - Other expenses		
Total Life (A-B)		
Damages		
A. Income - Other technical income, net of reinsurance - Change in commissions and other acquisition costs to be amortized - Commissions and investments in profits received from reinsurers -Other income		
B. Expenses - Other technical expenses, net of reinsurance - Acquisition commissions - Other acquisition costs - Collection commissions - Other expenses		
Total Damages (A-B)		

5.2.2 Changes in insurance liabilities or reinsurance assets

The following is the table used by the Mediolanum Group to present the annual changes in technical reserves.

Table_Technical reserves: annual changes

	31/12/XX	31/12/X-1
1. Life		
A Mathematical Reserve		
A.1 Gross Annual Amount		
A.2 Reinsurers' share (-)		
B Other Technical Reserves		
B.1 Gross annual amount		
B.2 Reinsurers' share (-)		
C Technical reserves under which the investment risk is borne by the insurance		
C.1 Gross Annual Amount		
C.2 Reinsurers' share (-)		
Total "life insurance reserves"		
2. Damages		

5.2.3 Concentration of insurance risk

In its life insurance business, the Mediolanum Group views the guarantee of a return as the variable that best represents the concentration of material risks. The following is the table presented:

Breakdown of concentration of risks by type of guarantee	**Premiums (%)**	**Total reserves (%)**
Insurance or investment products with guaranteed annual returns		
from 0% to 1%		
from 1% to 3%		
from 3% to 5%		
Insurance or investment products with guaranteed annual returns		
Shadow reserve		
Total		

In its non-life insurance business, the Meidolanum Group views LOB distribution as the variable that best represents the concentration of material risks.

5.2.4 Claims development

The Mediolanum Group presents a table that shows the use of non-life claims reserves

Claims reserve development	**N-4**	**N-3**	**N-2**	**N-1**	**N**	**Total**
Claims reserves						
As at 31.12 of generation year N						
As at 31.12 of generation year N+1						
As at 31.12 of generation year N+2						
As at 31.12 of generation year N+3						
As at 31.12 of generation year N+4						
Total amount of claims paid						
Claims reserve in year N						
Claims reserve in previous years						
Total reserve in the financial statements						

5.2.5 Credit risk, liquidity risk and market risk

The Mediolanum Group presents a table that analyzes the structure of mathematical reserves by estimated timing.

Breakdown of mathematical reserves	**Mathematical reserve**
Less than 1 year	
From 1 to 5 years	
From 6 to 10 years	
From 11 to 20 years	
More than 20 years	
Total	

The total amount in the table must be reconciled with the total amount of mathematical reserves disclosed in the financial statements.

IFRS Operating Manual

Chapter 8
Provisions

Chapter 8 Provisions

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 37 – Provisions, Contingent Liabilities and Contingent Assets;
- a list of most recent amendment to IAS 37.

1.1 Introduction

The objective of IAS 37 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount.

The key principle established by the Standard is that a provision should be recognised only when there is a liability i.e. a present obligation resulting from past events. The Standard thus aims to ensure that only genuine obligations are dealt with in the financial statements – planned future expenditure, even where authorised by the board of directors or equivalent governing body, is excluded from recognition.

1.2 Overview of IAS 37

IAS 37 Provisions, Contingent Liabilities and Contingent Assets outlines the accounting for provisions (liabilities of uncertain timing or amount), together with contingent assets (possible assets) and contingent liabilities (possible obligations and present obligations that are not probable or not reliably measurable). Provisions are measured at the best estimate (including risks and uncertainties) of the expenditure required to settle the present obligation, and reflects the present value of expenditures required to settle the obligation where the time value of money is material.

IAS 37 was issued in September 1998 and is operative for periods beginning on or after 1 July 1999.

Date	**Development**	**Comments**
30 June 2005	Exposure Draft *Amendments to IAS 37 Provisions, Contingent*	Comment deadline 28 October 2005 (proposals were not finalised,

	Liabilities and Contingent Assets and IAS 19 Employee Benefits published	instead being reconsidered as a longer term research project)
September 1998	IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* issued	Operative for annual financial statements covering periods beginning on or after 1 July 1999
August 1997	Exposure Draft E59 *Provisions, Contingent Liabilities and Contingent Assets* published	

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 37 that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Provision

IAS 37.10

A liability of uncertain timing or amount.

Liability

Present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow of from the entity of resources embodying economic benefits

Obligation event

An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

Contingent liability

A possible obligation depending on whether some uncertain future event occurs, or a present obligation but payment is not probable or the amount cannot be measured reliably.

Contingent asset

A possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

Onerous contract

Contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it

Restructuring

Programme that is planned and controlled by management, and materially changes eighetr: i) the scope of business undertaken by an entity; or ii) the manner in which that business is conducted

2.2 Scope of rules

IAS 37 excludes obligations and contingencies arising from:

IAS 37.1-6

- financial instruments that are in the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (or IFRS 9 *Financial Instruments*);
- non-onerous executory contracts;
- insurance contracts (see IFRS 4 *Insurance Contracts*), but IAS 37 does apply to other provisions, contingent liabilities and contingent assets of an insurer;
- items covered by another IFRS. For example, IAS 11 *Construction Contracts* applies to obligations arising under such contracts; IAS 12 *Income Taxes* applies to obligations for current or deferred income taxes; IAS 17 *Leases* applies to lease obligations; and IAS 19 *Employee Benefits* applies to pension and other employee benefit obligations.

2.3 Recognition

An entity must recognise a provision if, and only if:

- a present obligation (legal or constructive) has arisen as a result of a past event (the obligating event);
- payment is probable ('more likely than not'); and
- the amount can be estimated reliably.

IAS 37.14

An obligating event is an event that creates a legal or constructive obligation and, therefore, results in an entity having no realistic alternative but to settle the obligation.

IAS 37.10

A constructive obligation arises if past practice creates a valid expectation on the part of a third party, for example, a retail store that has a long-standing policy of allowing customers to return merchandise within, say, a 30-day period.

IAS 37.10

A possible obligation (a contingent liability) is disclosed but not accrued. However, disclosure is not required if payment is remote.

IAS 37.86

IAS 37.15

In rare cases, for example in a lawsuit, it may not be clear whether an entity has a present obligation. In those cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the balance sheet date. A provision should be recognised for that present obligation if the other recognition criteria described above are met. If it is more likely than not that no present obligation exists, the entity should disclose a contingent liability, unless the possibility of an outflow of resources is remote.

Examples

IAS 37.78

IAS 37.72

Circumstance	**Recognize a provision?**
Restructuring by sale of an operation	Only when the entity is committed to a sale, i.e. there is a binding sale agreement
Restructuring by closure or reorganisation	Only when a detailed form plan is in place and the entity has started to implement the plan, or announced its main features to those affected. A Board decision is insufficient.
Warranty	When an obligating event occurs (sale of product with a warranty and probable warranty claims will be made).
Land contamination	A provision is recognised as contamination occurs for any legal obligations of clean up, or for constructive obligations if the company's published policy is to clean up even if there is no legal requirement to do so (past event is the contamination and public expectation created by the company's policy).
Customer refunds	Recognise a provision if the entity's established policy is to give refunds (past event is the sale of the product together with the customer's expectation, at time of purchase, that a refund would be available).

Offshore oil rig must be removed and sea bed restored	Recognise a provision for removal costs arising from the construction of the the oil rig as it is constructed, and add to the cost of the asset. Obligations arising from the production of oil are recognised as the production occurs.
Abandoned leasehold, four years to run, no re-letting possible	A provision is recognised for the unavoidable lease payments.
CPA firm must staff training for recent changes in tax law	No provision is recognised (there is no obligation to provide the training, recognise a liability if and when the retraining occurs).
Major overhaul or repairs	No provision is recognised (no obligation).
Onerous (loss-making) contract	Recognise a provision
Future operating losses	No provision is recognised (no liability)

IAS 37.66

IAS 37.63

What is the debit entry?

When a provision (liability) is recognised, the debit entry for a provision is not always an expense. Sometimes the provision may form part of the cost of the asset. Examples: included in the cost of inventories, or an obligation for environmental cleanup when a new mine is opened or an offshore oil rig is installed. **IAS 37.8**

Use of provisions

Provisions should only be used for the purpose for which they were originally recognised. They should be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources will be required to settle the obligation, the provision should be reversed. **IAS 37.61**

Contingent liabilities

Since there is common ground as regards liabilities that are uncertain, IAS 37 also deals with contingencies. It requires that entities should not recognise contingent liabilities – but should disclose them, unless the possibility of an outflow of economic **IAS 37.86** resources is remote.

Contingent assets

Contingent assets should not be recognised – but should be disclosed where an inflow of economic benefits is probable. When the realisation of income is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate. **IAS 37.31-35**

2.4 Measurement

The amount recognised as a provision should be the best estimate of the expenditure required to settle the present obligation at the balance sheet date, that is, the amount that an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party. This means: **IAS 37.36**

- Provisions for one-off events (restructuring, environmental clean-up, settlement of a lawsuit) are measured at the most likely amount. **IAS 37.40**
- Provisions for large populations of events (warranties, customer refunds) are measured at a probability-weighted expected value. **IAS 37.39**
- Both measurements are at discounted present value using a pre-tax discount rate that reflects the current market assessments of the time value of money and the risks specific to the liability. **IAS 37.45-47**

In reaching its best estimate, the entity should take into account the risks and uncertainties that surround the underlying events. **IAS 37.42**

If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognised as a separate asset, and not as a reduction of the required provision, when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The amount recognised should not exceed the amount of the provision. **IAS 37.53**

In measuring a provision consider future events as follows:

- forecast reasonable changes in applying existing technology; **IAS 37.49**
- ignore possible gains on sale of assets; **IAS 37.51**
- consider changes in legislation only if virtually certain to be enacted. **IAS 37.50**

Remeasurement of provisions

- Review and adjust provisions at each balance sheet date;
- If an outflow no longer probable, provision is reversed. **IAS 37.59**

2.5 Restructurings

A restructuring is:

IAS 37.70

- sale or termination of a line of business
- closure of business locations
- changes in management structure
- fundamental reorganisations.

Restructuring provisions should be recognised as follows: **IAS 37.72**

IAS 37.78

- *Sale of operation*: recognise a provision only after a binding sale agreement;
- *Closure or reorganisation*: recognise a provision only after a detailed formal plan is adopted and has started being implemented, or announced to those affected. A board decision of itself is insufficient;
- *Future operating losses*: provisions are not recognised for future operating losses, even in a restructuring;
- *Restructuring provision on acquisition:* recognise a provision only if there is an obligation at acquisition date. **IFRS 3.11**

Restructuring provisions should include only direct expenditures necessarily entailed by the restructuring, not costs that associated with the ongoing activities of the entity. **IAS 37.80**

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

A provision is recognised by Mediolanum Group when:

- an entity has a present obligation (legal or constructive) as a result of a past event;
- it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

In accordance with IAS 37, Provisions are distinguished by Mediolanum Group from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:

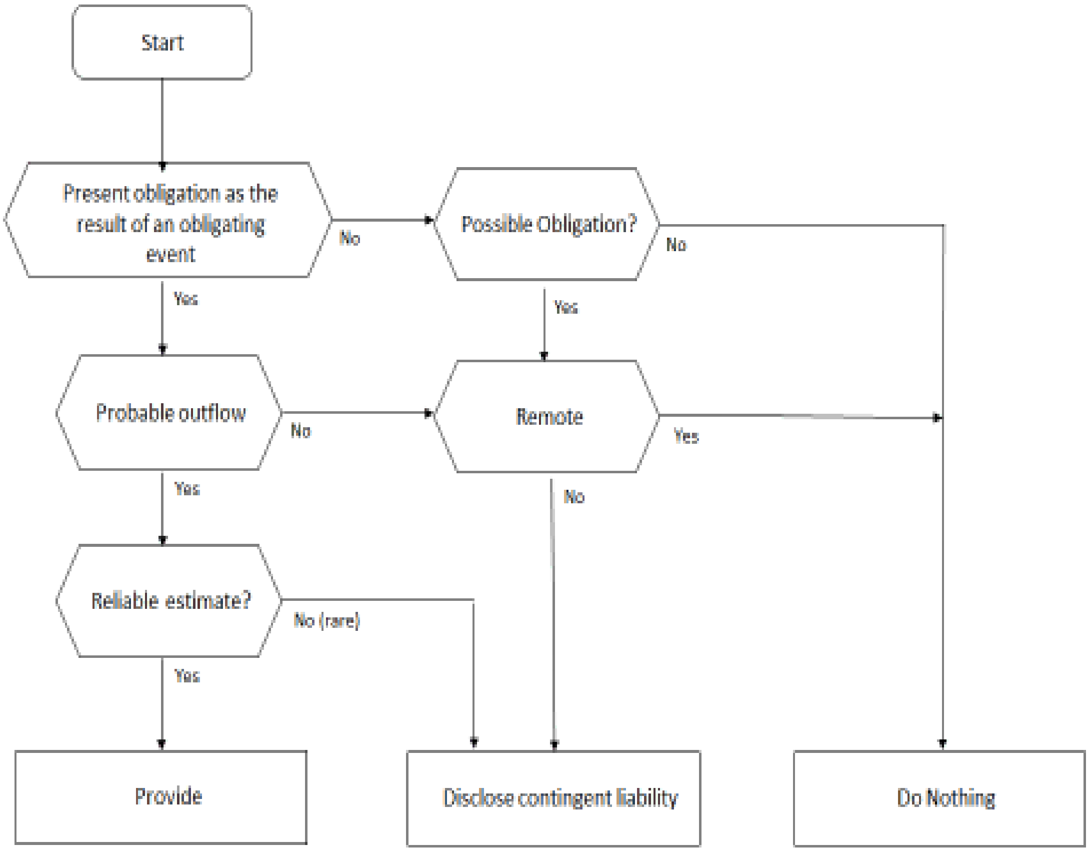
- trade payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier; and
- accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately

A contingent liability is defined by Mediolanum Group, in accordance with IAS 37, as

- a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- a present obligation that arises from past events that is not recognised because:
    - it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
    - the amount of the obligation cannot be measured with sufficient reliability

In the diagram below is summarized the main recognition requirements for provisions and contingent liabilities



The following table highlights the treatment of the most common provisions for risk and charges which are registered in the financial statements of Mediolanum Group:

Type of Provision*	Description	Accounting policy

Legal proceedings	• Legal liabilities (litigation and pre-litigation)	• registered when it become a present obligation (legal or constructive) as a result of a past event; • probable risk of losses that can be estimated.
Risk related to FA illegal actions	• covers the Bank's risk of future liabilities for claims below the deductible threshold of the insurance policy taken out to cover damage suffered by Customers as a result of the misconduct of the Bank's financial advisors; • Based on historical data and the claims received by the Bank at balance sheet date; • The provision also includes amounts set aside to cover the risk of liabilities arising from legal claims made by customers against the Bank in relation to securities defaults.	• registered when it become a present obligation (legal or constructive) as a result of a past event.
Customer base entitlements	• covers the related entitlements of financial advisors; • calculated on the basis of reaching retirement age in the next five years and future liabilities estimated on the basis of the Bank's historical data in accordance with the requirements of IAS 37.	• The amount is annually calculated based on the produced commissions: - 3 % for the first three years; - 3.5 % for the second three-year period ; - 4 % from the seventh year onwards;

		This amount is recognized in the financial statement by law.
Managerial Allowance	• paid to sales network members having managerial roles whose compensation is based on specific commercial parameters; • paid when the FA meets old age pension requirements – provided that he does not engage in any competitive activities in the two years after he retires – or in the event of full permanent disability or death of the FA; • calculated on indirect commissions received by the agent determined on specific trade parameters , not including direct commission and indirect fees generated from the assigned structure. The Manager Allowance value will be calculated on the monthly average of the commission received during the 12 months prior to the termination of the agency contract, multiplied by 36; • is paid within 3 years of the date on which the FA left the sales network.	• The actuarial calculation is based on the estimated probability of payment of the allowance for retirement of FAs in managerial roles at year end, as well as the risk of death or full permanent disability of FAs, and takes account of the relationship between the FA's length of service at the date of the calculation and the length of service at the date of occurrence of the events that trigger the payment (***pro-rata basis***) with the application of a discount rate.
Portofolio/Structure Allowance	• is paid to financial advisors in relation to the value of their	• registered when it become a present obligation (legal or

	customer portfolio or their agents' organization, as applicable; • at the time of transfer between financial advisors of the responsibility in the management of portfolios of bank customers • the regulation requires: ○ payment to the financial advisor originator – subject to the possession of certain personal qualifications and to the non-performance of competitive activities in the two years following the termination of the appointment – of compensation arising from the valuation of the portfolio sold or of the structure disposed, according to predetermined criteria and ○ the corresponding debit to the financial promoter successor of a charge of an equivalent amount equal to the value of the	constructive) as a result of a past event; • the actuarial calculation took account of the effect of any future cash-flow mismatches (due to the different timing between payment and collection and no interest being applied), and also of counterparty risk through the application of a discount rate.

	portfolio and/or structure acquired under management. • The Portfolio allowance is calculated only on direct fees, without considering Overs or Contest. The calculation of the value of each customer will be carried out by applying the values and criteria described in the schedule in force at the valuation date. The amount of portfolio Allowance will be determined by the sum of the unit values of the portfolio relative to customers for which there are one or more potential agents; • The allowance structure is calculated on indirect fees (cd . " Over ") received by the agent in relation to the structure assigned by the Bank, without consider direct commissions .The structure allowance will be calculated on the monthly average of over (from front and management fees) collected within 12 months prior to the termination of the agency contract or the property transfer, multiplied by 36	
Product Distribution	• Relates to amounts set	• subject to

	aside to cover expected future liabilities in connection with commissions payable to the sales force primarily on Tax Benefit New sales.	achievement of objectives during the vesting period and to the permanence of FA (future event); • share incentives by cash deferred, associated to a future event, and registered when it become a present obligation ad a result of a past event.

* for countries where the provision is applicable

Contingent asset

A contingent asset is defined as a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

In accordance with IAS 37, Contingent assets are not recognized by Mediolanum Group, but are disclosed by way of note when an inflow of economic benefits is probable.

However, only when the realisation of income is virtually certain, Mediolanum Group recognizes the asset in the financial statement: in accordance with the standard the related asset is not a contingent asset and its recognition is appropriate.

Present obligations and past events

The existence of a present obligation arising from a past obligating event is a key consideration when determining whether classification as a provision or as a contingent liability is appropriate.

An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation. A legal obligation derives either from the terms of a contract (either explicit or implicit), or legislation or other operation of the law. A constructive obligation is an obligation deriving from an entity's actions when:

- by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. The only liabilities recognised in an entity's statement of financial position are those that exist at the end of the reporting period.

Accordingly, if an obligation exists at the end of the reporting period, that obligation will exist irrespective of whether the reporting entity continues to trade after the end of the reporting period. Conversely, any outflow that can be avoided by ceasing to trade will not be an obligation at the end of the reporting period.

It is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognized as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed—indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a management or board decision does not give rise to a constructive obligation at the end of the reporting period unless the decision has been communicated before the end of the reporting period to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

It is possible that an event may not give rise to an obligation immediately, but may do so at a later date. This could be as a result of changes in the law or because an act (e.g. a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when an entity causes environmental damage, this may not give rise to an obligation for remedial costs if there is no applicable legislation. The causing of the damage will become an obligating event at a later date, however, if a new law requires the existing damage to be rectified or if the entity publicly accepts responsibility for rectification in a way that creates a constructive obligation.

In rare cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the end of the reporting period.

In almost all cases it will be clear whether a past event has given rise to a present obligation. In rare cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such a case, an entity determines whether a present obligation exists at the end of the reporting period by taking account of all available evidence, including, for example, the opinion of experts. The evidence considered includes any additional evidence provided by events after the reporting period. On the basis of such evidence:

- where it is more likely than not that a present obligation exists at the end of the reporting period, the entity recognises a provision (if the recognition criteria are met); and
- where it is more likely that no present obligation exists at the end of the reporting period, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits is remote

Probable outflow of economic benefits

An essential element of the definition of a liability is the existence of an obligation to transfer economic benefits. Recognition of a provision is conditional on the transfer of economic benefits being 'probable'. In accordance with IAS 37, probable is taken to mean by Mediolanum Group more likely than not to occur.

Thus, 'more likely than not' means that the probability that a transfer of economic benefits will occur is more than 50 per cent.

When a number of similar obligations exist (e.g. product warranties), the overall probability that a transfer of economic benefits will be made is determined by looking at the class of obligations as a whole. A typical situation will be that, despite the likelihood of an outflow of resources for any one item being small, it may well be probable that a transfer of some economic benefits will be needed to settle the class of obligations as a whole. When this is the case, assuming that the other recognition criteria are met, a provision is recognized.

The best estimate

The amount to be recognised as a provision is the 'best estimate' of the expenditure required to settle the present obligation at the end of the reporting period. The reference to the end of the reporting period does not preclude use of later additional evidence or better information, but indicates that the best estimate will be the amount that a reporting entity would rationally pay at the end of the reporting period to have the obligation taken away – by settlement or by transfer to a third party.

The addition of 'rationally' suggests that, although it may be difficult to arrange settlement or transfer, there is nevertheless a point of balance, and thus a price, at which management, taking all possible outcomes into account, could be willing to settle.

Ultimately, the best estimate will be determined based on the judgement of management and will reflect experience of similar transactions. In reaching that judgement, reports of independent experts may be required. Examples of relevant independent experts are:

- solicitors and barristers;
- surveyors and valuers;
- loss adjusters;
- actuaries; and
- technical experts (e.g. regarding a decommissioning process).

When the provision relates to a large population of items, the use of an 'expected value' is appropriate to arrive at a best estimate of the obligation. This is the amount that takes account of all possible outcomes, using probabilities to weight the outcomes. When there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.

Expected value, as a method of estimation, has a number of desirable features. The method provides an estimate that reflects the entire probability distribution, i.e. all the possible outcomes weighted by their probabilities. For a given assessed distribution, the method has the advantage of objectivity in that different measurers would calculate the same estimate. Furthermore, expected value is additive (i.e. the expected value of a number of items is the sum of the expected values of the individual items).

When a single obligation is being measured, indicates that the individual most likely outcome may be the best estimate of the liability. Even in such a case, however, it will be necessary to consider other possible outcomes. When the other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

In many cases, future events do not represent present obligations and, therefore, they are not provided for. Future events may, however, affect the measurement of a present obligation. Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision when there is sufficient objective evidence that they will occur

New legislation should be reflected in the measurement of a provision for an existing obligation when there is sufficient objective evidence that the legislation is virtually certain to be enacted. This will require evidence:

- of what the legislation will demand; and
- that the legislation will be enacted and implemented.

In practice, because of varying circumstances, there is no single event in the passage of new legislation prior to enactment that provides a general trigger point. In many cases, sufficient objective evidence will not exist until the new legislation is enacted.

Present value
Mediolanum Group, in accordance with IAS 37, discounts provisions to present value of the expenditures expected when the effect of the time value of money is material.
It will usually be appropriate to make an initial assessment as to whether the impact of discounting might be material before embarking on a potentially complex calculation. Quantifying materiality will depend on a range of factors, e.g. the size of the provision relative to other items in the statement of financial position and the impact of any adjustment on profit for the year.

The discount rate used by Mediolanum Group for the aforementioned provisions is consistent with the riskiness of the cash flows to be discounted of liabilities by maturity and reflects current market conditions. The discount rate used by the Group is based on the EUR ITALY Sovereign Curve.

An entity with a present obligation may be able to seek reimbursement of part or all of the expenditure from another party, for example via:

- an insurance contract arranged to cover a risk; or
- an indemnity clause in a contract; or
- a warranty provided by a supplier.

Finally, the Group companies use the same approach agreed with the parent company: any exception adopted by a foreign branches in application of their local rules may be immediately shared and agreed with the parent company.

Reimbursements, Changes in provisions and use of provisions
The basis underlying the recognition of a reimbursement is that any asset arising is separate from the related obligation. Consequently, such a reimbursement is recognised only when it is virtually certain that it will be received if the entity settles the obligation. This treatment is also consistent with the guidance on contingent assets.
When a provision has been recognised, the occurrence of the expenditure is taken to be certain for the purposes of assessing the probability of receiving reimbursement and judging whether it is virtually certain.
Note that it is the existence of the reimbursement asset that must be virtually certain, rather than its amount. An entity may be virtually certain that it has insurance to cover a particular provision, but it may not be certain of the precise amount that would be received from the insurer. Provided that the range of possible

recoveries is such that the entity can arrive at a reliable estimate, it will be able to recognise this as an asset, even though the amount ultimately received may be different.

The appropriate presentation of a reimbursement is as follows:

- in the statement of financial position, a separate asset is recognised (which must not exceed the amount of the provision);
- and in profit or loss, a net amount may be presented, being the anticipated cost of the obligation less the reimbursement.

Offset of a provision and the related reimbursement is never appropriate. If a reporting entity can avoid making payment in respect of an obligation in all circumstances (i.e. there can never be any recourse to the entity), then it has no liability and hence neither a provision nor a reimbursement asset should be recognised. In most cases, however, the entity will remain liable for the whole amount in question and will have to settle the full amount if the third party fails to pay for any reason. In these circumstances, no offset is permitted, irrespective of how unlikely it is that the entity will have to settle the obligation directly.

If a reporting entity is jointly and severally liable for an obligation, it should provide for that part of the obligation which it is probable will be settled by the entity. The remainder, expected to be paid by other parties, is a contingent liability.

If an entity has a provision and a matching reimbursement, and the time value of money is material to both, the question arises as to whether both should be discounted. In principle, both the asset and the liability should be discounted. If there will be a significant interval between the cash outflows and receiving the reimbursement, the reimbursement will be more heavily discounted; in such circumstances, if the gross inflows and outflows are the same, on initial recognition there will be a net cost. If (presumably rarely) the reimbursement will be received first, will restrict the discounted amount of the reimbursement so that it does not exceed the discounted amount of the provision. In profit or loss, the unwinding of the discount on the reimbursement may be offset against that on the provision.
When a reimbursement will not be received until some significant time after the outflows to which it relates, it is possible (though perhaps rare) that it may carry interest, or in some other way be increased, so as to reimburse the entity for the lost time value of money. The only restriction is that the asset recognised (i.e. the discounted amount) must not exceed the provision recognised. It is, in principle, possible for the gross amount of reimbursement used in the discounting calculation to exceed the gross outflows expected (i.e. for the undiscounted asset to be greater than the undiscounted liability).

Provisions should be reviewed at the end of each reporting period and adjusted to reflect current best estimates.

Adjustments to provisions arise from three sources:

- revisions to estimated cash flows (both amount and likelihood);
- changes to present value due to the passage of time; and
- revisions of discount rates to reflect prevailing current market conditions.

In the years following the initial measurement of a provision at a present value, the present value will be restated to reflect estimated cash flows being closer to the measurement date. This unwinding of the discount relating to the passage of time should be recognised as a finance cost. The effect of revising estimates of cash flows is not part of this unwinding and should be dealt with as part of any adjustment to the previous provision.

When a provision is no longer required (e.g. if it is no longer probable that a transfer of economic benefits will be required to settle the obligation), the provision should be reversed.

The degree of uncertainty associated with an obligation can change over time. In some cases, an obligation will be recognised initially as a provision due to the uncertainty surrounding the amount payable. Subsequently, after negotiation with the counterparty, an exact amount may be agreed. To the extent that the agreed amount is not settled immediately, it no longer meets the definition of a provision and, therefore, should be reclassified to another appropriate category within liabilities.

Specific applications of recognition criteria

Future operating losses

In accordance with IAS 37, Mediolanum Group set out two prohibitions on the recognition of provisions for future operating losses:

- a general prohibition, on the grounds that there is no present obligation and thus no liability (albeit that the expectation of future operating losses may indicate a need to test whether assets have been impaired); and
- a specific prohibition in respect of future operating losses up to the date of a restructuring - again on grounds that there is no present obligation, unless the losses relate to an onerous contract

In both circumstances, future operating losses relate to an activity that will continue, albeit in a restructured form, and are presumed to be avoidable (e.g. by an immediate closure of the loss-making activities). They are, therefore, appropriately recognised as the activity occurs.

Onerous contracts

A provision should be recognised for the present obligation arising under an onerous contract. When assets dedicated to a contract are involved, however, a separate provision is recognised only after any impairment loss has been recognised in respect

of those assets.
An onerous contract is defined as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. In other words, a provision should be recognised for any unavoidable net loss arising from the contract. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, i.e. the lower of:

- the cost of fulfilling the contract; and
- any compensation or penalties arising from failure to fulfil the contract.

It is not appropriate to test for an onerous contract only by comparing the value of the goods or services to be received or provided with the amount to be paid or received. A mere fall in price does not necessarily mean that a contract is onerous. Instead, the test of whether a contract is onerous focuses on how the goods or services that are the subject of the contract will be used within the business.
Depending on the facts and circumstances, a contract may or may not relate to a cash-generating unit (CGU) and this will affect the determination as to whether the contract is onerous.
It does not necessarily follow that a CGU reporting a loss has an onerous contract or contracts. Rather, it will always be necessary to consider individual contracts to assess whether the unavoidable costs of meeting the obligations under any contract exceed the economic benefits expected to be received under it. Onerous contracts may arise when an entity prepares financial statements on a basis other than that of a going concern. In those circumstances, contracts that would not normally be onerous (e.g. employee contracts) may become onerous.

Long-term contracts for the supply of goods or services when costs have risen or current market prices have fallen may be onerous and, if so, a provision is recognised to the extent that future supplies must be made at a loss. No provision is recognised under a contract for the supply of goods which is profitable but at a reduced margin compared to other contracts, because there is no probable net transfer of economic benefits by the reporting entity.

Restructuring provisions
A restructuring is defined as a programme that is planned and controlled by management, and materially changes either:

- the scope of a business undertaken by an entity; or
- the manner in which that business is conducted.

The term 'restructuring' therefore includes events such as:

- the sale or termination of a line of business;
- the closure of business locations in a country or region or the relocation of business activities from one country or region to another;
- changes in management structure (e.g. the elimination of a layer of management);

- and fundamental reorganisations that have a material effect on the nature and focus of the entity's operations.

The two principal requirements for the recognition of a provision for a restructuring are that the entity:

- has a detailed formal plan; and
- has raised a valid expectation in those affected that the plan will be carried out by starting to implement that plan or by announcing its main features to those affected by it.

The detailed formal plan must identify:
- the business or part of a business concerned;
- the principal locations affected;
- the location, function and approximate number of employees who will be compensated for terminating their services;

Generally, it is not necessary for the plan to be so detailed that it identifies which individual employees will be leaving. However, it must be sufficiently detailed that those employees in the employee groups affected by the restructuring plan have a valid expectation that either they or their colleagues in the group will be affected.
- the expenditures that will be undertaken; and
- when the plan will be implemented.

Suitable evidence that an entity has started to implement a restructuring plan will, for example, be provided by:
- dismantling plant; or
- selling assets; or
- the public announcement of the main features of the plan.

Note, however, that a public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (i.e. setting out the main features of the plan) that it gives rise to valid expectations in other parties such as customers, suppliers and employees (or their representatives) that the entity will carry out the restructuring. Accordingly, for a plan to be sufficient to give rise to a constructive obligation when it is communicated to those affected by it, implementation of the plan should be planned to begin as soon as possible and to be completed within a timeframe that makes significant change to the plan unlikely. When either there is a long delay before commencement, or execution of the plan will take an unreasonably long time, the timeframe allows opportunities for the plan to be changed. Thus, it is unlikely that the reporting entity has raised a valid expectation that it is sufficiently committed to the restructuring.

When a restructuring plan will take quite a long time to be completed, it is possible that the entity may be demonstrably committed to earlier actions in the plan but not to later actions in the plan. In such circumstances, a provision should be recognised only for those actions to which the entity is committed (i.e. the earlier actions in the restructuring plan).

The requirement for the existence of a valid expectation in those affected relates to the situation at the end of the reporting period. The fact that implementation has commenced by the date that the financial statements are authorised for issue does not, by itself, provide evidence that a present obligation existed at the end of the reporting period.

A management or board decision to go ahead with its plan does not, by itself, give rise to a constructive obligation, unless it is accompanied by commencement of the plan, or by a suitable announcement. An obligation may, however, result from earlier events taken together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale of an operation, may have been concluded subject only to board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure if the general conditions set out above have been met. In addition, a constructive obligation could arise if, as happens in some countries, a board includes non-management representatives such as employees, because a decision by such a board involves communication to those representatives.
A valid expectation is unlikely to exist in either of the following circumstances:

- management has developed a detailed plan, but has not notified those affected by it, even though it can point to previous instances when it has proceeded with a plan; or
- management has developed a plan that involves the closure of one of two possible sites. It has made general indications to employees that one site will close, but has not communicated which of the two sites will close, in order to avoid alienation of employees at that site before implementation commences.

The amounts to be included in a restructuring provision are restricted to the direct expenditures arising from the restructuring, i.e. those that are both:

- necessarily entailed by the restructuring; and
- not associated with the ongoing activities of the reporting entity.

Specific items that are excluded from restructuring provisions under, on the basis that they relate to the ongoing activities of the business, are:

- retraining or relocating continuing staff;
- marketing;
- and investment in new systems and distribution networks.

3.2 Relevant topics

Issues related to IFRS 2 “Shared-based payment” (specific Chapter of the Manual):

IFRS 2 *Share-based Payment* requires an entity to recognise share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Specific requirements are included for equity-settled and cash-settled share-based payment transactions, as well as those where the entity or supplier has a choice of cash or equity instruments.

The concept of share-based payments is broader than employee share options. IFRS 2 encompasses the issuance of shares, or rights to shares, in return for services and goods. Examples of items included in the scope of IFRS 2 are share appreciation rights, employee share purchase plans, employee share ownership plans, share option plans and plans where the issuance of shares (or rights to shares) may depend on market or non-market related conditions.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognition (paragraph 4.1)
- Measurement (paragraph 4.2)
- Reimbursement (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to provisions.

4.1 Recognition

4.1.1 Onerous Contracts

Example 4.1.1.1

Recognition and measurement of onerous contracts

Entity A has entered into a contract with Entity B to supply goods for a fixed price of CU100. Because of price inflation, Entity A's expenditure to meet its obligations under the contract is expected to be CU120. No other benefits are expected under the contract. Therefore, the contract is considered to be onerous, and a provision should be recognised. Entity A estimates that any compensation or penalties arising from failure to fulfil the contract are equal to the cost of fulfilling the contract (i.e. CU120).

At the end of the reporting period, Entity A has commenced negotiations with Entity B with a view to increasing the price at which the goods are supplied under the contract. Entity A expects that Entity B will be willing to agree to such a price increase so as to avoid Entity A ceasing to trade as a result of the losses incurred under the contract (and, consequently, cutting off the source of supply of goods necessary for Entity B's own business).

Should the potential renegotiation of the supply contract between Entity A and Entity B be reflected in the amount of provision recognised for the onerous contract?

No. The onerous contract should be measured based on the contractual terms in existence at the end of the reporting period because that is Entity A's 'present obligation' required to be recognised and measured in accordance with IAS 37. Any future amendment to the terms of the contract would be a change in the obligation resulting in remeasurement of the provision when the amendment occurs.

IAS 37 states that "future events that may affect the amount required to settle an obligation shall be reflected in the amount of a provision where there is sufficient objective evidence that they will occur". However, this reference to future events is not to changes in the underlying obligation, but to those future events that are factors in estimating the costs of meeting a present obligation or in assessing the extent to which a present contractual obligation is onerous.

Should the provision recognised by Entity A be the entire cost of fulfilling the contract (CU120) or only the expected loss (CU20)?

Entity A should recognise a provision for the onerous contract equal to the expected loss of CU20.

IAS 37 defines an onerous contract as "a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it". IAS 37 further states that "the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it".

Because IAS 37 refers to the net cost rather than the gross cost associated with the contract, the provision for the onerous contract should reflect the costs required to fulfil the contract net of any income that the entity will receive as a consequence of fulfilling the contract.

4.1.2 Restructuring Provisions

Example 4.1.2.1

Relocation costs

An entity has decided to relocate one of its employees. The employee is aware of the impending move.

No provision should be recognised until the relocation occurs, because the relocation relates to the ongoing activities of the business.

4.2 Measurement

4.2.1 Use of expected value

Example 4.2.1.1

Best estimate: expected value (1)

An entity is required to replace a major component in an asset under warranty. Each replacement costs CU1 million. From experience, there is a 30 per cent chance of a single failure, a 50 per cent chance of two failures, and a 20 per cent chance of three failures.

The most likely outcome is two failures, costing CU2 million. The expected value is CU1.9 million ((30 per cent × CU1 million) + (50 per cent × CU2 million) + (20 per cent × CU3 million)). The expected value supports the provision for the most likely outcome of CU2 million.

When the most likely outcome and the expected value are not close together, it will often be appropriate to provide for whichever possible outcome is nearest to the expected value.

Example 4.2.1.2

Best estimate: expected value (2)

An entity is required to replace a major component in an asset under a warranty. Each replacement costs CU1 million. From experience, there is a 40 per cent chance of a single failure, a 30 per cent chance of two failures, and a 30 per cent chance of three failures.

The most likely outcome is a single failure, costing CU1 million. The expected value is CU1.9 million ((40 per cent × CU1 million) + (30 per cent × CU2 million) + (30 per cent × CU3 million)). In this case, the most likely outcome of CU1 million has only a 40 per cent probability. There is a 60 per cent probability that the cost will be higher. The outcome closest to expected value is CU2 million (i.e. two failures) and, therefore, a provision for CU2 million should be recognised.

4.2.2 Adjusting for risk

Example 4.2.2.1

Risk-adjusting the discount rate

An entity's best estimate of the amount that it will have to pay to settle a liability in two years' time is CU1,000. The actual liability could be anything between CU500 and CU1,500. At the end of the reporting period, the entity knows that it could transfer the liability to a third party immediately if it agrees to pay that third party CU1,075 in two years' time. Accordingly, before taking the time value of money into account, the entity's best estimate of the outflow is CU1,000, excluding any risk adjustment, and the equivalent certain amount payable in two years' time is CU1,075, i.e. including an adjustment for risk of CU75. The amount of the provision recognised at the end of the reporting period should be the same whether the unadjusted best estimate or the risk-adjusted best estimate is used as the basis for the net present value calculation.

The appropriate risk-free rate is 4 per cent per annum.

	Undiscountedamount	*Net presentvalue*
	CU	CU

Risk-adjusted cash flow	1,075	994*
Expected cash flow (unadjusted for risk)	1,000	994#

As illustrated by this example, the risk-adjusted discount rate will generally be lower than the risk-free rate when discounting liabilities.

* Using a risk-free rate of 4% on the risk-adjusted cash flow of CU1,075 gives a net present value of CU994.

\# To arrive at the same net present value (CU994), a risk-adjusted rate of 0.3% must be used to discount the expected cash flow of CU1,000.

4.3 Reimbursement

4.3.1 Collateralised or guaranteed loan commitments

Example 4.3.1.1

Collateralised or guaranteed loan commitments

Entity A has issued a non-cancellable loan commitment at market terms to Entity B. The loan commitment cannot be settled net, and Entity A has no past practice of selling the assets resulting from its loan commitments shortly after origination. Entity A did not designate this loan commitment at fair value through profit or loss; therefore, in accordance with IFRS 9 *Financial Instruments*, this loan commitment is scoped out of IFRS 9.

Scenario 1
The loan subject to the loan commitment is guaranteed by another party (e.g. the parent of the borrowing entity or an insurer). That party will reimburse Entity A for any loss incurred if Entity B fails to make payments when due (i.e. if there is a breach of contract). The loan commitment has not been settled at the end of the reporting period; however, Entity A assesses that Entity B will not be able to repay the loan that it has committed to grant to Entity B.

