# FINANCIAL STATEMENTS

# 2006 ACCOUNTING PERIOD

CONTENTS

# FINANCIAL STATEMENTS

# EUROPEAN PATENT ORGANISATION
## Income Statement
for the year ended 31 December 2006
in '000 EUR

| | Notes | 2006 | 2005 |
|---|---|---|---|
| Revenue | | | |
| Revenue from patent and procedural fees | (3) | 982 011 | 930 456 |
| Other revenue | (3) | 36 583 | 34 190 |
| Other operating income | (5) | 12 142 | 9 720 |
| Work performed by the entity and capitalised | (11) | 2 016 | 1 641 |
| Employee benefit expenses | (6) | (900 754) | (813 627) |
| Depreciation and amortisation expenses | (10)(11) | (58 661) | (64 883) |
| Other operating expenses | (7) | (187 200) | (183 580) |
| **OPERATING RESULT** | | **(113 863)** | **(86 083)** |
| Finance revenue | (8) | 244 076 | 199 779 |
| Finance costs | (9) | (198 829) | (190 145) |
| **FINANCIAL RESULT** | | **45 247** | **9 634** |
| **PROFIT / (LOSS) FOR THE YEAR** | | **(68 616)** | **(76 449)** |

The notes are an integral part of the financial statements.

Regarding the potential national future renewal fees reference is made to Notes 2.5.3 and 4.

# EUROPEAN PATENT ORGANISATION
## Balance Sheet
as at 31 December 2006
in '000 EUR

| | Notes | 2006 | 2005 |
|---|---|---|---|
| **ASSETS** | | | |
| **NON-CURRENT ASSETS** | | | |
| Property, plant and equipment | (10) | 725 947 | 727 416 |
| Intangible assets | (11) | 32 084 | 27 786 |
| Marketable securities | (13) | 298 734 | 222 405 |
| Home loans to staff | (14) | 90 441 | 84 438 |
| Other assets | (12) | 44 491 | 44 522 |
| | | 1 191 697 | 1 106 567 |
| **CURRENT ASSETS** | | | |
| Trade and other receivables | (15) | 129 346 | 112 044 |
| Marketable securities | (13) | 46 563 | 40 196 |
| Home loans to staff | (14) | 2 872 | 4 709 |
| Other financial assets | (16) | 79 000 | 6 500 |
| Cash and cash equivalents | (17) | 81 954 | 146 131 |
| | | 339 735 | 309 580 |
| **TOTAL ASSETS** | | **1 531 432** | **1 416 147** |
| **EQUITY AND LIABILITIES** | | | |
| **EQUITY** | | | |
| Retained earnings | | (1 225 157) | (1 156 541) |
| Other reserves | | (2 627) | 446 |
| **TOTAL EQUITY** | | **(1 227 784)** | **(1 156 095)** |
| **NON-CURRENT LIABILITIES** | | | |
| Net defined benefit liability | (18) | 1 829 325 | 1 737 418 |
| Trade and other payables | (19) | 5 232 | 6 010 |
| Finance lease liabilities | (20) | 11 329 | 13 337 |
| Provisions | (21) | 11 798 | 2 374 |
| Prepaid fees | (22) | 439 207 | 363 877 |
| | | 2 296 891 | 2 123 016 |
| **CURRENT LIABILITIES** | | | |
| Bank overdrafts | (17) | — | 184 |
| Trade and other payables | (19) | 164 322 | 153 938 |
| Finance lease liabilities | (20) | 7 838 | 6 934 |
| Provisions | (21) | 1 645 | 859 |
| Prepaid fees | (22) | 288 520 | 287 311 |
| | | 462 325 | 449 226 |
| **TOTAL LIABILITIES** | | 2 759 216 | 2 572 242 |
| **TOTAL EQUITY AND LIABILITIES** | | **1 531 432** | **1 416 147** |

The notes are an integral part of the financial statements.

Regarding the potential national future renewal fees reference is made to Notes 2.5.3 and 4.

# EUROPEAN PATENT ORGANISATION
## Statement of Change in Equity
for the year ended 31 December 2006
in '000 EUR

| | Issued capital | Reserves | | Total equity |
|---|---|---|---|---|
| | | Cumulative changes in equity not recognised through profit or loss (Note 13) | Retained earnings | |
| **BALANCE AT 1 JANUARY 2005** | **—** | **2 729** | **(1 080 092)** | **(1 077 363)** |
| **CHANGES IN EQUITY FOR 2005** | | | | |
| Available for sale investments | | | | |
| Valuation gains/(losses) taken to equity | | (1 326) | | (1 326) |
| Transferred to profit or loss on sale | | (957) | | (957) |
| Profit (loss) for the period | | | (76 449) | (76 449) |
| **BALANCE AT 31 DECEMBER 2005** | **—** | **446** | **(1 156 541)** | **(1 156 095)** |
| **CHANGES IN EQUITY FOR 2006** | | | | |
| Available for sale investments | | | | |
| Valuation gains/(losses) taken to equity | | (2 826) | | (2 826) |
| Transferred to profit or loss on sale | | (247) | | (247) |
| Profit (loss) for the period | | | (68 616) | (68 616) |
| **BALANCE AT 31 DECEMBER 2006** | **—** | **(2 627)** | **(1 225 157)** | **(1 227 784)** |

The notes are an integral part of the financial statements.

Regarding the potential national future renewal fees reference is made to Notes 2.5.3 and 4.

# EUROPEAN PATENT ORGANISATION
## Cash Flow Statement
for the year ended 31 December 2006
in '000 EUR

| | Notes | 2006 | 2005 |
|---|---|---|---|
| **CASH FLOWS FROM OPERATING ACTIVITIES** | | | |
| Profit/loss of the year | | (68 616) | (76 449) |
| Adjustments for: | | | |
| depreciation and amortisation | (10)(11) | 58 661 | 64 883 |
| disposal of property, plant and equipment | (10) | (24) | (128) |
| other gains and losses | | 3 076 | 4 577 |
| net interest | | (14 755) | (14 692) |
| changes in net defined benefit liability | (18) | 91 907 | 80 820 |
| changes in provisions | (21) | (413) | 28 |
| changes in prepaid fees | (22) | 76 539 | 34 975 |
| changes in other assets and liabilities carried as working capital | | (80 194) | (13 714) |
| **Cash flows from operating activities** | | **66 181** | **80 300** |
| **CASH FLOWS FROM INVESTING ACTIVITIES** | | | |
| Proceeds from disposal of: | | | |
| - property, plant and equipment | | 33 | 128 |
| - marketable securities | | 40 000 | 165 170 |
| Purchases of: | | | |
| - property, plant and equipment | | (37 585) | (103 618) |
| - intangible assets | | (7 445) | (7 067) |
| - marketable securities | | (128 515) | (187 097) |
| Home loans granted to staff | | (16 800) | (16 800) |
| Repayment staff home loans | | 12 160 | 14 274 |
| Interest received | | 16 370 | 17 920 |
| **Cash flows from investing activities** | | **(121 782)** | **(117 090)** |
| **CASH FLOWS FROM FINANCING ACTIVITIES** | | | |
| Repayment advances to extension states | | — | 65 |
| Interest paid | | (1 613) | (1 883) |
| Repayment of lease liabilities | | (6 952) | (5 329) |
| **Cash flows from financing activities** | | **(8 565)** | **(7 147)** |
| **NET INCREASE/DECREASE IN CASH AND CASH EQUIVALENTS** | (17) | **(64 166)** | **(43 937)** |
| **Cash and cash equivalents net of bank overdrafts at the beginning of the period** | | **145 947** | **189 985** |
| Effect of exchange rate changes on cash and cash equivalents | | 173 | 101 |
| **Cash and cash equivalents net of bank overdrafts at the end of the period** | | **81 954** | **145 947** |

The notes are an integral part of the financial statements.

Regarding the potential national future renewal fees reference is made to Notes 2.5.3 and 4.

# 1. GENERAL INFORMATION

The European Patent Organisation (the Organisation or the EPO) is an intergovernmental organisation set up pursuant to the European Patent Convention (EPC) which entered into force in 1977. It is the outcome of the European countries' collective political determination to establish a uniform patent system in Europe.

The Organisation comprises its legislative body, the Administrative Council, and its executive body, the European Patent Office. The Organisation is represented by the President of the European Patent Office. The task of the Organisation is to grant European patents, and is carried out by the European Patent Office supervised by the Administrative Council.