Scenario 2
The loan subject to the loan commitment is a collateralised loan; that is, if Entity B fails to make payments when due, the legal ownership of the collateral (e.g. property) will be transferred to Entity A. The loan commitment has not been settled at the end of the reporting period; however, Entity A assesses that Entity B will not be able to repay the loan that it has committed to grant to Entity B.

How should Entity A account for the loan commitments under Scenarios 1 and 2 at the end of the reporting period?

General

In general, a provision should be recognised when the conditions set out in IAS 37 are met. That is, if Entity A has assessed at the end of the reporting period that Entity B will not be able to repay the loan that it has committed to grant to Entity B, a provision should be recognised.

Scenario 1

- The provision should be measured according to IAS 37 at "the best estimate of the expenditure required to settle the present obligation at the end of the reporting period". In accordance with IAS 37, Entity A should not take into account the guarantee provided by the parent or insurer when assessing the amount of the provision necessary at the end of the reporting period.
- The guarantee provided by the parent or insurer is a reimbursement right because Entity A "is able to look to another party to pay part or all of the expenditure required to settle a provision". The guarantee, therefore, should be recognised as a separate asset. However, this should only be done when the criteria in IAS 37 are met, which requires that a reimbursement from another party is recognised only when it is virtually certain that reimbursement will be received if Entity B fails to make payment when due. The 'virtually certain' criteria may be met once Entity B's breach of contract has occurred (e.g. at the first interest payment date).
- If the guarantee was part of the same contractual arrangement (e.g. when the loan commitment issued to Entity B is guaranteed by the parent of Entity B, and the guarantee is part of the same contractual arrangement), then it would be bundled and an alternative treatment would be appropriate (see the answer for scenario 2 below).

Scenario 2

- Collateral held on the loan is not a reimbursement right because Entity A is not "able to look to another party to pay part or all of the expenditure required to settle a provision". Accordingly, this collateral is not separate from the loan commitment and, when accounting for the provision, it should be treated as a net arrangement with a single counterparty (i.e. the collateral should be taken into account when measuring the provision amount).

The provision is measured in accordance with IAS 37. Although the loan commitment is within the scope of IAS 37, in practice, a provision will be recognised at the amount equivalent to the impairment that would have been required under IAS 39, which states that "the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows". Additionally, IAS 39 indicates that "the calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, less costs for obtaining and selling the collateral, whether or not foreclosure is probable". Accordingly, the provision is recognised for the present value of the net non-recoverable amount (taking into account the value of the collateral, less the cost for obtaining and selling it).

5 PRESENTATION

5.1 Disclosure rules

The objective of IAS 37 with respect to disclosure is to ensure that sufficient information is disclosed in the notes to the financial statements to enable users to understand the nature, timing and amount of provisions, contingent liabilities and contingent assets. **IAS 37.84**

Provisions

For each class of provision, the following should be disclosed (comparative information is not required):

- the carrying amount at the beginning and end of the period;
- additional provisions recognised in the period, including increases to existing provisions;
- amounts used (i.e. incurred and charged against the provision) during the period; **IAS 37.85**
- unused amounts reversed during the period; and
- the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

The following should also be disclosed for each class of provision:

- a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits;
- an indication of the uncertainties about the amount or timing of those outflows. When necessary to provide adequate information, the entity should disclose the major assumptions made concerning future events; and **IAS 37.87**
- the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

In determining which provisions may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements outlined above with respect to disclosure of the nature of and uncertainties surrounding such liabilities. **IAS 37.86**

Contingent liabilities

For each class of contingent liability (unless the possibility of an outflow in settlement is remote), a brief description of the nature of the contingent liability should be provided. The following information should also be disclosed, if practicable:

IAS 37.87

- an estimate of its financial effect;
- an indication of the uncertainties relating to the amount or timing of any outflow; and
- the possibility of any reimbursement.

IAS 37.88

In determining which contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfil the requirements outlined above with respect to disclosure of the nature of and uncertainties surrounding such items.

When a provision and a contingent liability arise from the same set of circumstances, the reporting entity should make the required disclosures in a way that clearly shows the link between the provision and the contingent liability.

IAS 37.89-90

Contingent assets

When an inflow of economic benefits is probable, the entity should disclose a brief description of the nature of the contingent assets at the end of the reporting period and, if practicable, an estimate of their financial effect, taking care to avoid giving misleading indications of the likelihood of income arising.

5.2 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present provisions in the consolidated financial statements.

As required by Bank of Italy, caption 120 of liabilities - *Provisions for risk and charges* includes:

a) severance benefits and similar obligations; and
b) other provisions.

The following tables show detailed analysis of caption 120 including their related year's movements.

Liabilities and Shareholders' equity		
€/t	*Year T*	*Year T - 1*
10. Amounts due to banks		
20. Payables due to customers		
30. Securities issued		
40. Financial liabilities held for trading		
50. Financial liabilities measured at fair value		
60. Hedge derivatives		
70. Value adjustment of financial liabilities backed by generic hedges (+/-)		
80. Tax liabilities a) current b) deferred		
90. Liabilities associated with assets held for sale		
100. Other liabilities		
110. Employee completion-of-service entitlements		
120. Provisions for risks and charges: a) severance benefits and similar obligations b) other provisions		
130. Technical reserves		
140. Valuation reserves		
150. Redeemable shares		
160. Capital instruments		
170. Reserves		
175. Interim dividend (-)		
180. Share premium reserve		
190. Share capital		
200. Treasury shares (-)		
210. Shareholders' equity attributable to minority interest (+/-)		
220. Net profit (loss) for the year (+/-)		
Total liabilities and shareholders' equity		

12.1 Analysis of provisions for risks and charges		
€/t	**Year T**	**Year T -1**
1. Company severance entitlements		
2. Other provisions for risks and charges 2.1 Legal proceedings 2.2 Personnel expenses 2.3 Others		
Total		

12.2 Year's movements in provisions for risks and charges €/t	**Severance entitlements**	**Other provisions**
A. Opening balance		
B. Increases		
B.1 Provisions for the year		
B.2 Time-related changes		
B.3 Discount rate changes		
B.4 Other changes		
C. Decreases		
C.1 Used in the year		
C.2 Discount rate changes		
C.3 Other changes		
D. Closing balance		

12.4 Analysis of other provisions for risks and charges: other

€/t	**Balance at Year T**	**Amounts set aside in the year**	**Other changes**	**Used in the year**	**Balance at Year T -1**
Provision:					
- legal disputes					
- other:					
Risks related to FA illegal actions					
Customer base entitlements					
Managerial allowance					
Portfolio allowance					
Future expenses on distributed products					
Other provisions					
Total					

Finally, net provisions for risk and charges are recorded in caption 190 of consolidated income statement. These item includes:

- portfolio allowance;
- supplementary customer allowances;
- risks for financial advisor offences;
- future expenses on distributed products;
- legal proceedings;
- managerial allowance; and
- other allocations to the provisions for risks and charges.

CONSOLIDATED INCOME STATEMENT	*Year T*	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

12.1. Analysis of net provisions for risks and charges

€/t	*Year T*	*Year T - 1*
Portfolio allowance		
Supplementary customer allowances		
Risks for financial advisor offences		
Future expenses on distributed products		
Legal proceedings		
Managerial allowance		
Other allocations to the provisions for risks and charges		
Total		

IFRS Operating Manual

Chapter 9
Employee Benefits

CHAPTER IX – EMPLOYEE BENEFITS 415

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 19 – Employee Benefits;
- a list of most recent amendment to IAS 19.

1.1 Introduction

In 2011, the IASB issued revisions of IAS 19 that provide significant changes in the recognition and the disclosure of post-employment benefits. The impact of these revisions for an entity depends on the types of benefits it provides to its employees and on the accounting options selected by it under the IAS 19. Despite that, employee compensation is a fundamental area of accounting and all entities need to be aware of its changes and their implications.

1.2 Overview IAS 19

IAS 19 Employee Benefits outlines the accounting requirements for employee benefits, including short-term benefits (e.g. wages and salaries, annual leave), post-employment benefits such as retirement benefits, other long-term benefits (e.g. long service leave) and termination benefits.

The standard establishes the principle that the cost of providing employee benefits should be recognised in the period in which the benefit is earned by the employee, rather than when it is paid or payable, and outlines how each category of employee benefits are measured, providing detailed guidance in particular about post-employment benefits.

Here below a list of the amendment to IAS 19:

Date	Development	Comments
25 September 2014	Amended by *Improvements to IFRSs 2014* (discount rate: regional market issue)	Effective for annual periods beginning on or after 1 January 2016
21 November 2013	*Defined Benefit Plans: Employee Contributions (Amendments to*	Effective for annual periods beginning on or after 1 July 2014

	IAS 19) issued	
25 March 2013	ED/2013/4 *Defined Benefit Plans: Employee Contributions (Proposed amendments to IAS 19)* published	Comment deadline 25 July 2013
16 June 2011	IAS 19 *Employee Benefits* (amended 2011) issued	Effective for annual periods beginning on or after 1 January 2013
29 April 2010	ED/2010/3 *Defined Benefit Plans (Proposed amendments to IAS 19)* published	Comment deadline 6 September 2010
20 August 2009	ED/2009/10 *Discount Rate for Employee Benefits (Proposed amendments to IAS 19)* published	Comment deadline 30 September 2009 (proposals were not finalised)
22 May 2008	Amended by *Annual Improvements to IFRSs* (negative past service costs and curtailments)	Effective for annual periods beginning on or after 1 January 2009
19 December 2004	*Actuarial Gains and Losses, Group Plans and Disclosures* issued	Effective for annual periods beginning on or after 1 January 2006
29 April 2004	Exposure Draft *Proposed Amendments to IAS 19 Employee Benefits: Actuarial Gains and Losses, Group Plans and Disclosures* published	Comment deadline 31 July 2004
February 2004	Equity compensation benefits requirements	Effective for annual reporting periods

	replaced by IFRS 2 *Share-based Payment*	beginning on or after 1 January 2005
5 December 2002	ED 2 *Share-based Payment* published, proposing to replace the equity compensation benefits requirements of IAS 19	Comment deadline 7 March 2003
May 2002	Amended to prevent the recognition of gains solely as a result of actuarial losses or past service cost and the recognition of losses solely as a result of actuarial gains	Operative for annual financial statements covering periods ending on or after 31 May 2002
October 2000	Amended to change the definition of plan assets and to introduce recognition, measurement and disclosure requirements for reimbursements	Operative for annual financial statements covering periods beginning on or after 1 January 2001
July 2000	E67 *Pension Plan Assets* published	
February 1998	IAS 19 *Employee Benefits* issued	Operative for financial statements covering periods beginning on or after 1 January 1999
October 1996	E54 *Employee Benefits* published	Comment deadline 31 January 1997
December 1993	IAS 19 *Retirement Benefit Costs* issued	Operative for financial statements covering periods beginning on or after 1 January 1995

December 1992	E47 *Retirement Benefit Costs* published	
January 1983	IAS 19 *Accounting for Retirement Benefits in Financial Statements of Employers* issued	Operative for financial statements covering periods beginning on or after 1 January 1985
April 1980	Exposure Draft E16 *Accounting for Retirement Benefits in Financial Statements of Employers* published	

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 19 and from related International Financial Reporting Stadards (IFRSs) that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of employee benefits

IAS 19 defines employee benefits as all forms of consideration given by an entity in exchange for service rendered by employees or for the termination of employment. This includes: **IAS 19.8**

- benefits provided either to employees or to their dependents or beneficiaries; and **IAS 19.6**
- benefits settled by payments (or the provision of goods or services) either directly to employees or to others (e.g. spouses, children or dependants, or to insurance companies).

For the purposes of IAS 19, 'employees' are considered to include directors and other management personnel, and to encompass those providing service on a full-time, part-time, permanent, casual or temporary basis. **IAS 19.7**

The Standard divides the employee benefits within its scope into four categories:

- short-term employee benefits;
- post-employment benefits;
- other long-term employee benefits; and
- termination benefits.

Definition of short-term employee benefits

Short-term employee benefits are those expected to be settled wholly before twelve months after the end of the annual reporting period during which employee services are rendered, but do not include termination benefits. Examples include wages, salaries, profit-sharing and bonuses and non-monetary benefits paid to current employees. **IAS 19.9** **IAS 19.5**

Definition of post-employment benefits

Post-employment benefits are informal or formal arrangements where an entity provides post-employment benefits to one or more employees, e.g. retirement benefits (pensions or lump sum payments), life insurance and medical care.

The accounting treatment for a post-employment benefit plan depends on the economic substance of the plan and results in the plan being classified as either a defined contribution plan or a defined benefit plan:

- *Defined contribution plans*: under a defined contribution plan, the entity pays fixed contributions into a fund but has no legal or constructive obligation to make further payments if the fund does not have sufficient assets to pay all of the employees' entitlements to post-employment benefits. The entity's obligation is therefore effectively limited to the amount it agrees to contribute to the fund and effectively place actuarial and investment risk on the employee.
- *Defined benefit plans*: these are post-employment benefit plans other than a defined contribution plans. These plans create an obligation on the entity to provide agreed benefits to current and past employees and effectively places actuarial and investment risk on the entity.

Other long-term employee benefits

Other long-term employee benefits include items such as the following, if not expected to be settled wholly before 12 months after the end of the annual reporting period in which the employees render the related service:

IAS 19.153

- long-term paid absences such as long-service or sabbatical leave;
- jubilee or other long-service benefits;
- long-term disability benefits;
- profit-sharing and bonuses; and
- deferred remuneration.

Termination benefits

Termination benefits are defined as employee benefits provided in exchange for the termination of an employee's employment as a result of either:

IAS 19.8

- an entity's decision to terminate an employee's employment before the normal retirement date; or
- an employee's decision to accept an offer of benefits in exchange for the termination of employment.

Termination benefits are considered a separate category of employment benefits because the event that gives rise to an obligation is the termination of employment rather than employee service. **IAS 19.159**

The form of the employee benefit does not determine whether it is provided in exchange for service or in exchange for termination of the employee's employment. Termination benefits are typically lump sum payments, but sometimes also include: **IAS 19.161**

- enhancement of post-employment benefits, either indirectly through an employee benefit plan or directly; and/or
- salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

Indicators that an employee benefit is provided in exchange for services (i.e. that it is not a termination benefit) include the following: **IAS 19.162**

- the benefit is conditional on future service being provided (including benefits that increase if further service is provided); and
- the benefit is provided in accordance with the terms of an employee benefit plan.

Definition of past service costs

Past service cost is the term used to describe the change in a defined benefit obligation for employee service in prior periods, arising as a result of changes to plan arrangements in the current period (i.e. plan amendments introducing or changing benefits payable, or curtailments which significantly reduce the number of covered employees). They may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

2.2 Scope of rules

IAS 19 applies to:

- wages and salaries
- compensated absences (paid vacation and sick leave)
- profit sharing and bonuses
- medical and life insurance
- benefits during employment
- non-monetary benefits such as houses, cars, and free or subsidised goods or services
- retirement benefits, including pensions and lump sum payments
- post-employment medical and life insurance benefits
- long-service or sabbatical leave

- 'jubilee' benefits
- deferred compensation programmes
- termination benefits.

IAS 19 (2011) does not apply to employee benefits within the scope of IFRS 2 Share-based Payment or the reporting by employee benefit plans. **IFRS 2**

2.3 Recognition

Short-term employee benefits

The undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in an accounting period is recognised in that period. The expected cost of short-term compensated absences is recognised as the employees render service that increases their entitlement or, in the case of non-accumulating absences, when the absences occur, and includes any additional amounts an entity expects to pay as a result of unused entitlements at the end of the period. **IAS 19.11 IAS 19.13-16**

Profit-sharing and bonus payments

An entity recognises the expected cost of profit-sharing and bonus payments when, and only when, it has a legal or constructive obligation to make such payments as a result of past events and a reliable estimate of the expected obligation can be made. **IAS 19.19**

Defined contribution plans

For defined contribution plans, the amount recognised in the period is the contribution payable in exchange for service rendered by employees during the period. **IAS 19.51**

Contributions to a defined contribution plan which are not expected to be wholly settled within 12 months after the end of the annual reporting period in which the employee renders the related service are discounted to their present value. **IAS 19.52**

Defined benefit plans

An entity is required to recognise the net defined benefit liability or asset in its statement of financial position. However, the measurement of a net defined benefit asset is the lower of any surplus in the fund and the 'asset ceiling' (i.e. the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan). **IAS 19.63-64**

The components of defined benefit cost is recognised as follows:

IAS 19.120
IAS 19.130

Component	**Recognition**
Service cost attributable to the current and past periods	Profit or loss
Net interest on the net defined benefit liability or asset, determined using the discount rate at the beginning of the period	Profit or loss
Remeasurements of the net defined benefit liability or asset, comprising: • actuarial gains and losses • return on plan assets • some changes in the effect of the asset ceiling	Other comprehensive income (Not reclassified to profit or loss in a subsequent period)

Past service cost

Past service cost is recognised as an expense at the earlier of the date when a plan amendment or curtailment occurs and the date when an entity recognises any termination benefits, or related restructuring costs under IAS 37 Provisions, Contingent Liabilities and Contingent Assets. **IAS 19.103**

Gains or losses on the settlement of a defined benefit plan are recognised when the settlement occurs. **IAS 19.110**

Before past service costs are determined, or a gain or loss on settlement is recognised, the net defined benefit liability or asset is required to be remeasured, however an entity is not required to distinguish between past service costs resulting from curtailments and gains and losses on settlement where these transactions occur together. **IAS 19.99-100**

Other long-term benefits

IAS 19 (2011) prescribes a modified application of the post-employment benefit model described above for other long-term employee benefits: **IAS 19.153** **IAS 19.154**

- the recognition and measurement of a surplus or deficit in an other long-term employee benefit plan is consistent with the requirements outlined above service cost, net interest and remeasurements are all recognised in profit or loss (unless recognised in the cost of an asset under another IFRS), i.e. when compared to accounting for defined benefit plans, the effects of remeasurements are not recognised in other comprehensive income.

Termination benefits

A termination benefit liability is recognised at the earlier of the following dates: **IAS 19.165**

- when the entity can no longer withdraw the offer of those benefits - additional guidance is provided on when this date occurs in relation to an employee's decision to accept an offer of benefits on termination, and as a result of an entity's decision to terminate an employee's employment when the entity recognises costs for a restructuring under IAS 37 Provisions, Contingent Liabilities and Contingent Assets which involves the payment of termination benefits. Termination benefits are measured in accordance with the nature of employee benefit, i.e. as an enhancement of other post-employment benefits, or otherwise as a short-term employee benefit or other long-term employee benefit. **IAS 19.168** **IAS 19.169**

2.4 The measurement of defined benefit plans

The measurement of a net defined benefit liability or assets requires the application of an actuarial valuation method, the attribution of benefits to periods of service, and the use of actuarial assumptions. The fair value of any plan assets is deducted from the present value of the defined benefit obligation in determining the net deficit or surplus. **IAS 19.66** **IAS 19.113**

The determination of the net defined benefit liability (or asset) is carried out with sufficient regularity such that the amounts recognised in the financial statements do not differ materially from those that would be determined at end of the reporting period. **IAS 19.58**

The present value of an entity's defined benefit obligations and related service costs is determined using the 'projected unit credit method', which sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately in building up the final obligation. This requires an entity to attribute benefit to the current period (to determine current service cost) and the current and prior periods (to determine the present value of defined benefit obligations). Benefit is attributed to periods of service using the plan's benefit formula, unless an employee's service in later years will lead to a materially higher of benefit than in earlier years, in which case a straight-line basis is used. **IAS 19.67-68** **IAS 19.70**

Actuarial assumptions used in measurement

The overall actuarial assumptions used must be unbiased and mutually compatible, and represent the best estimate of the variables determining the ultimate post-employment benefit cost: **IAS 19.75-76**

- Financial assumptions must be based on market expectations at the end of the reporting period; **IAS 19.80**
- Mortality assumptions are determined by reference to the best estimate of the mortality of plan members during and after employment; **IAS 19.81**
- The discount rate used is determined by reference to market yields at the end of the reporting period on high quality corporate bonds, or where there is no deep market in such bonds, by reference to market yields on government bonds. Currencies and terms of bond yields used must be consistent with the currency and estimated term of the obligation being discounted; **IAS 19.83**
- Assumptions about expected salaries and benefits reflect the terms of the plan, future salary increases, any limits on the employer's share of cost, contributions from employees or third parties, and estimated future changes in state benefits that impact benefits payable; **IAS 19.87**
- Medical cost assumptions incorporate future changes resulting from inflation and specific changes in medical costs. **IAS 19.96**

2.5 Other guidance

IAS 19 also provides guidance in relation to:

- when an entity should recognise a reimbursement of expenditure to settle a defined benefit obligation; **IAS 19.116**
- when it is appropriate to offset an asset relating to one plan against a liability relating to another plan; **IAS 19.119**
- accounting for multi-employer plans by individual employers; **IAS 19.131** **IAS 19.132**
- defined benefit plans sharing risks between entities under common control; **IAS 19.32-39**
- entities participating in state plans; **IAS 19.40-42**
- insurance premiums paid to fund post-employment benefit plans. **IAS 19.43-45** **IAS 19.46-49**

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Completion-of-service entitlements are recognized at the present value of the benefit obligations calculated using actuarial techniques in accordance with the rules governing “defined benefit plans”. Future disbursements are estimated on the basis of past data (such as employee turnover and retirement) and demographic patterns, including assumptions for pay hikes pursuant to section 2120 of the Italian Civil Code (application of a fixed rate of 1.5 percent and a rate equal to 75 percent of ISTAT inflation rate where applicable). To determine the present value of benefit obligations the Projected Unit Credit Method is used. The rate used for discounting is determined on the basis of market rates of high-quality bonds, in line with the estimated residual timing of commitments.

Such values involve the recognition in the income statement of expenses related to work performance and net financial expense and the inclusion of actuarial gains and losses arising from the remeasurement of liabilities in Other comprehensive income/(loss).

Entitlements accrued from January 1, 2007 allocated to either INPS or private pension plans are defined contribution payment obligations, since the company’s obligation is limited to the amount it agrees to contribute to the fund. The defined contribution obligations for each period are the amounts to be contributed for that period.

The discount rate used is consistent with the riskiness of the cash flows to be discounted of liabilities by maturity and reflects current market conditions. Given the current market situation with the discount rates at historic lows, a further significant reduction cannot be assumed. An increase in the discount rate would result in a reduction in provisions with a positive impact on the income statement.
The Group uses the projected Unit Credit Method (also known as the accrued benefit method pro-rated on service or as the benefit method / working years or PUC) to determine the present value of its defined benefit obligations and the related benefit cost of current service and, where applicable, the social security cost of past service. This method considers each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately for the purposes of calculating the obligation, and is the only one required by IAS 19.

The reversal of discounting is necessary even if part of the obligation falls due within twelve months from the date of the balance sheet.
To determine the present value of its obligations relating to defined benefit and the related social security costs relative to current service and, if applicable, social security costs relative to past performance, the projected unit credit method provides that company of the Group attribute benefit to periods of service under the plan's benefit formula.

Each Group company benefit to periods must therefore be attributed at which the obligation to provide post-employment benefits to the transaction, or when the employees have worked.

An exception to the above is the case where the level of benefits is amended in recent years in the activity of the employee's working: in such case, in fact, the measurement of the liability for assigned benefits should reflect the expected time because the employee ends the their work and must be discounted.

Formulating actuarial assumptions
In order to estimate as best as possible the total cost for the provision of benefits, the actuary in charge of the evaluation of the variables that will determine the cost, it must use objective assumptions, ie neither imprudent nor excessively conservative, and mutually compatible, and must reflect the economic relationships between factors such as inflation, the rate of increase of wages, the return on plan assets and discount rates.

Actuarial assumptions include:

- demographic assumptions about the future characteristics of current and previous employees who are eligible for benefits, such as:
    - the rate of mortality, both during and after termination of the employment relationship;

IAS 19.75-76

  - the rates of employee turnover, disability and early retirement;
  - the proportion of plan members with dependents family members who will be entitled to the benefits;
  - the proportion of plan participants who choose any form of payment option available under the contractual terms of the plan;
  - the incidence rates of reimbursement requests under medical plans;

- financial assumptions, which must be based on market expectations, at the balance sheet date, for the period over which the obligations must be settled and which concern:
  - the discount rate;
  - the levels of benefits, excluding costs of dependent benefits for employees and future salary;
  - in the case of medical benefits, future medical costs include costs, if significant, administration of claims and benefit payments;
  - taxes payable by the plan for contributions and benefits prior to the reporting date.

Financial assumptions should be based on market expectations, at the balance sheet date, for the period over which the obligations must be settled; also financial assumptions, including the discount rate, must be determined in nominal terms, unless they are no longer reliable estimates in real terms, adjusted for inflation (ie when the benefits are indexed).

The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate is not reflect the specific credit risk of each Group company and the risk that the actual data in the future may be different from actuarial assumptions. The discount rate reflects the estimated timing of payment of the benefits.
The discount rate is the rate used to discount the obligations in relation to benefits subsequent to the termination of the employment relationship, and must be determined with reference to market yields at the balance sheet date of high quality corporate bonds.

In countries where there is not a market for such securities, they must use market yields on government bonds at the balance sheet date. In addition, the currency and term of the corporate bonds shall be consistent with the currency and estimated term of obligations to benefits after the end of the employment relationship.
Net interest on the liability (asset) for defined benefits are calculated multiplying the liability (asset) for defined benefit determined at beginning of year (including changes in liabilities/assets Net defined benefit occurred during the year following the payment of contributions and benefits) for the discount rate.

The Group uses the following actuarial assumptions:

- in accordance with the provisions of accounting principle in question, all Group italian companies will be used as a discount rate the Eur Italy Soverign Curve;
- referring to the inflation rate, it will use the expected rate provided by the Economic and Financial Document or, if possible, the annual coefficient of sliding scale increases and / or tabular (bank collective agreements) which considers both inflation, both the changes in the economic level of the banking category, and that the average annual rate of increase in salaries for tabular variations and / or escalator, rate due to the adjustment of pensions for staff it is also the average annual rate of increase in pensions during their course;
- with reference to demographic assumptions it specifies that the Group will use the ISTAT tables normalized by adopting a factor considered adequate. For branch offices and foreign subsidiaries the assumptions are consistent with the legislation and local currency.

Following the definition of these assumptions (inflation rate, wage growth, turnover) annually revised , the Group must continue to perform the actuarial valuation on a monthly basis, based on a duration which is defined on half basis.

Finally, the Group companies use the same approach agreed with the parent company: any exception adopted by a foreign branches in application of their local rules may be immediately shared and agreed with the parent company.

Actuarial gains and losses

The Actuarial gains and losses include, as required by IAS 19.8:

- the adjustments based on past experience (the effects of differences between previous actuarial assumptions and what has actually occurred);
- the effects of changes in actuarial assumptions.

Gains and losses, defined as the difference between the carrying value of the liability and the present value of the obligation at the end of the period are recognized in equity as part of valuation reserves in application of IAS 19 Revised.

Changes in the liability for defined benefit plans relating to actuarial gains and losses are recognized immediately with an impact on comprehensive income (OCI Other Comprehensive Income-).

The valuation of actuarial gains and losses must be at least six months.

The Employee Benefits provided by Mediolanum Group are summerized as follows:

Type benefit	**Description of benefit**	**Accounting treatment**
Short-term employee benefits	• INCENTIVES (performance and productivity variable bonus) • Welfare bonus/benefits	The undiscounted amount of the benefits expected to be paid in respect of service rendered by employees in an accounting period is recognised in that period: a) as a liability (accrued expense), after deducting any amount already paid; if the latter is greater than the undiscounted amount of the benefits, each company should recognize that excess as an asset to the extent that the prepayment will lead to, for example, a reduction in future payments or a refund; b) as an expense, unless some other principle requires or permits the inclusion of the benefits in the cost of an asset
Termination benefits	Early retirement incentives	The Group companies detect a liability at the relative cost of these benefits in the most immediate of the following dates (IAS 19.165-166): a) the time when the entity can no longer withdraw the offer of those benefits, that is when the employee has accepted the offer or when it enters into force a restriction (legal) to entity's ability to withdraw the offer; b) the time when the entity recognizes costs for a restructuring that is within the application of IAS 37 and involves the payment of benefits due to the termination of employment relationship.

Benefits after the end of the employment relationship	PENSION FUNDS (Previgest Fund Mediolanum)	The amount recognised in the period is the contribution payable in exchange for service rendered by employees during the period (IAS 19.51) Contributions to a defined contribution plan which are not expected to be wholly settled within 12 months after the end of the annual reporting period in which the employee renders the related service are discounted to their present value (IAS 19.52).
	DEFINED CONTRIBUTION PLANS	In defined contribution plans (IAS 19.28): a) the entity's obligations is limited to the contribution payable to the fund of the Agreement; the amount of benefits after the employee received from the employment relationship is therefore determined by the amount of contributions paid by the Group companies (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; b) as a result, the actuarial risk that benefits will be less than expected and the risk of investment that assets invested will be insufficient to meet expected benefits fall on the employee.
	RETIREMENT PAYMENT ITEM 120 - Provisions for risks and charges (Pension funds)	The provision of which is defined (for example on the basis of the employee participant at the time of retirement, as proportion of final salary or the average wage in a given period the employee has performed the work, with a guaranteed minimum return)

	DEFINED BENEFIT PLANS	Accounting for defined benefit plans must be articulated in the following phases, separately for each program (IAS 19:57): a) Determination of the surplus or deficit in the plan; b) Determination of the liability (asset) for defined benefit; c) Determination of the amounts to be recognized in the income statement; d) Determination of revaluations (remeasurements) to detect in OCI.

About the company bonus (ex VAP), it is stated that the vesting conditions provided by Mediolanum Group for the payment of that benefit refer in substance to the actual achievement of the company by a certain level of profit for the year.
With reference to the Corporate Performance Award (PAR) under the incentive scheme, the vesting conditions for the Medionalum Group for the payment of the premiums themselves refer over the employee remaining at the company on the vesting date, the achievement of a mix of Synthetic Performance Indicators (ISP) and, exclusively for deferred variable remuneration, the maintenance of certain levels of TIER 1 and the achievement of a fixed annual net profit of the Group.

For members of the Corporate Pension Fund "Previgest Fund Mediolanum" there is also the possibility to choose to allocate that Company Bonus to the Fund itself, enjoying the established increase (+ 0.2%).
For details, please refer to the Regulations of the Fund Previgest.

With reference to welfare bonus, it represents business initiative to the benefit of the recipients (middle managers, employees) designed to provide socio/economic support to them and to their families.

3.2 Relevant topics

For each form of benefit, the Group shall assess the specific features in order to define the application of the related standard and the accounting rules, under IAS 19 or, alternatively, under:

- IFRS 2 “Shared-based payment” (specific Chapter of the Manual): IFRS 2 *Share-based Payment* requires an entity to recognise share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Specific requirements are included for equity-settled and cash-settled share-based payment transactions, as well as those where the entity or supplier has a choice of cash or equity instruments. The concept of share-based payments is broader than employee share options. IFRS 2 encompasses the issuance of shares, or rights to shares, in return for services and goods. Examples of items included in the scope of IFRS 2 are share appreciation rights, employee share purchase plans, employee share ownership plans, share option plans and plans where the issuance of shares (or rights to shares) may depend on market or non-market related conditions;
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets (specific Chapter of the Manual): the objective of IAS 37 is to ensure that appropriate recognition criteria and measurement bases are applied to provisions, contingent liabilities and contingent assets and that sufficient information is disclosed in the notes to the financial statements to enable users to understand their nature, timing and amount. The key principle established by the Standard is that a provision should be recognised only when there is a liability i.e. a present obligation resulting from past events. The Standard thus aims to ensure that only genuine obligations are dealt with in the financial statements – planned future expenditure, even where authorised by the board of directors or equivalent governing body, is excluded from recognition

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the recognition and the measurement of the employee benefits discussed above. They could be considered by Group Component to make decisions on accounting issues related to this topic.

4.1 Recognition and Measurement

4.1.1 Obligation for short-term paid absences

Example 4.1.1

Measurement of obligation for short-term paid absences

Entity A has 200 employees, who are each entitled to 20 working days of paid leave each year. Paid leave is first taken out of the current year's entitlement and then out of the balance brought forward from the previous year. Unused leave cannot be carried forward more than one year. Employees are not entitled to a cash payment for unused leave if they leave Entity A's employment.

At 31 December 20X1, the average unused entitlement is 3 days per employee (i.e. 600 days in total). Based on past experience, Entity A expects that 175 employees will take no more than their annual entitlement in 20X2 and that the remaining 25 employees will, in total, use 70 days of the entitlement brought forward from 20X1.

The benefit described can be carried forward if the current period's entitlement is not used in full, but only for 12 months; it is therefore an 'accumulating' short-term paid absence. The accumulating paid leave is non-vesting, because employees are not entitled to a cash payment for unused leave when they leave Entity A's employment.

IAS 19 requires Entity A to recognise an obligation at 31 December 20X1 for the amount it expects to pay as a result of the unused entitlement that has accumulated at the end of the period. Moreover, it clarifies that, for non-vesting entitlements, the possibility that some employees will not take their entitlement should be reflected in that measurement.

Therefore, at 31 December 20X1, Entity A recognises a liability and an expense equal to the undiscounted amount of 70 days of paid leave (i.e. the number of days of the entitlement that are expected to be taken)

4.1.2 Multi-employer plans

Example 4.1.2

Multi-employer plans

An entity participates in a multi-employer defined benefit plan that does not prepare plan valuations on an IAS 19 basis. It therefore accounts for the plan as if it were a defined contribution plan. A non-IAS 19 funding valuation shows a deficit of 100 million in the plan. The plan has agreed under contract a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. The entity's total contributions under the contract are 8 million.
The entity recognises a liability for the contributions adjusted for the time value of money, and an equal expense in profit or loss.

4.1.3 Defined contribution plans with vesting conditions

Example 4.1.3

Defined contribution plans with vesting conditions

Entity E sponsors a defined contribution post-employment benefit plan for its 10 employees. It pays contributions of 100 per year (10 per employee) to the plan.

Under the terms of the plan, employees only become entitled to post-employment benefits if they remain in Entity E's employment for a minimum of three years. Contributions made in respect of an employee who leaves before the three-year period is completed are refunded to Entity E.

Two employees leave at the start of Year 3, so that Entity E becomes entitled to a refund of 40 (2 employees × 10 × 2 years) in Year 3.

Entity E is obliged to pay contributions of 10 per employee per year. It recognises an expense that is based on this obligation, without reference to the period over which the employees become entitled to the benefits. Therefore, Entity E recognises an expense in respect of contributions payable of 100 in each of Years 1 and 2 and 80 in Year 3. The refund of 40 is recognised as an asset and as income in Year 3 – resulting in a net expense of 40 in Year 3.

4.1.4 Attributing benefit to periods of service

Example 4.1.4.1

Attributing benefit to periods of service (1)

- A defined benefit plan provides a lump sum benefit of Euro 100 payable on retirement for each year of service. A benefit of Euro 100 is attributed to each year. The current service cost is the present value of Euro 100. The present value of the defined benefit obligation is the present value of Euro 100, multiplied by the number of years of service up to the end of the reporting period.If the benefit is payable immediately when the employee leaves the entity, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the end of the reporting period.

- A plan provides a monthly pension of 0.2 per cent of final salary for each year of service. The pension is payable from the age of 65. Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2 per cent of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2 per cent of final salary, multiplied by the number of years of service up to the end of the reporting period. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

Example 4.1.4.2

Attributing benefit to periods of service (2)

- A plan pays a benefit of Euro 100 for each year of service. The benefits vest after ten years of service. A benefit of Euro 100 is attributed to each year. In each of the first ten years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service.

- A plan pays a benefit of Euro 100 for each year of service, excluding service before the age of 25. The benefits vest immediately. No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of Euro 100 is attributed to each subsequent year.

Example 4.1.4.3

Attributing benefit to periods of service (3)

- A plan pays a lump sum benefit of Euro 1,000 that vests after ten years of service. The plan provides no further benefit for subsequent service. A benefit of Euro 100 (Euro 1,000 divided by ten) is attributed to each of the first ten years. The current service cost in each of the first ten years reflects the probability that the employee may not complete ten years of service. No benefit is attributed to subsequent years.

- A plan pays a lump sum retirement benefit of Euro 2,000 to all employees who are still employed at the age of 55 after twenty years of service, or who are still employed at the age of 65, regardless of their length of service. For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each year from the age of 35 to the age of 55.For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of Euro 100 (Euro 2,000 divided by twenty) to each of the first twenty years. For an employee who joins at the age of 55, service beyond ten years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of Euro 200 (Euro 2,000 divided by ten) to each of the first ten years. For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

- A post-employment medical plan reimburses 40 per cent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service. Under the plan's benefit formula, the entity attributes 4 per cent of the present value of the expected medical costs (40 per cent divided by ten) to each of the first ten years and 1 per cent (10 per cent divided by ten) to each of the second ten years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within ten years, no benefit is attributed.

- A post-employment medical plan reimburses 10 per cent of an employee's post-employment medical costs if the employee leaves after more than ten and less than twenty years of service and 50 per cent of those costs if the employee leaves after twenty or more years of service.Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after twenty or more years, the entity attributes benefit on a straight-line basis under IAS 19. Service

> beyond twenty years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first twenty years is 2.5 per cent of the present value of the expected medical costs (50 per cent divided by twenty). For employees expected to leave between ten and twenty years, the benefit attributed to each of the first ten years is 1 per cent of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving. For employees expected to leave within ten years, no benefit is attributed.

Example 4.1.4.4

Attributing benefit to periods of service (4)

Employees are entitled to a benefit of 3 per cent of final salary for each year of service before the age of 55. Benefit of 3 per cent of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

4.1.5 Death-in-service benefit

Example 4.1.5

Measurement of incapacity benefit or death-in-service benefit based on service life

An entity operates a defined benefit post-employment benefit plan. Under the terms of the plan, the employee is entitled to a pension of 1/60th of final earnings for each year of service until retirement. If an employee becomes incapacitated or dies prior to the normal retirement date, the benefit paid (to the employee or the employee's dependant) is based on the years of employment until the date of incapacity or death, and credit is given for 50 per cent of the years from that date until the normal retirement date.

For example, an employee works for 20 years and then becomes incapacitated 10 years prior to the normal retirement date. The benefit paid is 25/60ths based on 25 years of service (the 20 years actually worked plus 50 per cent of the remaining years until the normal retirement date).

In the circumstances described, the assumptions used for attributing benefits to service periods should reflect that, for employees expected to become incapacitated or to die prior to their normal retirement date, the service period would only encompass the period until the expected incapacity or death. A consistent benefit formula should be used over the years of service to reflect the value of the benefit. The expense should be attributed to the periods of service under the benefit formula because the employee's service does not result in a materially higher level of benefit in later years than in earlier years.

In determining costs, actuaries will make assumptions about the number of employees who are expected to become incapacitated or to die prior to normal retirement date. Therefore, for the employees not expected to reach retirement age, the total expected benefit payable, including that related to credited years not actually worked (in this example, 50 per cent of the years between the date of expected incapacity or death and the normal retirement date) will be attributed to the years of expected service up to the date of expected incapacity or death.

4.1.6 Termination benefits

Example 4.1.6

Recognition and measurement of termination benefits

Background

As a result of a recent acquisition, an entity plans to close a factory in ten months and, at that time, terminate the employment of all of the remaining employees at the factory. Because the entity needs the expertise of the employees at the factory to complete some contracts, it announces a plan of termination as follows.

Each employee who stays and renders service until the closure of the factory will receive on the termination date a cash payment of Euro 30,000. Employees leaving before closure of the factory will receive Euro 10,000.

There are 120 employees at the factory. At the time of announcing the plan, the entity expects 20 of them to leave before closure. Therefore, the total expected cash outflows under the plan are Euro 3,200,000 (ie 20 × Euro 10,000 + 100 × Euro 30,000). As required by IAS 19, the entity accounts for benefits provided in exchange for termination of employment as termination benefits and accounts for benefits provided in exchange for services as short-term employee benefits.

Termination benefits

The benefit provided in exchange for termination of employment is Euro 10,000. This is the amount that an entity would have to pay for terminating the employment regardless of whether the employees stay and render service until closure of the factory or they leave before closure. Even though the employees can leave before closure, the termination of all employees' employment is a result of the entity's decision to close the factory and terminate their employment (ie all employees will leave employment when the factory closes). Therefore the entity recognises a liability of Euro 1,200,000 (ie 120 × Euro 10,000) for the termination benefits provided in accordance with the employee benefit plan at the earlier of when the plan of termination is announced and when the entity recognises the restructuring costs associated with the closure of the factory.

Benefits provided in exchange for service

The incremental benefits that employees will receive if they provide services for the full ten-month period are in exchange for services provided over that period. The entity accounts for them as short-term employee benefits because the entity expects to settle them before twelve months after the end of the annual reporting period. In this example, discounting is not required, so an expense of Euro 200,000 (ie Euro 2,000,000 ÷ 10) is recognised in each month during the service period of ten months, with a corresponding increase in the carrying amount of the liability.

5 PRESENTATION

5.1 Disclosures about defined benefit plans

IAS 19 sets the following disclosure objectives in relation to defined benefit plans:

- an explanation of the characteristics of an entity's defined benefit plans, and the associated risks;
- identification and explanation of the amounts arising in the financial statements from defined benefit plans;
- a description of how defined benefit plans may affect the amount, timing and uncertainty of the entity's future cash flows.

Extensive specific disclosures in relation to meeting each the above objectives are specified, e.g. a reconciliation from the opening balance to the closing balance of the net defined benefit liability or asset, disaggregation of the fair value of plan assets into classes, and sensitivity analysis of each significant actuarial assumption.

Additional disclosures are required in relation to multi-employer plans and defined benefit plans sharing risk between entities under common control.

5.2 Mediolanum Financial Statements disclosures

Mediolanum's Group provide a reconciliation from the opening balance to the closing balance for each of the following, if applicable: **IAS 19.135**

- the net defined benefit liability (asset), showing separate reconciliations for:
  - plan assets;
  - the present value of the defined benefit obligation;
  - the effect of the asset ceiling.
- Any reimbursement rights.

Disclosure of the entity's own transferable financial instruments held as plan assets.

Disclosure of significant actuarial assumptions in absolute terms. **IAS 19.136**

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present employee benefits in the consolidated financial statements. **IAS 19.148**

The entity provided about the defined benefit plans:

- Disclosure of the characteristics of the plan, including
  - The nature of the benefits;

IAS 19.140

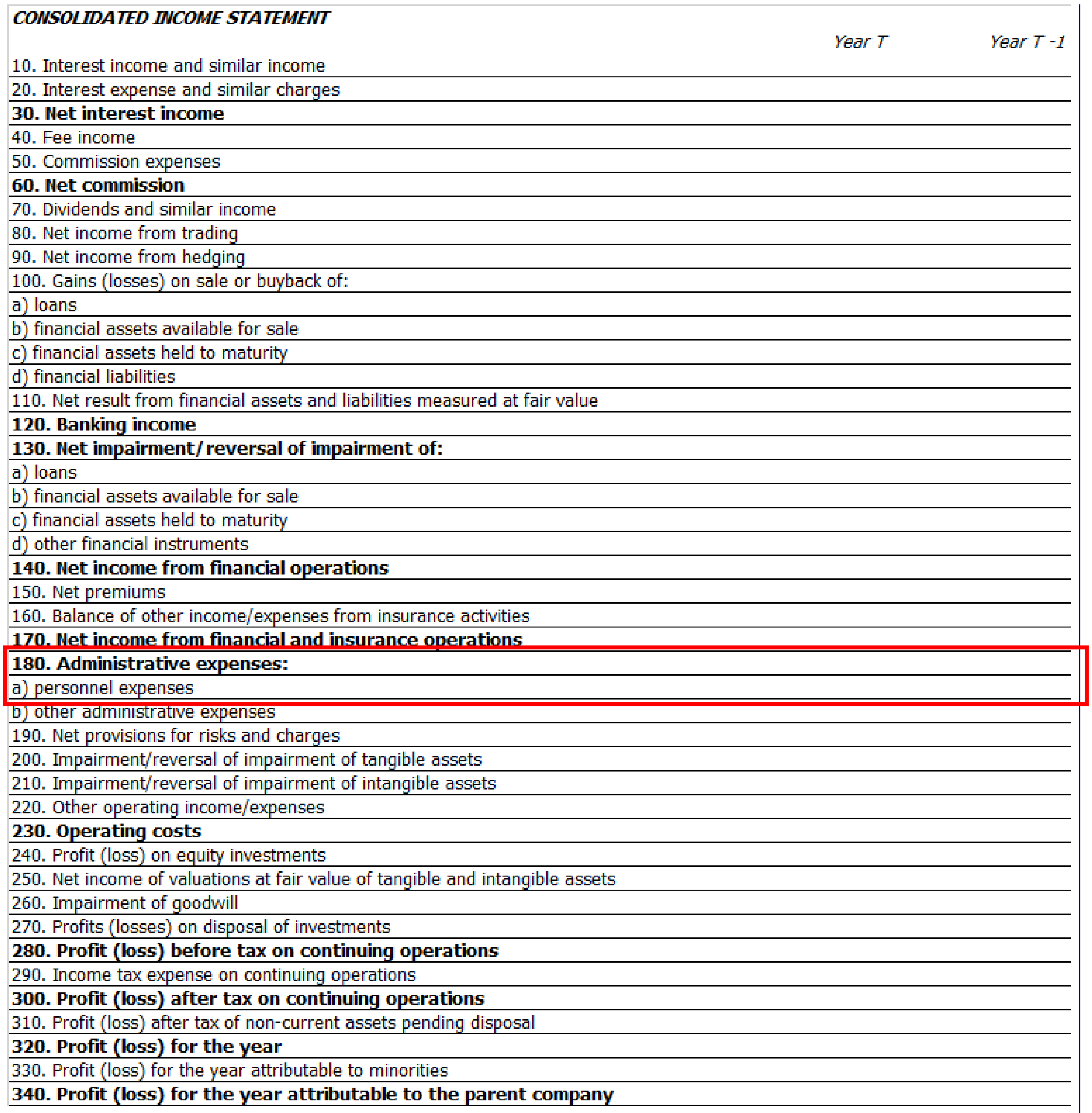
    - a description of the regulatory framework, and
    - governance responsabilities
- Description of the risks to which the plan exposes the entity;
- Description of the plan amendments, curtailments and settlements.

Items in scope of IAS 19 are recognised in the following captions of the Consolidated Financial Statements:

- Caption 100 "Other liabilities", including other liabilities due to employees, staff, directors and statutory auditors in scope of IAS 19;
- Caption 110 "Provision for employee severance pay" that includes the liability recognised in the balance sheet related to the employee severance indemnity calculated as a "Defined benefit plan" as indicated in IAS 19, once granted to Italian Geography employees by law.
- Caption 120 "Provisions for risks and charges - Pensions and other postretirement benefit obligations", including:
    - liabilities arising from pension funds, severance pay and other long-term and post-employment benefits that are classified as **defined benefit plans** in accordance with IAS 19: the entity's obligations is to provide the agreed benefits to current and former employees and actuarial risk and investment risk fall, in substance, on the entity";
    - liabilities arising from complementary retiring funds that are classified as **defined contribution plans** in accordance with IAS 19: funds under which the entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Benefits are the results of the amount of contributions paid and return on contributions invested. In consequence, actuarial risk and investment risk fall, in substance, on the employee;
- Caption 140 "Revaluation reserves" impacted by IAS 19 as per employment benefits.
- Caption 180 "Administrative costs - Staff expenses" impacted by IAS 19.
- Caption 190 "Net provisions for risks and charges" impacted by IAS 19.

IAS 19.139

As required by Bank of Italy, employee benefits are included in section a) personnel expenses of the caption 180 - administrative expenses of the consolidated income statement.

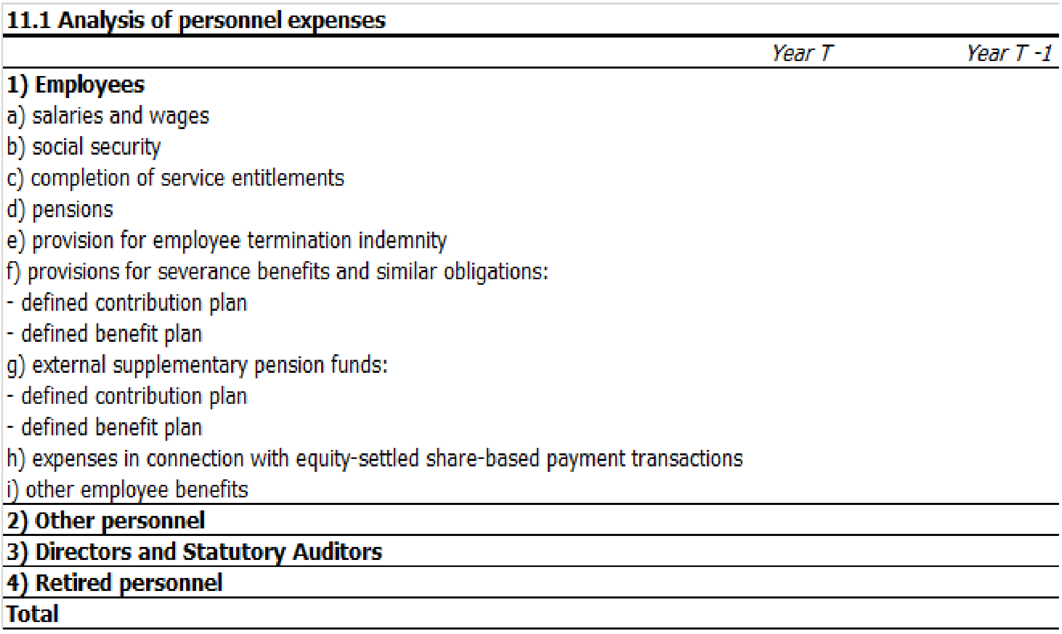


CONSOLIDATED INCOME STATEMENT

	Year T	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

In particular, the sub-category a) includes:

- salaries and wages
- social security
- completion of service entitlements
- pensions
- provision for employee termination indemnity
- provisions for severance benefits and similar obligations:
- external supplementary pension funds:
- expenses in connection with equity-settled share-based payment transactions
- other employee benefits



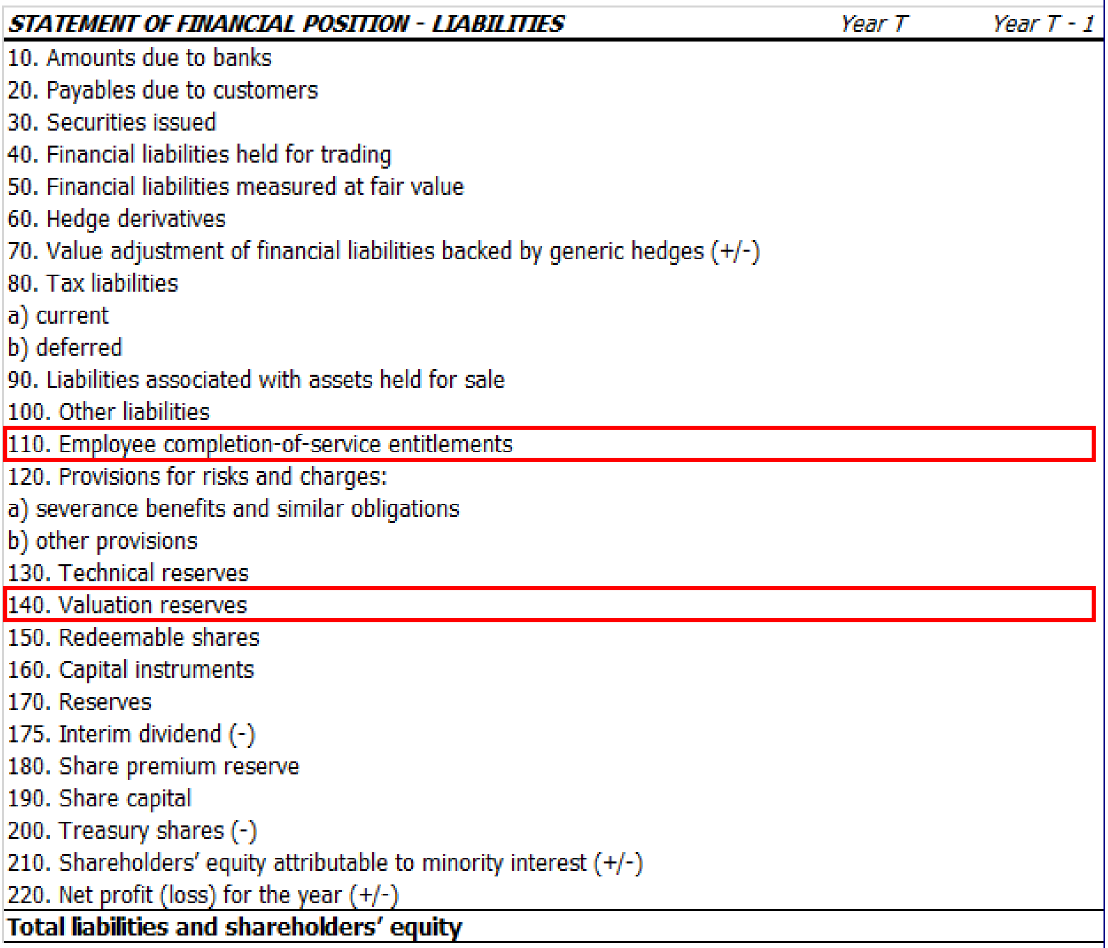
11.1 Analysis of personnel expenses

	Year T	*Year T -1*
1) Employees		
a) salaries and wages		
b) social security		
c) completion of service entitlements		
d) pensions		
e) provision for employee termination indemnity		
f) provisions for severance benefits and similar obligations:		
- defined contribution plan		
- defined benefit plan		
g) external supplementary pension funds:		
- defined contribution plan		
- defined benefit plan		
h) expenses in connection with equity-settled share-based payment transactions		
i) other employee benefits		
2) Other personnel		
3) Directors and Statutory Auditors		
4) Retired personnel		
Total		

More specifically, in Table 11.1 are included:

- the costs of the company's employees seconded to other companies;
- expenses related to atypical employment contracts (ie. contracts of "temporary employment");
- reimbursement of cost to employees of other companies seconded to the enterprise;
- the recovery of expenses for the company's employees seconded to other companies;
- the remuneration of the directors and auditors (including the costs incurred for entering into insurance policy for civil liability of directors and auditors);
- costs arising from payment agreements based on own instruments to employees capital;
- the provisions made in the item "other liabilities" in the face of productivity bonuses this period, but paid the following year;
- costs for insurance policies for employees;
- costs for food vouchers distributed to employees;
- the cost of training courses for employees;
- costs flat rate for general food and lodging reimbursements incurred by employees away;
- the standard-rate costs for mileage allowances, whose value is independent of the quantification of path and the use of valid tariff;
- the costs for the check-up visits by employees, except those carried out in when hiring staff and costs for mandatory visits arranged for law.

The statement of financial position, among liabilities, includes caption 110 – Employee completion-of-service entitlements and caption 140 – Valuation reserves, which are strictly related with the topics treated above.



STATEMENT OF FINANCIAL POSITION - LIABILITIES	*Year T*	*Year T - 1*
10. Amounts due to banks		
20. Payables due to customers		
30. Securities issued		
40. Financial liabilities held for trading		
50. Financial liabilities measured at fair value		
60. Hedge derivatives		
70. Value adjustment of financial liabilities backed by generic hedges (+/-)		
80. Tax liabilities		
a) current		
b) deferred		
90. Liabilities associated with assets held for sale		
100. Other liabilities		
110. Employee completion-of-service entitlements		
120. Provisions for risks and charges:		
a) severance benefits and similar obligations		
b) other provisions		
130. Technical reserves		
140. Valuation reserves		
150. Redeemable shares		
160. Capital instruments		
170. Reserves		
175. Interim dividend (-)		
180. Share premium reserve		
190. Share capital		
200. Treasury shares (-)		
210. Shareholders' equity attributable to minority interest (+/-)		
220. Net profit (loss) for the year (+/-)		
Total liabilities and shareholders' equity		

In addition, in caption 110 of balance sheet the Company must give information about annual movements of the reserve for the employee termination.

Changes in the liability for defined benefit plans relating to actuarial gains and losses are recognized immediately with an impact on comprehensive income (OCI Other Comprehensive Income).

Euro		Year T		
		Gross amount	**Income tax**	**Net amount**
10.	**Profit (Loss) for the year**	**X**	**X**	
	Other income components without reversals to the income statement			
20.	Tangible assets			
30.	Intangible assets			
40.	Defined benefit plans			
50.	Non-current assets held for sale			
60.	Share of valuation reserves on investments accounted for by the equity method			
	Other income components with reversals to the income statement			
70.	**Hedges of investments in foreign operations:**			
	a) changes in fair value			
	b) reversals to the income statement			
	c) other changes			
80.	**Exchange differences:**			
	a) changes in fair value			
	b) reversals to the income statement			
	c) other changes			
90.	**Cash flow hedges:**			
	a) changes in fair value			
	b) reversals to the income statement			
	c) other changes			
100.	**Financial assets available for sale:**			
	a) changes in fair value			
	b) reversals to the income statement			
	- impairment			
	- realized gains/losses			
	c) other changes			
110.	**Non-current assets held for sale**			
	a) changes in fair value			
	b) reversals to the income statement			
	c) other changes			
120.	**Share of valuation reserves on investments accounted for by the equity method:**			
	a) changes in fair value			
	b) reversals to the income statement			
	- impairment			
	- realized gains/losses			
	c) other changes			
130.	**Total other income components**			
140.	**Comprehensive income (Captions 10+130)**			

IFRS Operating Manual

Chapter 10
Share-Based Payments

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IFRS 2 – Share-based payments;
- a list of most recent amendment to IFRS 2.

1.1 Introduction

Entities often grant shares or share options to employees or other parties. Share plans and share option plans are a common feature of employee remuneration, for directors, senior executives and many other employees.

Until IFRS 2 was issued, there was no IFRS covering the recognition and measurement of these transactions. IFRS 2 was originally issued in February 2004 and first applied to annual periods beginning on or after 1 January 2005.

1.2 Overview of IFRS 2

IFRS 2 Share-based Payment requires an entity to recognise share-based payment transactions (such as granted shares, share options, or share appreciation rights) in its financial statements, including transactions with employees or other parties to be settled in cash, other assets, or equity instruments of the entity. Specific requirements are included for equity-settled and cash-settled share-based payment transactions, as well as those where the entity or supplier has a choice of cash or equity instruments.

Date	**Development**	**Comments**
12 December 2013	Amended by *Annual Improvements to IFRSs 2010–2012 Cycle* (definition of vesting condition)	Effective for annual periods beginning on or after 1 July 2014
18 June 2009	Amended by *Group Cash-settled Share-based Payment Transactions*	Effective for annual periods beginning on or after 1 January 2010

16 April 2009	Amended by *Improvements to IFRSs* (scope of IFRS 2 and revised IFRS 3)	Effective for annual periods beginning on or after 1 July 2009
17 January 2008	Amended by *Vesting Conditions and Cancellations (Amendments to IFRS 2)*	Effective for annual periods beginning on or after 1 January 2009
2 February 2006	Exposure Draft *Vesting Conditions and Cancellations* published	Comment deadline 2 June 2006
19 February 2004	IFRS 2 *Share-based Payment* issued	Effective for annual periods beginning on or after 1 January 2005
7 November 2002	Exposure Draft ED 2 *Share-Based Payment* published	Comment deadline 7 March 2003
20 September 2001	IASB invites comments on G4+1 Discussion Paper *Accounting for Share-Based Payments*	Comment deadline 15 December 2001
July 2001	Project added to IASB agenda	History of the project
July 2000	G4+1 Discussion Paper *Accounting for Share-Based Payments* published	Comment deadline 31 October 2000

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IFRS 2 that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Share-Based Payment

A share-based payment is a transaction in which the entity receives goods or services either as consideration for its equity instruments or by incurring liabilities for amounts based on the price of the entity's shares or other equity instruments of the entity. The accounting requirements for the share-based payment depend on how the transaction will be settled, that is, by the issuance of (a) equity, (b) cash, or (c) equity or cash.

Employees and others providing similar services

Individuals who render personal services to the entirty and either (a) the individuals are regarded as employees for legal or tax purposes, (b) the individuals work for the entity under its direction in the same way as individuals who are regarded as employees for legal or tax purposes, or (c) the services rendered are similar to those rendered by employees.

Equity instruments

A contract that evidences a residual interest in the assets of an entity after deducting all off its liabilities

Equity instruments granted

The right (conditional or unconditional) to an equity instrument of the entity conferred by the entity on another party, under a share-based payment arrangement.

Grant date

The date at which the entity and another party agree a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. A grant date the entity confers on the counterparty the right to cash, other asset, or equity instruments of the entity, provided the specified vesting conditions, in any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when the approval is obtained.

Vesting condition

A condition that determines whether the entity receives the services entitle the counterparty to receive the cash, other assets or equity instruments of the entity. A vesting condition is either a service condition or a performance condition.

Service condition

A vesting condition that requires the counterparty to complete a specified period of service during which services are provided to the entity. If the counterparty, regardless of the reason, ceases to provide service during the vesting period, it has failes to satisfy the condition. A service condition does not require a performance target to be met.

Performance condition

A vesting condition that requires:

- the counterparty to complete a specified period of service; the service requirement can be explicit or implicit, and
- Specified performance target(s) to be met while the counterparty is rendering the service required in (a)

The period of achieving the performance target:

- shall not extend beyond the end of the service period; and
- may start before the service period on the condition that the commencement date of the performance target is not substantially before the commencement of the service period

Vesting period

The period during which all the specified vesting condition of a share-based payment arrangement are to be satisfied.

2.2 Scope of rules

The concept of share-based payments is broader than employee share options. IFRS 2 encompasses the issuance of shares, or rights to shares, in return for services and goods. Examples of items included in the scope of IFRS 2 are share appreciation rights, employee share purchase plans, employee share ownership plans, share option plans and plans where the issuance of shares (or rights to shares) may depend on market or non-market related conditions.

IFRS 2 applies to all entities. There is no exemption for private or smaller entities. Furthermore, subsidiaries using their parent's or fellow subsidiary's equity as consideration for goods or services are within the scope of the Standard.

There are two exemptions to the general scope principle:

- First, the issuance of shares in a business combination should be accounted for under IFRS 3 *Business Combinations*. However, care should be taken to distinguish share-based payments related to the acquisition from those related to continuing employee services

- Second, IFRS 2 does not address share-based payments within the scope of paragraphs 8-10 of IAS 32 *Financial Instruments: Presentation*, or paragraphs 5-7 of IAS 39 *Financial Instruments: Recognition and Measurement*. Therefore, IAS 32 and IAS 39 should be applied for commodity-based derivative contracts that may be settled in shares or rights to shares.

IFRS 2 does not apply to share-based payment transactions other than for the acquisition of goods and services. Share dividends, the purchase of treasury shares, and the issuance of additional shares are therefore outside its scope.

2.3 Recognition

An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction. **IFRS 2.7**

When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, they shall be recognised as expenses. **IFRS 2.8**

2.4 Equity-settled share-based payment transactions

For equity-settled share-based payment transactions, the entity shall measure the goods or services received, and the corresponding increase in equity, directly, at the fair value of the goods or services received, unless that fair value cannot be estimated reliably. If the entity cannot estimate reliably the fair value of the goods or services received, the entity shall measure their value, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted. **IFRS 2.10**

To apply the requirements of paragraph 10 to transactions with employees and others providing similar services, the entity shall measure the fair value of the services received by reference to the fair value of the equity instruments granted, because typically it is not possible to estimate reliably the fair value of the services received. **IFRS 2.11**
The fair value of those equity instruments shall be measured at grant date.

To apply the requirements of paragraph 10 to transactions with parties other than employees, there shall be a rebuttable presumption that the fair value of the goods or services received can be estimated reliably. That fair value shall be measured at the date the entity obtains the goods or the counterparty renders service. In rare cases, if the entity rebuts this presumption because it cannot estimate reliably the fair value of the goods or services received, the entity shall measure the goods or services received, and the corresponding increase in equity, indirectly, by reference to the fair value of the equity instruments granted, measured at the date the entity obtains the goods or the counterparty renders service. **IFRS 2.13**

2.4.1 Transactions in which services are rendered

If the equity instruments granted vest immediately, the counterparty is not required to complete a specified period of service before becoming unconditionally entitled to those equity instruments. In the absence of evidence to the contrary, the entity shall presume that services rendered by the counterparty as consideration for the equity instruments have been received. In this case, on grant date the entity shall recognize the services received in full, with a corresponding increase in equity. **IFRS 2.14**

If the equity instruments granted do not vest until the counterparty completes a specified period of service, the entity shall presume that the services to be rendered by the counterparty as consideration for those equity instruments will be received in the future, during the vesting period. The entity shall account for those services as they are rendered by the counterparty during the vesting period, with a corresponding increase in equity. For example: **IFRS 2.15**

- if an employee is granted share options conditional upon completing three years' service, then the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over that three-year vesting period;

- if an employee is granted share options conditional upon the achievement of a performance condition and remaining in the entity's employ until that performance condition is satisfied, and the length of the vesting period varies depending on when that performance condition is satisfied, the entity shall presume that the services to be rendered by the employee as consideration for the share options will be received in the future, over the expected vesting period.
  The entity shall estimate the length of the expected vesting period at grant date, based on the most likely outcome of the performance condition. If the performance condition is a market condition, the estimate of the length of the expected vesting period shall be consistent with the assumptions used in estimating the fair value of the options granted, and shall not be subsequently revised. If the performance condition is not a market condition, the entity shall revise its estimate of the length of the vesting period, if necessary, if subsequent information indicates that the length of the vesting period differs from previous estimates

2.4.2 Transactions measured by reference to the fair value of the equity instruments granted

For transactions measured by reference to the fair value of the equity instruments granted, an entity shall measure the fair value of equity instruments granted at the measurement date, based on market prices if available, taking into account the terms and conditions upon which those equity instruments were granted (subject to the requirements of paragraphs 19–22). **IFRS 2.16**

If market prices are not available, the entity shall estimate the fair value of the equity instruments granted using a valuation technique to estimate what the price of those equity instruments would have been on the measurement date in an arm's length transaction between knowledgeable, willing parties. The valuation technique shall be consistent with generally accepted valuation methodologies for pricing financial instruments, and shall incorporate all factors and assumptions that knowledgeable, willing market participants would consider in setting the price (subject to the requirements of paragraphs 19–22). **IFRS 2.17**

A grant of equity instruments might be conditional upon satisfying specified vesting conditions. For example, a grant of shares or share options to an employee is typically conditional on the employee remaining in the entity's employ for a specified period of time. There might be performance conditions that must be satisfied, such as the entity achieving a specified growth in profit or a specified increase in the entity's share price. **IFRS 2.19**

Vesting conditions, other than market conditions, shall not be taken into account when estimating the fair value of the shares or share options at the measurement date.
Instead, vesting conditions shall be taken into account by adjusting the number of equity instruments included in the measurement of the transaction amount so that, ultimately, the amount recognised for goods or services received as consideration for the equity instruments granted shall be based on the number of equity instruments that eventually vest. Hence, on a cumulative basis, no amount is recognised for goods or services received if the equity instruments granted do not vest because of failure to satisfy a vesting condition, eg the counterparty fails to complete a specified service period, or a performance condition is not satisfied, subject to the requirements of paragraph 21.

To apply the requirements of paragraph 19, the entity shall recognise an amount for the goods or services received during the vesting period based on the best available estimate of the number of equity instruments expected to vest and shall revise that estimate, if necessary, if subsequent information indicates that the number of equity instruments expected to vest differs from previous estimates. On vesting date, the entity shall revise the estimate to equal the number of equity instruments that ultimately vested, subject to the requirements of paragraph 21. **IFRS 2.20**

Market conditions, such as a target share price upon which vesting (or exercisability) is conditioned, shall be taken into account when estimating the fair value of the equity instruments granted. Therefore, for grants of equity instruments with market conditions, the entity shall recognise the goods or services received from a counterparty who satisfies all other vesting conditions (eg services received from an employee who remains in service for the specified period of service), irrespective of whether that market condition is satisfied. **IFRS 2.21**

For options with a reload feature, the reload feature shall not be taken into account when estimating the fair value of options granted at the measurement date. Instead, a reload option shall be accounted for as a new option grant, if and when a reload option is subsequently granted. **IFRS 2.22**

Having recognised the goods or services received and a corresponding increase in equity, the entity shall make no subsequent adjustment to total equity after vesting date. **IFRS 2.23**

2.4.3 Modifications, cancellations, and settlements

The determination of whether a change in terms and conditions has an effect on the amount recognised depends on whether the fair value of the new instruments is greater than the fair value of the original instruments (both determined at the modification date).

IFRS 2.27
IFRS 2 Appendix B42-43

Modification of the terms on which equity instruments were granted may have an effect on the expense that will be recorded. IFRS 2 clarifies that the guidance on modifications also applies to instruments modified after their vesting date. If the fair value of the new instruments is more than the fair value of the old instruments (e.g. by reduction of the exercise price or issuance of additional instruments), the incremental amount is recognised over the remaining vesting period in a manner similar to the original amount. If the modification occurs after the vesting period, the incremental amount is recognised immediately. If the fair value of the new instruments is less than the fair value of the old instruments, the original fair value of the equity instruments granted should be expensed as if the modification never occurred.

IFRS 2.28

The cancellation or settlement of equity instruments is accounted for as an acceleration of the vesting period and therefore any amount unrecognised that would otherwise have been charged should be recognised immediately. Any payments made with the cancellation or settlement (up to the fair value of the equity instruments) should be accounted for as the repurchase of an equity interest. Any payment in excess of the fair value of the equity instruments granted is recognised as an expense.

IFRS 2.30

New equity instruments granted may be identified as a replacement of cancelled equity instruments. In those cases, the replacement equity instruments are accounted for as a modification. The fair value of the replacement equity instruments is determined at grant date, while the fair value of the cancelled instruments is determined at the date of cancellation, less any cash payments on cancellation that is accounted for as a deduction from equity.

IFRS 2.32

2.5 Cash-settled share-based payment transactions

For cash-settled share-based payment transactions, the entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability.
Until the liability is settled, the entity shall remeasure the fair value of the liability at the end of each reporting period and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

The entity shall recognise the services received, and a liability to pay for those services, as the employees render service. For example, some share appreciation rights vest immediately, and the employees are therefore not required to complete a

IFRS 2.34

specified period of service to become entitled to the cash payment.
In the absence of evidence to the contrary, the entity shall presume that the services rendered by the employees in exchange for the share appreciation rights have been received. Thus, the entity shall recognise immediately the services received and a liability to pay for them. If the share appreciation rights do not vest until the employees have completed a specified period of service, the entity shall recognise the services received, and a liability to pay for them, as the employees render service during that period.

2.6 Share-based payment transactions with cash alternatives

IFRS 2.41

For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred.

IFRS 2.42

IFRS 2.43

For a share-based payment transaction in which the terms of the arrangement provide an entity with the choice of whether to settle in cash or by issuing equity instruments, the entity shall determine whether it has a present obligation to settle in cash and account for the share-based payment transaction accordingly. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (e.g. because the entity is legally prohibited from issuing shares), or the entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

If the entity has a present obligation to settle in cash, it shall account for the transaction in accordance with the requirements applying to cash-settled share-based payment transactions, in paragraphs 30–32.

If no such obligation exists, the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in paragraphs 10–29. Upon settlement:

- if the entity elects to settle in cash, the cash payment shall be accounted for as the repurchase of an equity interest, i.e. as a deduction from equity, except as noted in (c) below;
- if the entity elects to settle by issuing equity instruments, no further accounting is required (other than a transfer from one component of equity to another, if necessary), except as noted in (c) below;
- if the entity elects the settlement alternative with the higher fair value, as at

the date of settlement, the entity shall recognise an additional expense for the excess value given, i.e. the difference between the cash paid and the fair value of the equity instruments that would otherwise have been issued, or the difference between the fair value of the equity instruments issued and the amount of cash that would otherwise have been paid, whichever is applicable.

2.7 Share-based payment transactions among group entities

A share-based payment in which the receiving entity and the settling entity are in the same Group from the perspective of the ultimate parent and which is settled either by an entity in that Group or by an external shareholder of any entity in that Group is a Group share-based payment transaction from the perspective of the receiving and the settling entities. In a Group share-based payment transaction in which the parent grants a share-based payment to the employees of its subsidiary, the share-based payment is recognised in the consolidated financial statements of the parent, in the separate financial statements of the parent and in the financial statements of the subsidiary. Recharge arrangements do not affect the classification of the share-based payment arrangement, but may be accounted by analogy to share-based payments. **IFRS 2.43A**

For share-based payment transactions among Group entities, in its separate or individual financial statements, the entity receiving the goods or services shall measure the goods or services received as either an equity-settled or a cash-settled share-based payment transaction by assessing: **IFRS 2.43B**

- the nature of the awards granted; and
- its own rights and obligations.

The amount recognised by the entity receiving the goods or services may differ from the amount recognised by the consolidated Group or by another Group entity settling the share-based payment transaction.

The entity receiving the goods or services shall measure the goods or services received as an equity-settled share-based payment transaction when:

- the awards granted are its own equity instruments, or
- the entity has no obligation to settle the share-based payment transaction. **IFRS 2.43C**

The entity shall subsequently remeasure such an equity-settled share-based payment transaction only for changes in non-market vesting. In all other circumstances, the entity receiving the goods or services shall measure the goods or services received as a cash-settled share-based payment transaction.

The entity settling a share-based payment transaction when another entity in the Group receives the goods or services shall recognise the transaction as an equitysettled share-based payment transaction only if it is settled in the entity's own equity instruments. Otherwise, the transaction shall be recognised as a cash-settled sharebased payment transaction. **IFRS 2.43D**

Some Group transactions involve repayment arrangements that require one Group entity to pay another Group entity for the provision of the share-based payments to the suppliers of goods or services. In such cases, the entity that receives the goods or services shall account for the share-based payment transaction in accordance with paragraph 43B regardless of intragroup repayment arrangements.

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
    a. their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
    b. the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

3.1.1 Performance Shares

Description of plan

In line with the most common practices in the market Banca Mediolanum has decided to deploy the instrument of "Performance shares" which provides for the free allocation to the beneficiaries of the plans of rights ("Unit") to receive shares of the parent company Banca Mediolanum.

The provision of such shares will be made through the purchase of own shares by the same Banca Mediolanum.

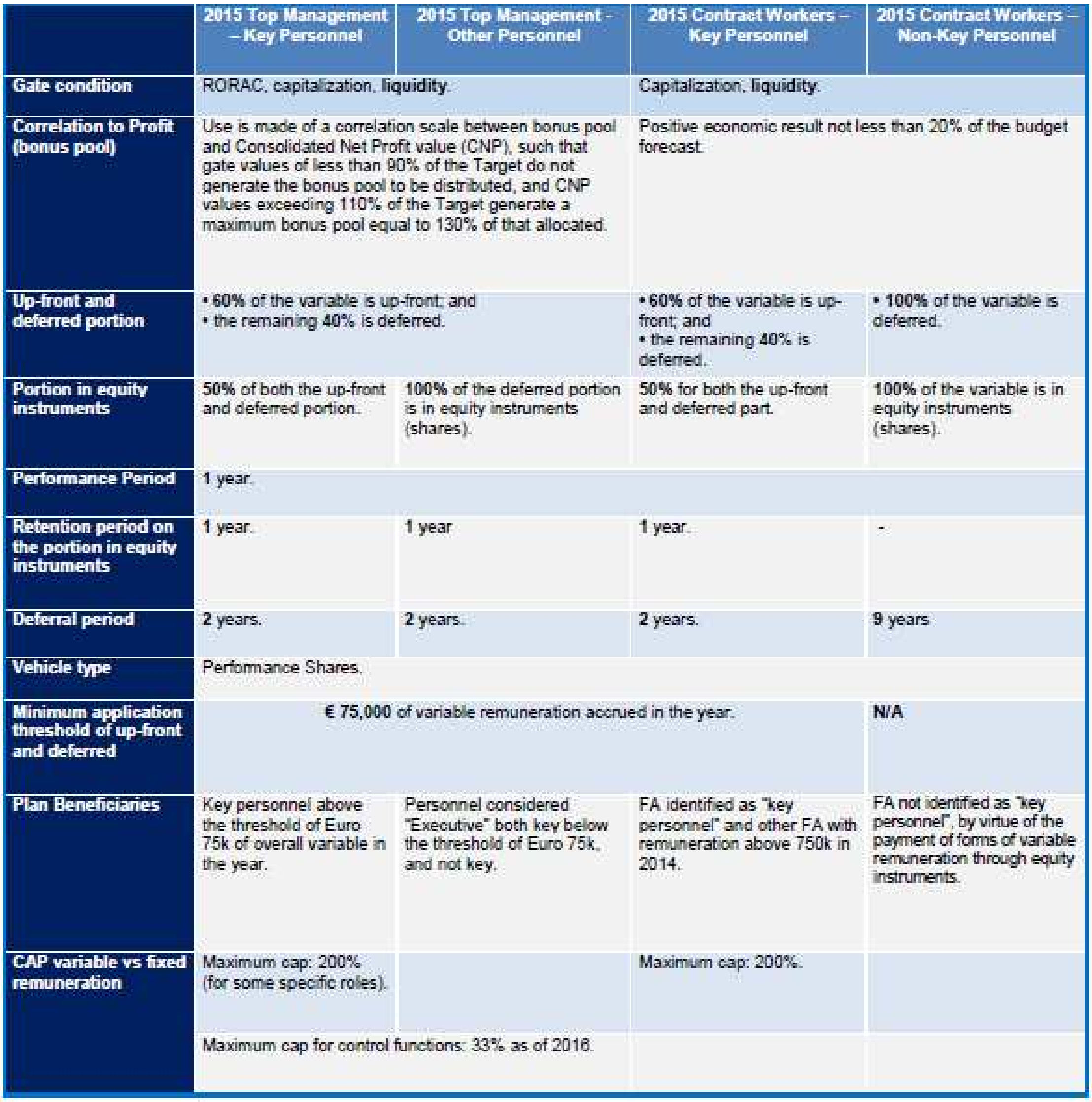
The allocation of shares is conditional upon to the achievement of the Group's performance objectives and verified at the end of the period, or at 31/12 of the year performance measurement.

Among them:

- excess capital compared with capital requirements for the Mediolanum financial conglomerate
- a Liquidity Coverage Ratio (LCR) greater than 100%;
- with reference only to "Top Management" a RORAC greater than 15%

The Performance share plan approved by Banca Mediolanum involves, not only the Top Management and the members of the Banca Mediolanum's sales network, but also some subsidiaries.