The Organisation constitutes as a legal entity and has its seat in Munich, a branch at The Hague/Rijswijk and sub-offices in Berlin and Vienna. The address of its head office is Erhardtstrasse 27, 80469 Munich, Germany.

As laid down in the EPC and in the Organisation's Financial Regulations (FinRegs) effective as of 26 June 2007, the financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as provided by the International Accounting Standards Board (IASB), with the exception of the criteria for plan assets as defined in IAS 19.7.

These financial statements have been authorised for issue by the President on 29 June 2007.

With respect to the information provided in the income statement and balance sheet, it should be noted that the value of national future renewal fees, which cannot be shown as an asset, is an essential factor for the Organisation's actual financial position.

A peculiar characteristic of the EPO as a patent granting authority – differing substantially from a commercial business – is the way its operations are financed.

A substantial part of the costs of current operations is not covered by current income related to these operations but by future income. As in all patent offices, much of the cost of its operations is financed by annual national renewal fees on patents. Whereas the costs are generated in the period of processing the patent application from filing up to grant, the renewal fees on patents are received thereafter and spread over the years the patent is maintained in force.

This phenomenon is also reflected in the Organisation's fee policy: when fixing its fees for the specific services delivered in the grant procedure, the potential national future renewal fees on granted patents are explicitly taken into account.

Renewal fees are payable in the countries the proprietor wants his patent to cover (designated states), and are paid to national authorities in the Contracting States. The structure and level of national renewal fees are fixed by the Contracting States.

Under Article 39 EPC, each contracting state pays to the Organisation, for each European patent maintained in that state, a proportion of its national renewal fee fixed by the Administrative Council and which may not exceed 75% and is the same for all contracting states (since 1984, this proportion has been fixed at 50%). If that proportion is less than a uniform minimum amount fixed by the Administrative Council, the contracting state has to pay that minimum to the Organisation.

Under Article 40 EPC, the proportion under Article 39 EPC is fixed at such a level as to ensure that the revenue in respect thereof is sufficient for the budget of the Organisation to be balanced.

Since there is no legal obligation for the patentee to renew and pay the corresponding renewal fees and the structure and level of the fees are defined by the Contracting States, the net present value of expected national future renewal fees on patents granted is not included in the assets.

# 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

## 2.1. BASIS OF PREPARATION

The financial statements have been prepared on a historical cost basis, except for marketable securities which are measured at fair value. The financial statements are presented in euros (EUR) and all values are rounded to the nearest thousand (EUR '000) except when otherwise indicated.

These are the Organisation's first financial statements prepared in accordance with IFRS. Due to the exception in the Financial Regulations as regards non-adoption of the criteria for plan assets as defined in IAS 19.7, the Organisation is not an IFRS first-time adopter within the meaning of IFRS 1. However, the Organisation is applying IFRS 1 to be comparable with other IFRS first-time adopters and fulfils the disclosure requirements of IFRS 1.

According to IFRS 1 "First-Time Adoption of International Financial Reporting Standards", assets and liabilities are recognised and measured in accordance with the IFRS applicable as of 31 December 2006. The resulting differences between the IFRS carrying amounts and the carrying amounts of the assets and liabilities in the balance sheet under the EPO's previous Generally Accepted Accounting Principles (GAAP) as of 1 January 2005 are recognised directly in equity at the date of transition to IFRS. A detailed explanation of how the transition to IFRS has affected the reported financial position, financial performance and cash flows of the Organisation is provided in Note 29.

In accordance with IAS 14 "Segment Reporting", the Organisation has not prepared a segment reporting as IAS 14 must be applied only by entities whose debt or equity securities are publicly traded and by those in the process of issuing such securities in public securities markets.