The table below indicates the main assumptions of the performance shares plan:



	2015 Top Management – Key Personnel	2015 Top Management - Other Personnel	2015 Contract Workers – Key Personnel	2015 Contract Workers – Non-Key Personnel
Gate condition	RORAC, capitalization, liquidity.		Capitalization, liquidity.	
Correlation to Profit (bonus pool)	Use is made of a correlation scale between bonus pool and Consolidated Net Profit value (CNP), such that gate values of less than 90% of the Target do not generate the bonus pool to be distributed, and CNP values exceeding 110% of the Target generate a maximum bonus pool equal to 130% of that allocated.		Positive economic result not less than 20% of the budget forecast.	
Up-front and deferred portion	• 60% of the variable is up-front; and • the remaining 40% is deferred.		• 60% of the variable is up-front; and • the remaining 40% is deferred.	• 100% of the variable is deferred.
Portion in equity instruments	50% of both the up-front and deferred portion.	100% of the deferred portion is in equity instruments (shares).	50% for both the up-front and deferred part.	100% of the variable is in equity instruments (shares).
Performance Period	1 year.			
Retention period on the portion in equity instruments	1 year.	1 year	1 year.	-
Deferral period	2 years.	2 years.	2 years.	9 years
Vehicle type	Performance Shares.			
Minimum application threshold of up-front and deferred	€ 75,000 of variable remuneration accrued in the year.			N/A
Plan Beneficiaries	Key personnel above the threshold of Euro 75k of overall variable in the year.	Personnel considered "Executive" both key below the threshold of Euro 75k, and not key.	FA identified as "key personnel" and other FA with remuneration above 750k in 2014.	FA not identified as "key personnel", by virtue of the payment of forms of variable remuneration through equity instruments.
CAP variable vs fixed remuneration	Maximum cap: 200% (for some specific roles).		Maximum cap: 200%.	
	Maximum cap for control functions: 33% as of 2016.			

With reference to the Top Management incentive plan, the risk indicators identified and related threshold values are as follows:

- RORAC: > 15%
- LCR: > 100%
- Existence of a surplus of capital over capital requirements.

The values of these indicators are measured at Group level and verified at the end of the period, or as at December 31 of the performance measurement year (accrual period) and at the end of each year preceding the year of disbursement in relation to any deferral portions.

The new plan of variable remuneration is addressed to "Top Management - Key personnel", Directors/Managers (with accrued portion in the year in total above the materiality threshold of Euro 75,000/year).

In addition, the new variable remuneration plan is also for personnel so-called "Executive" (whether they are relevant below threshold or non-key) according to specific forms illustrated below.

With regard to persons identified as "key personnel" that accrue bonuses above Euro 75,000 during the year, a deferral system is applied for disbursement of a portion of the amount of variable remuneration in accordance with the Supervisory regulations in force and based on the application of the principle of proportionality, providing that:

- a substantial portion - equal to 50% of the up-front portion and the deferred portion - is provided through the allocation of Performance Shares;
- an adequate percentage - 40% of the variable remuneration - is subject to deferred payment systems for a period of 2 years and disbursed pro rata, so that the remuneration may take into account the risks assumed;
- a specified retention period - equivalent to a year - both for the short-term component (up-front) and for the deferred part.
- the previsions of mechanism of malus, to consider the individual performance and behavioural.

In addition, in order to encourage the permanence and commitment in the Group of other resources that contribute significantly to the success of the Company and the Group, to pay a remuneration component still in line with market practices and foster the loyalty of recipients, the Company decided to adopt, also with reference to other groups of managers, some of the main elements of the applicable regulatory framework, with less stringent rules for the provision of the variable with respect to the plan "Top management – key personnel".

In particular, a "sub-plan" was introduced for Executives (whether they are key below the threshold and nonkey), according to which:

- a percentage - equal to 60% of the variable remuneration - is paid in cash and up-front;
- an adequate percentage - the remaining 40% of the variable remuneration - is paid in performance shares and subject to deferred payment systems for a period of 2 years and disbursed pro rata, so that the remuneration may take into account the risks assumed;
- a specific retention period - equal to a year - is envisaged for the deferred portion;
- the previsions of mechanism of malus, to consider the individual performance and behavioural.

Since recognition of the part related to the variable bonus is uncertain in its final quantification, as it is subject to the achievement of specific objectives, the Group has chosen to proceed with the relative accounting depending on the time lag.

The part of the variable remuneration recognized in equity instruments and cash will therefore follow the following deferral scheme the purpose of recording.

		Year t	Year t+1	Year t+2	Year t+3	Year t+4
DISTRIBUTION						
Top Management "key personnel"	Cash		60%	20%	20%	
Top Management "key personnel"	Equity		0%	60%	20%	20%
Top Management "executives"	Cash		100%			
Top Management "executives"	Equity		0%	0%	0%	100%
COMPETENCE						
Top Management "key personnel"	Cash	76,67%	16,67%	6,67%		
Top Management "key personnel"	Equity	41,67%	41,67%	11,67%	5%	
Top Management "executives"	Cash	100%	0%	0%		
Top Management "executives"	Equity	25%	25%	25%	25%	

With reference to the Contract Workers incentive plan, the right to receive the incentives, in addition to the actual result achieved, is linked to the achievement of risk indicators.

The following indicators and related threshold values (access gates) have been identified:

- LCR: > 100%
- Existence of a surplus of capital over capital requirements.

The values of these indicators are measured at Group level and verified at the end of the period, or as at December 31 of the performance measurement year (accrual period) and at the end of each year preceding the year of disbursement in relation to any deferral portions.

The incentive system is based on the identification of individual targets of bankers and group targets for supervisors and managers.

The new variable remuneration plan is aimed at "Contract Workers - key personnel", Network "Material risk takers".

The new variable remuneration plan is also aimed at "non-key" Network Managers.
With regard to Contract Workers and Network Personnel identified as "key personnel" and those that have accrue total remuneration above Euro 750,000, a deferral system is applied for disbursement of a part of the amount of the non-recurring component in accordance with the Supervisory regulations in force and based on the application of the principle of proportionality, providing that:

- an adequate percentage - 40% of the non-recurring component - is subject to deferred payment systems for a period of 2 years and disbursed pro rata, so that the remuneration may take into account the risks assumed;
- a substantial portion - equal to 50% of the up-front portion and the deferred portion - is provided through the allocation of Performance Shares with the

purchase of treasury shares;
- a specified retention period - equivalent to a year - both for the non-recurring component disbursed upfront and for the deferred part.

The deferred payments will be made on the condition of exceeding minimum access thresholds (LCR and capitalization) for the year preceding that of liquidation.
If even only one of the thresholds is not reached, the variable remuneration systems are zeroed for everyone (in exceptional cases and carefully assessed and however in case of positive profit, the Board of Directors, after consulting with the Remuneration Committee, may decide to distribute a reduced portion of the bonus pool, also with reference to specific categories of personnel).

Moreover, the correlation between the Consolidated Net Profit and the determination of the bonus pool is ensured if the economic result amounts to not less than 20% of the budget forecast.

Accounting Treatment

The requirements of IFRS2 concerning share-based payment transaction among group entities focus on transaction whit employees.

For share-based payment transaction among group entities, in its separate or individual financial statements, the entity receinving the goods or services measures the goods or services received as eighter an equity-settled or a cash-settled by assessing:
- the nature of the awards granted; and
- its own rights and obligations.

The classification of common forms of share-based payment arrangement in consolidated, parent and subsidiary financial statements is summarized below:

ENTITY RECEIVING GOODS OR SERVICES	ENTITY WITH OBLIGATION TO SETTLE	SETTLED IN	CLASSIFICATION		
			PARENT'S SEPARATE FINANCIAL STATEMENTS	SUBSIDIARY'S INDIVIDUAL FINANCIAL STATEMENTS	CONSOLIDATED FINANCIAL STATEMENTS
SUBSIDIARY	SUBSIDIARY	SUBSIDIARY'S EQU	n/a	Equity	Equity
SUBSIDIARY	SUBSIDIARY	CASH	n/a	Cash	Cash
SUBSIDIARY	SUBSIDIARY	PARENT'S EQUITY	n/a	Cash	Equity
SUBSIDIARY	PARENT	SUBSIDIARY'S EQU	Cash	Equity	Equity
SUBSIDIARY	PARENT	PARENT'S EQUITY	Equity	Equity	Equity
SUBSIDIARY	PARENT	CASH	Cash	Equity	Cash

In relation to the current performance share plans and to those described in the above table, the Group is in the following case:

ENTITY RECEIVING GOODS OR SERVICES	**ENTITY WITH OBLIGATION TO SETTLE**	**SETTLED IN**	**CLASSIFICATION**		
			PARENT'S SEPARATE FINANCIAL STATEMENTS	**SUBSIDIARY'S INDIVIDUAL FINANCIAL STATEMENTS**	**CONSOLIDATED FINANCIAL STATEMENTS**
SUBSIDIARY	PARENT	PARENT'S EQUITY	Equity	Equity	Equity

The parent should recognise an entry each year to debit the cost of investment in subsidiary and credit equity with an amount equal to the expense recognised in the subsidiary in accordance with IFRS2. The rationale is that the parent had made a capital contribution to the subsidiary's by taking on the cost of remunerating the subsidiary's employees that the subsidiary would otherwise have had to bear, and also granted an equity instruments in accepting the obligation to those employees. This is consistent with the credit to equity recognised in the subsidiary.

Banca Mediolanum grants rights to its equity instruments to employees of its subsidiary, the subsidiary does not have an obligation to provide its parent's equity instruments to its employees. The arrangement is accounted for as equity-settled in the consolidated financial statements. The subsidiary should, in its own separate financial statements, measure the services received from its employees in accordance with the requirements of IFRS 2 applicable to equity-settled share-based payment transactions. There will be a corresponding increase recognised in equity as a capital contribution from the parent. (IFRS 2:B53).

For the entity no IAS adopter (**Bankhaus August Lenz, Mediolanum International Funds and Mediolanum Vita**), on a basis of contractual agreements Banca Mediolanum is committed in settle share-based payment to Legal entities employees.

The Accounting treatment for entities no IAS adopter is reported below:

ENTITY RECEIVING GOODS OR SERVICES	**ENTITY WITH OBLIGATION TO SETTLE**	**SETTLED IN**	**CLASSIFICATION**		
			PARENT'S SEPARATE FINANCIAL STATEMENT	**SUBSIDIARY'S INDIVIDUAL FINANCIAL STATEMENTS**	**CONSOLIDATED FINANCIAL STATEMENTS**
SUBSIDIARY	PARENT	PARENT'S EQUITY	EQUITY	DEBIT	EQUITY

In conclusion the subsidiary records the cost related to Perfomance share as debit to

Banca Mediolanum and the parent company records the respective credit in the net equity.

3.1.2 Stock Option Plan

Description of plan

The Stock Options Plan reserved to the Directors and Executives of the Company and its subsidiaries ("Top Management Plan 2010") as well as the guidelines for the Stock Options Plan for Contract Workers - i.e. the members of the sales network – of the Company and its subsidiary ("Contract Workers Plan 2010"), collectively the "Plans".

The Plans were submitted to the Extraordinary General Meeting of April 27, 2010 for approval. Pursuant to section 84-bis, paragraph 3 of the Regulation for Issuers, readers are informed that:
· The Top Management Plan 2010 is the stock options plan reserved to the Directors and other key management of the Company and/or its subsidiaries. The Contract Workers Plan 2010 is the stock options plan reserved to the financial advisors working for the Company and its subsidiaries, as may be selected from time to time for their individual role and contribution to business growth.

The Plans entail annual awards of rights to subscribe to newly issued ordinary shares of the Company (the "Options"). The implementation of the Plans entails two new share capital increases reserved to each of the two categories of Beneficiaries, pursuant to art. 2441, paragraph five, of the Italian Civil Code, as resolved by the Board of Directors pursuant to art. 2443 of the Italian Civil Code. The Options under the Top Management Plan 2010 shall vest over a period of three to five years of the grant date and be exercisable for a period of three years after the date of vesting. The Stock Options under the Contract Workers Plan 2010 shall vest over a period of five to ten years of the grant date and be exercisable for a period of three years after the date of vesting. The plans also anticipate that the exercise of the Options is subject to certain performance targets of the Company and/or the individual. The details of the Plans shall be laid down by the Board of Directors after consultation with the competent bodies of the Company and its subsidiaries.

The Plans are designed to provide incentives to the beneficiaries and at the same time promote value creation and growth for the Company and, accordingly, its shareholders. The Top Management Plan 2010 is believed to be an adequate scheme to link key management incentives to both medium-term performance of the Company/Group and individual performance, align goals and maximize the creation of value for the shareholders. The Contract Workers Plan 2010 is an adequate scheme to link sales network incentives to both medium-term performance of the

Company/Group and individual performance, align goals and maximize the creation of value for the shareholders. Considering the length of the vesting period, the Contract Workers Plan 2010 is also a powerful way to enhance the sales network loyalty.

Accounting Treatment

Stock option plans currently in force are considered "equity settled" share-based payments; consequently the Stock options granted, and the corresponding increase in equity, are measured by reference to the fair value of the stock option at grant date, and accounted for during the vesting period.

The fair value of the stock option is determined using a valuation technique that takes into account the specific terms and conditions of the stock option plan in place, in addition to information such as the exercise price and the life of the option, the current price of underlying shares, the expected volatility of the share price, dividends expected on the shares and the risk-free interest rate for the life of the option. The pricing model separately measures the stock option and the probability that the market conditions upon which vesting is conditioned be satisfied. The combination of the two values is the fair value of the stock option.

The cumulative expense recognized at each annual reporting date up until the vesting date takes account of the vesting period and is based on the best available estimate of options that are going to be exercised upon vesting. The reversal recognized in the income statement for each year represents the change in the cumulative expense over the amount recognized in the prior year. No expense is recognized for options that do not vest.

3.2 Relevant topics

As part of the prudential supervisory framework established by the CRD IV directive, the European Banking Authority has developed and submitted to the European Commission, the Regulatory Technical Standards implemented with Regulation no. 604 of March 4, 2014. These qualitative and quantitative regulatory technical standards meet the need to guide the entities in the identification process of personnel whose professional activities have a material impact on the entity's risk profile.

For this purpose the new incentive system based on Performance Share is relevant for the Group.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognition and Measurement: equity-settled transactions (paragraph 4.1)
- Recognition and Measurement: cash-settled transactions (paragraph 4.2)
- Recognition and Measurement: transactions with settlement alternatives (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to share-based payments.

4.1 Recognition and Measurement: equity-settled transactions

4.1.1 Measurement of transactions with employees and others providing similar services

Example 4.1.1.1

Cash received from employees entering a share purchase plan

Entity R offers all its employees the opportunity to participate in an employee share purchase plan. The employees have a limited time to decide whether to accept the offer. The plan entitles the employees to purchase a maximum of 100 shares each at a purchase price of CU0.10 per share (the nominal value of a share). The purchase price is lower than the fair value of the shares at the grant date.

The employees are required to pay the purchase price on accepting the offer and receive the shares immediately. However, they must remain employed with Entity R for five years before being permitted to sell the shares. If an employee leaves before the vesting period ends, Entity R will automatically repurchase the shares from the employee at CU0.10 per share. The employees are not entitled to dividends on the shares during the vesting period.

This is an equity-settled share-based payment arrangement because the employees are ultimately only entitled to receive shares. However, the distinctive feature of this share purchase plan is that the shares are delivered immediately on receipt of the cash payment even though they do not vest for five years. In substance, the employees do not receive the shares until they vest unconditionally.

To reflect the prepaid purchase price and the potential that the shares will be repurchased, Entity R should recognise the cash received as a financial liability until the end of the vesting period, at which time it will be reclassified to equity provided that the employee is still employed by Entity R. If the employee leaves Entity R before the end of the vesting period, Entity R repays the original purchase price to the employee and derecognises the financial liability.

Because the financial liability could be repaid at any time within the vesting period, it will be measured at CU0.10 per share. The ‘prepayment’ of the exercise price will be factored into the grant date fair value of the share option.

Entitlement to dividends during the vesting period would be factored into the fair value determination, but would otherwise not affect the accounting treatment described above.

Example 4.1.1.2

Shares to a monetary value

On 1 January 20X5 (the grant date), an entity grants share awards to each of its employees to the value of CU1,500. If an employee remains employed with the entity until 31 December 20X7, the shares will vest and the employee will receive as many shares as are (on 31 December 20X7) worth CU1,500.

How should the entity account for this share-based payment?

The grant is an equity-settled share-based payment because the employees will receive shares. The fair value of the awards should be determined at the grant date (i.e. 1 January 20X5). Therefore, the grant date fair value of the awards is CU1,500. Although the time value of money is ignored for simplicity in this example, it should be considered in the determination of the fair value of the award. Vesting conditions are either service conditions or performance conditions. In this case, employment is a service condition because the condition relates to the provision of services only and does not require a performance target to be met. This is reflected by adjusting the expense for changes in the number of awards that are expected to vest based on meeting this service condition.

The actual number of shares issued in settlement of the awards will vary according to the share price on the vesting date, but the total value of the awards will not change. Therefore, the expense should not be adjusted for changes in the number of shares that will be issued as a result of changes in the market value of the shares.

Therefore, the entity will recognise CU1,500 as an expense over the vesting period, subject to the service condition (i.e. employment), regardless of how many shares are actually issued on the vesting date.
This approach is illustrated below.

At 1 January 20X5, the market price per share is CU5. At 31 December 20X7, it is CU10. At 31 December 20X5 and 20X6, the entity expects that 95 per cent of the employees will remain employed until 31 December 20X7. Ultimately, 96 per cent of the employees remain in service at 31 December 20X7.

At the grant date, the fair value of the awards issued per employee is CU1,500.

Year	Calculation of expense:grant date fair value of awards issued × proportion expected to vest	Remuneration expense for period	Cumulative remuneration expense
		CU	CU
1	(CU1,500 × 100 employees) × 95% expected to vest × 1/3 years	47,500	47,500
2	(CU1,500 × 100 employees) × 95% expected to vest × 2/3 years	47,500	95,000
3	(CU1,500 × 100 employees) × 96% actually vested × 3/3 years	49,000	144,000

Example 4.1.1.3

Share-based payment arrangements with share and option exercise price denominated in a foreign currency

Company E is a UK entity with Sterling as its functional currency. Company E is registered on the New York Stock Exchange with a current market price of US$15 per share. Company E issues 100 options to its employees with an exercise price of US$15 per share and a vesting period of three years. The share options can only be equity-settled.

At the date of issue of the options, the fair value of each option is determined to be US$15 and the exchange rate is US$1.5/£1.

Given that the share price is quoted in a currency other than the functional currency of the entity, how should these arrangements be accounted for?

The debt/equity requirements of IAS 32 (which would require a contract to issue shares for a fixed amount of foreign currency cash to be classified as a liability) do not apply to share-based payments.

Because the options will be settled in Company E's shares, they should be accounted for as equity-settled share-based payments by expensing the grant date fair value in functional currency terms (£10 per option, £1,000 in total in this example) over the vesting period. Changes in the exchange rate over the life of the options will not change the amount expensed.

Example 4.1.1.4

Number of shares to be issued determined by reference to the relative fair value of shares of another group entity

Entity A owns 100 per cent of Entity B.

On 1 January 20X5 (the grant date), Entity B grants share options to each of its employees, conditional on them remaining in employment until 31 December 20X7.
The share-based payment arrangement specifies that each employee of Entity B will receive as many of Entity A's shares as are, on 31 December 20X7, of the same value as 1,000 shares of Entity B.

The fair value of both Entity A's and Entity B's shares can be reliably obtained on 1 January 20X5 and 31 December 20X7.

The grant is an equity-settled share-based payment because the employees will receive shares. The fair value of the awards should be determined as of the grant date (i.e. 1 January 20X5).

The actual number of Entity A's shares issued in settlement of the awards will vary according to the relative fair values of Entity A's and Entity B's shares on the vesting date, but there is no target that the fair value of Entity B's shares needs to meet for vesting to occur. The fair values are only used as a converter to define the number of Entity A's shares to be issued; they do not constitute a vesting condition.

The expense measured at the grant date will not be adjusted for changes in the number of shares of Entity A that will be issued as a result of changes in the fair value of the shares in Entity B.

Employment is a service condition that is reflected by adjusting the expense for changes in the number of awards that are expected to vest based on meeting this service condition.

4.1.2 Determining the fair value of equity instruments granted

Example 4.1.2.1

Determination of the grant date for a share-based bonus plan

On 1 January 20X1, Entity A enters into an agreement with each of its executives whereby Entitiy A will issue shares to each executive. The number of shares to be issued will vary in line with growth in revenue and profits for the year ended 31 December 20X1. Depending on audited revenue and profit growth for that year (which will be known at 31 March 20X2), Entity A will issue between nil and 100 restricted shares to each employee.

The restricted shares will vest if the executive remains in Entity A's employment at the end of a further three years. Therefore, the earliest an executive will be able to sell his or her restricted shares is at the end of 20X4. The board of directors has already approved the formula and no further approvals are needed.

At what date should the fair value of the shares issued be measured – 1 January 20X1 or 31 March 20X2?

IFRS 2 requires that the fair value of the equity instruments should be measured at the grant date, which is defined in IFRS 2 as "the date at which the entity and another party ... agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement". In the circumstances described, at 1 January 20X1 all parties understand the terms and, therefore, this should be viewed as the grant date.

An estimate of the number of shares that will vest is made at 1 January 20X1. A fair value is assigned to each share. Because the formula used to determine the number of shares that will finally be issued is considered a non-market vesting condition that should be accounted for using the 'true up' method in IFRS 2, the number of shares is adjusted at 31 March 20X2 based on the number of restricted shares actually issued to the executives. The fair value of each share should be based on its value at 1 January 20X1.

Example 4.1.2.2

Accounting for dividends paid on share options

Company B purchases its own shares in the market and holds them in an employee share trust (over which Company B has control) for use in settlement of an award of options to its employees. Under the terms of the award, if an employee leaves Company B within three years of the grant, the employee forfeits the share options. After three years of service, the options vest and an employee is eligible to receive shares on payment of a predetermined exercise price. Consider the following three scenarios:

Scenario A: employees are not entitled to dividends on the shares declared prior to vesting.
Scenario B: employees are entitled to dividends in cash on the shares and any dividends declared are paid to the employees. The exercise price is unaffected by these dividends and, if the shares are forfeited, the employees retain the dividends declared and paid up to that date.
Scenario C: employees are notionally entitled to dividends, but the dividends are automatically applied to reduce the exercise price. If the shares are forfeited, the employee loses the right to dividends accrued and applied to reduce the exercise price.

- *How should dividends declared and paid on the shares be treated in measuring the share options?*
- *How should dividends be accounted for in Company B's financial statements when declared?*

IFRS 2 clarify that when dividends are paid to the option holders before the exercise of the options, the value of those options is greater than the value of options for which there is no dividend entitlement prior to exercise.

Scenario A: employees not entitled to dividends declared prior to vesting

When no dividend accrues to employees, the fair value of the share options at grant date should be reduced by the present value of dividends expected to be paid during the vesting period (for example, by including the expected dividend yield in a Black-Scholes calculation).

When the share-based payment related to these options is recognised, provided that they are classified as equity-settled share-based payments, the appropriate journal entry for the shares expected to vest is as follows.

Dr	Share-based payment expense	XXX

Cr	Equity	XXX

To recognise the share-based payment expense.

Dividends accrued on the shares held by the employee share trust are eliminated from the aggregate of dividends paid and proposed by Company B.

Scenario B: dividends declared are paid to employees

When dividends are paid to the option holders before the exercise date of the options, the share options should be valued as if no dividends will be paid on the underlying shares during the vesting period (for example, by including an expected dividend yield of zero per cent in a Black-Scholes calculation). As a result, the grant date valuation is not reduced by the present value of the dividends expected to be paid during the vesting period.

The accounting for any dividends paid on the underlying shares will depend on whether the underlying shares are expected to vest. Provided that the share-based payment is equity-settled:

- for awards that are expected to vest, IFRS 2 treats the employees as holders of equity share options. Therefore, any dividends paid on these share options are recognised directly in equity. This is consistent with the principles of ias 32 which states that "distributions to holders of an equity instrument shall be debited by the entity directly to equity, net of any related income tax benefit". In addition, expensing the dividends through profit or loss as additional compensation when paid would result in double counting of an expense that has already been reflected in the grant date fair value of the award recognised under IFRS 2; and
- for awards that are not expected to vest (due to employees expected to leave during the three-year service period), employees are not treated as holders of equity share options. Any cash paid as 'dividends' on those share options represents employee remuneration in accordance with IAS 19 *Employee Benefits* and should, therefore, be recognised as an expense. The expense is measured at the amount of cash paid on these shares. Expensing these dividends through profit or loss does not result in double counting because no cumulative expense will be recognised under IFRS 2 for awards not expected to vest due to non-fulfilment of a service condition.

The appropriate journal entries are as follows.

Share-based payment expense related to the share options that are expected to vest (provided that they are considered to be an equity-settled share-based payment).

Dr	Share-based payment expense	XXX	
Cr	Equity		XXX

To recognise the share-based payment expense.

Dividends paid on share options that are expected to vest.

Dr	Equity/retained earnings	XXX	
Cr	Cash		XXX

To recognise the dividends paid on share options that are expected to vest.

Dividends paid on share options that are NOT expected to vest.

Dr	Employee expense	XXX	
Cr	Cash		XXX

To recognise the dividends paid on share options that are not expected to vest.

If the assessment of the number of shares expected to vest changes, there will need to be an adjustment to reverse or increase the share-based payment expense as appropriate, together with an adjustment to increase or decrease the amount of dividend considered an additional employee expense.

Scenario C: dividends reduce exercise price, lost if shares forfeited

When dividends are automatically applied to reduce the exercise price, the input for dividends into the valuation of the option is the same as in Scenario B, as indicated in IFRS 2.

When the share-based payment expense related to these options is recognised, provided that they are considered to be an equity-settled share-based payment, the appropriate journal entry is as follows.

Dr	Share-based payment expense	XXX	

Cr	Equity	XXX

To recognise the share-based payment expense.

When the dividends are declared, the entity may make a transfer from retained earnings to another component of equity for the amount of the dividends because this represents a part of the exercise price 'paid' by the employee. This is relevant only if the credit to equity under IFRS 2 is made to a separate reserve.

Example 4.1.2.3

Employee share purchase plan

Background
An entity offers all its 1,000 employees the opportunity to participate in an employee share purchase plan. The employees have two weeks to decide whether to accept the offer. Under the terms of the plan, the employees are entitled to purchase a maximum of 100 shares each. The purchase price will be 20 per cent less than the market price of the entity's shares at the date the offer is accepted and the purchase price must be paid immediately upon acceptance of the offer. All shares purchased must be held in trust for the employees, and cannot be sold for five years. The employee is not permitted to withdraw from the plan during that period. For example, if the employee ceases employment during the five-year period, the shares must nevertheless remain in the plan until the end of the five-year period. Any dividends paid during the five-year period will be held in trust for the employees until the end of the five-year period.

In total, 800 employees accept the offer and each employee purchases, on average, 80 shares, i.e. the employees purchase a total of 64,000 shares. The weighted-average market price of the shares at the purchase date is CU30 per share, and the weighted-average purchase price is CU24 per share.

Application of requirements
For transactions with employees, IFRS 2 requires the transaction amount to be measured by reference to the fair value of the equity instruments granted. To apply this requirement, it is necessary first to determine the type of equity instrument granted to the employees. Although the plan is described as an employee share purchase plan (ESPP), some ESPPs include option features and are therefore, in effect, share option plans. For example, an ESPP might include a 'lookback feature', whereby the employee is able to purchase shares at a discount, and choose whether the discount is applied to the entity's share price at the date of grant or its share price at the date of purchase. Or an ESPP might specify the purchase price, and then

allow the employees a significant period of time to decide whether to participate in the plan. Another example of an option feature is an ESPP that permits the participating employees to cancel their participation before or at the end of a specified period and obtain a refund of amounts previously paid into the plan.
However, in this example, the plan includes no option features. The discount is applied to the share price at the purchase date, and the employees are not permitted to withdraw from the plan.

Another factor to consider is the effect of post-vesting transfer restrictions, if any. IFRS 2 states that, if shares are subject to restrictions on transfer after vesting date, that factor should be taken into account when estimating the fair value of those shares, but only to the extent that the post-vesting restrictions affect the price that a knowledgeable, willing market participant would pay for that share. For example, if the shares are actively traded in a deep and liquid market, post-vesting transfer restrictions may have little, if any, effect on the price that a knowledgeable, willing market participant would pay for those shares.

In this example, the shares are vested when purchased, but cannot be sold for five years after the date of purchase. Therefore, the entity should consider the valuation effect of the five-year post-vesting transfer restriction. This entails using a valuation technique to estimate what the price of the restricted share would have been on the purchase date in an arm's length transaction between knowledgeable, willing parties. Suppose that, in this example, the entity estimates that the fair value of each restricted share is CU28. In this case, the fair value of the equity instruments granted is CU4 per share (being the fair value of the restricted share of CU28 less the purchase price of CU24). Because 64,000 shares were purchased, the total fair value of the equity instruments granted is CU256,000.

In this example, there is no vesting period. Therefore, in accordance with IFRS 2, the entity should recognise an expense of CU256,000 immediately.

However, in some cases, the expense relating to an ESPP might not be material. IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors states that the accounting policies in IFRSs need not be applied when the effect of applying them is immaterial. IAS 8 also states that an omission or misstatement of an item is material if it could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor. Therefore, in this example, the entity should consider whether the expense of CU256,000 is material.

4.1.3 Modifications to equity-settled transactions

Example 4.1.3.1

Grant of share options that are subsequently repriced

Background
At the beginning of year 1, an entity grants 100 share options to each of its 500 employees. Each grant is conditional upon the employee remaining in service over the next three years. The entity estimates that the fair value of each option is CU15. On the basis of a weighted average probability, the entity estimates that 100 employees will leave during the three-year period and therefore forfeit their rights to the share options.

Suppose that 40 employees leave during year 1. Also suppose that by the end of year 1, the entity's share price has dropped, and the entity reprices its share options, and that the repriced share options vest at the end of year 3. The entity estimates that a further 70 employees will leave during years 2 and 3, and hence the total expected employee departures over the three-year vesting period is 110 employees. During year 2, a further 35 employees leave, and the entity estimates that a further 30 employees will leave during year 3, to bring the total expected employee departures over the three-year vesting period to 105 employees. During year 3, a total of 28 employees leave, and hence a total of 103 employees ceased employment during the vesting period. For the remaining 397 employees, the share options vested at the end of year 3.

The entity estimates that, at the date of repricing, the fair value of each of the original share options granted (ie before taking into account the repricing) is CU5 and that the fair value of each repriced share option is CU8.

Application of requirements
IFRS 2 requires the entity to recognise the effects of modifications that increase the total fair value of the share-based payment arrangement or are otherwise beneficial to the employee. If the modification increases the fair value of the equity instruments granted (eg by reducing the exercise price), measured immediately before and after the modification, IFRS 2 requires the entity to include the incremental fair value granted (ie the difference between the fair value of the modified equity instrument and that of the original equity instrument, both estimated as at the date of the modification) in the measurement of the amount recognised for services received as consideration for the equity instruments granted. If the modification occurs during the vesting period, the incremental fair value granted is included in the measurement of the amount recognised for services received over the period from the modification date until the date when the modified equity instruments vest, in addition to the

amount based on the grant date fair value of the original equity instruments, which is recognised over the remainder of the original vesting period.

The incremental value is CU3 per share option (CU8 – CU5). This amount is recognised over the remaining two years of the vesting period, along with remuneration expense based on the original option value of CU15.

The amounts recognised in years 1 - 3 are as follows:

Year	**Calculation**	**Remuneration expense for period**	**Cumulative remuneration expense**
		CU	**CU**
1	(500 – 110) employees × 100 options × CU15 × 1/3	195,000	195,000
2	(500 – 105) employees × 100 options × (CU15 × 2/3 + CU3 × 1/2) – CU195,000	259,250	454,250
3	(500 – 103) employees × 100 options × (CU15 + CU3) – CU454,250	260,350	714,600

4.2 Recognition and Measurement: cash-settled transactions

4.2.1 Measurement of cash-settled transactions

Example 4.2.1.1

Cash-settled share appreciation rights

Background
An entity grants 100 cash share appreciation rights (SARs) to each of its 500 employees, on condition that the employees remain in its employ for the next three years.

During year 1, 35 employees leave. The entity estimates that a further 60 will leave during years 2 and 3. During year 2, 40 employees leave and the entity estimates that a further 25 will leave during year 3. During year 3, 22 employees leave. At the end of year 3, 150 employees exercise their SARs, another 140 employees exercise their SARs at the end of year 4 and the remaining 113 employees exercise their SARs at the end of year 5.

The entity estimates the fair value of the SARs at the end of each year in which a liability exists as shown below. At the end of year 3, all SARs held by the remaining employees vest. The intrinsic values of the SARs at the date of exercise (which equal the cash paid out) at the end of years 3, 4 and 5 are also shown below.

Year	Fair value	Intrinsic value
1	CU14.40	
2	CU15.50	
3	CU18.20	CU15.00
4	CU21.40	CU20.00
5		CU25.00

Application of requirements

Year	Calculation		Expense	Liability
			CU	CU
1	(500 – 95) employees × 100 SARs × CU14.40 × 1/3		194,400	194,400
2	(500 – 100) employees × 100 SARs × CU15.50 × 2/3 – CU194,400		218,933	413,333
3	(500 – 97 – 150) employees × 100 SARs × CU18.20 – CU413,333	47,127		460,460
	+ 150 employees × 100 SARs × CU15.00	225,000		
	Total		272,127	
4	(253 – 140) employees × 100 SARs × CU21.40 – CU460,460	(218,640)		241,820

	+ 140 employees × 100 SARs × CU20.00	280,000		
	Total		61,360	
5	CU0 – CU241,820	(241,820)		0
	+ 113 employees × 100 SARs × CU25.00	282,500		
	Total		40,680	
	Total		787,500	

Example 4.2.1.2

Cash-settled share-based payment arrangement with share price and option exercise price denominated in a foreign currency

Entity E is a UK entity with Sterling as its functional currency. Entity E is registered on the New York Stock Exchange with a current market price of US$15 per share. Entity E issues 100 options to its employees with an exercise price of US$15 per share and a vesting period of three years. The share options can only be cash settled.

For cash-settled share options, the liability recognised would be considered a US dollar denominated liability and would need to be remeasured at the end of each reporting period (the remeasurement would include the effect of changes in the exchange rate).

4.2.2 Modifications to cash-settled transactions

Example 4.2.2.1

Cancellation of a cash-settled share-based payment transaction

100 cash-settled SARs are granted on 1 January 20X0 with a fair value of CU10 each. The terms of the award require the employee to provide service for four years in order to earn the award. At the end of the second year of service (20X1), the employer cancels the award without issuing any replacement award or cash. The fair

value of each SAR at each reporting date is as follows.

31 December 20X0	CU12
31 December 20X1	CU5

The following journal entries reflect the accounting for the award at each period end (assuming there are no expected forfeitures).

At 31 December 20X0

		CU	**CU**
Dr	Profit or loss [CU12 × 100 awards × 1 year/4 years of service required]	300	
Cr	Liability		300

To recognise the share-based payment expense and associated liability.

At 31 December 20X1

Dr	Liability	300	
Cr	Profit or loss		300

To recognise the reversal of the share-based payment expense and associated liability.

Because, in this example, the award is cancelled without issuing anything in return, the value of the liability at 31 December 20X1 should be adjusted to CUnil. Therefore, all prior share-based payment expense recognised should be reversed.

4.3 Recognition and measurement: transactions with settlement alternatives

4.3.1 Counterparty’s choice as to the manner of settlement

Example 4.3.1.1

Share-based payment with settlement alternatives – measurement and recognition

On 1 January 20X1, an entity enters into an agreement with 10 employees whereby the employees receive a bonus payment of CU300 if they complete a 3-year service period.

On completion of the 3-year service period, the employees can choose between the following settlement alternatives:

Alternative A – receive the full amount of CU300 in cash; or
Alternative B – receive CU150 in cash and the remaining 50 per cent of the reward in the form of shares that are, on 31 December 20X3, worth CU150 (say 500 shares).

Employees that opt for settlement Alternative B will, in addition to the original 500 shares, receive a further 500 shares (i.e. 'matching shares') upon completion of an additional 2-year service period (i.e. they have to be employed until 31 December 20X5). Employees that leave employment during the additional 2-year service period forfeit the matching shares and the original 500 shares awarded (i.e. they lose the first award even if the initial 3-year service period was completed).

The award can be summarised as follows:

- cash of CU300 at the end of Year 3; or
- cash of CU150 at the end of Year 3, plus shares worth CU300 as at 31 December 20X3 (original award of shares worth CU150 plus the matching shares worth CU150) with all shares subject to remaining in employment until the end of Year 5.

In accordance with IFRS 2, an entity that has granted a counterparty the right to choose whether a share-based payment transaction is settled in cash or by issuing equity instruments has granted a compound financial instrument which includes a debt component (the right to demand settlement in cash) and an equity component (the right to demand settlement in equity instruments).

The fair value of the compound financial instrument is measured at the grant date (1 January 20X1) taking into account the terms and conditions under which the rights to cash or equity instruments are granted. To arrive at this measurement, the fair value of the debt component should be measured first and then the fair value of the equity component should be measured, adjusting for the fact that the counterparty must forfeit the right to receive cash to receive the equity instrument. The fair value of the compound instrument is the sum of the fair values of the two components.

In this example, it is assumed for simplicity that the fair value of the debt component is CU300 and the fair value of the equity component is CU150.

In the three years to 31 December 20X3, expenses of CU300 and CU90 (CU150 × 3/5) are recognised on the debt and equity components, respectively.

If the employees choose Alternative B (i.e. they take settlement of part of the share-based arrangement in shares at 31 December 20X3), the portion of the liability settled in shares at that date (CU150) will be reclassified to equity.

If the employees opt for Alternative A (i.e. cash settlement at 31 December 20X3), the scheme has vested and the total grant date fair value of the compound financial instrument should, therefore, be recognised. As a result, the unrecognised portion of the equity component (CU150 × 2/5 = CU60) will be recognised as a share-based payment expense at 31 December 20X3.

4.3.2 Entity's choice as to the manner of settlement

Example 4.3.2.1

Classification of an employee share option plan in which the entity has the choice of settlement

Company A, a listed entity, grants its employees options to acquire ordinary shares in Company A. Company A's shares trade in an active market. The exercise of the options is conditional upon the achievement of certain performance conditions during the vesting period. In addition, the holders of the options have to be employed within the group headed by Company A or can be retired, if they retire at the normal retirement age.

Employees can exercise the options over a period of 5 years. Following the exercise of an option, the employee is required to sell the shares obtained immediately. Company A has first right to purchase these shares at a price equal to the market price at the moment employees exercise the underlying options. If Company A chooses not to purchase the shares, there are no constraints on how the employees dispose of the shares, or to whom. There is no enforcement mechanism by Company A.

Company A has the legal right to buy its own shares in the market, and has sufficient authorised capital to issue new shares to deliver the required number of shares to the employees upon exercise.

The share option scheme is a new arrangement, and there have been no other arrangements in the past when the entity has had a choice of cash or equity settlement; therefore, there is no evidence regarding past practice of settlement in cash. The share option scheme has been approved by the shareholders without objection, and no indication was provided as to what course of action Company A would take when the exercise date is reached (i.e. whether Company A would seek to acquire the shares based on its pre-emptive right or choose not to do so).

Company A represents that it will act in its own interest every time it has the right to buy back shares, and that it does not believe any situation exists which would force it to buy back the shares given to the employees under the scheme.
Under applicable regulatory rules, employees cannot exercise their rights during a 'closed period'. Therefore, employees will not be able to sell shares in a closed period.

When employees exercise the options granted by Company A, they are obliged to sell the shares on the date of exercise. Company A has first right to purchase these shares. In substance, this right to repurchase shares immediately gives Company A an option to settle the share-based payment transaction in cash. Therefore, IFRS 2 apply.

IFRS 2 requires an entity that has a choice of settlement to determine whether it has a present obligation to settle the share-based payment transaction in cash. The entity has a present obligation to settle in cash if the choice of settlement in equity instruments has no commercial substance (e.g. because the entity is legally prohibited from issuing shares), or the entity has a past practice or a stated policy of settling in cash, or generally settles in cash whenever the counterparty asks for cash settlement.

If an entity with a choice of settlement has no present obligation to settle the transaction in cash, IFRS 2 requires that "the entity shall account for the transaction in accordance with the requirements applying to equity-settled share-based payment transactions, in IFRS 2".

The management of Company A considers all relevant facts and circumstances to determine whether there are any factors that could create an obligation to deliver cash and concludes that there are no situations in which the entity would have a legal obligation, or has created a constructive obligation, to repurchase the shares and thereby deliver cash.

In particular:

- there is an active market in which the shares could be sold;
- from a legal perspective, Company A has sufficient authorised share capital in order to be able to issue new shares;
- current shareholders raised no objection to the scheme in the general shareholders' meeting and the entity did not raise an expectation of a particular action;
- no restrictions on trading in a closed period apply as exercise is prohibited in

this period; and
- there is no stated policy or constructive obligation created by past practice.

Therefore, this scheme should be accounted for as an equity-settled share-based payment arrangement.

However, it remains the responsibility of management to consider all facts and circumstances affecting the entity to determine whether there are any other circumstances in which the entity would have an obligation to repurchase the shares, resulting in a different conclusion.

5 PRESENTATION

5.1 Disclosure rules

An entity should disclose information that enables users of the financial statements to understand the nature and extent of share-based payment arrangements that existed during the period.

To give effect to this principle, IFRS 2 specifies that at least the following should be disclosed:

- a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement such as:

    a. the vesting requirements;
    b. the maximum term of options granted; and
    c. the method of settlement (e.g. whether in cash or equity).

An entity with substantially similar types of share-based payment arrangements may aggregate this information, unless separate disclosure of each arrangement is necessary to satisfy the principle in IFRS 2;

- the number and weighted average exercise prices of share options for each of the following groups of options: **IFRS 2.44**

    a. outstanding at the beginning of the period;
    b. granted during the period; **IFRS 2.45**
    c. forfeited during the period;
    d. exercised during the period;
    e. expired during the period;
    f. outstanding at the end of the period; and

  g. exercisable at the end of the period;

- for share options exercised during the period, the weighted average share price at the date of exercise. If options were exercised on a regular basis throughout the period, the weighted average share price during the period may instead be disclosed; and

- for share options outstanding at the end of the period, the range of exercise prices and weighted average contractual life. If the range of exercise prices is wide, the outstanding options should be divided into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received upon exercise of those options.

An entity should disclose information that enables users of the financial statements to understand how the fair value of the goods or services received, or the fair value of the equity instruments granted, during the period was determined.

To give effect to this principle, IFRS 2 specifies that at least the following should be disclosed if the entity has measured the fair value of goods and services received indirectly, by reference to the fair value of the equity instruments granted:

- for share options granted during the period, the weighted average fair value of those options at the measurement date and information on how the fair value was measured, including:

    a. the option pricing model used and the inputs to that model, including the weighted average share price, exercise price, expected volatility, option life, expected dividends, the risk-free interest rate and any other inputs to the model, including the method used and the assumptions made to incorporate the effects of expected early exercise;
    b. how expected volatility was determined, including an explanation of the extent to which it was based on historical volatility; and
    c. whether and how any other features of the option grant were incorporated into the measurement of fair value, such as a market condition;

IFRS 2.46

IFRS 2.47

- for other equity instruments granted during the period (i.e. other than share options) the number and weighted average fair value of those equity instruments at the measurement date, and information on how that fair value was determined, including:

    a. if the fair value was not measured on the basis of observable market price, how it was determined;
    b. whether and how expected dividends were incorporated into the

measurement of fair value; and

c. whether and how any other features of the equity instruments granted were incorporated into the measurement of fair value; and

- for share-based payment arrangements that were modified during the period:

  a. an explanation of those modifications;
  b. the incremental fair value granted as a result of those modifications; and
  c. information on how the incremental fair value was measured.

If the entity has measured directly the fair value of goods or services received during the period, disclosure is required of how that fair value was determined (e.g. whether fair value was measured at a market price for those goods or services).

The presumption in IFRS 2 is that, in the case of transactions with parties other than employees, the fair value of the goods or services received can be estimated reliably. If that presumption has been rebutted, that fact should be disclosed together with an explanation of why the presumption was rebutted.

An entity should disclose information that enables users of the financial statements to understand the effect of share-based payment transactions on its profit or loss for the period and on its financial position.

To give effect to this principle, IFRS 2 specifies that at least the following should be disclosed:

- the total expense recognised for the period arising from share-based payment transactions in which the goods or services received did not qualify for recognition as assets and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment transactions; and **IFRS 2.48** **IFRS 2.49**

- for liabilities arising from share-based payment transactions:

  a. the total carrying amount at the end of the period; and
  b. the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (e.g. vested share appreciation rights). **IFRS 2.50**

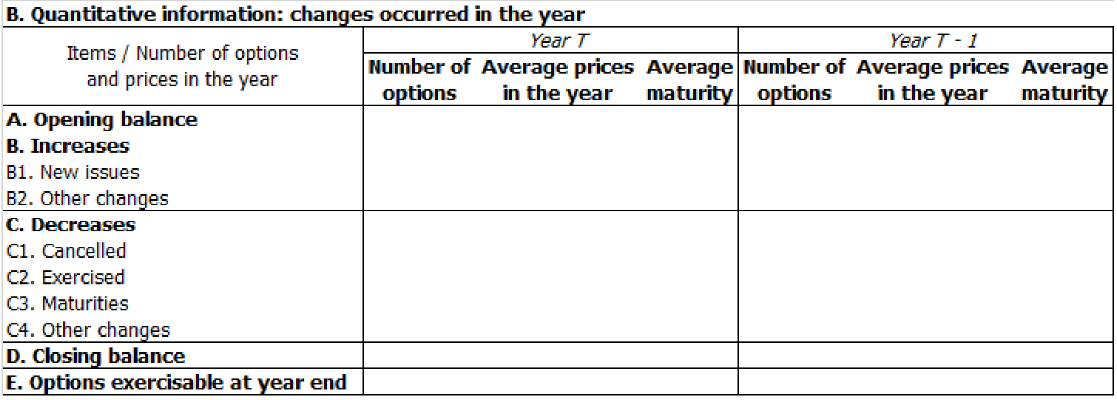
IFRS 2.51

5.2 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following Table provides guidance on how to present quantitative information on changes occurred in the year regarding share-based payments in the consolidated financial statements.

In particular, it includes:

- opening Balance
- increases
- decreases
- closing Balance; and
- options exercisable at year end.



B. Quantitative information: changes occurred in the year

Items / Number of options and prices in the year	*Year T*			*Year T - 1*		
	Number of options	**Average prices in the year**	**Average maturity**	**Number of options**	**Average prices in the year**	**Average maturity**
A. Opening balance						
B. Increases						
B1. New issues						
B2. Other changes						
C. Decreases						
C1. Cancelled						
C2. Exercised						
C3. Maturities						
C4. Other changes						
D. Closing balance						
E. Options exercisable at year end						

IFRS Operating Manual

Chapter 11
Revenues

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 18 – Revenues;
- a reference to other standard strictly related to IAS 18;
- a list of most recent amendments to IAS 18.

1.1 Introduction

Under the IFRSs, IAS 18 is the main standard for the accounting of revenues. It was reissued in December 1993 and is operative for periods beginning on or after 1 January 1995. **IAS 18.2**

Starting from 1 January 2018, IAS 18 will be superseded by IFRS 15 - *Revenue from Contracts with Customers*. In particular, IFRS 15 was issued in May 2014 and will apply to annual reporting periods beginning on or after January 2018. **IFRS 15**

1.2 Overview IAS 18

IAS 18 Revenue outlines the accounting requirements for when to recognize revenue from the sale of goods, rendering of services, and for interest, royalties and dividends.

Revenue is measured at the fair value of the consideration received or receivable and recognized when prescribed conditions are met, which depend on the nature of the revenue.

Here below the history of the amendments to IAS 18:

1 January 2018	IAS 18 will be superseded by IFRS 15 *Revenue from Contracts with Customers*
16 April 2009	Appendix to IAS 18 amended for Annual Improvements to IFRSs 2009. It now provides guidance for determining whether an entity is acting as a principal or as an agent.
December 1998	Amended by IAS 39 *Financial Instruments: Recognition and Measurement*, effective 1 January 2001
1 January 1995	Effective date of IAS 18 (1993) *Revenue Recognition*

December 1993	IAS 18 *Revenue Recognition* (revised as part of the 'Comparability of Financial Statements' project)
May 1992	E41 *Revenue Recognition*
1 January 1984	Effective date of IAS 18 (1982)
December 1982	IAS 18 *Revenue Recognition*
April 1981	Exposure Draft E20 *Revenue Recognition*

For what concerns IFRS 15, the initial effective date fixed in 2014 together with the issue (1 January 2017), has been modified with the amendment of September 2015 and set at the 1 January 2018.

On 12 April 2016, clarifying amendments were issued and have the same effective date as the standard itself. In particular, they do not change the underlying principles of the standard but just clarify and offer some additional transition relief.

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 18, which have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of revenue

The gross inflow of economic benefits (cash, receivables, other assets) arising from the ordinary operating activities of an entity (such as sales of goods, sales of services, interest, royalties, and dividends).

IAS 18.7

2.2 Recognition

Recognition, as defined in the IASB Framework, means incorporating an item that meets the definition of revenue in the income statement when it meets the following criteria:

- it is probable that any future economic benefit associated with the item of revenue will flow to the entity; and
- the amount of revenue can be measured with reliability.

IAS 18 provides guidance for recognising the following specific categories of revenue:

Sale of goods

Revenue arising from the sale of goods should be recognised when all of the following criteria have been satisfied:

IAS 18.14

- the seller has transferred to the buyer the significant risks and rewards of ownership;
- the seller retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- the amount of revenue can be measured reliably;
- it is probable that the economic benefits associated with the transaction will flow to the seller; and

- the costs incurred or to be incurred in respect of the transaction can be measured reliably.

Rendering of services

For revenue arising from the rendering of services, provided that all of the following criteria are met, revenue should be recognised by reference to the stage of completion of the transaction at the balance sheet date (the percentage-of-completion method): **IAS 18.20**

- the amount of revenue can be measured reliably;
- it is probable that the economic benefits will flow to the seller;
- the stage of completion at the balance sheet date can be measured reliably;
- the costs incurred, or to be incurred, in respect of the transaction can be measured reliably.

When the above criteria are not met, revenue arising from the rendering of services should be recognized only to the extent of the expenses recognised that are recoverable (a "cost-recovery approach"). **IAS 18.26**

Interest, royalties, and dividends

For interest, royalties and dividends, provided that it is probable that the economic benefits will flow to the enterprise and the amount of revenue can be measured reliably, revenue should be recognised as follows: **IAS18.29-30**

- interest: using the effective interest method as set out in IAS 39;
- royalties: on an accruals basis in accordance with the substance of the relevant agreement;
- dividends: when the shareholder's right to receive payment is established.

2.3 Measurement of revenue

Revenue should be measured at the fair value of the consideration received or receivable. An exchange for goods or services of a similar nature and value is not regarded as a transaction that generates revenue. However, exchanges for dissimilar items are regarded as generating revenue. **IAS 18.9**

IAS 18.12

If the inflow of cash or cash equivalents is deferred, the fair value of the consideration receivable is less than the nominal amount of cash and cash equivalents to be received, and discounting is appropriate. This would occur, for instance, if the seller is providing interest-free credit to the buyer or is charging a below-market rate of interest. Interest must be imputed based on market rates. **IAS 18.11**

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Financial services Fees and Transaction costs

The recognition of revenue for financial services fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided.

Transaction Costs, in accordance with IAS 39.9, are incremental costs that are directly attributable to the acquisition of the instrument, that is to say a cost that would not have been incurred if the entity had not acquired the instrument.

With respect to Financial Services Fees, each Legal Entity has necessarily to distinguish between the following typologies of fees:

a) fees that are an integral part of the effective interest rate of a financial instrument;
b) fees that are earned as services are provided;
c) fees that are earned on the execution of a significant act.

The following sections give guidance to distinguish between the 3 type of fees; in any case, if a certain degree of uncertainty on the classification of the fees is encountered, the Legal Entities are requested to share with the Parent company the relevant information.

(a) Fees that are an integral part of the effective interest rate of a financial

instrument

Such fees are generally treated as an adjustment to the effective interest rate in accordance with the disposition of IAS 39. However, when the financial instrument is measured at fair value with the change in fair value recognised in profit or loss, the fees are recognised as revenue when the instrument is initially recognised. Please find below some examples of that kind of fees:

- *Origination fees received by the entity relating to the creation or acquisition of a financial asset (other than one that under IAS 39 is classified as a financial asset at fair value through profit or loss)*
  Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in IAS 39), are deferred and recognized as an adjustment to the effective interest rate.

- *Commitment fees received by the entity to originate a loan when the loan commitment does not satisfy the definition of financial instrument (outside IAS 39).*
  If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IAS 39, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IAS 39), is deferred and recognized as an adjustment to the effective interest rate.
  If the commitment expires without the entity making the loan, the fee is recognised as revenue on expiry. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

- *Origination fees received on issuing financial liabilities measured at amortized cost.*
  These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as at fair value through profit or loss, the origination fees received are included, with the related transaction costs (as defined in IAS 39) incurred, in the initial carrying amount of the financial liability and recognized as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) Fees earned as services are provided

- *Fees charged for servicing a loan.*
  Fees charged by an entity for servicing a loan are recognized as revenue as the services are provided.

- *Commitment fees to originate a loan when the loan commitment does not satisfy the definition of financial instrument (outside IAS 39).*
  If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IAS 39, the commitment fee is recognized as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IAS 39 are accounted for as derivatives and measured at fair value.

- *Investment management fees.*
  Fees charged for managing investments are recognized as revenue as the services are provided. Incremental costs that are directly attributable to securing an investment management contract are recognised as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IAS 39, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortized as the entity recognizes the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

(c) Fees that are earned on the execution of a significant act

The fees are recognized as revenue when the significant act has been completed, as in the examples below.

- *Commission on the allotment of shares to a client.*
  The commission is recognized as revenue when the shares have been allotted.

- *Placement fees for arranging a loan between a borrower and an investor.*
  The fee is recognized as revenue when the loan has been arranged.

- *Loan syndication fees.*
  A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognized as revenue when the syndication has been completed.

- *Investment performance fees.*
  This type of fee is charged to the mutual funds managed by the asset management company in accordance with the regulations issued by the Bank of Italy or the corresponding national authorities which heads the asset management regulation in the countries in which Mediolanum Group operates.
  The overall guiding principle for revenue recognition, established by IAS 18, requires the registration of the same only when it is probable that future economic benefits will flow to the company. Basically there must be the actual probability of obtaining revenues and their assessment must be trusted.
  The proceeds of the performance fees can not be considered reasonably likely before the actual closing of the period to which they refer as the performance of the fund is to "beat" the market benchmark at the close of the period and the detection of such a value it can not, therefore, be carried out at an earlier stage.

Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties.
Transaction costs do not include debt premiums or discounts, financing costs or internal administrative or holding costs.
The term "transaction costs" covers both the transaction expenses in scope of IAS 39 as well as the revenues in scope of IAS 18.
As general rules:

- transaction costs which are not certain at initial recognition shall be expensed to P&L when incurred;
- in some cases the transaction costs are paid on a recurring basis (i.e. at every instalments). In such case it is possible not to include them in amortized cost but to recognize them in the period in which they are actually received;
- all commissions received together with the granting of a loan have to be accrued as interest income over the lifetime of the loan.

The following table highlights the treatment of the most common Financial fees which may arise from the financial services provided by the Group:

FEE	**RECOGNITION**
Origination Fees on Loans	Registered in the carrying value of the financial instrument (amortized cost)
Transaction Costs on Loans – certain part	Registered in the carrying value of the financial instrument (amortized cost)
Transaction Costs on Loans – uncertain part	Discounted in profit and loss account throughout the life of the facility

Transaction Costs on Loans – paid on recurrent basis	Registered in profit and loss account "on-going" (as the services are provided)
Banking Management Fees	Registered in the carrying value of the financial instrument (amortized cost)
Commitment fees – loan will be probably originated	Registered in the carrying value of the financial instrument (amortized cost)
Commitment fees – loan will not be probably originated	Registered in profit and loss account when the significant act has been completed
Fees on receipts and payments	Registered in profit and loss account when the significant act has been completed
Fees on custody services	Registered in profit and loss account "on-going" (as the services are provided)
Fees on reception and transmission of orders	Registered in profit and loss account when the significant act has been completed
Up-Front Fees – OICR/Pension funds	Registered in profit and loss account when the significant act has been completed
Up-Front Fees – Insurance Products	Registered in profit and loss account when the significant act has been completed
Management Fees – OICR/Pension funds	Registered in profit and loss account "on-going" (as the services are provided)
Management Fees – Insurance Products	Registered in profit and loss account "on-going" (as the services are provided)
Placement Fees – Securities	Registered in profit and loss account when the significant act has been completed
Placement Fees – OICR/Pension funds	Registered in profit and loss account when the significant act has been completed
Placement Fees – Insurance Products	Registered in profit and loss account when the significant act has been completed
Performance Fees	Registered in profit and loss account when the significant act has been completed

Insurance agency commissions

Insurance agency commissions received or receivable, which do not require the agent to render further service, are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as revenue over the period during which the policy is in force.

Dividends

Dividend revenue is recognized when:

- it is probable that the economic benefits associated with the transaction will flow to the entity;

- the amount of the revenue can be measured reliably; and
- the shareholder's right to receive payment is established.

The timing of the establishment of the shareholders' right to receive payment may vary based on the laws of particular countries. In some countries, it may occur when the board of directors of an entity formally declares its intention to pay a dividend. In other countries, it may occur only after such a declaration has been approved by shareholders.

In Mediolanum Group dividends are recognized in the income statement when their distribution is approved by shareholders. If a Legal Entity retains that there are elements to recognize the dividends before the shareholders approval, is requested to share with the Parent Company all the relevant information.
In any case if, subsequent to revenue recognition but before receipt of the dividend, it becomes apparent that the investee will not be able to pay the dividend, the amount of dividend revenue previously recognized is dealt with as a bad debt expense rather than as a reversal of dividend revenue.

Royalties
Royalty revenue is recognized on an accrual basis in accordance with the substance of the relevant agreement when:

- it is probable that the economic benefits associated with the transaction will flow to the entity; and
- the amount of the revenue can be measured reliably.

In Mediolanum Group, royalties accrue in accordance with the terms of the relevant agreement and are recognized on that basis.

If a Legal Entity retains, having regard to the substance of the agreement, that it is more appropriate to recognize revenue on some other systematic and rational basis, is requested to share with the Parent Company all the relevant information.

When an uncertainty arises about the collectability of an amount already included in revenue, however, the uncollectible amount, or the amount in respect of which recovery has ceased to be probable, is recognized as a bad debt expense, rather than as an adjustment of the amount of revenue originally recognized.

3.2 Relevant topics

Potential impacts related to IFRS 15

The core principle of IFRS 15 is that an entity will recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This core principle is delivered in a five-step model framework:

- Identify the contract(s) with a customer
- Identify the performance obligations in the contract
- Determine the transaction price
- Allocate the transaction price to the performance obligations in the contract
- Recognise revenue when (or as) the entity satisfies a performance obligation.

Application of this guidance will depend on the facts and circumstances present in a contract with a customer and will require the exercise of judgment.

Step 1: Identify the contract with the customer
A contract with a customer will be within the scope of IFRS 15 if all the following conditions are met:
- the contract has been approved by the parties to the contract;
- each party's rights in relation to the goods or services to be transferred can be identified;
- the payment terms for the goods or services to be transferred can be identified;
- the contract has commercial substance; and
- it is probable that the consideration to which the entity is entitled to in exchange for the goods or services will be collected.

IFRS 15.9

If a contract with a customer does not yet meet all of the above criteria, the entity will continue to re-assess the contract going forward to determine whether it subsequently meets the above criteria. From that point, the entity will apply IFRS 15 to the contract.

The standard provides detailed guidance on how to account for approved contract modifications. If certain conditions are met, a contract modification will be accounted for as a separate contract with the customer. If not, it will be accounted for by modifying the accounting for the current contract with the customer. Whether the latter type of modification is accounted for prospectively or retrospectively depends on whether the remaining goods or services to be delivered after the modification are distinct from those delivered prior to the modification. Further details on accounting for contract modifications can be found in the Standard.

IFRS 15.14

IFRS 15.18-21

Step 2: Identify the performance obligations in the contract
At the inception of the contract, the entity should assess the goods or services that have been promised to the customer, and identify as a performance obligation:
- a good or service (or bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and that have

the same pattern of transfer to the customer.

A series of distinct goods or services is transferred to the customer in the same pattern if both of the following criteria are met:
- each distinct good or service in the series that the entity promises to transfer consecutively to the customer would be a performance obligation that is satisfied over time (see below); and
- a single method of measuring progress would be used to measure the entity's progress towards complete satisfaction of the performance obligation to transfer each distinct good or service in the series to the customer.

IFRS 15.22

IFRS 15.23

A good or service is distinct if both of the following criteria are met:
- the customer can benefit from the good or services on its own or in conjunction with other readily available resources; and
- the entity's promise to transfer the good or service to the customer is separately idenitifable from other promises in the contract.

Factors for consideration as to whether a promise to transfer goods or services to the customer is not separately identifiable include, but are not limited to:
- the entity does provide a significant service of integrating the goods or services with other goods or services promised in the contract;
- the goods or services significantly modify or customise other goods or services promised in the contract;
- the goods or services are highly interrelated or highly interdependent.

IFRS 15.27

IFRS 15.29

Step 3: Determine the transaction price

The transaction price is the amount to which an entity expects to be entitled in exchange for the transfer of goods and services. When making this determination, an entity will consider past customary business practices.

Where a contract contains elements of variable consideration, the entity will estimate the amount of variable consideration to which it will be entitled under the contract. Variable consideration can arise, for example, as a result of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. Variable consideration is also present if an entity's right to consideration is contingent on the occurrence of a future event.

IFRS 15.47

IFRS 15.50

The standard deals with the uncertainty relating to variable consideration by limiting the amount of variable consideration that can be recognised. Specifically, variable consideration is only included in the transaction price if, and to the extent that, it is highly probable that its inclusion will not result in a significant revenue reversal in the future when the uncertainty has been subsequently resolved.

IFRS 15.51

Step 4: Allocate the transaction price to the performance obligations in the contracts

IFRS 15.56

Where a contract has multiple performance obligations, an entity will allocate the transaction price to the performance obligations in the contract by reference to their relative standalone selling prices.
If a standalone selling price is not directly observable, the entity will need to estimate it. IFRS 15 suggests various methods that might be used, including:
- Adjusted market assessment approach
- Expected cost plus a margin approach
- Residual approach (only permissible in limited circumstances).

IFRS 15.74

Any overall discount compared to the aggregate of standalone selling prices is allocated between performance obligations on a relative standalone selling price basis. In certain circumstances, it may be appropriate to allocate such a discount to some but not all of the performance obligations. **IFRS 15.79**

Where consideration is paid in advance or in arrears, the entity will need to consider whether the contract includes a significant financing arrangement and, if so, adjust for the time value of money. A practical expedient is available where the interval between transfer of the promised goods or services and payment by the customer is expected to be less than 12 months. **IFRS 15.81**

Step 5: Recognise revenue when (or as) the entity satisfies a performance obligation
Revenue is recognised as control is passed, either over time or at a point in time. **IFRS 15.60**

IFRS 15.63

Control of an asset is defined as the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. This includes the ability to prevent others from directing the use of and obtaining the benefits from the asset. The benefits related to the asset are the potential cash flows that may be obtained directly or indirectly. These include, but are not limited to:
- using the asset to produce goods or provide services;
- using the asset to enhance the value of other assets; **IFRS 15.32**
- using the asset to settle liabilities or to reduce expenses;
- selling or exchanging the asset; **IFRS 15.31-33**
- pledging the asset to secure a loan; and
- holding the asset.

An entity recognises revenue over time if one of the following criteria is met:
- the customer simultaneously receives and consumes all of the benefits provided by the entity as the entity performs;
- the entity's performance creates or enhances an asset that the customer controls as the asset is created; or
- the entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date.

IFRS 15.35

If an entity does not satisfy its performance obligation over time, it satisfies it at a point in time. Revenue will therefore be recognised when control is passed at a certain point in time. Factors that may indicate the point in time at which control passes include, but are not limited to:
- the entity has a present right to payment for the asset;
- the customer has legal title to the asset;
- the entity has transferred physical possession of the asset;
- the customer has the significant risks and rewards related to the ownership of the asset; and
- the customer has accepted the asset.

IFRS 15.38

Contract costs

The incremental costs of obtaining a contract must be recognised as an asset if the entity expects to recover those costs. However, those incremental costs are limited to the costs that the entity would not have incurred if the contract had not been successfully obtained (e.g. 'success fees' paid to agents). A practical expedient is available, allowing the incremental costs of obtaining a contract to be expensed if the associated amortisation period would be 12 months or less.
Costs incurred to fulfil a contract are recognised as an asset if and only if all of the following criteria are met:

- the costs relate directly to a contract (or a specific anticipated contract);
- the costs generate or enhance resources of the entity that will be used in satisfying performance obligations in the future; and
- the costs are expected to be recovered.

These include costs such as direct labour, direct materials, and the allocation of overheads that relate directly to the contract
The asset recognised in respect of the costs to obtain or fulfil a contract is amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services to which the asset relates.

Contracts with customers will be presented in an entity's statement of financial position as a contract liability, a contract asset, or a receivable, depending on the relationship between the entity's performance and the customer's payment.

The standard should be applied in an entity's IFRS financial statements for annual reporting periods beginning on or after 1 January 2018. Earlier application is permitted. When first applying IFRS 15, entities should apply the standard in full for the current period, including retrospective application to all contracts that were not yet complete at the beginning of that period. In respect of prior periods, the transition guidance allows entities an option to either:

- apply IFRS 15 in full to prior periods (with certain limited practical expedients being available); or

- retain prior period figures as reported under the previous standards, recognizing the cumulative effect of applying IFRS 15 as an adjustment to the opening balance of equity as at the date of initial application (beginning of current reporting period).

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the revenue recognition that could be considered by Group Component to make decisions on accounting issues related to revenues.

4.1 Recognition

4.1.1 Interest Revenue

Example 4.1.1

Unpaid interest accrued before acquisition of investment

An entity purchases CU1 million face value bonds for CU1,030,000 on 1 April 20X1. The bonds pay interest at 12 per cent per annum on 31 December and 30 June each year. The investor will receive CU60,000 as interest for the period from 1 January 20X1 to 30 June 20X1, but only CU30,000 of this should be recognised as interest revenue.

Therefore, the entries to record the acquisition of the bond and the receipt of interest at 30 June 20X1 will be as follows.

		CU'000	**CU'000**
Dr	Investments	1,000	
Dr	Debtor (interest receivable)	30	
Cr	Cash		1,030

To recognise the acquisition of the bond.

		CU'000	**CU'000**
Dr	Cash	60	
Cr	Debtor (interest receivable)		30
Cr	Interest income (profit or loss)		30

To recognise the receipt of interest.

4.1.2 Performance fee Revenue

Performance-based fee part way through the performance period

Company A, an investment manager, will earn a bonus of CU1 million if a managed fund's performance exceeds the performance of the S&P 500 by 20 per cent for the calendar year 20X1. Company A's financial year ends 30 June 20X1. At that time, the fund is outperforming the S&P 500 by 25 per cent.

Should Company A recognise revenue in relation to the bonus at 30 June 20X1 and, if so, CU500,000 (one half-year's worth) or CU1 million (the expected total bonus)?

IAS 18 states that revenue can be recognised when the amount of revenue can be measured reliably and it is probable that the economic benefits will flow to the entity. Company A will not receive any bonus unless the annual return exceeds the performance of the S&P 500 by 20 per cent. Because the markets are very volatile, it is unlikely that Company A will be able to estimate reliably at 30 June 20X1 whether the return for the year ended 31 December 20X1 will exceed the performance of the S&P 500. Consequently, no amount of the bonus can be determined reliably at 30 June 20X1 and Company A should not recognise any of the bonus at 30 June 20X1.

4.1.2 Dividend Revenue

Example 4.1.2.1

Dividends in the form of equity instruments of the investee (no cash alternative)

I Limited holds an equity investment in Entity A. Entity A distributes a dividend in the form of its own equity shares to all of its ordinary shareholders on a pro rata basis. No cash alternative is offered. After the distribution, the relative shareholdings of the investors in Entity A remain unchanged.

Should I Limited recognise dividend revenue for the fair value of the shares in Entity A it receives?

No. When all ordinary shareholders are paid a share dividend on a pro rata basis, there is no change in the financial position or economic interest of any of the investors. In such circumstances, in accordance with IAS 18, the dividend is not recognised as revenue because it is not probable that there is an economic benefit associated with the transaction that will flow to the investor.

Example 4.1.2.2

Dividends in the form of equity instruments of the investee (with a cash alternative)

I Limited holds an equity instrument in Entity A. Entity A offers all of its shareholders the right to receive a dividend in cash or in shares. I Limited subsequently elects to receive the dividend in shares.

How should I Limited recognise the dividend received?

The substance of a share dividend with a cash alternative is that of a dividend in cash with an immediate reinvestment in shares. Accordingly, at the date the dividend is authorised (i.e. the date when the shareholders' right to receive the dividend is established), I Limited should recognise the dividend as revenue, measured at the higher of the value of the shares offered and the value of the cash alternative. This reflects the fact the investor would be expected to opt for the most economically advantageous alternative

.

From the date of authorisation of the dividend until the date on which I Limited elects to receive cash or shares, the estimated revenue should be adjusted to reflect changes in the fair value of the shares but it should never fall below the value of the cash alternative.

On the date that I Limited makes its final election, the revenue amount becomes fixed.

4.1.3 Royalty Revenue

Example 4.1.3

Licence fees and royalties

Fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognised in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, e.g. when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred

5 PRESENTATION

5.1 Disclosure rules

Entities are required to disclose the accounting policies adopted for revenue recognition, including the methods adopted to determine the stage of completion of transactions involving the rendering of services.

The amount of each significant category of revenue recognized during the period is also required to be disclosed, including revenue arising from:

- the sale of goods;
- the rendering of services;
- interest;
- royalties; and
- dividends.

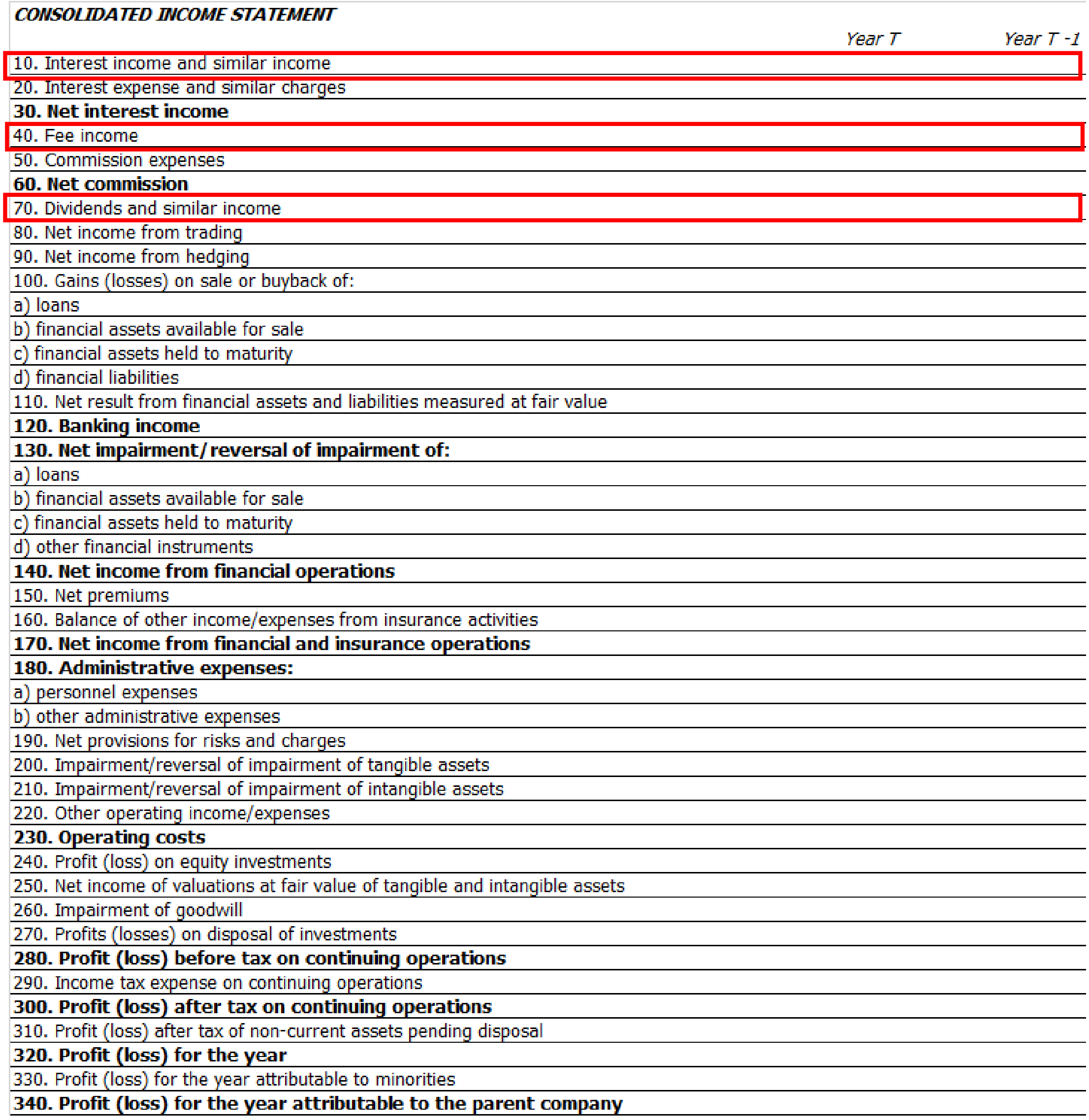
The entity is also required to disclose the amount of revenue arising from exchanges of goods or services included in each significant category of revenue.

5.2 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present revenues in the consolidated financial statements.

As required by Bank of Italy, revenues under IAS 18 are disclosed in consolidated income statement as follows:

- Caption 10 – Interest
- Caption 40 – Commission
- Caption 70 – Dividends



CONSOLIDATED INCOME STATEMENT	*Year T*	*Year T -1*
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

In Caption 10 are recorded interest income and similar income related to

- financial assets held for trading;
- financial assets available for sale;
- financial assets held to maturity;
- financial assets at fair value;
- loans to banks and customers;
- hedge derivatives; and
- other interest accrued during the year.

These items also include spreads or positive margins accrued until the reference date of the related financial statements, relatively to:

a) hedge derivatives related to assets that generate interest, including the differentials on interest rates generated by "currency interest rate swap" and "total rate of return swaps";
b) derivative contracts classified in the balance sheet but operationally linked to financial assets evaluated at fair value (so-called fair value options);
c) derivative contracts connected with financial assets classified in the balance sheet which provide for the payment of differentials or margins at various maturities (so-called "multiple-flow contracts, such as the" interest rate swaps ").

1.1 Analysis of interest income and similar income

	Debt securities	Loans	Other transactions	*Year T*	*Year T-1*
1. Financial assets held for trading					
2. Financial assets available for sale					
3. Financial assets held to maturity					
4. Loans to banks					
5. Loans to customers					
6. Financial assets measured at fair value					
7. Hedge derivatives					
8. Other assets					
Total					

In Caption 40 are included the incomes related to

- guarantees issued;
- credit derivatives;
- management, brokerage and consulting service fees;
- collection and payment services fees;
- servicing for securitization transactions;
- factoring services;
- tax collection services;
- management of multilateral trading systems;
- bank accounts custodian and management services;
- other services.

2.1 Analysis of fee income	*Year T*	*Year T-1*
a) Guarantees issued		
b) Credit derivatives		
c) Management, brokerage and consulting services:		
1. financial instruments brokerage		
2. currency brokerage		
3. portfolio management		
3.1. individual		
3.2. collective		
4. securities in custody and under administration		
5. custodian bank		
6. sale of securities		
7. receipt and transmission of orders		
8. consulting activities		
8.1 investment consulting		
8.2 financial structure consulting		
9. services to third parties		
9.1 portfolio management		
9.1.1. individual		
9.1.2. collective		
9.2 insurance products		
9.3 other products		
d) Collection and payment services		
e) Servicing for securitization transactions		
f) Factoring services		
g) Tax collection services		
h) Management of multilateral trading systems		
i) Bank accounts custodian and management services		
j) Other services		
Total		

From commission revenues must be excluded the proceeds which, based on the law or contractual provisions, constitute the mere reimbursement of expenses incurred by the intermediary.

In Caption 70 are included dividends generated by

- financial assets held for trading;
- financial assets available for sale;
- financial assets measured at fair value; and
- equity investments.

3.1 Dividends and similar income

	Year T		*Year T-1*	
	Dividends	Income from holdings in UCITS	Dividends	Income from holdings in UCITS
A. Financial assets held for trading				
B. Financial assets available for sale				
C. Financial assets measured at fair value				
D. Equity investments				
Total				

IFRS Operating Manual

Chapter 12
Property, plant and equipment

CHAPTER XII – PROPERTY, PLANT AND EQUIPMENT **516**

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 16 – Property, plant and equipment and IAS 40 – Investment Property;
- a reference to other standard strictly related to IAS 16 and IAS 40;
- a list of most recent amendment to IAS 16 and IAS 40.

1.1 Introduction

Under IFRSs, the main standard that addresses the accounting of fixed assets is *IAS 16 – Property, Plant and Equipment*. In addition, there is a separate standard, *IAS 40 – Investment Property*, that provides a different accounting treatment for this particular category of property, plant and equipment. Moreover: **IAS 16.2-5** **IAS 40**

- Impairment is covered by *IAS 36 – Impairment of Assets* (see chapter Impairment) **IAS 36**
- *IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations* deals with the accounting required when items of property, plant and equipment are classified as held for sale **IFRS 5**
- Other standards require an item of property, plant and equipment to be recognized based on an approach different from that required by IAS 16. In particular, *IAS 17 – Leases* has its own accounting rules for property, plant and equipment held under lease contracts and *IFRS 3 – Business Combinations* for property, plant and equipment acquired in a business combination. **IAS 17** **IFRS 3**

1.2 Overview of IAS 16 and IAS 40

IAS 16 Property, Plant and Equipment specifies the required accounting treatment for most types of property, plant and equipment and addresses issue such as the recognition of assets, the determination of their carrying amounts, and the depreciation charges and impairment losses to be recognized in relation to them.

Property, plant and equipment is initially measured at its cost, subsequently measured either using a cost or revaluation model, and depreciated so that its depreciable amount is allocated on a systematic basis over its useful life.