Certain new standards, amendments and interpretations to existing standards that are mandatory for the Organisation's accounting periods beginning on or after 1 January 2007 but which the Organisation has not adopted early have been published as follows:

*IFRS 7, Financial Instruments: Disclosures, and a complementary amendment to IAS 1, Presentation of Financial Statements – Capital Disclosures (effective from 1 January 2007)*: IFRS 7 introduces new disclosures to improve the information about financial instruments. It requires the disclosure of qualitative and quantitative information about exposure to risks arising from financial instruments, including specified minimum disclosures about credit risk, liquidity risk and market risk, including sensitivity analysis to market risk. It replaces IAS 30 "Disclosures in the Financial Statements of Banks and Similar Financial Institutions" and disclosure requirements in IAS 32 "Financial Instruments: Disclosure and Presentation". It is applicable to all entities that report under IFRS. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. The Organisation assessed the impact of IFRS 7 and the amendment to IAS 1 and concluded that the main additional disclosures will be the sensitivity analysis to market risk and the capital disclosures required by the amendment of IAS 1. The Organisation will apply IFRS 7 and the amendment to IAS 1 to annual periods as from 1 January 2007.

*IFRS 8, Operating Segments (effective from 1 January 2009)*: IFRS 8 which replaces IAS 14 "Segment Reporting" requires an entity to report financial and descriptive information about its reportable segments. IFRS 8 applies to the separate or individual financial statements of an entity (and to the consolidated financial statements of a group with a parent) whose debt or equity instruments are traded in a public market; or that files, or is in the process of filing, its (consolidated) financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market. Therefore, IFRS 8 will have no impact on the Organisation's financial statements.

*IFRIC 11, IFRS 2 - Group and Treasury Share Transactions (effective from 1 March 2007):* The interpretation addresses how to apply IFRS 2 "Share-based Payment" to share-based payment arrangements involving an entity's own equity instruments or equity instruments of another entity in the same group. This interpretation will have no impact on the Organisation.

*IFRIC 12 Service Concession Arrangements (effective from 1 January 2008):*
Service concessions are arrangements whereby a government or other public sector entity grants contracts for the supply of public services to private sector operators. Control of the assets remains in public hands but the private sector operator is responsible for construction activities, as well as for operating and maintaining the public sector infrastructure. IFRIC 12 addresses how service concession operators should apply existing International Financial Reporting Standards to account for the obligations they undertake and rights they receive in service concession arrangements. This interpretation will have no impact on the Organisation.

## 2.2. CONSOLIDATION

Although the Reserve Funds for Pensions and Social Security (RFPSS) have to be internally treated as a special class of asset of the Organisation, the EPO does not prepare consolidated financial statements as under IFRS the Organisation constitutes a single entity.

## 2.3. FOREIGN CURRENCY TRANSLATION

The financial statements are presented in Euro, which is the Organisation's functional currency. Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

## 2.4. SIGNIFICANT ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported in the financial statements in order to conform to IFRS. These estimates and assumptions affect the reported amounts of assets and liabilities, the disclosure of contingent liabilities of the balance sheet date and the reported amounts of revenue and expenses during the reporting period. The estimates and judgements are continually evaluated and are based on historical experience, third-party transactions and other factors, including expectations of current and future events that are believed to be reasonable under the circumstances. The following significant accounting judgements and estimates and related assumptions and uncertainties inherent in the accounting policies applied are essential to an understanding of the underlying financial reporting risks and the effects on the financial statements.

The assets and liabilities relating to the *defined benefit pension plans and other post-employment benefits* are determined using actuarial valuations. The actuarial valuation involves making assumptions about discount rates, expected rates of return on assets, future salary increases, mortality rates and future pension increases. Due to the long-term nature of these plans, such estimations are subject to significant uncertainties.

The Organisation exercises judgement in measuring and recognising *provisions* related to outstanding legal claims. Judgement is necessary in assessing the likelihood that an outstanding legal claim will succeed and to quantify the possible range of the final settlement. Provisions are recorded for liabilities when losses are expected from executory contracts, a loss is considered probable and can be reasonably estimated. Because of the inherent uncertainties, actual losses may be different from the originally estimated provision. These estimates are subject to change as soon as new information becomes available.

The Organisation follows the guidance of IAS 39 on determining when an *available-for-sale financial asset* is other than temporarily impaired. This requires significant judgement. In making this judgement, the Organisation evaluates, among other factors, the duration and extent to which the fair value of an investment is less than its cost.

*Development costs* are capitalised in accordance with the accounting policy in Note 2.10. Determining the amounts to be capitalised requires management to make assumptions about e.g. technological feasibility, expected benefits, allocation of costs to research or development phases, and the costs directly attributable to development of the assets.