IAS 16 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005. It was most recently amended in June 2014:

Date	Development	Comments
30 June 2014	Amended by Agriculture: Bearer Plants (Amendaments to IAS 16 and IAS 41)	Effective for annual periods beginning on or after 1 January 2016
12 May 2014	Amended by Clarification of Acceptable Methods of Depreciation and Amortisation: (Amendaments to IAS 16 and IAS 38)	Effective for annual periods beginning on or after 1 January 2016
12 December 2013	Amended by Annual Improvements to IFRSs 2010-2012 Cycle (proportionate restatement of accumulated depreciation under the revaluation method)	Effective for annual periods beginning on or after 1 July 2014
17 May 2012	Amended by Annual Improvements 2009-2011 Cycle (classification of servicing equipment)	Effective for annual periods beginning on or after 1 January 2013
22 May 2008	Amended by Improvements to IFRSs (routine sales of assets held for rental)	Effective for annual periods beginning on or after 1 January 2009
18 December 2003	IAS 16 Property, Plant and Equipment issued	Effective for annual periods beginning on or after 1 January 2005

IAS 40 Investment Property applies to the accounting for property (land and/or buildings) held to earn rentals or for capital appreciation (or both). Investment properties are initially measured at cost and, with some exceptions. may be subsequently measured using a cost model or fair value model, with changes in the fair value under the fair value model being recognised in profit or loss.

IAS 40 was reissued in December 2003 and applies to annual periods beginning on or after 1 January 2005.

Date	Development	Comments
12 December 2013	Amended by Annual Improvements to IFRSs 2011–2013 Cycle (interrelationship between IFRS 3 and IAS 40)	Effective for annual periods beginning on or after 1 July 2014
22 May 2008	Amended by Annual Improvements to IFRSs 2007 (include property under construction or development for future use within scope)	Effective for annual periods beginning on or after 1 January 2009
18 December 2003	IAS 40 Investment Property (2003) issued	Effective for annual periods beginning on or after 1 January 2005
May 2002	Exposure Draft Improvements to International Accounting Standards (2000) published	Comment deadline 16 September 2002

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 16 and from related International Financial Reporting Stadards (IFRSs) that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of property, plant and equipment

Property, plant and equipment are tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes, and
- are expected to be used during more than one period.

IAS 16.6

An item of property, plant and equipment is held for use in the production when it does not generate cash flows on its own but is instrumental to the generation of cash flows of the whole Group together with other assets or liabilities used for performing the business of the Group.

In this context, this category comprises assets held for use in the production or supply of goods or services or for administrative purposes and that are expected to be used during more than one full period (e.g. one year).
For example, a building constitutes an item of property, plant and equipment when it is used as offices for group employees.

As required by Bank of Italy, property, plant and equipment include also assets waiting to be leased or assets under construction to be leased under a finance lease. In the latter case, this applies only for those finance leases which provide for retention of risks by the lessor until the acceptance of the assets by the lessee and the start of the rentals under the finance lease.

Definition of investment property

Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- use in the production or supply of goods or services or for administrative purposes, or
- sale in the ordinary course of business.

IAS 40.5

Hence, investment property is described as real estate property that has been purchased or developed with the intention of earning a return on the investment either through rent and/or future resale of the property.

Definition of inventories

Inventories are properties (land or a building – or part of a building – or both) held:

- for sale in the ordinary course of business, or
- in the process of construction or development for such sale

Definition of construction contracts

IAS 2.6
IAS 2.8

A construction contract is a contract specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

Other relevant definitions

IAS 11.3

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, where applicable, the amount attributed to that asset when initially recognized in accordance with the specific requirements of other IFRSs, eg IFRS 2 Share-based Payment.

Depreciable amount is the cost of an asset, or other amount substituted for cost, less its residual value.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

The residual value of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

Useful life is:

- the period over which an asset is expected to be available for use by an entity; or
- the number of production or similar units expected to be obtained from the

asset by an entity.

2.2 Scope of rules

IAS 16 applies to the accounting for property, plant and equipment, except where another standard requires or permits differing accounting treatments, for example:

- assets classified as held for sale in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations biological assets related to agricultural activity accounted for under IAS 41 Agriculture
- exploration and evaluation assets recognised in accordance with IFRS 6 Exploration for and Evaluation of Mineral Resources mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources
- the standard does apply to property, plant, and equipment used to develop or maintain the last three categories of assets.

Please note that IAS 17 *Leases* prescribes a different approach as regards recognition for assets held under leases. IAS 17 applies to contracts that transfer the right to use assets even though substantial services by the lessor are required in connection with the operation or maintenance of such assets. Examples include the supply of property, motor vehicles and photocopiers. **IAS 16.3**

IAS 17
IAS 17.3

The cost model in IAS 16 also applies to investment property accounted for using the cost model under IAS 40 Investment Property.
The standard does apply to bearer plants but it does not apply to the produce on bearer plants.

IAS 16.5

2.3 Recognition

IAS 16.3

Items of property, plant, and equipment should be recognised as assets when it is probable that:

- it is probable that the future economic benefits associated with the asset will flow to the entity, and
- the cost of the asset can be measured reliably.

IAS 16.7

This recognition principle is applied to all property, plant, and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

IAS 16 does not prescribe the unit of measure for recognition – what constitutes an item of property, plant, and equipment. Note, however, that if the cost model is used (see below) each part of an item of property, plant, and equipment with a cost that is significant in relation to the total cost of the item must be depreciated separately.

IAS 16.9
IAS 16.43

IAS 16 recognises that parts of some items of property, plant, and equipment may require replacement at regular intervals. The carrying amount of an item of property, plant, and equipment will include the cost of replacing the part of such an item when that cost is incurred if the recognition criteria (future benefits and measurement reliability) are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of IAS 16.67-72. **IAS 16.13**

Also, continued operation of an item of property, plant, and equipment may require regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant, and equipment as a replacement if the recognition criteria are satisfied. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed. **IAS 16.14**

Investment property should be recognised as an asset when it is probable that the future economic benefits that are associated with the property will flow to the entity, and the cost of the property can be reliably measured.

IAS 40.16

2.4 Initial measurement

An item of property, plant and equipment should initially be recorded at cost.
Cost includes all costs necessary to bring the asset to working condition for its intended use. This would include not only its original purchase price but also costs of site preparation, delivery and handling, installation, related professional fees for architects and engineers, and the estimated cost of dismantling and removing the asset and restoring the site (see IAS 37 Provisions, Contingent Liabilities and Contingent Assets).

IAS 16.15 -
IAS 16.16 -
IAS 16.17

If payment for an item of property, plant, and equipment is deferred, interest at a market rate must be recognised or imputed.

If an asset is acquired in exchange for another asset (whether similar or dissimilar in nature), the cost will be measured at the fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not **IAS 16.23** measured at fair value, its cost is measured at the carrying amount of the asset given up. **IAS 16.24**

Investment property is initially measured at cost, including transaction costs. Such cost should not include start-up costs, abnormal waste, or initial operating losses incurred before the investment property achieves the planned level of occupancy

IAS 40.20
IAS 40.23

2.5 Measurement subsequent to initial recognition

IAS 16

IAS 16 permits two accounting models:

- Cost Model;
- Revaluation Model.

Under the cost model, the asset is carried at cost less accumulated depreciation and impairment. **IAS 16.30**

Under the revaluation model, the asset is carried at a revalued amount, being its fair value at the date of revaluation less subsequent depreciation and impairment, provided that fair value can be measured reliably. **IAS 16.31**

Revaluations should be carried out regularly, so that the carrying amount of an asset does not differ materially from its fair value at the balance sheet date. **IAS 16.36**

If an item is revalued, the entire class of assets to which that asset belongs should be revalued.

Revalued assets are depreciated in the same way as under the cost model.

If a revaluation results in an increase in value, it should be credited to other comprehensive income and accumulated in equity under the heading "revaluation surplus" unless it represents the reversal of a revaluation decrease of the same asset previously recognised as an expense, in which case it should be recognised in profit or loss. **IAS 16.39**

A decrease arising as a result of a revaluation should be recognised as an expense to the extent that it exceeds any amount previously credited to the revaluation surplus relating to the same asset.

When a revalued asset is disposed of, any revaluation surplus may be transferred directly to retained earnings, or it may be left in equity under the heading **IAS 16.40** revaluation surplus. The transfer to retained earnings should not be made through profit or loss.

IAS 40

IAS 16.41

IAS 40 permits entities to choose between:

- a fair value model, and
- a cost model.

One method must be adopted for all of an entity's investment property. Change is permitted only if this results in a more appropriate presentation. IAS 40 notes that this is highly unlikely for a change from a fair value model to a cost model. **IAS 40.30**

Fair value model

Investment property is remeasured at fair value, which is the amount for which the property could be exchanged between knowledgeable, willing parties in an arm's length transaction. Gains or losses arising from changes in the fair value of investment property must be included in net profit or loss for the period in which it arises. **IAS 40.5** **IAS 40.35**

Fair value should reflect the actual market state and circumstances as of the balance sheet date.

The best evidence of fair value is normally given by current prices on an active market for similar property in the same location and condition and subject to similar lease and other contracts. **IAS 40.38**

In the absence of such information, the entity may consider current prices for properties of a different nature or subject to different conditions, recent prices on less active markets with adjustments to reflect changes in economic conditions, and discounted cash flow projections based on reliable estimates of future cash flows. **IAS 40.45**

IAS 40.46

There is a rebuttable presumption that the entity will be able to determine the fair value of an investment property reliably on a continuing basis. However:

- if an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it measures that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed; **IAS 40.53**
- if an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in IAS 16. The residual value of the investment property shall be assumed to be zero. The entity shall apply IAS 16 until disposal of the investment property.

Where a property has previously been measured at fair value, it should continue to be measured at fair value until disposal, even if comparable market transactions become less frequent or market prices become less readily available.

IAS 40.55

Cost model
After initial recognition, investment property is accounted for in accordance with the cost model as set out in IAS 16 Property, Plant and Equipment – cost less accumulated depreciation and less accumulated impairment losses.

IAS 40.56

IAS 17
A lease is defined as an agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time. The definition includes hire purchase contracts, i.e. contracts for the hire of an asset that contain a clause giving the hirer an option to acquire title to the asset upon fulfilment of agreed conditions.

IAS 17.4

IAS 17.6

2.6 Depreciation

For all depreciable assets:

- The depreciable amount (cost less residual value) should be allocated on a systematic basis over the asset's useful life.
- The residual value and the useful life of an asset should be reviewed at least at each financial year-end and, if expectations differ from previous estimates, any change is accounted for prospectively as a change in estimate under IAS 8.

IAS 16.50

IAS 16.51

The depreciation method used should reflect the pattern in which the asset's economic benefits are consumed by the entity; a depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate.

IAS 16.60
IAS 16.62A

Note: The clarification regarding the revenue-based depreciation method was introduced by Clarification of Acceptable Methods of Depreciation and Amortisation, which applies to annual periods beginning on or after 1 January 2016.

The depreciation method should be reviewed at least annually and, if the pattern of consumption of benefits has changed, the depreciation method should be changed prospectively as a change in estimate under IAS 8. Expected future reductions in selling prices could be indicative of a higher rate of consumption of the future economic benefits embodied in an asset.

IAS 16.61

Note: The guidance on expected future reductions in selling prices was introduced by Clarification of Acceptable Methods of Depreciation and Amortisation, which applies to annual periods beginning on or after 1 January 2016.

IAS 16.56

Depreciation should be charged to profit or loss, unless it is included in the carrying amount of another asset.

Depreciation begins when the asset is available for use and continues until the asset is derecognised, even if it is idle.

IAS 16.48

IAS 16.55

2.7 Recoverability of the carrying amount

IAS 16 Property, Plant and Equipment requires impairment testing and, if necessary, recognition for property, plant, and equipment. An item of property, plant, or equipment shall not be carried at more than recoverable amount. Recoverable amount is the higher of an asset's fair value less costs to sell and its value in use.

Any claim for compensation from third parties for impairment is included in profit or loss when the claim becomes receivable.

2.8 Derecognition

IAS 16.65

An asset should be removed from the statement of financial position on disposal or when it is withdrawn from use and no future economic benefits are expected from its disposal. The gain or loss on disposal is the difference between the proceeds and the carrying amount and should be recognised in profit and loss.

IAS 16.67-71

If an entity rents some assets and then ceases to rent them, the assets should be transferred to inventories at their carrying amounts as they become held for sale in the ordinary course of business.

IAS 16.68

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Mediolanum Group's tangible assets include both:

- those held for use in the production that are expected to be used during more than one period (Property, plant and equipment under IAS 16)
- investment property: property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation.

An item of property, plant and equipment is to be recognised as an asset if, and only if:

- it is probable that future economic benefits associated with the asset will flow to the entity; and
- the cost of the asset to the entity can be measured reliably.

Items such as spare parts, stand-by equipment and servicing equipment should be recognised as property, plant and equipment when they meet the definition of property, plant and equipment. Otherwise, they should be classified as inventories in accordance with *IAS 2 Inventories*.

Items of less than 516 euro value are not capitalized by the Group and are accounted as operating expenses (useful lives are assumed to be minor than one year for the sake of simplicity).

Properties and other assets accounted under IAS 16 are valuated by Mediolanum Group using the cost model (no revaluation model adopted by Mediolanum Group).

Cost is defined as the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs (*e.g. IFRS 2 Share-based Payment*).

In the case of an acquired asset, cost comprises:

- the purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates;
- any directly attributable costs of bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management; and
- the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which the entity incurred either when the item was acquired, or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

Costs suitable for inclusion in the cost of an item of property, plant and equipment are:

- costs of employee benefits arising directly from the construction or acquisition of the item of property, plant and equipment;
- costs of site preparation;
- initial delivery and handling costs;
- installation and assembly costs;
- costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (e.g. samples produced when testing equipment); and
- professional fees.

Costs as unsuitable for capitalisation and, therefore, to be expensed are:

- costs of opening a new facility;
- costs of introducing a new product or service (including costs of advertising and promotional activities);
- costs of conducting business in a new location, or with a new class of customer (including costs of staff training); and

- administration and other general overhead costs.

An investment property is measured initially at its cost. Transaction costs are included in the initial measurement.
The cost of an investment property includes its purchase price (if purchased) and other directly attributable expenditure (e.g. professional fees for legal services, property transfer taxes and other transaction costs). Start-up costs are not included unless they are necessary to bring the asset to the condition required for its intended operation. Abnormal costs, and operating losses incurred before the property reaches its required level of occupancy, are excluded from the cost of the investment property.

Investment properties accounted under IAS 40 are valuated using the cost model (no fair value model adopted). In any case, each Legal Entity has to measure the fair value of all of its investment property for disclosure purposes, other than in exceptional circumstances when the fair value cannot be reliably measured

The cost model measures all of its investment property in accordance with IAS 16's requirements for that model, other than investment property classified as held for sale or included in a disposal group classified as held for sale, which is measured in accordance with *IFRS 5*.

Depreciation of an asset commences when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. This is the same point in time at which the entity is required to cease capitalising costs within the carrying amount of the asset.

Depreciation of an asset ceases at the earlier of:

- the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with *IFRS 5 Non-current Assets Held for Sale and Discontinued Operations*; and
- the date that the asset is derecognised.

The consumption of the future economic benefits embodied in an asset occurs principally through usage. Other factors should also be taken into account, however, such as technical obsolescence and wear and tear while an asset remains idle, because they may result in a reduction in the economic benefits expected to be derived from the asset. Consequently, all of the following factors need to be considered in determining the useful life of an asset:

- the expected usage of the asset by the entity. Usage is assessed by reference to the asset's expected capacity or physical output;
- the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme of the entity, and the care and maintenance of

the asset while idle;
- technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset which, in turn, might reflect a reduction of the future economic benefits embodied in the asset; and
- legal or similar limits on the use of the asset, such as the expiry dates of related leases

Tangible assets are systematically depreciated *on a straight-line basis* over their useful lives except for land, be it acquired separately or together with buildings, which has an indefinite useful life. When the value of land is embedded in the value of the building, only for land on which a building stands, their respective value is determined by independent experts.

Each Legal Entity should determine the useful life of the intangible asset considering the factors listed above, and the following useful life assessed in the Mediolanum Group:

Class of Asset	Standard Useful Life	Max Useful Life*
Land	Indefinite	Indefinite
Buldings	33 years	35 years
Equipment	6 years	8 years
Furniture	6 years	8 years
Installations	8 years	12 years
Anti-thef security systems	3 years	4 years
Office machines	5 years	5 years
Hardware	5 years	5 years
Mobile phones	3 years	5 years
Vehicles	4 years	5 years

* misalignment from Standard Useful life is subject to communication to Parent Company to allow adequate disclosure at Group level

At each interim and annual reporting date, if there is an indication that an asset may be impaired the carrying amount of the asset is compared to its recoverable amount. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. Any reduction is recognized as impairment loss in the income statement. For Group policies related to impairment test please see the specific Chapter of the Manual (IAS 36 Impairment of Assets).

The carrying amount of an item of property, plant and equipment should be derecognised:

- on disposal; or
- when no future economic benefits are expected from its use or disposal.

3.2 Relevant topics

Finance Leasing under IAS 17

A lease is classified as a finance lease if it transfers substantially all the risks and rewards incident to ownership. All other leases are classified as operating leases. Classification is made at the inception of the lease.

Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form. Situations that would normally lead to a lease being classified as a finance lease include the following:

- the lease transfers ownership of the asset to the lessee by the end of the lease term
- the lessee has the option to purchase the asset at a price which is expected to be sufficiently lower than fair value at the date the option becomes exercisable that, at the inception of the lease, it is reasonably certain that the option will be exercised
- the lease term is for the major part of the economic life of the asset, even if title is not transferred **IAS 17.4**
- at the inception of the lease, the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset
- the lease assets are of a specialised nature such that only the lessee can use them without major modifications being made **IAS 17.10**

Other situations that might also lead to classification as a finance lease are:

- if the lessee is entitled to cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee
- gains or losses from fluctuations in the fair value of the residual fall to the lessee (for example, by means of a rebate of lease payments)
- the lessee has the ability to continue to lease for a secondary period at a rent that is substantially lower than market rent

The Legal Entities are requested to share with the Parent Company the accountability of the new leasing contract arisen, in particular those contracts for which there may be some uncertainty about the classification as a financial lease or an operating lease.

The following principles should be applied in the financial statements of lessees:

- at commencement of the lease term, finance leases should be recorded as an asset and a liability at the lower of the fair value of the asset and the **IAS 17.11**

present value of the minimum lease payments (discounted at the interest rate implicit in the lease, if practicable, or else at the entity's incremental borrowing rate);
- finance lease payments should be apportioned between the finance charge and the reduction of the outstanding liability (the finance charge to be allocated so as to produce a constant periodic rate of interest on the remaining balance of the liability);
- the depreciation policy for assets held under finance leases should be consistent with that for owned assets. If there is no reasonable certainty that the lessee will obtain ownership at the end of the lease – the asset should be depreciated over the shorter of the lease term or the life of the asset;
- for operating leases, the lease payments should be recognised as an expense in the income statement over the lease term on a straight-line basis, unless another systematic basis is more representative of the time pattern of the user's benefit. **IAS 17.20**

Incentives for the agreement of a new or renewed operating lease should be recognised by the lessee as a reduction of the rental expense over the lease term, irrespective of the incentive's nature or form, or the timing of payments. **IAS 17.25**

IAS 17.27

Potential impacts related to IFRS 16

The standard provides a single lessee accounting model, requiring lessees to recognize assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value.
Upon lease commencement a lessee recognises a right-of-use asset and a lease liability (for lessee all leases are financial leases, with recognition of right of use as asset and of related financial liability). **IAS 17.33**

The right-of-use asset is initially measured at the amount of the lease liability plus any initial direct costs incurred by the lessee. Adjustments may also be required for lease incentives, payments at or prior to commencement and restoration obligations or similar. **SIC-15**

After lease commencement, a lessee shall measure the right-of-use asset using a cost model, unless:
- the right-of-use asset is an investment property and the lessee fair values its investment property under IAS 40; or
- the right-of-use asset relates to a class of PPE to which the lessee applies IAS 16's revaluation model, in which case all right-of-use assets relating to that class of PPE can be revalued. **IFRS 16.22**

Under the cost model a right-of-use asset is measured at cost less accumulated depreciation and accumulated impairment. **IFRS 16.24**

The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease if that can be readily determined. If that rate cannot be readily determined, the lessee shall use their incremental borrowing rate. **IFRS 16.29**

IFRS 16.34-35

Variable lease payments that depend on an index or a rate are included in the initial measurement of the lease liability and are initially measured using the index or rate as at the commencement date. Amounts expected to be payable by the lessee under residual value guarantees are also included.

Variable lease payments that are not included in the measurement of the lease liability are recognised in profit or loss in the period in which the event or condition that triggers payment occurs, unless the costs are included in the carrying amount of another asset under another Standard. **IFRS 16.30**

IFRS 16.26

The lease liability is subsequently remeasured to reflect changes in:

- the lease term (using a revised discount rate);
- the assessment of a purchase option (using a revised discount rate);
- the amounts expected to be payable under residual value guarantees (using an unchanged discount rate);
- or future lease payments resulting from a change in an index or a rate used to determine those payments (using an unchanged discount rate).

IFRS 16.27

The re-measurements are treated as adjustments to the right-of-use asset. **IFRS 16.38**

Lease modifications may also prompt remeasurement of the lease liability unless they are to be treated as separate leases.

IFRS 16 is effective for annual reporting periods beginning on or after January 1, 2019. Earlier application is permitted if *IFRS 15, Revenue From Contracts With Customers*, has also been applied. If a Legal Entity intends to early adopt IFRS 16 is requested to share with the Parent Company the considerations performed and the expected accounting effects. **IFRS 16.36**

IFRS 16.39

IFRS 16.36

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognition (paragraph 4.1)
- Measurement at recognition (paragraph 4.2)
- Depreciation (paragraph 4.3)
- Derecognition (paragraph 4.4)

that could be considered by Group Component to make decisions on accounting issues related to tangible Assets.

4.1 Recognition

4.1.1 Replacement costs

Example 4.1.1

Replacement costs

An entity refurbishes its offices every ten years, on average. The cost of refurbishment is considered a replacement of assets capitalised (the recognition criteria in IAS 16.7 are met. The replacement indicates, however, that previously recognised assets may now be required to be derecognised, typically giving rise to a loss to the extent that they have not already been depreciated.

4.1.2 Substantial modification costs

Example 4.1.2

Substantial modification costs

The offices of an entity need to be redecorated each year. Because the expenditure is incurred on a regular basis and is not particularly large, the entity treats the redecoration as a cost and recognises an expense as it is incurred. In the current year, the entity has asked the supplier carrying out the redecoration work to install new partitioning, which is intended to make the offices more profitable and result in additional future economic benefits.

The redecoration costs should be recognised in profit or loss as an expense under IAS 16.12, while the incremental partitioning costs should be capitalised if they satisfy the recognition criteria set out in IAS 16.7 (the cost incurred to install new partitioning can be measured reliably and it is probable that future economic benefits associated with the partitioning will flow to the entity). To the extent that the new partitioning replaces existing partitioning, the partitioning being replaced should be derecognised.

4.1.3 Classification of a property

Example 4.1.3.1

Classification of a property resulting from bail-out purchases

An entity (bank or financial intermediary) can take possession of property (repossessed assets) that was originally pledged as collateral in full and final settlement of the mortgage for loans. Such property, which is primarily acquired to prevent losses from credit business, shall be classified in as follows:

- property resulting from a bail-out purchase is classified as property, plant and equipment if the property acquired is intended to be used in the long term for the bank's own business purposes. In this (relatively rare) case, the accounting requirements of IAS 16 – Property, Plant and Equipment are applicable;

- if the bank intends to hold the property acquired within a bail-out purchase to earn rentals and/or for capital appreciation in the long term, the property is classified as investment property in accordance with IAS 40 – Investment Property; the same classification applies also to those properties where any improvement has been done or planned after repossession;

- properties acquired within a bail-out purchase that are not be used for own business purposes or held to earn rentals and/or for capital appreciation in the long term (the classification criteria of property, plant and equipment (IAS 16) or investment property (IAS 40) are not met), but are intended to be sold in the near future (within 12 months) should be classified as IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations. Conditions set in IFRS 5 need to exist for this classification (i.e. property ready to be sold in its current status; high probability of closing of deal will within 12 months, active search of a buyer,…);

- properties that are intended to be sold in the ordinary course of business, however exceeding 12 months, should be classified as current assets and accounted for as inventories under the provisions of IAS 2 – Inventories. Usually, the existence of rental contracts might not be consistent with IAS 2 classification but more in line with IAS 40 requirements.

If the property resulting from a bail-out purchase that has originally been used for own business purposes (initially classified as IAS 16) or held to earn rentals and/or for capital appreciation (initially classified as IAS 40), shall be sold in the near future, this long-term used property is subsequently reclassified as held for sale. A noncurrent asset shall be classified as held for sale if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. For such property, the accounting requirements of IFRS 5 – Non-current Assets Held for Sale and Discontinued Operations apply, premising the application criteria are met. However, non-current assets that are accounted for in accordance with the fair value model in IAS 40 (i.e. application of IAS 40.32A as an exception for purposes of subsequent measurement as stated below in this Chapter) are completely excluded from measurement scope of IFRS 5 (IFRS 5.5 (d)).

Example 4.1.3.2

Intercompany rentals

An entity owns property that is leased to, and occupied by, its parent or another subsidiary.

The property does not qualify as investment property in the consolidated financial statements, because the property is owner-occupied from the perspective of the group. However, if the entity prepares separate IFRSs financial statements, property leased to other Group companies must also be treated as investment property in accordance with IAS 40 in these financial statements.

In determining the classification of a property in consolidated financial statements, the assessment is made from the point of view of the Group as a single reporting entity. This means that a property might be classified differently in consolidated financial statements than in any separate financial statements.
Consolidated financial statement side, for the classification of a property between property used for own business purposes (IAS 16) and property held for investments (IAS 40), it shall be taken into account who the final user is. In particular:

- if the final user is a Group entity, it shall be classified as property for own use, while

- if the final user is a third counterparty, the property shall be classified as investment property.

An entity leases an office block to its subsidiary, which uses the offices as its

administrative head office.
In the entity's separate financial statements the property is classified as investment property (assuming that the lease is an operating lease).
However, in the consolidated financial statements the property is classified as property, plant and equipment because the property is owner-occupied.

Example 4.1.3.3

Dual-use property

An entity owns a property that comprise a portion that is held to earn rentals or for capital appreciation and another portion that is owner-occupied, i.e. held for use in the production or supply of goods or services or for administrative purposes.

In this case:

- if these portions could be sold or leased out under a finance lease separately, the bank accounts for the portions separately,

- if the portions could not be sold or leased out under a finance lease separately, the property is investment property only if an insignificant portion is owner occupied.

In some cases, property has dual purposes and might be partially held for investments and partially used for own business purposes.
- As a basic principle, the portions of dual-use property shall be classified and
- accounted for separately as investment property (IAS 40) and as property, plant and equipment (IAS 16) if these portions could be sold or leased out separately,
- Otherwise, when the portions of the property could not be sold or leased out separately, the entire property is classified and accounted for as investment property (IAS 40) depending on the percentage of the asset used for own use or for investment.

4.2 Measurement at recognition

4.2.1 Element of costs

Example 4.2.1.1

Existing building demolished in order to construct new building

In the year 1, an entity purchased land and buildings for CUo 10 million (land: CU 4 million and building: CU 6 million). The building is used by the entity in its business; it is classified as property, plant and equipment and is depreciated over its estimated useful life. In the year 3, the entity demolishes the building and constructs a new building for its own use on the same piece of land. The carrying amount of the old building prior to demolition was CU 5.5 million.

Should the CU 5.5 million be written off to profit or loss or be capitalised as part of the cost of the new building?

The carrying amount of CU 5.5 million should be written off to profit or loss. Under IAS 16, the entity is required to depreciate the building to its residual value over its useful life. The remaining useful life of the entity's building is equivalent to the period from when the entity decided to demolish the building to the demolition date in the year 3. The residual value of the building is zero because the building will be demolished. Therefore, after management's decision to demolish the building, the entity should revise its estimates for both the remaining useful life and the residual value of the building and should adjust the depreciation expense accordingly, resulting in a write-down of the building to zero before demolition.

Example 4.2.1.2

Broker's commission rebate to purchaser of property

During negotiations to purchase a property, the purchaser was unwilling to accept the seller's best offer. To induce the purchaser to proceed with the transaction, the broker agreed to rebate a portion of the seller-paid commission to the purchaser.

As far as the purchaser is concerned, only one transaction has occurred – the purchase of property. The commission rebate is not immediate income to the purchaser. The seller's best offer is not the price that the purchaser actually paid. If the purchaser had been required to pay a brokerage commission, that commission would have been part of the cost of the property as a cost necessarily incurred to obtain the asset. In the circumstances described, the commission rebate is similarly a component of the cost of the property.

4.2.2 Measurement of cost

Example 4.2.2.1

Deferred payment terms

On 1 January 20X1, an item of property is offered for sale at CU 1 million, with payment terms being three equal instalments of CU 333,333 over a two year period (payments are made on 1 January 20X1, 31 December 20X1 and 31 December 20X2). The property developer is offering a discount of 5 per cent (i.e. CU 50,000) if payment is made in full at the time of completion of the sale and purchase agreement (which corresponds to an implicit interest rate of 5.36 per cent per annum).

A purchaser that takes up the deferred payment terms will recognise the acquisition of the asset as follows.

Initial recognition of property.

		CU	**CU**
Dr	Property, plant and equipment	950,000	
Cr	Cash		333,333
Cr	Accounts payable		616,667

The following entry will be required at the end of 20X1.

Recognition of interest expense and payment of second instalment.

		CU	**CU**
Dr	Interest expense (5.36% × CU 616,667)	33,046	
Dr	Accounts payable	300,287	
Cr	Cash		333,333

The following entry will be required at the end of 20X2.

Recognition of interest expense and payment of final instalment.

		CU	**CU**
Dr	Interest expense (5.36% × (CU 616,667 – CU 300,287))	16,954	
Dr	Accounts payable	316,379	
Cr	Cash		333,333

4.3 Depreciation

Example 4.3.1

Change in estimate of useful life

An entity purchased an asset at a cost of CU 1.2 million with an estimated useful life of 10 years.
At the end of Year 3, the asset has a carrying amount of CU 840,000. During Year

4, on the basis of experience of similar assets, the item of plant is now estimated to have a remaining useful life of 4 years. The asset is determined not to be impaired. Consequently, the carrying amount of CU 840,000 is depreciated over the remaining 4 years at CU 210,000 per annum.

Depreciation charges for Years 1 to 7 will be as follows.

	CU '000		**CU '000**	
Year 1	120	Year 5	210	
Year 2	120	Year 6	210	
Year 3	120	Year 7	210	
Year 4	210			

Example 4.3.2

Change in depreciation method

An entity acquired an asset 3 years ago at a cost of CU 5 million. The depreciation method adopted for the asset was 10 per cent reducing balance.
At the end of Year 3, the carrying amount of the asset is CU 3,645,000. The entity estimates that the remaining useful life of the asset is 8 years and determines to adopt straight-line depreciation from that date so as to reflect better the revised estimated pattern of recovery of economic benefits.

Depreciation charges for years 1 to 11 will be as follows.

	CU '000		**CU '000**
Year 1	500	Year 7	456
Year 2	450	Year 8	456
Year 3	405	Year 9	455
Year 4	456	Year 10	455
Year 5	456	Year 11	455
Year 6	456		

4.4 Derecognition

Example 4.4.1

Disposal of property, plant and equipment

An entity enters into a transaction whereby it sells an item of property, plant and equipment to a third party. It concurrently enters into a contract with the third party to buy all of the actual output of the asset over its remaining useful life at a fixed per-unit price, but in total not less than a minimum payment equal to the value of 90 per cent of the expected output. The minimum payment must be made even if the actual output is below expectation.

Should the entity recognise the sale of the asset by removing it from its statement of financial position?

In this situation, the entity should consider the requirements of IFRIC 4 *Determining Whether an Arrangement Contains a Lease*. If it is concluded that the supply arrangement involves a finance lease, the requirements of IAS 17 *Leases* regarding sale and leaseback transactions apply, and the entity will still recognise the asset in its statement of financial position after title has been transferred to the third party.

Example 4.4.2

Application of IFRS 5 to 'in-period' disposals of assets

An entity prepares its financial statements to 31 December and it does not prepare interim financial reports. At 31 December 20X1, the entity carried a property asset in its statement of financial position at its revalued amount of CU 2 million in accordance with IAS 16. Depreciation is CU 60,000 per year. In April 20X2, management decides to sell the property and it is advertised for sale. By 30 April 20X2, the sale is considered to be highly probable. At that date, the asset's fair value is CU 2.6 million and its value in use is CU 2.8 million. Costs of disposal of the asset are estimated at CU 100,000. On 15 June 20X2, the property is sold for CU 2.75 million.

Is Entity R required to apply IFRS 5 to the disposal of the property?

Yes. When the effect is material, the requirements of IFRS 5 should be applied to 'in-period' disposals of assets.

In the circumstances described, the following steps are required.

- The entity should determine the date at which the IFRS 5 criteria for classification as held for sale are met (assume the date is determined to be 30 April 20X2 in this case).
- The entity should depreciate the property until the date of reclassification as held for sale. Accordingly, the depreciation charge is CU 60,000 × 4/12 = CU 20,000.
- The property should be revalued to its fair value at that date of CU 2.6 million if the difference between the property's carrying amount at that date and its fair value is material. The revaluation increase should be recognised in other comprehensive income in accordance with IAS 16.

- The entity should consider whether the property is impaired by comparing its carrying amount (fair value) with its recoverable amount (higher of value in use and fair value less costs of disposal). In the above example, no impairment loss is recognised because value in use of CU 2.8 million is higher than fair value less costs of disposal of CU 2.5 million. If any impairment loss were identified at this point, it would be accounted for as a revaluation decrease under IAS 16.
- The property should be reclassified as held for sale and remeasured to fair value less costs to sell (CU 2.5 million). Because, in this example, the property is already carried at fair value, the requirement to deduct costs to sell results in the immediate recognition of a loss of CU 100,000. In accordance with IFRS 5, this write down to fair value less costs to sell should be recognised in profit or loss.
- When the property is disposed of on 15 June 20X2, a profit on disposal of CU 150,000 is recognised (net proceeds of CU 2.65 million less carrying amount of CU 2.5 million). Any remaining revaluation reserve relating to the property is not recognised in profit or loss, but it may be transferred to retained earnings in accordance with IAS 16.

The application of IFRS 5 in the above example affects the amounts reported in profit or loss, because the valuation movement prior to the date of reclassification (CU 620,000) is recognised in other comprehensive income and is not subsequently reclassified to profit or loss. In addition to the depreciation expense of CU 20,000, a net gain is recognised of CU 50,000 in profit or loss which is comprised of the fair value movement after reclassification (CU 150,000) less costs of disposal (CU 100,000). If IFRS 5 had not been applied, in addition to the depreciation expense of CU 27,500 (CU 60,000 × 5.5/12), the net gain recognised in profit or loss would have been CU 677,500 (net proceeds of CU 2.65 million less the carrying amount at 15 June 20X2 of CU 1,972,500).

For assets measured under IAS 16's cost model, the application will not affect the net amount reported in profit or loss for the period. However, it will affect the amounts disclosed under IFRS 5.41 (c) and, when disclosed separately, amounts reported for gains or losses arising on the disposal of property, plant and equipment.

5 PRESENTATION

5.1 Disclosure rules

IAS 16

For each class of property, plant, and equipment, disclose:

- basis for measuring carrying amount;
- depreciation method(s) used;
- useful lives or depreciation rates;
- gross carrying amount and accumulated depreciation and impairment losses;
- reconciliation of the carrying amount at the beginning and the end of the period, showing:
  - additions;
  - disposals;
  - acquisitions through business combinations;
  - revaluation increases or decreases;
  - impairment losses;
  - reversals of impairment losses;
  - depreciation;
  - net foreign exchange differences on translation other movements

The following disclosures are also required:

- restrictions on title and items pledged as security for liabilities;
- expenditures to construct property, plant, and equipment during the period;
- contractual commitments to acquire property, plant, and equipment;
- compensation from third parties for items of property, plant, and equipment that were impaired, lost or given up that is included in profit or loss.

IAS 16 also encourages, but does not require, a number of additional disclosures.

If property, plant, and equipment is stated at revalued amounts, certain additional disclosures are required:

- the effective date of the revaluation;
- whether an independent valuer was involved; **IAS 16.73**
- for each revalued class of property, the carrying amount that would have been recognised had the assets been carried under the cost model;
- the revaluation surplus, including changes during the period and any restrictions on the distribution of the balance to shareholders.

IAS 40

Both Fair Value Model and Cost Model

- whether the fair value or the cost model is used
- if the fair value model is used, whether property interests held under

operating leases are classified and accounted for as investment property

- if classification is difficult, the criteria to distinguish investment property from owner-occupied property and from property held for sale
- the methods and significant assumptions applied in determining the fair value of investment property **IAS 16.74**
- the extent to which the fair value of investment property is based on a valuation by a qualified independent valuer; if there has been no such valuation, that fact must be disclosed
- the amounts recognised in profit or loss for:
    - rental income from investment property
    - direct operating expenses (including repairs and maintenance) arising from investment property that generated rental income during the period **IAS 16.77**
    - direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental income during the period
    - the cumulative change in fair value recognised in profit or loss on a sale from a pool of assets in which the cost model is used into a pool in which the fair value model is used
- restrictions on the realisability of investment property or the remittance of income and proceeds of disposal
- contractual obligations to purchase, construct, or develop investment property or for repairs, maintenance or enhancements

Additional Disclosures for the Fair Value Model:

- a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing additions, disposals, fair value adjustments, net foreign exchange differences, transfers to and from inventories and owner-occupied property, and other changes; **IAS 40.75**
- significant adjustments to an outside valuation (if any);
- if an entity that otherwise uses the fair value model measures an item of investment property using the cost model, certain additional disclosures are required.

Additional Disclosures for the Cost Model

- the depreciation methods used
- the useful lives or the depreciation rates used
- the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period
- a reconciliation of the carrying amount of investment property at the beginning and end of the period, showing additions, disposals, depreciation, impairment recognised or reversed, foreign exchange differences, transfers to and from inventories and owner-occupied property, and other changes
- the fair value of investment property. If the fair value of an item of investment property cannot be measured reliably, additional disclosures are

required, including, if possible, the range of estimates within which fair value is highly likely to lie.

5.2 Mediolanum Financial Statements disclosures

IAS 40.76

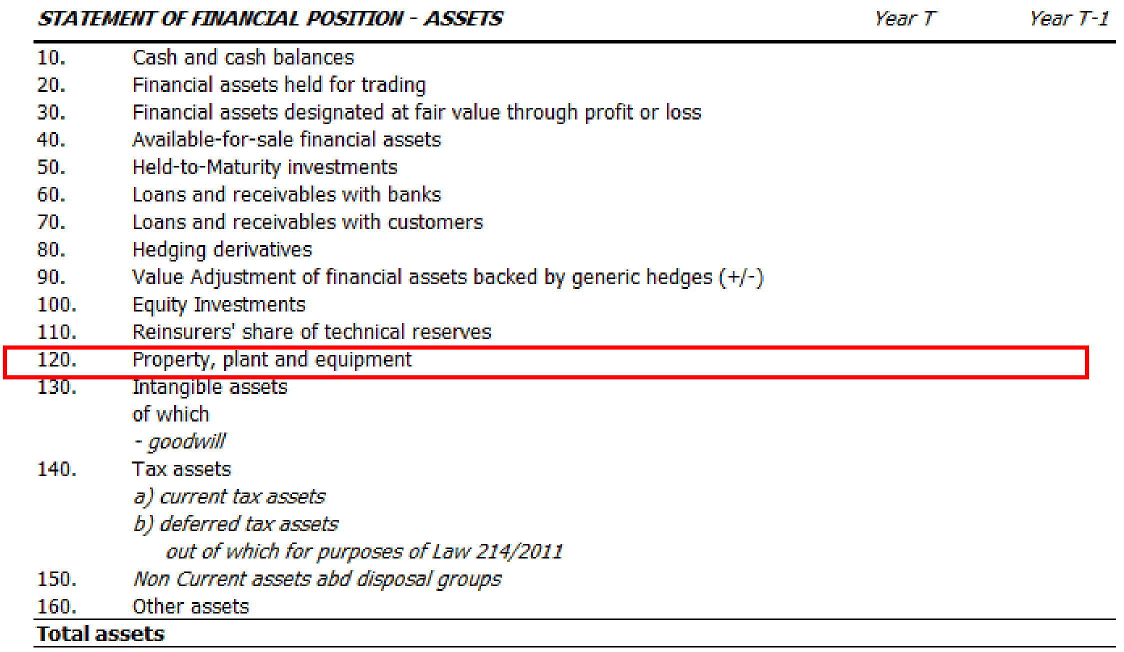
In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present items of property, plant and equipment and investment property in the consolidated financial statements.

IAS 40.77
IAS 40.78

As required by Bank of Italy, caption 120. Property, plant and equipment receives the following tangible assets:

IAS 40.79

- property, plant and equipment as defined by IAS 16 (see above). This category include also:
  - tangible assets acquired under a finance lease (entity as a lessee),
  - tangible leased assets under an operating leasing (entity as a lessor),
- investment property as defined by IAS 40 (see above).



STATEMENT OF FINANCIAL POSITION - ASSETS		*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			

Therefore, caption 120. Property, plant and equipment, includes the following subcategories of assets used in the business or held for investments:

- Land,
- Buildings,
- Furnishings,
- Electronic equipment,
- Other.

12.1 Analysis of tangible assets held for use	*Year T*	*Year T-1*
1. Property assets		
a) land		
b) buildings		
c) furnishings		
d) electronic equipment		
e) other		
2. Assets under financial lease		
a) land		
b) buildings		
c) furnishings		
d) electronic equipment		
e) other		
Total		

12.2 Analysis of tangible assets held for investements	*Total Year T*				*Total Year T-1*			
	Book value	*Fair value*			*Book value*	*Fair value*		
		L1	L2	L3		L1	L2	L3
1. Property assets								
a) land								
b) buildings								
2. Assets acquired undere finance leases								
a) land								
b) buildings								
Total								

The sum of the total of the table 12.1 and 12.2 corresponds to item 120 of consolidated financial statement position (assets).

Where relevant, it must be provided the amount of property and equipment held investment purposes under operating leases.
At the bottom of the tables are provided with the information specified in IAS 40.75 and limited to table 11.1 of paragraph IAS.40.78

In particular, each sub-categories includes the following assets:

- *Land*
  The sub-category Land consists on lands. Land and buildings are recognized separately, even if acquired together.

- *Buildings*
  The sub-category Buildings consists on buildings acquired or internally constructed - if it is the case, from the completion of the construction - held for use in the production or supply of goods or services or for rental to others or for administrative purposes. Land and buildings are recognized separately, even if acquired together.

- *Furnishings*
  The sub-category Office furniture and fittings consists on:
  - furniture,

- bulletproof counters and windows,
- branch house and office furniture,
- office furniture,
- work canteen furniture,
- neon signs and plates,
- lights,
- electric clocks,
- bookcases.

- *Electronic equipment*
  The sub-category Electronic equipment consists on:
  - hardware (hard disk, video, keyboard, mouse),
  - lifting, loading and unloading, weighing systems,
  - telephone and radio equipment and pneumatic tube,
  - telecommunication systems,
  - night safe systems,
  - strongbox systems,
  - burglar alarm systems,
  - communication systems,
  - anti-theft security systems,
  - electrical systems,
  - heating, cooling and air ventilation systems,
  - data elaboration and related appliances,
  - portables,
  - firefighting systems,
  - generators and UPSs.

- *Others*
  The sub-category Others consists on:
  - cars, motor vehicles and other transport vehicles,
  - ATMs,
  - safe deposit boxes,
  - electromechanical office equipment,
  - manual strongboxes.

The amount of each item could also include, if it is the case, (i) the good owned under finance leases (the entity as a lessee) and (ii) the expenditure for leasehold improvements if they are identifiable and separable (see below).

At each interim and annual reporting date, the Group must give information about annual changes.

This information is required both property, plan and equipment held for own use both held for investment purposes.

12.5 Property and equipment held for own use: annual changes	*Land*	*Buildings*	*Furnishings*	*Electronic equipment*	*Other*	***Total***
A. Gross opening balance						
A.1 Total net write-downs						
A.2 Net opening balance						
B. Increases:						
B.1 Acquisitions						
B.2 Capitalised improvements costs						
B.3 Reversal of impairment						
B.4 Increase in fair value:						
a) equity						
b) income statement						
B.5 Positive Exchange differences						
B.6 Reclassified from investment property						
B.7 Other changes						
C. Decreases:						
C.1 Disposals						
C.2 Depreciation						
C.3 Impairment						
a) equity						
b) income statement						
C.4 Decreases in fair value:						
a) equity						
b) income statement						
C.5 Negative exchange differences						
C.6 Reclassified to:						
a) tangible assets held for investment						
b) assets held for sale						
C.7 Other changes						
D. Net closing balance						
D.1 Total net write-downs						
D.2 Gross closing balance						
E. Measured at cost						

12.6 Year's movements in tangilble assets held for investment purposes	*Land*	*Buildings*
A. Opening balance		
B. Increases:		
B.1 Acquisitions		
B.2 Capitalised improvements costs		
B.3 Increase in fair value		
B.4 Reversal of impairment		
B.5 Positive Exchange differences		
B.6 Reclassified from assets held for use		
B.7 Other changes		
C. Decreases:		
C.1 Disposals		
C.2 Depreciation		
C.3 Decreases in fair value		
C.4 Impairment		
C.5 Negative exchange differences		
C.6 Reclassified to other asset portfolios:		
a) assets held for use		
b) non-current assets held for sale		
C.7 Other changes		
D. Closing balance		
E. Measured at fair value		

The depreciation term of tangible assets is presented in caption 200 of the consolidated income statement as required by Bank of Italy.

CONSOLIDATED INCOME STATEMENT	***Year T***	***Year T-1***
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

The caption 200 shall indicate the balance, positive or negative, between the value adjustments and reversals of impairment losses relating to tangible assets held for own use or for the purpose of Investment, including those relating to assets acquired under finance leases and activities under operating leases.

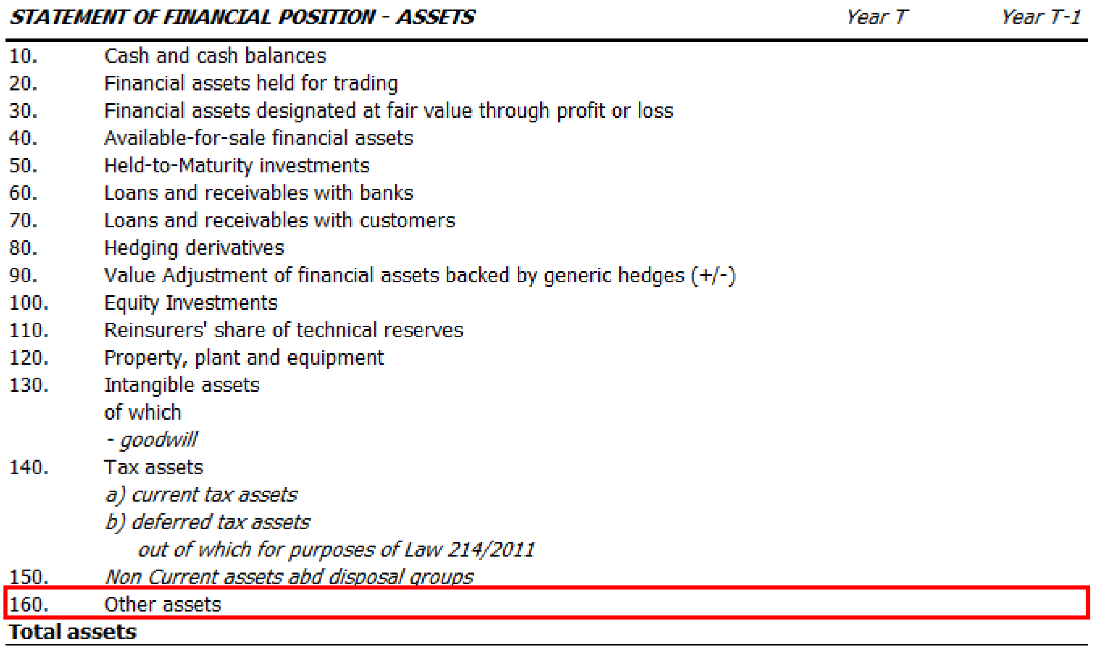
Therein conventionally also the results of the evaluations carried out pursuant IFRS 5, the tangible assets classified as "individual assets."

13.1 Analysis of Depreciation and net impairment of intangible assets	*Amortization (a)*	*Impairment (b)*	*Write-backs (c)*	*Net Result (a+b+c) Year T*	*Net Result (a+b+c) Year T-1*
A. Tangible Assets					
A.1 Owned					
- held for use					
- Held for investment purposes					
A.2 Asset acquired under finance					
- held for use					
- Held for investment purposes					
Total					

Leasehold improvements

Leasehold improvements are usually borne in order to make leased premises fit for the expected use. The improvement costs related to property, plant and equipment leased by the entity are capitalized because the bank has the control of the assets and receives future economic benefits.

Leasehold improvements are classified as tangible assets in accordance with IAS 16 and shall be included in the specific sub-items relating to the asset type listed above, if the improvement can be identified and separated from the leasehold. Therefore, caption 120. Property, plant and equipment of consolidated financial statement, also includes leasehold improvements relating to assets which can be separately identified.
Leasehold improvements identifiable but not separable shall be recognized in caption 160. Other assets of consolidated financial statement as required by Bank of Italy.



STATEMENT OF FINANCIAL POSITION - ASSETS		*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			

They shall be separate into:

- inseparable improvements on third parties NOT belonging to the Group assets, and
- inseparable improvements on third parties belonging to the Group.

The depreciation term of separable Leasehold improvements shall not exceed the maturity of the contract and is presented in caption 200. Impairment/write-backs on property, plant and equipment of consolidated income statement.

The depreciation term of inseparable Leasehold improvements shall not exceed the maturity of the contract and is presented in caption 220. Other net operating income (expenses), of consolidated income statement.

IFRS Operating Manual

Chapter 13
Intangible Assets

CHAPTER XIII – INTANGIBLE ASSETS **554**

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1 INTRODUCTION AND OVERVIEW OF RULES

This Section of the Chapter provides:

- an overview of the International Accounting Standard IAS 38 – Intangible Assets;
- a list of most recent amendment to IAS 38.

1.1 Introduction

The main standard that addresses the accounting of intangible assets is *IAS 38.* The objective of this standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another IFRS.
Furthermore, IAS 38 is accompanied by the interpretation *SIC-32 – Intangible Assets – Website Costs* that regulates the accounting treatment for specific internally generated intangible assets.

1.2 Overview IAS 38

IAS 38 Intangible Assets outlines the accounting requirements for intangible assets, which are non-monetary assets which are without physical substance and identifiable, either being separable or arising from contractual or other legal rights.

Intangible assets meeting the relevant recognition criteria are initially measured at cost, subsequently measured at cost or using the revaluation model, and amortised on a systematic basis over their useful lives (unless the asset has an indefinite useful life, in which case it is not amortised).

IAS 38 was revised in March 2004 and applies to intangible assets acquired in business combinations occurring on or after 31 March 2004, or otherwise to other intangible assets for annual periods beginning on or after 31 March 2004. Moreover, it was recently amended in May 2014:

Date	Development	Comments
February 1977	Exposure Draft E9 *Accounting for Research and Development Activities*	
July 1978	IAS 9 (1978) *Accounting for Research and Development*	Effective 1 January 1980

	Activities issued	
August 1991	Exposure Draft E37 *Research and Development Costs* published	
December 1993	IAS 9 (1993) *Research and Development Costs* issued	Operative for annual financial statements covering periods beginning on or after 1 January 1995
June 1995	Exposure Draft E50 *Intangible Assets* published	
August 1997	E50 was modified and re-exposed as Exposure Draft E59 *Intangible Assets*	
September 1998	IAS 38 *Intangible Assets* issued	Operative for annual financial statements covering periods beginning on or after 1 July 1998
31 March 2004	IAS 38 *Intangible Assets* issued	Applies to intangible assets acquired in business combinations occurring on or after 31 March 2004, or otherwise to

		other intangible assets for annual periods beginning on or after 31 March 2004
22 May 2008	Amended by *Improvements to IFRSs* (advertising and promotional activities, units of production method of amortisation)	Effective for annual periods beginning on or after 1 January 2009
16 April 2009	Amended by *Improvements to IFRSs* (measurement of intangible assets in business combinations)	Effective for annual periods beginning on or after 1 July 2009
12 December 2013	Amended by *Annual Improvements to IFRSs 2010–2012 Cycle* (proportionate restatement of accumulated depreciation under the revaluation method)	Effective for annual periods beginning on or after 1 July 2014
12 May 2014	Amended by *Clarification of Acceptable Methods of Depreciation and Amortisation (Amendments to IAS 16 and IAS 38)*	Effective for annual periods beginning on or after 1 January 2016

1.3 Overview of SIC-32

SIC-32 concludes that a website developed by an entity using internal expenditure, whether for internal or external access, is an internally generated intangible asset that is subject to the requirements of IAS 38 Intangible Assets.

Date	Development	Comments
9 July 2001	SIC-D32 Intangible Assets — Web Site Costs published	Comment deadline 10 September 2001.
25 March 2002	SIC-32 Intangible Assets — Web Site Costs issued	Effective 25 March 2002.

2 ACCOUNTING RULES

This Section of the Chapter provides the accounting rules, adapted from IAS 38 and from related International Financial Reporting Standards (IFRSs) that have to be followed by each Legal Entity for preparing:

- their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
- the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).

2.1 General definition

Definition of intangible assets

An intangible asset is an identifiable non-monetary asset without physical substance. An asset is a resource that is controlled by the entity as a result of past events (for example, purchase or self-creation) and from which future economic benefits (inflows of cash or other assets) are expected. Thus, the three critical attributes of an intangible asset are:

IAS 38.8

- identifiability
- control (power to obtain benefits from the asset)
- future economic benefits (such as revenues or reduced future costs)

Definition of identifiability

An intangible asset is identifiable when it:

- is separable (capable of being separated and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract); or

IAS 38.12

- arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Examples of intangible assets are patented technology, computer software, databases and trade secrets trademarks, trade dress, newspaper mastheads, internet domains video and audiovisual material.

Intangibles can be acquired:

- by separate purchase

- as part of a business combination
- by a government grant
- by exchange of assets
- by self-creation (internal generation)

2.2 Scope of rules

IAS 38 applies to all intangible assets other than:

- financial assets (*IAS 32 Financial Instruments: Presentation*)
- exploration and evaluation assets (*IFRS 6 Exploration for and Evaluation of Mineral Resources*)
- expenditure on the development and extraction of minerals, oil, natural gas, and similar resources
- intangible assets arising from insurance contracts issued by insurance companies
- intangible assets covered by another IFRS, such as intangibles held for sale *(IFRS 5 Non-current Assets Held for Sale and Discontinued Operations)*, deferred tax assets *(IAS 12 Income Taxes)*, lease assets *(IAS 17 Leases)*, assets arising from employee benefits *(IAS 19 Employee Benefits)*, and goodwill (*IFRS 3 Business Combinations*).

IAS 38.2-3

Intangible assets contained in or on a physical substance

When an intangible asset is contained in or on a physical substance (such as computer software on a compact disc or a motion picture on film), management must assess which element is more significant. For example, software that controls machinery would normally be considered an integral part of the machinery and, therefore, would be treated as property, plant and equipment rather than as an intangible asset. The same would normally be true for the operating system for a computer. When the software does not form an integral part of the machinery or computer hardware to which it relates, it is separately accounted for under IAS 38.

IAS 38.4

Leases for intangible assets

A reporting entity may enter into a lease in respect of an intangible asset. The appropriate classification of the lease is determined in accordance with the requirements of IAS 17 - Leases. When the lease is a finance lease, IAS 17 directs the lessee to IAS 38 for the appropriate accounting treatment after initial recognition. However, certain rights are specifically excluded from the scope of IAS 17 (rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents and copyrights) and are accounted for under IAS 38.

2.3 Recognition

IAS 38 requires an entity to recognize an intangible asset, whether purchased or self-created if, and only if:

- it is probable that the future economic benefits that are attributable to the asset will flow to the entity; and
- the cost of the asset can be measured reliably. **IAS 38.21**

This requirement applies whether an intangible asset is acquired externally or generated internally.

The probability of future economic benefits must be based on reasonable and supportable assumptions about conditions that will exist over the life of the asset. The probability recognition criterion is always considered to be satisfied for intangible assets that are acquired separately or in a business combination.

IAS 38.22-33

If an intangible item does not meet both the definition of and the criteria for recognition as an intangible asset, IAS 38 requires the expenditure on this item to be recognized as an expense when it is incurred.

IAS 38.68

In case of business combination, an expenditure included in the cost of acquisition on an intangible item that does not meet both the definition of and recognition criteria should form part of the amount attributed to the goodwill recognized at the acquisition date.

IAS 38.35

IAS 38 includes additional recognition criteria for internally generated intangible assets:

Research and development costs

- Charge all research cost to expense.
- Development costs are capitalised only after technical and commercial feasibility of the asset for sale or use have been established. This means that the entity must intend and be able to complete the intangible asset and either use it or sell it and be able to demonstrate how the asset will generate future economic benefits.

IAS 38.54-57

If an entity cannot distinguish the research phase of an internal project to create an intangible asset from the development phase, the entity treats the expenditure for that project as if it were incurred in the research phase only.

In-process research and development acquired in a business combination

A research and development project acquired in a business combination is recognized as an asset at cost, even if a component is research. Subsequent expenditure on that project is accounted for as any other research and development cost (expensed except to the extent that the expenditure satisfies the criteria in IAS 38 for recognising such expenditure as an intangible asset). **IAS 38.34**

Internally generated brands, mastheads, titles, lists

Brands, mastheads, publishing titles, customer lists and items similar in substance that are internally generated should not be recognised as assets.

Computer software

IAS 38.63

- Purchased: capitalize;
- Operating system for hardware: include in hardware cost;
- Internally developed: charge to expense until technological feasibility, probable future benefits, intent and ability to use or sell the software, resources to complete the software, and ability to measure cost;
- Amortisation: over useful life, based on pattern of benefits (straight-line is the default).

Web site costs
SIC-32 Intangible Assets – Web Site Costs addresses the appropriate accounting treatment for internal expenditure to develop, enhance and maintain a web site incurred by an entity (whether for internal or external access). Specifically, the Interpretation addresses the application of IAS 38 to web site development costs.
The Interpretation does not apply to purchasing, developing and operating the hardware associated with a web site (accounted for under *IAS 16 Property, Plant and Equipment*), nor to expenditure on the development or operation of a web site for sale to another entity (accounted for under *IAS 2 Inventories* and *IAS 11 Construction Contracts*). **SIC-32**

SIC-32 identifies the following stages of web site development:

- Planning (including undertaking feasibility studies, defining objectives and specifications, evaluating alternatives and selecting preferences);
- Application and Infrastructure Development (including obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications and stress testing); **SIC-32.2** **SIC-32.3**
- Graphical Design (including designing the appearance of web pages);
- Content Development (including creating, purchasing, preparing and uploading information, either textual or graphical in nature, on the web site before the completion of the web site's development. This information may

either be stored in separate databases that are integrated into, or accessed from, the web site or coded directly into the web pages); and
- Operating (including maintaining and enhancing the applications, infrastructure, graphical design and content of the web site).

The Interpretation states that:

- a web site developed by an entity for its own use (whether for internal or external access) is an internally generated intangible asset that is subject to the requirements of IAS 38;
- future economic benefits, as envisaged by IAS 38's criteria for recognition of internally generated intangible assets, will be generated from a web site only when the web site is capable of generating revenue. For example, the requirement may be satisfied when the web site is capable of generating direct revenues from enabling orders to be placed; and **SIC 32.7** **SIC-32.8**
- if the web site has been developed solely or primarily for promoting or advertising the entity's products and services, the entity will be unable to demonstrate that such a web site will generate future economic benefits, and costs incurred on the development of the web site should be expensed as incurred.

SIC-32 concludes as follows:

- the nature of each activity for which expenditure is incurred (e.g. training employees and maintaining the web site) and the web site's stage of development or post-development are evaluated to determine the appropriate accounting treatment
- the Planning stage of a web site development is similar to the research phase and, therefore, any expenditure incurred in this stage is recognised as an expense when it is incurred; **SIC-32.9**
- the Application and Infrastructure Development stage, the Graphical Design stage and the Content Development stage are similar in nature to the development phase. Therefore, expenditure incurred in these stages is recognised as an intangible asset if the expenditure can be directly attributed and is necessary to creating, producing or preparing the web site for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own products and services) specifically for a web site, or to enable use of the content (e.g. a fee for acquiring a licence to reproduce) on the web site, is included in the cost of development when this condition is met; and
- expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own products and services (e.g. digital photographs of products), is recognised as an expense when incurred. For example, when accounting for expenditure on

professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure is recognised as an expense as the professional services are received during the process, not when the digital photographs are displayed on the web site.

In accordance with IAS 38.71, expenditure on web site development that has previously been recognised as an expense should not be recognised as part of the cost of the web site intangible asset at a later date.

Other defined types of costs

IAS 38.71

The following items must be charged to expense when incurred:

- internally generated goodwill;
- start-up, pre-opening, and pre-operating costs;
- training cost;
- advertising and promotional cost, including mail order catalogues;
- relocation costs.

IAS 38.48-69

For this purpose, 'when incurred' means when the entity receives the related goods or services. If the entity has made a prepayment for the above items, that prepayment is recognized as an asset until the entity receives the related goods or services.

IAS 38.70

2.4 Initial measurement

Intangible assets are initially measured at cost.

2.5 Measurement subsequent to initial recognition

IAS 38.24

IAS 38 permits two accounting models:

- Cost model - after initial recognition intangible assets should be carried at cost less accumulated amortisation and impairment losses.

- Revaluation model - intangible assets may be carried at a revalued amount (based on fair value) less any subsequent amortisation and impairment losses only if fair value can be determined by reference to an active market. Such active markets are expected to be uncommon for intangible assets.

IAS 38.74

IAS 38.75

Under the revaluation model, revaluation increases are recognised in other comprehensive income and accumulated in the "revaluation surplus" within equity except to the extent that it reverses a revaluation decrease previously recognised in profit and loss. If the revalued intangible has a finite life and is, therefore, being amortised then the revalued amount is amortised, too. **IAS 38.85**

IAS 38 classifies intangible assets as having:

- Indefinite life: no foreseeable limit to the period over which the asset is expected to generate net cash inflows for the entity;
- Finite life: a limited period of benefit to the entity.

IAS 38.88

Measurement subsequent to acquisition: intangible assets with finite lives

The cost less residual value of an intangible asset with a finite useful life should be amortised on a systematic basis over that life:

- The amortisation method should reflect the pattern of benefits;
- If the pattern cannot be determined reliably, amortise by the straight line method; **IAS 38.97**
- The amortisation charge is recognised in profit or loss unless another IFRS requires that it be included in the cost of another asset;
- The amortisation period should be reviewed at least annually.

Expected future reductions in selling prices could be indicative of a higher rate of consumption of the future economic benefits embodied in an asset.
The standard contains a rebuttable presumption that a revenue-based amortisation method for intangible assets is inappropriate. However, there are limited circumstances when the presumption can be overcome:

IAS 18.92

- the intangible asset is expressed as a measure of revenue; and
- it can be demonstrated that revenue and the consumption of economic benefits of the intangible asset are highly correlated.

Measurement subsequent to acquisition: intangible assets with indefinite useful lives

An intangible asset with an indefinite useful life should not be amortised.

Its useful life should be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite should be accounted for as a change in an accounting estimate. **IAS 38.107**

The asset should also be assessed for impairment in accordance with IAS 36. **IAS 38.109**

2.6 Subsequent expenditure

Due to the nature of intangible assets, subsequent expenditure will only rarely meet the criteria for being recognised in the carrying amount of an asset. **IAS 38.111**

Subsequent expenditure on brands, mastheads, publishing titles, customer lists and similar items must always be recognised in profit or loss as incurred. **IAS 38.20**

2.7 Depreciation

IAS 38.63

Depreciation methods permitted under IAS 38 are the same of those permitted under IAS 16 – Property, plant and equipment (please see Chapter 12).

2.8 Derecognition

IAS 16

IAS 38 requires that the carrying amount of an intangible asset should be derecognised:

- on disposal; or
- when no future economic benefits are expected from its use or disposal.

The gain or loss arising from the derecognition of an intangible asset is to be recognised in profit or loss when the asset is derecognized. IAS 38 specifically prohibits the classification as revenue of gains arising on the derecognition of intangible assets. **IAS 38.112**

The gain or loss arising from the derecognition of an intangible asset is determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item. Therefore, when a revalued asset is disposed of, any credit balance on the revaluation reserve attributable to that asset may be transferred directly to retained earnings, but should not be reflected in profit or loss. **IAS 38.113** **IAS 38.103**

IAS 38.87

3 GROUP POLICIES AND RELEVANT TOPICS TO MEDIOLANUM GROUP

This Section of the Chapter provides:

- the Group policies and interpretations that have to be taken into account by each Legal Entity for preparing:
  - their individual financial statements when prepared in accordance with International Financial Reporting Standards (IFRSs),
  - the reporting needed for preparation of Group consolidated financial statements (i.e. reporting package).
- an analysis of issues that are relevant to Mediolanum Group in the current context of operations and taking into account recent developments and perspective in the regulatory framework.

The Companies of the Group are therefore expected to start promptly the necessary activities aimed at the correct application of the present document. If a Legal Entity believe that it could be necessary to make changes/exceptions to the previsions contained in the following paragraphs, for compliance with the local regulations, or because of organizational/operational constraints, is requested to share with the Parent Company the relevant information and the considerations made.

3.1 Group policies

Mediolanum Group's intangible assets include:

- Long-term application software
- Goodwill (please see Chapter 3)
- Intangible asset generated during the acquisition of a business (please see also Chapter 3)
- Other intangibles asset

An item is recognized as intangible asset in the balance sheet if it meets both of the definition criteria and the recognition criteria described in the previous paragraph and here reported:

- the intangible asset should be clearly identifiable
- the legal entity controls the asset in the sense that it has the power to obtain the future economic benefits flowing from the underlying resource and to restrict the access of others to those benefits
- it is probable that the asset will generate benefits for the legal entity, in terms of revenues or cost saving
- the cost of asset can be measured reliably.

Application of the recognition criteria is differentiated depending on the fact that they refer:

- to costs incurred initially to acquire an intangible asset (separate

acquisition),
- to intangible asset acquired in a business combination (see also chapter Business combination for the initial recognition criteria),
- to costs incurred to internally generate an intangible asset,
- to costs incurred subsequently to add to, replace part of, or service it.

Intangible assets acquired separately include software licenses acquired by external software providers. The initial measurement is at cost.
The cost of the intangible asset comprises:
- its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- any directly attributable expenditure on preparing the asset for its intended use.

Examples of directly attributable expenditure are:
- the salaries, wages and other employment-related costs of personnel directly engaged in bringing the asset to its working condition;
- professional fees arising directly from bringing the asset to its working condition; and
- costs of testing whether the asset is functioning properly.

Examples of expenditure that *does not* form part of the cost of an intangible asset are:
- costs of introducing a new product or service (including costs of advertising and promotional activities);
- costs of conducting business in a new location or with a new class of customer (including the cost of staff training); and
- administration and general overhead costs.

Intangible assets arising from a business combination are initially measured at fair value in the context of the purchase price allocation process occurring, according to IFRS 3, upon acquisition of the acquiree (see also chapter Business Combinations).

Intangible assets arising from business combinations in the banking/financial sector typically include:
- software licenses,
- customer relationships and similar items that will generate future economic benefits
- trademarks

Customer relationships and similar items meet the definition of intangible assets when either:
- they are protected or otherwise controlled by legal rights; or
- the ability to control the expected benefits flowing from the relationships, and the separability of the customer relationships, have been evidenced by

exchange transactions for the same or similar non-contractual customer relationships (other than as part of a business combination).

In the former case, where there is no protection or legal control over the intangible asset identified, Legal Entities are invited to pay particular attention to the evalution of the control of the expected benefits and are requested to share with the Parent Company the relevant information and the accounting considerations made.

Trademarks, customer relationships and similar items typically are not quoted in active markets. In addition, market transactions rarely provide relevant information for the evaluation of these items due to the fact that such transactions rarely occur or, in any case, are not relevant due to the fact that such assets are often specialized. Accordingly, the fair value of such assets may be determined through discounting cash flow techniques.
Such techniques discount the cash flows arising from the assets at an appropriate discount rate.
Cash flows arising from the assets are determined by:

- determining the revenue flows of the acquiree that are affected by the intangible assets considering the business plans of the acquiree,
- identifying which part of such cash flows benefits/is generated by the intangible assets (e.g. through application of a royalty rate).

Due to complexity arising from this evaluation, it is suggested that it shall be performed by external appraisers.

Insurance contracts acquired in a business combination or portfolio transfer may give rise to intangible assets in accordance with IFRS 4 dispositions, if the fair value of acquired insurance contracts is split into two components:

- a liability measured in accordance with the insurer's accounting policies for insurance contracts that it issues; and
- an intangible asset, representing the difference between (i) the fair value of the contractual insurance rights acquired and insurance obligations assumed and (ii) the amount described in (a). The subsequent measurement of this asset shall be consistent with the measurement of the related insurance liability.

The intangible assets described above are excluded from the scope of IAS 36 Impairment of Assets and IAS 38. However, IAS 36 and IAS 38 apply to customer lists and customer relationships reflecting the expectation of future contracts that are not part of the contractual insurance rights and contractual insurance obligations that existed at the date of a business combination or portfolio transfer. **IFRS 4.31-33**

Internally generated intangible assets might be recognized only in case of internal development of IT platforms and/or software. It is not permitted the recognition of internally generated goodwill as an asset. Each Legal Entity, in the generation of an

intangible asset internally has to clearly distinguish between
– the research phase and
- the development phase.
Capitalisation is only permitted during the development phase.

The following examples of research activities given in the Standard illustrate that the main objective of research activities is the discovery of something new:

- activities aimed at obtaining new knowledge;
- the search for, evaluation and final selection of, applications of research findings or other knowledge;
- the search for alternatives for materials, devices, products, processes, systems or services; and
- the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

The following examples of development activities illustrate that the main objective of development activities is to apply research findings for a business purpose:

- the design, construction and testing of pre-production or pre-use prototypes and models;
- the design of tools, jigs, moulds and dies involving new technology;
- the design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- the design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

<u>An intangible asset arising from development (or from the development phase of an internal project) should be recognised if, and only if, the Legal Entity can demonstrate all of the following:</u>

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible asset and use or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and
- its ability to measure the expenditure attributable to the intangible asset during the development phase.

<u>Internally generated intangible assets have to be initially recognised at its cost. Cost</u>

includes all costs incurred from the date on which all of the recognition criteria (i.e. those for purchased as well as for internally generated intangible assets) are met. Similar to self-constructed items of property, plant and equipment, the cost of an internally generated intangible asset includes all directly attributable costs necessary to create, produce and prepare an asset to be capable of operating in the manner intended by management. These costs may include:

- expenditure on materials and services used or consumed in generating the intangible asset;
- the salaries, wages and other employment-related costs of personnel directly engaged in generating the asset;
- borrowing costs, in accordance with the requirements of IAS 23 Borrowing Costs
- any other expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset.

The inclusion of the following items in the cost of an internally generated intangible asset is prohibited:

- selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;
- clearly identified inefficiencies and initial operating losses incurred before an asset achieves planned performance; and
- expenditure on training staff to operate the asset

In the Mediolanum Group *Web Sites* has been developed solely or primarily for promoting or advertising the entity's products and services, and due to the difficulty to demonstrate that such web sites will generate future economic benefits, the costs incurred on the development of the web sites should be expensed as incurred.

The following types of expenditure have to be always recognised as an expense:

- research (except to the extent that it relates to an intangible asset acquired in a business combination);
- start-up activities, unless the expenditure qualifies to be included in the cost of an item of property, plant and equipment. Start-up costs may include:
  a) establishment costs such as legal and secretarial costs incurred in establishing a legal entity;
  b) expenditure to open a new facility or business (i.e. pre-opening costs); and
  c) expenditure prior to starting new operations or launching new products or processes (i.e. pre-operating costs);
- training activities;
- advertising and promotional activities (including mail order catalogues); and
- relocating or reorganising part or all of an entity.

More generally, if expenditure does not give rise to an intangible asset:

- for a supply of goods, an expense is recognised when the entity has a right to access those goods. This is when the entity owns the goods or, if they have been constructed by a supplier in accordance with the terms of a supply contract, when the entity could demand delivery of them in return for payment; and
- for a supply of services, an expense is recognised when the entity receives the services. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example to deliver an advertisement to customers.

This does not, however, preclude the recognition of a prepayment asset when payment for goods or services has been made in advance of the entity obtaining a right to access those goods, or in advance of receiving those services.

The useful life of an intangible asset shall be estimated considering the following factors:

- the expected usage of the asset by the entity and whether the asset could be efficiently managed by another management team;
- typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;
- technical, technological, commercial or other types of obsolescence;
- the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
- expected actions by competitors or potential competitors;
- the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the entity's ability and intent to reach such a level;
- the period of control over the asset, and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
- whether the useful life of the asset is dependent on the useful life of other assets of the entity.

Each Legal Entity should determine the useful life of the intangible asset considering the factors listed above, and the following useful life assessed in the Mediolanum Group:

Intangible Asset	**Standard Useful life**	**Max. useful life***
Software	3 years	5 years
Licences	To be determined on the basis of the expected economic benefits	Contract/agreement termination

Customer relations and similar items	To be determined on the basis of the expected economic benefits	Contract/agreement termination
Intangible asset deriving from insurance contracts acquired in Business Combinations or portfolio transfers (IFRS 4)	On an actuarial basis, consistent with the measurement of the related insurance liability	Insurance contract termination
Other Intangible asset	5 years	10 years
Trademarks	Indefinite	Indefinite
Goodwill	Indefinite	Indefinite

* misalignment from Standard Useful life is subject to communication to Parent Company to allow adequate disclosure at Group level

Goodwill has an indefinite useful life. Trademarks may have an indefinite useful life as long as they are regularly used and the entity has no plans to perform rebranding projects. An intangible asset with an indefinite life is tested for impairment, in accordance with IAS 36, by comparing its recoverable amount with its carrying amount:

- annualy, and
- whenever there is an indication that the intangible asset may be impaired.

Note that the term 'indefinite' does not mean 'infinite'. There does not need to be an expectation that the cash inflows generated by the asset will go on forever – simply that, at the date of assessment, there is no foreseeable point at which the cash inflows will cease.
Amortisation commences from the date the asset is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. It is important to distinguish the date an asset is available for use from the date on which it is actually brought into use. Amortisation will commence from the former.
Amortisation ceases at the earlier of:

- the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with IFRS 5 Non-current Assets Held for Sale and Discontinued Operations; and
- the date that the asset is derecognised

At least at each financial year end, the amortisation periods for intangible assets with finite lives should be reviewed. If the expected useful life of the asset is different from previous estimates, the amortisation period should be adjusted accordingly.

Amortisation method should reflect expected consumption of economic benefits; the method used in the Mediolanum Group is the straight-line method. If it occurs the case that the straight-line method does not reflect the pattern in which the asset's economic benefits are expected to be consumed by the entity itself, all the considerations have to be discussed at Group Level (mandatory communication to Parent Company) to allow adequate disclosure at Group level.

4 ILLUSTRATIVE EXAMPLES

This Section of the Chapter contains illustrative examples related to the following topics:

- Recognition (paragraph 4.1)
- Measurement after initial recognition (paragraph 4.2)
- Depreciation (paragraph 4.3)

that could be considered by Group Component to make decisions on accounting issues related to intangible Assets.

4.1 Recognition

4.1.1 Commissions paid to acquire contracts

Example 4.1.1

Commissions paid to acquire contracts

An entity A pays commission to an external party, entity B, which markets its security contracts. When a customer commits to a security contract, the customer agrees to use entity A's security services for a minimum of two years and entity B earns a commission of 100. If, for any reason, the customer cancels within those two years, it is required to pay in full for the unexpired term of the contract. Entity A has a history of enforcing these payments in the event of cancellation.

The commission is paid to acquire an asset, that is the ability to obtain revenues over a minimum two-year period. The asset is controlled by entity A as evidenced by the enforcement of cancellation penalties, and it has arisen as a result of past events (the signing of the contract) from which future economic benefits (security contract revenues) are expected to flow.

More specifically, the asset meets the definition of an intangible asset because it is "an identifiable non-monetary asset without physical substance". The amount, which represents a right to receive future revenue from customers, is clearly identifiable; it is non-monetary, because it cannot be readily converted into cash; and it does not have physical substance.

4.1.2 Capitalisation of periodic licence fees on purchase of an intangible asset

Example 4.1.2

Capitalisation of periodic licence fees on purchase of an intangible asset

In 20X0, Entity A is granted a licence from a national authority for a fixed period commencing 1 January 20X2. The purchase of the licence is deemed to be an executed transaction and the definition of and recognition criteria for an intangible asset in IAS 38 are met.

Entity A is required to pay an up-front fee for the licence and, in addition, from 20X2 onwards Entity A will be required to pay a fixed fee on a quarterly basis irrespective of whether the licence is used. The obligation to pay the quarterly licence fees will remain constant over the whole licence period and is non-cancellable.

Entity A is permitted to sell the licence, in which case the buyer would be expected to take on the obligation for the quarterly fees, but permission from the national authority would be required for any such transaction.

Should the quarterly licence fees be accounted for as part of the cost of the intangible asset or as an operating expense on a quarterly basis as they become due?
The quarterly licence fees should be accounted for as part of the cost of the intangible asset when the asset is acquired. The total cost of the licence will be the up-front payment plus the present value of the quarterly fees over the licence period.

4.1.3 Internally generated intangible assets

Example 4.1.3.1

Development costs paid to an external party

Entity A pays Entity B, an external party, to develop an asset that would meet the requirements of IAS 38 for recognition as an internally generated intangible asset in Entity A's financial statements. Entity B is performing only development work; all the associated research has already been performed, and the costs expensed, by Entity A.

Entity A should recognise an internally generated intangible asset for these

development costs under IAS 38. Whether Entity A incurs the costs directly via an internal development function or outsources the development process to an external party does not influence how Entity A should account for the asset in its financial statements.
Therefore, because the expenditure meets the requirements for the recognition of an internally generated intangible asset under IAS 38, Entity A should recognise the asset as an internally generated intangible asset in its financial statements. If the asset being developed did not meet the requirements for recognition of an internally generated intangible asset under IAS 38, the costs would be considered research expenditures and would be expensed as incurred. Similarly, if Entity B was paid by Entity A to perform both research and development activities, the research element would be expensed as incurred, but the development element would be capitalised provided that it met the requirements of IAS 38.

Example 4.1.3.2

Subsequent expenditure on an internally generated intangible asset under development for use in a cash-generating unit after impairment indicators are identified

Entity R is developing computer software for use in its business. On 1 January 20X1, the criteria for recognition as an internally generated intangible asset are met and expenditure on the development incurred after that date is included in the cost of the asset. Budgeted total expenditure to completion of the project at the end of 20X3 is 3 million and the incremental benefits to be derived from the software are expected to be approximately 5 million.

At 31 December 20X1, the intangible asset is tested for impairment but no impairment loss is identified.

At 31 May 20X2, the carrying amount of the intangible asset is 1.5 million. In June 20X2, estimates of the additional costs to complete the project are increased to 4.5 million (i.e. total project costs of 6 million). A decision is taken to proceed with the project because the expected incremental benefits (5 million) are still in excess of the costs not yet incurred (4.5 million). However, the directors consider that this is an indication of impairment and that the recoverable amount of the software should be estimated.

The software does not generate independent cash flows, and its fair value less costs of disposal is estimated to be lower than its carrying amount; accordingly, the software asset is tested for impairment as part of its cash-generating unit.

The recoverable amount of the cash-generating unit as a whole is determined to be

100 million and its carrying amount is 75 million; therefore, no impairment loss is recognised.
As additional expenditure is incurred on completion of the software development, Entity R should continue to include that expenditure in the cost of the software asset in accordance with IAS 38. In addition, although the total costs are significantly in excess of the original budget, and are expected to exceed the incremental benefits that will be generated by the software, no impairment loss is required to be recognised unless the carrying amount of the cash-generating unit as a whole exceeds its recoverable amount.

4.2 Measurement after initial recognition

4.2.1 Revaluation not permitted in the absence of an active market

Example 4.2.1.1

Revaluation not permitted in the absence of an active market

Over the past two years, a group has developed various items of computer software to be used internally and/or to be sold to prospective buyers. In accordance with IAS 38, the group capitalised the development costs incurred during the development phase and recognised an intangible asset of 1 million. After the reporting date, the group began discussions with a third party for the sale of the subsidiary that owns the software, or the sale of that subsidiary's assets. The selling price under negotiation is much higher than the carrying amount of the subsidiary's assets (which mainly relate to the internally generated intangible asset and other computer equipment).

The group is not permitted to revalue its internally generated intangible asset because no active market exists. Although the entity has entered into sale negotiations, this is not sufficient to indicate an active market. If an active market, as defined, genuinely existed, the price for which the asset could be sold would be publicly available and would not be a matter for negotiation. Indeed, IAS 38 indicates that the fact that there is a sale agreement between an entity and a buyer does not provide evidence of an active market.

4.3 Depreciation

Example 4.3.1

Date of commencement of amortisation of an intangible asset

Entities usually are required to purchase a licence prior to the provision of services in a particular location or prior to the provision of certain types of services. Because licences normally are granted for a specified period of time, the cost of the licence has to be amortised over the best estimate of its useful life. The entity is generally required to build and commission its network before it can earn revenues from the use of its licence.

The ability to receive economic benefits from the licence is linked directly to the ability to use the network; therefore, the licence is only available for use when the network is in place. Consequently, amortisation of the licence should commence at the date the network is available for use.

Determination of the useful life of an intangible asset

The illustrative examples accompanying IAS 38 provide guidance for the determination of the useful life of an asset in accordance with the Standard. Each example details the specific facts and circumstances surrounding the determination of the asset's useful life. The following table summarises the key determinants for each example. Readers should refer to the text of the Standard, however, to obtain a full understanding of each of the circumstances and of the factors assessed in each scenario.

Asset description	**Finite or indefinite life?**	**Amortisation period**
Acquired customer list – anticipated to generate benefits for between 1 and 3 years.	Finite. Although the entity may expect to generate further benefits by the addition of new customers to the list, the useful life is determined by reference only to customers on the list at the acquisition date.	Management's best estimate of the useful life – say 18 months.
Acquired patent that expires in 15 years. The entity intends to sell the patent to a committed third party in five years for 60 per cent of its fair value at the date of acquisition	Finite	The period over which the patent is expected to generate cash inflows for the entity, i.e. five years. The residual value should equal the present value of 60 per cent of

		the fair value at the date of acquisition.
Copyright with remaining legal life of 50 years, but management estimates that net cash inflows will only be generated for 30 years.	Finite	30 years
Licence that expires in five years. Can be renewed indefinitely, at little cost every 10 years, provided that certain conditions are met. Management intends to renew the licence indefinitely, and evidence supports its ability to do so. No third party or obsolescence issues that would indicate a problem with indefinite renewal.	Indefinite. Potential to renew indefinitely is taken into account.	N/a
Same licence as previous example but, when licence has three years remaining, licensing authority decides to auction licences at future renewal dates.	Finite. No potential to renew the existing arrangement	Three years
Acquired trademark for a market-leading consumer product with a remaining legal life of five years, but renewable every 10 years at little cost. Management intends	Indefinite. Potential to renew indefinitely is taken into account.	N/a

to renew indefinitely and market indicators support cash inflows for an indefinite period.		
Acquired trademark for leading consumer product previously regarded as having an indefinite life. Increased competitor activity indicates reduced future cash inflows for an indefinite period	Indefinite. If, as a result of the reduced future cash inflows, the recoverable amount is less than the carrying amount of the intangible asset, an impairment loss is recognised.	N/a
Trademark acquired in a business combination some years ago, previously considered to have an indefinite life. Management decides to discontinue related product line over the next four years.	Finite	Four years

5 PRESENTATION

5.1 Disclosure rules

Presentation of intangible assets is treated by *IAS 1 – Presentation of Financial Statements*. The entity shall classify an intangible asset as current intangible asset when:

- it expects to realize the asset, or intends to sell or consume it, in its normal operating cycle,
- it holds the asset primarily for the purpose of trading, or
- it expects to realize the asset within twelve months after the reporting period.

Otherwise, the entity shall classify the intangible asset as non-current intangible asset.

For each class of intangible asset, disclose:

- useful life or amortisation rate
- amortisation method
- gross carrying amount
- accumulated amortisation and impairment losses
- line items in the income statement in which amortisation is included
- reconciliation of the carrying amount at the beginning and the end of the period showing:
    - additions (business combinations separately)
    - assets held for sale
    - retirements and other disposals
    - revaluations
    - impairments
    - reversals of impairments
    - amortisation
    - foreign exchange differences
    - other changes
- basis for determining that an intangible has an indefinite life
- description and carrying amount of individually material intangible assets
- certain special disclosures about intangible assets acquired by way of government grants
- information about intangible assets whose title is restricted
- contractual commitments to acquire intangible assets.

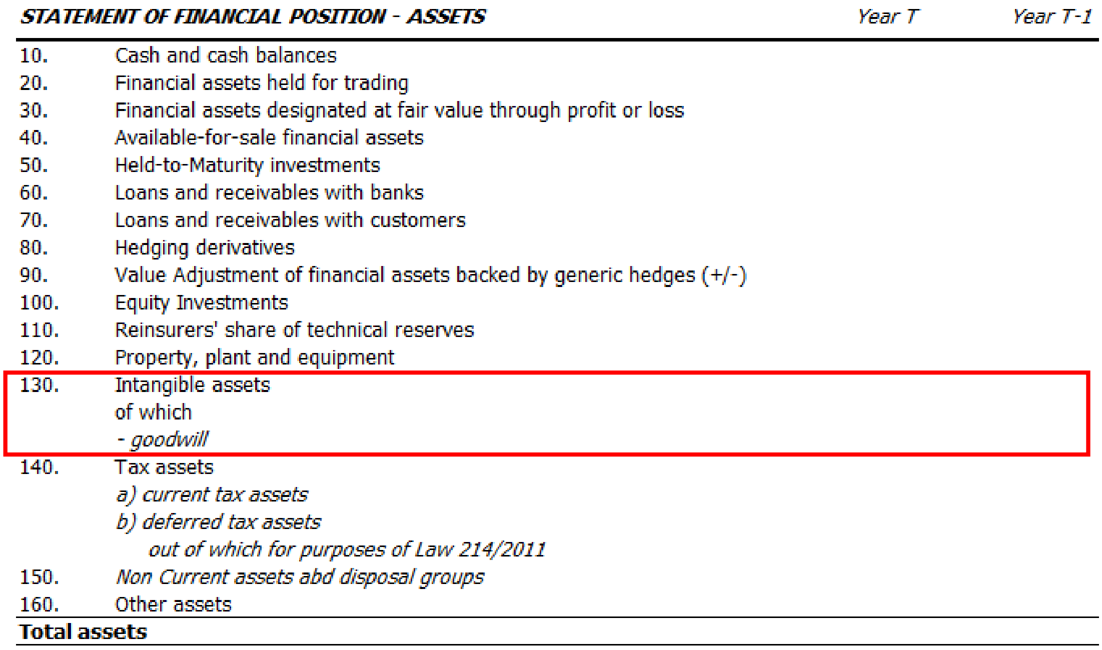
IAS 1

Additional disclosures are required about the intangible assets carried at revalued amounts and the amount of research and development expenditure recognised as an expense in the current period.

5.2 Mediolanum Financial Statements disclosures

In accordance with the definitions and classification criteria mentioned above and in compliance with the requirements of Bank of Italy, the following policy provides guidance on how to present in the consolidated financial statements.

As required by Bank of Italy, caption 130 includes the intangible assets under IAS 38 as well as the ones which are objects of a financial leasing (for the lessee) and of an operating leasing (for the lessor) under IAS 17. It also provides a separate indication for goodwill.

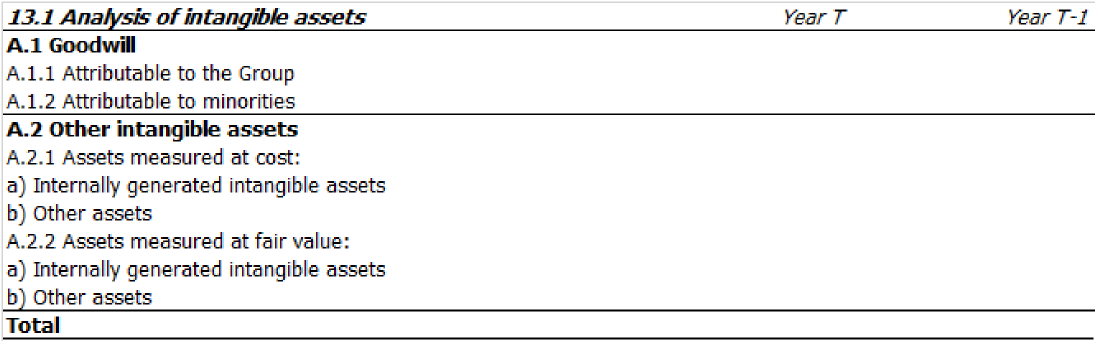


STATEMENT OF FINANCIAL POSITION - ASSETS		*Year T*	*Year T-1*
10.	Cash and cash balances		
20.	Financial assets held for trading		
30.	Financial assets designated at fair value through profit or loss		
40.	Available-for-sale financial assets		
50.	Held-to-Maturity investments		
60.	Loans and receivables with banks		
70.	Loans and receivables with customers		
80.	Hedging derivatives		
90.	Value Adjustment of financial assets backed by generic hedges (+/-)		
100.	Equity Investments		
110.	Reinsurers' share of technical reserves		
120.	Property, plant and equipment		
130.	Intangible assets		
	of which		
	- goodwill		
140.	Tax assets		
	a) current tax assets		
	b) deferred tax assets		
	out of which for purposes of Law 214/2011		
150.	*Non Current assets abd disposal groups*		
160.	Other assets		
Total assets			

Caption 130 – intangible assets includes the following subcategories of assets:

- Goodwill
- Other intangible assets.

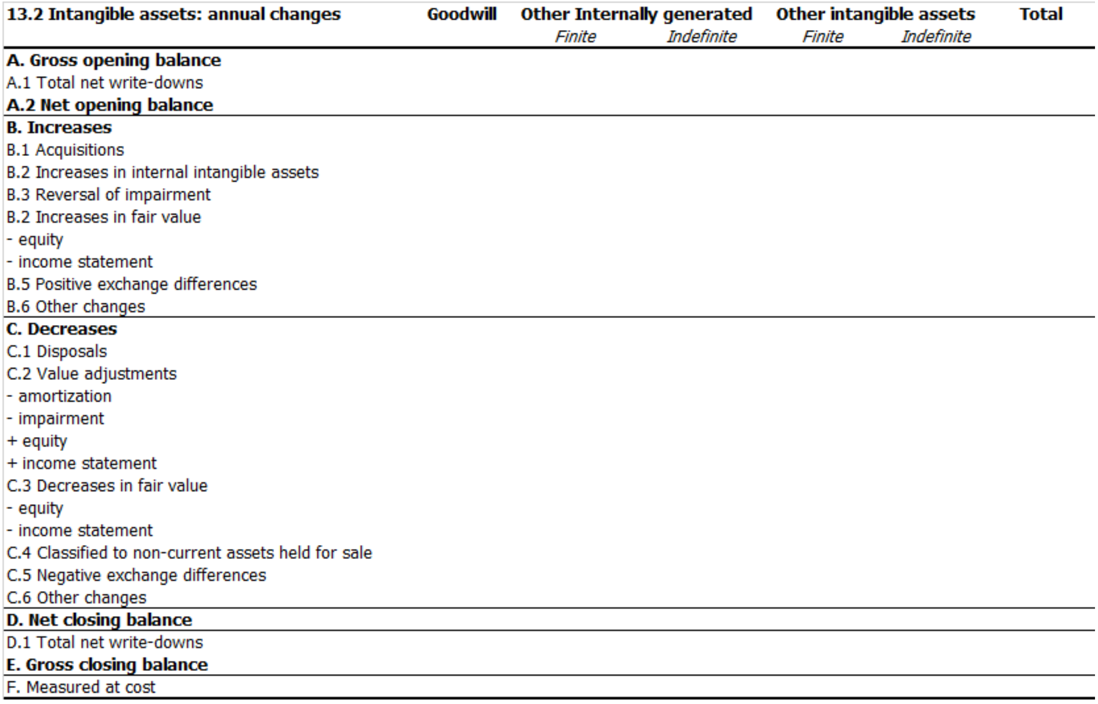
IAS 17



13.1 Analysis of intangible assets	*Year T*	*Year T-1*
A.1 Goodwill		
A.1.1 Attributable to the Group		
A.1.2 Attributable to minorities		
A.2 Other intangible assets		
A.2.1 Assets measured at cost:		
a) Internally generated intangible assets		
b) Other assets		
A.2.2 Assets measured at fair value:		
a) Internally generated intangible assets		
b) Other assets		
Total		

In particular, goodwill can be defined as the excess of the cost of the acquisition over the acquirer’s interest in the fair value of the identifiable assets and liabilities acquired, while the category other intangible assets can include:

- patented technology, computer software, databases and trade secrets
- trademarks, trade dress, newspaper mastheads, internet domains
- video and audiovisual material
- customer lists
- mortgage servicing rights
- licensing, royalty and standstill agreements
- import quotas
- franchise agreements
- customer and supplier relationships (including customer lists)
- marketing rights



13.2 Intangible assets: annual changes	**Goodwill**	**Other Internally generated**		**Other intangible assets**		**Total**
		Finite	*Indefinite*	*Finite*	*Indefinite*	
A. Gross opening balance						
A.1 Total net write-downs						
A.2 Net opening balance						
B. Increases						
B.1 Acquisitions						
B.2 Increases in internal intangible assets						
B.3 Reversal of impairment						
B.2 Increases in fair value						
- equity						
- income statement						
B.5 Positive exchange differences						
B.6 Other changes						
C. Decreases						
C.1 Disposals						
C.2 Value adjustments						
- amortization						
- impairment						
+ equity						
+ income statement						
C.3 Decreases in fair value						
- equity						
- income statement						
C.4 Classified to non-current assets held for sale						
C.5 Negative exchange differences						
C.6 Other changes						
D. Net closing balance						
D.1 Total net write-downs						
E. Gross closing balance						
F. Measured at cost						

The depreciation term of intangible assets is presented in caption 210 of the consolidated income statement as required by Bank of Italy.

CONSOLIDATED INCOME STATEMENT	***Year T***	***Year T-1***
10. Interest income and similar income		
20. Interest expense and similar charges		
30. Net interest income		
40. Fee income		
50. Commission expenses		
60. Net commission		
70. Dividends and similar income		
80. Net income from trading		
90. Net income from hedging		
100. Gains (losses) on sale or buyback of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) financial liabilities		
110. Net result from financial assets and liabilities measured at fair value		
120. Banking income		
130. Net impairment/reversal of impairment of:		
a) loans		
b) financial assets available for sale		
c) financial assets held to maturity		
d) other financial instruments		
140. Net income from financial operations		
150. Net premiums		
160. Balance of other income/expenses from insurance activities		
170. Net income from financial and insurance operations		
180. Administrative expenses:		
a) personnel expenses		
b) other administrative expenses		
190. Net provisions for risks and charges		
200. Impairment/reversal of impairment of tangible assets		
210. Impairment/reversal of impairment of intangible assets		
220. Other operating income/expenses		
230. Operating costs		
240. Profit (loss) on equity investments		
250. Net income of valuations at fair value of tangible and intangible assets		
260. Impairment of goodwill		
270. Profits (losses) on disposal of investments		
280. Profit (loss) before tax on continuing operations		
290. Income tax expense on continuing operations		
300. Profit (loss) after tax on continuing operations		
310. Profit (loss) after tax of non-current assets pending disposal		
320. Profit (loss) for the year		
330. Profit (loss) for the year attributable to minorities		
340. Profit (loss) for the year attributable to the parent company		

The caption 210 shall indicate the balance, positive or negative, between the value adjustments and reversals of impairment losses relating to intangible assets, including those relating to assets acquired under finance leases and activities under operating leases.

14.1 Analysis of amortization and net impairment of intangible assets

	Amortization (a)	Impairment (b)	Write-backs (c)	Net result (a+b+c)
A. Intangible assets				
A. 1 Owned				
- internally generated				
- other				
A.2 Assets acquired under finance leases				
Total				

BANCA mediolanum

Annex

ANNEX 1

Financial Checklist

Mediolanum Group

Group accounting principles for preparing consolidated financial statements according to IAS / IFRS

This checklist has been prepared in order to permit certification of the accounting policies used in the preparation of reporting package for IAS / IFRS by subsidiaries of the Mediolanum Group in accordance with the dispositions of the IFRS Operating Manual.

It is essential to fill in the check list in its entirety, as follows:
- YES
- NO
- N/A

Any refusal must be justified using the column notes.

The column "not applicable" (N / A) can be used only in cases of actual lack of applicability of the principle assumptions or when the company has no cases regulated by the principle in question.

After filling carefully the checklist you need to subscribe. The documents signed in original will be kept by the declarant company.

Only the original certification date indicated in the appropriate field of the report will be considered.
It is required to enter, in the bottom of the document, the name and surname of the persone in charge to sign.

Checklist IFRS Operating Manual

Cell containing 'x' should be filled.

ACCOUNTING CHECKLIST			**DATE: xx/xx/xxxx**				**OWNER**	
		GENERAL DISPOSITIONS						
	Number	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
GENERAL DISPOSITIONS	1	Are Financial Statements/Reporting package denominated in euro units ?					**x**	
	2	The Financial Statements/Reporting package include and clearly identify:					**x**	
	3	a) a statement of financial position					**x**	
	4	b) an income statement and a statement of other comprehensive income					**x**	
	5	c) a statement of changes in equity					**x**	
	6	d) a Statement of cash flows					**x**	
	7	e) the notes to the account, included a summary of significant accounting policies and other explanatory information					**x**	
	8	f) comparative informations on the previous year					**x**	
	9	Balance between statement of financial position and income statements in TAGETIK - SAP has been verified					**x**	
	10	Bank Accounts Reconciliations & Ageing has been verified					**x**	
	11	Transitory Accounts Reconciliations & Ageing has been verified					**x**	
	12	IC Reconciliation has been verified					**x**	
	13	Net Equity reconciliation (with description of any change) has been verified					**x**	
	14	Tax calculation analysis has been verified					**x**	
		CONSOLIDATED FINANCIAL STATEMENTS_INVESTMENTS IN ASSOCIATES AND JOINT VENTURES						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
1-2	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.						**x**
1-2	2	In the application of the accounting principles included in these Chapters I confirm that I have reviewed and complied with the following elements. ASSESSMENT OF CONTROL. Control presupposes the power over the investee to direct the relevant activities and the exposure, or rights, to variable returns from its involvement with the investee; the ability to use power over the investee to affect the amount of the investor's returns (link between power and returns). USE OF CONTROL. Control is exercised through ownership of the voting rights (including potential) that are concretely exercisable to direct relevant activities; contractual agreements; the ability to affect the investee returns						**x**
1-2	3	In the application of accounting principles contained in these Chapters I confirm I have made the evaluation of joint control that fulfills the following characteristics: the agreement must be contractually agreed (for example, the Statute or shareholder agreements); "de facto" joint control are not relevant; decisions on significant activities must be taken with the unanimous consent of the parties that collectively control the arrangement						**x**
1-2	4	I have provided all the informations required by the accounting principles, included in these Chapters, and necessary in order to give proper disclosure in the financial statements/reporting package in relation to the area and methos of consolidation: - FULL CONSOLIDATION (line-by-line): the 100% subsidiaries are to be considered under the control of the parent company. - CONSOLIDATION USING THE EQUITY METHOD: in relation to the investment in Banca Esperia, the Group believes that the same holding has to be considered as a joint venture; in relation to the investment in Mediobanca, the Group believes that the same holding has to be considered as an company under significant influence. - Mutual funds promoted and managed (securities, real estate and fund) and internal insurance funds 'unit-linked' (for which it holds 100% of the shares, but whose return is pertaining to the insured) are not to be considered under the control of parent.						**x**
1-2	5	During the reporting period I confirm I have not made changes to the area and method of consolidation.						**x**
1-2	6	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies reported in these Chapters, that are needed to understand: - nature and risks associated with investments in other entities; - effects of these investments on financial position and cash flows						**x**
1-2	7	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.						**x**
		BUSINESS COMBINATIONS						
3	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
3	2	At the reporting date business combinations have been carried out?					**x**	**x**
3	3	In case of business combinations, I confirm the application of the acquisition method and dispositions contained in the accounting principles and policies discussed in this Chapter.					**x**	**x**
3	4	The cost of a business combination is determined as the sum of the fair values, at the date of the exchange, of assets given, liabilities incurred or assumed, and equity instruments issued in exchange for control on the acquiree, plus any costs directly attributable to the business combination.					**x**	**x**
3	5	The acquisition date is the date on which the acquirer effectively obtains control. When this is achieved through a single exchange transaction, the date of exchange coincides with the acquisition date.					**x**	**x**
3	6	If the business combination involves more than one exchange transaction, the cost of the combination is the aggregate cost of the individual transactions and the date of exchange is the date of each exchange transaction, while the date of acquisition coincides with the one the control on the acquiree is get.					**x**	**x**
3	7	The cost of a business combination is allocated by recognizing the assets, liabilities and contingent liabilities at their fair values at the acquisition date.					**x**	**x**
3	8	The surplus between the cost of acquisition and the acquirer's interest in the net fair value of assets, liabilities and contingent liabilities is recorded as goodwill.					**x**	**x**
3	9	In case of a negative difference a new measurement is done. This negative difference, if confirmed, is immediately recognized as income in the income statement.					**x**	**x**
3	10	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					**x**	**x**
3	11	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					**x**	**x**
		IMPAIRMENT OF ASSETS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
4	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					**x**	
4	2	If there are indications that the assets may be impaired, tangible and intangible assets, excluding goodwill, are tested for impairment in accordance with IAS 36. The impairment loss, that occurs when the carrying value of the asset exceeds its recoverable amount, is the new base for the calculation of future depreciation.					**x**	
4	3	At the reporting date the assets covered by this accounting principle have not be impaired.					**x**	
4	4	I considered all the external and internal sources of information, set out in IAS 36, about the indications of impairment.					**x**	
4	5	In case of impairment, the asset's depreciation charge has been adjusted.					**x**	
4	6	If indications of impairment are subsequently failed, I proceeded with the reversal of the carrying value of the asset, in the limit of the previous impairment.					**x**	
4	7	In relation to financial assets, excluding those classified as at fair value through profit or loss, if there is objective evidence of impairment, I applied the dispositions of IAS 39, and in particular the dispositions contained in this Chapter. Indications of possible reduction in value are, for example, significant financial difficulties, default in interest payments, borrower bankruptcy or the disappearance of an active market for the asset. In particular, with regard to equities, impairment indicators consist of a reduction for more than one third in fair value or a prolonged reduction for over 36 months compared to the initial recognition value.					**x**	
4	8	If indications of impairment are subsequently failed, I proceeded with the reversal of the carrying value of the asset, posting in the income statement in the case of debt securities and in equity in the case of equities.					**x**	
4	9	On annual basis (or whenever there is evidence of impairment) an impairment test on goodwill is carried out. For this purpose cash-generating units (CGUs) to which the goodwill is allocated are identified. I proceeded to report any exceptions concerning the periodicity of the impairment test.					**x**	
4	10	If the carrying amount of the unit exceeds the recoverable amount of the unit, the entity must recognise an impairment loss.					**x**	
4	11	Any impairment made to the goodwill, even if the reasons that originated them failde, have not been restored.						
4	12	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					**x**	
		FINANCIAL INSTRUMENTS						

Chapter IFRS Operating Manual	Number	Questions	YES	NO	N/A	Note	SUBSIDIARY	PARENT COMPANY
5	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
5	2	I confirm that as of the reporting date the classification of loans is consistent with the rules of classification provided by the Group's policies in line with the EBA regulation.						
5	3	I confirm that as of the reporting date the valuation of loans is consistent with international accounting standards discussed in this chapter as well as the Bank of Italy regulations on specific and general write-downs						
5	4	I confirm that at of the reporting date the classification of financial instruments is consistent with international accounting standards and policies set out in this Chapter.					x	
5	5	I confirm that in the reporting period I have not made transfers of financial asset portfolios from one category to another and I confirm that any transfer between portfolios have been carried out in accordance with international accounting standards discussed in this Chapter. In case of transfers, I provided proper disclosure in the financial statements/reporting package.						
5	6	I confirm proper allocation of fair value levels, in accordance with the policies set out in this Chapter.					x	
5	7	I confirm that in the reporting period I have not made changes in fair value level on financial instruments.					x	
5	8	I confirm that the valuation techniques for estimating the fair value have not changed in the reporting period.					x	
	9	I confirm that I have done adequate analysis on the need to carry out impairment of loans and / or financial assets, in accordance with the Group's policies and dispositions set out in this Chapter.						
5	10	I confirm that in the reporting period, there were no conditions to do a reversal and that any reversal on debt securities and equity securities that have been previously impaired, have been properly accounted in accordance with the accounting standards and the policies set out in this Chapter.					x	
5	11	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	
5	12	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		DERIVATIVES AND HEDGE ACCOUNTING						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
6	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
6	2	I confirm that I have adopted the type of fair value hedges, which aims to hedge exposure to changes in the fair value of an asset or liability attributable to a particular risk.					x	
6	3	I confirm that I have designated as hedging instruments only instruments that involve a counterpart external to the Group and that are consistent with hedge accounting requirements for management and accounting purposes.					x	
6	4	I confirm that the determination of fair value is based on prices recorded in active markets, prices provided by market participants or on internal valuation models commonly used by market participants, which take account of all the factors related to the instruments and are based on data available on the market.					x	
6	5	I confirm the effectiveness of the hedging relationship which, it is believed that if, at the beginning of the hedge and in subsequent periods, changes in the fair value of the hedging instrument are offset by changes in fair value of the hedged instrument and if the hedge ratios are included within a set range (80% -125%).					x	
6	6	I confirm that the evaluation has been performed using prospective and retrospective tests.					x	
6	7	In case of non-hedge effectiveness, I confirm to have stopped the accounting for hedging operations, to have reclassified the derivative hedging contract under trading instruments,to have proceeded to the correct classification of the hedged financial instrument and have subsequently amortized with the method of the effective interest rate changes in the fair value recognized on the hedged item up to the cutoff date of coverage.					x	
6	8	I confirm to have carried out the analysis required by international accounting standards and policies of the Group in terms of the need for separation of embedded derivatives.						
6	9	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	
6	10	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		INSURANCE CONTRACTS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
7	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
7	2	At the reporting date, I analyzed the significance of insurance risk for the correct identification and classification of the contracts (insurance, financial and service) as disclosed by international accounting standard and internal procedures.					x	
7	3	I confirm that the above classification has been done by tariffs.					x	
7	4	During the reporting period, the Mediolanum Group has not applied the unbundling method.					x	
7	5	At the reporting date I proceeded to make the LAT (Liability Adequacy Test) to evaluate the possible adequacy of the insurance liabilities.					x	
7	6	As regards contracts with DPF, I confirm that I have set aside a reserve of shadow accounting on the basis of the average rates of relegation of returns of segregated funds.					x	
7	7	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	
7	8	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		PROVISIONS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
8	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
8	2	Provisions for risks and charges include provisions related to current obligations originating from a past event for which it is probable an outflow of resources in order to settle the obligation, if a reliable estimate of the amount can be made.					x	
8	3	Provisions are recorded considering the best estimate possible and all the informations available at the reporting date, based on the summary table included in this chapter.					x	
8	4	Provisions are examined at each balance sheet date and adjusted to reflect the current best estimate.					x	
8	5	When it becomes unlikely the need to use resources to fulfill the obligation, the provision is reversed.					x	
8	6	In the event that the effect of the time should play an important aspect, the Company calculates the amount of the provision as the present value of the expenditure expected to settle the obligation.					x	
8	7	The rate used for discounting is before tax and reflects current market valuations on the time value of money and the risks specific to the liability. This rate does not reflect risks for which future expected cash flows have been adjusted.					x	
8	8	At the reporting date there were no changes in the discount rates used and the parameters shown in this chapter have been met.					x	
8	9	We have not made any changes to the criteria used in subsequent evaluations.					x	
8	10	At the reporting date there were no contingent liabilities for which it is necessary to give information.					x	
8	11	At the reporting date no contingent assets, except those virtually certain, are recorded.					x	
8	12	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	
8	13	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		EMPLOYEE BENEFITS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
9	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
9	2	The recognition of the employee termination indemnity is based on the actuarial value calculated in accordance with the rules of defined benefit plan. The estimate of future payments is made on the basis of historical data (for example staff turnover, retirements) and the demographic curve, including the salary increases provided for by art. 2120 of the Civil Code (application of a fix rate of 1.5 percent and 75 percent of ISTAT inflation index where applicable).					x	
9	3	The discounting of these flows is done using the 'projected unit credit method'. The rate used for discounting is determined on the basis of high quality bond market rates, in line with the estimated timing of commitments.					x	
9	4	Actuarial gains and losses, defined as the difference between the carrying value of the liability and the present value of the obligation at the end of the period are recognized in equity as part of revaluation reserves.					x	
9	5	At the reporting date, the defined contribution plans in favor of pension funds for which the company, through the payment of contributions, does not assume any further obligation towards the members of the fund, consists of the registration in the income statement of the benefits accrued during year.					x	
9	6	The employee benefits which are considered as other long-term benefits (for example bonuses paid on reaching a predefined seniority) are recognized as a liability based on the valuation of commitments at the reporting date. The valuation of commitments is determined by "projected unit credit method". Actuarial gains and losses for these benefits are recognized immediately in income statements.					x	

9	7	To benefits due to agents such indemnities, merit payments, contractual indemnity and non-competition agreement, if treated as employee termination indemnity, shall apply the rules relating to "subsequent performance-employment defined benefit" with the recording in equity of actuarial gains / losses, as part of the evaluation reserves.					x	
9	8	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	
9	9	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		SHARE-BASED PAYMENTS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
10	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	x
10	2	These are payments to top management, employees and financial advisors, as compensation for work done, based on shares representing the capital, which comprise: a. rights to subscribe to capital increases (properly so called stock options); b. rights to receive shares upon achievement of certain objectives (so-called performance shares); c. shares subject to unavailability clauses (so-called restricted shares).					x	x
10	3	I confirm that I have recorded the remuneration and incentive plans (Share-based payments) in accordance with international accounting standards and with the instructions given by the Parent Company.					x	x
10	4	All necessary informations in order to give proper disclosure in the financial statements/reporting package have been provided, as required by international accounting standard and policies set out in this Chapter.					x	x
10	5	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	x
		REVENUES						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
11	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
11	2	Revenues are recognized when received or when it is likely that future benefits will be received and these benefits can be measured reliably; in particular: - Commissions are recorded according to the accrual basis; - Interest income and interest expense are recognized on an accrual basis using the method of effective interest rate; - Dividends are recognized in income statements when the distributions is declared; - Default interest, if provided for by contract, are recognized in the income statement only when actually collected. I confirm that I have complied with the criteria according to the disposition set out in the present Chapter					x	
11	3	We have not made any changes to the criteria used in subsequent evaluations.					x	
11	4	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		PROPERTY, PLANT AND EQUIPMENT						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
12	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
12	2	The property, plant and equipment covered by this Chapter include land, held for use properties, properties helf for investment purpose, technical plants, furniture, furnishings, equipment and any kind of assets held under finance leases. These activities, which are expected to be used for more than one period, are held for use in the production and supply of goods and services, for rental to third parties and / or for administrative purposes.					x	
12	3	The property, plant and equipment covered by this chapter are initially recognized at cost, including all ancillary expenses directly attributable to the purchase and commissioning of the same.					x	
12	4	We have not made any changes to the cost method in subsequent evaluations.					x	
12	5	Any extraordinary maintenance costs which led to an increase in future economic benefits have been recorded as an increase in the value of assets, while any ordinary maintenance costs are recorded in the income statement.					x	
12	6	Tangible assets are amortized based on their useful life, as described in this chapter and any changes have been made at the reporting date.					x	
12	7	At the reporting date there are no indicators of impairment and the carrying value of assets does not exceed its recoverable amount.					x	
12	8	Leasehold improvements, separable and identifiable, have been recorded as property, plant and equipmente and amortized over a period not exceeding the duration of the contract.					x	
12	9	Leasehold improvements, not separable and identifiable, have been recorded in other assets.					x	
12	10	The assets whose value is less than 516 euro are recorded in the income statement.					x	
12	11	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	
		INTANGIBLE ASSETS						
Chapter IFRS Operating Manual	**Number**	**Questions**	**YES**	**NO**	**N/A**	**Note**	**SUBSIDIARY**	**PARENT COMPANY**
13	1	I have read and clearly understood the accounting standards and policies dispositions discussed in this Chapter.					x	
13	2	Intangible assets include goodwill and application software used for several years, as well as intangible assets generated during the acquisition of a business.					x	
13	3	Intangible assets other than goodwill, are stated at cost less accumulated amortization and impairment losses.					x	
13	4	We have not made any changes to the criteria used in subsequent evaluations.					x	
13	5	Intangible assets are amortized based on their useful life, if the useful life is indefinite they are not amortized but they are tested for impairment, as set out in this chapter. At the reporting date there were no changes in the accounting treatment.					x	
13	6	At the reporting date there were no indications of impairment and the carrying value of intangible assets does not exceed its recoverable amount.					x	
13	7	An intangible asset is derecognized on disposal or when future economic benefits from its use or its disposalare not expected.					x	
13	8	At the reporting date there are no internally generated intangible assets.					x	
13	9	An intangible asset may be recorded as goodwill when the surplus between the FV of the acquired assets and the cost of the investment including the ancillary expenses represents the future earnings capacity of the investment (goodwill). If the difference is negative (badwill), the difference is recognized directly in the income statement. The other intangible assets are recorded at cost adjusted for any ancillary expenses only if it is probable that future economic benefits attributable to the asset will be realized. On the contrary the cost is recognized in the income statement when incurred.					x	
13	10	Goodwill is the difference, if positive, between the acquisition cost and the fair value at the acquisition date, of the assets acquired.					x	
13	11	Goodwill is not amortized, but is tested for impairment (impairment test) at least once a year, generally for the annual report or when there are indications of reduction in value.					x	
13	12	At the reporting date there are no exceptions and or derogations in the application of the accounting standards and policies set out in this Chapter.					x	

Date of certification	xx/xx/xx

For certification conformity
Responsible for signing

Name / Surname of those who have signed (Person in charge)

xx/xx/xx
GIUSEPPE ROSSI

ANNEX 4

Submission form

General Informations

Request type	New accounting items/deviation from an accounting policy
Inquiry prepared by	
Entity(ies) involved	
Reference to Operating Manual	
Involvement of local auditor	
Time constraints for response	
Submission date	
Response prepared by	
Response reviewed by	
Response date	

Submission form

Executive Summary

Background

Questions

Tentative decision
(local entity proposal)

Bilancio & Data Reporting Conclusion

Accounting literature and attachments

Quantification of potential impact	
Calculations attached	

ANNEX 5 - TIMETABLE

2 0 1 6 **QUARTERLY & CUT-OFF DEADLINES**		**Quarterly Report**	**Cut-off Report**	**Cut-off Report**	**Semi-annual Report**	**Cut-off Report**	**Quarterly Report**	**Cut-off Report**	**Cut-off Report**
		MARCH	**APRIL**	**MAY**	***JUNE***	**AUGUST**	***SEPTEMBER***	**OCTOBER**	**NOVEMBER**
1	*Input of intercompany balances in Tagetik*	*11 April 2016*	*12 May 2016*	*09 June 2016*	*08 July 2016*	*09 September 2016*	*10 October 2016*	*11 November 2016*	*12 December 2016*
2	*Reconciliation of intercompany balances in Tagetik*	*12 April 2016*	*13 May 2016*	*10 June 2016*	*11 July 2016*	*12 September 2016*	*11 October 2016*	*14 November 2016*	*13 December 2016*
3	*Only for italian companies*	*13 April 2016*	*16 May 2016*	*13 June 2016*	*13 July 2016*	*13 September 2016*	*12 October 2016*	*15 November 2016*	*14 December 2016*
4	*Input/upload of BS and P&L accounts in Tagetik for Banco, Irish companies, BAL & Gamax*	*14 April 2016*	*16 May 2016*	*15 June 2016*	*13 July 2016*	***14 September 2016***	*14 October 2016*	*16 November 2016*	*15 December 2016*
5	*Delivery Segment Report and reclassifications for irish companies. Delivery of trial balance and reclassifications for BAL & Banco Med.*	*14 April 2016*	*16 May 2016*	*15 June 2016*	*13 July 2016*	***14 September 2016***	*14 October 2016*	*16 November 2016*	*15 December 2016*
6	*Input/upload of BS and P&L accounts in Tagetik for italian companies*	*14 April 2016*	*17 May 2016*	*15 June 2016*	*14 July 2016*	*14 September 2016*	*14 October 2016*	*16 November 2016*	*16 December 2016*
7	*Input/upload of BS and P&L accounts in Tagetik for italian companies*	*14 April 2016*	*17 May 2016*	*15 June 2016*	*15 July 2016*	*15 September 2016*	*17 October 2016*	*16 November 2016*	*16 December 2016*
8	*Delivery Consolidated Segment Report*	*15 April 2016*	*18 May 2016*	*16 June 2016*	*18 July 2016*	*15 September 2016*	*18 October 2016*	*17 November 2016*	*19 December 2016*
9	*Input/upload of Notes to the accounts in Tagetik*	*18 April 2016*	*N/A*	*N/A*	*18 July 2016*	*N/A*	*20 October 2016*	*N/A*	*N/A*