## 2.5. REVENUE RECOGNITION

### 2.5.1. REVENUE FROM PATENT AND PROCEDURAL FEES

#### 2.5.1.1. Patent granting and opposition and appeal procedures (EPC and EURO-PCT procedure)

The EPO, as the patent granting authority for Europe, processes patent applications from filing up to grant (or refusal), opposition procedures against granted patents and appeals against EPO decisions.

A European patent can be obtained in one of two ways:

a) European route
Direct European patent application (EPC application)

b) International route
European patent application derived from an international application filed under the Patent Cooperation Treaty (Euro-PCT application).

**Principles of revenue recognition for patent granting fees and opposition and appeal procedures:**

Patent granting, opposition and appeal procedures are fully standardised at the EPO and consist of different steps.

The fees for each step and the corresponding due dates are regulated in the European Patent Convention of 5 October 1973 and its Implementing Regulations (as last amended on 9 December 2004) and Rules relating to Fees of 20 October 1977 (as last amended on 15 December 2005).

The patent applicant can decide at any time to abandon the procedure by not paying a fee which is due; the EPO then deems the application to be withdrawn.

In most cases the EPO only starts with the service performance related to each step when the corresponding fees have been received from the patent applicant.

Patent granting fees are recognised in the income statement after the service related to each fee has been fully performed by the EPO.

Fees are initially booked in the income statement upon receipt of payment. To ensure that the income statement shows only revenue for services actually rendered within the accounting period, the initially posted cash-based revenue is adjusted for prepaid fees at the closing date.

The prepaid fees, recognised in the balance sheet as liabilities, are carried forward and released to current revenue upon full completion of the underlying work as follows:

- *Search fees* and *claims fees for the eleventh and each subsequent claims*: the underlying search service is fully performed when the search report has been dispatched to the patent applicant.

- *Examination fees:* the underlying examination service is fully performed when the written communication of the intention to grant the patent or the decision to refuse the application has been sent to the patent applicant.

- *Opposition fees*: the underlying service is fully performed when the opposition procedure has been finalised, i.e. when a final decision by the opposition division has been communicated to the parties.

- *Appeal fees:* the underlying service is fully performed when the appeal procedure has been finalised, i.e. when a final decision by the board of appeal has been communicated to the parties.

The following remaining fees are accounted for as current revenue upon receipt and are not adjusted for prepaid fees:

*- Filing fees:* the underlying service consisting in the formal check of the patent application is completed by the EPO within a short time after filing. Payment is due within one month after the filing date.

- *Designation fees*
Designation fees are not work-related; rather they are one-off fees payable to ensure protection of the invention in the EPO contracting states and extension states of the applicant's choice.
The underlying service has already been fully performed by the EPO at the date of filing, before payment of the fee is due.

As these fees are not refundable in any case, a liability for received payments for designation/extension fees not yet due at the year-end closing date is not recognised in the balance sheet.

Due to the lack of a legal payment obligation by the patent applicant, a trade receivable for potentially receivable fees at the closing balance sheet date with a due date in the following period is not recognised in the balance sheet.

- *Grant and printing fees*
Grant and printing fees are due two months after conclusion of the examination service by the EPO.

Due to the lack of a legal payment obligation by the patent applicant, a trade receivable for potentially receivable fees at the closing balance sheet date with a due date in the following period is not recognised in the balance sheet.

- *Renewal fees for patent applications*
Renewal fees for patent applications are not work-related and are due in advance on a yearly basis starting from the third year after the filing date. The last renewal fee payable in respect of a European patent application covers the year in which mention of the grant of the patent is published.

For information on renewal fees once the patent has been granted, see point 2.5.1.3 below (national renewal fees for granted patents).

A deferral of the amount for renewal fees for patent applications covering two financial periods is not recognised.

#### 2.5.1.2. Searches and preliminary examinations on international applications (PCT procedure)

The EPO as an International Searching and Preliminary Examining Authority also performs international searches and preliminary examinations on international applications under the Patent Cooperation Treaty.

The due dates of the related fees are established by the World Intellectual Property Organization (WIPO) in the Patent Cooperation Treaty of 19 June 1970, as last amended on 3 October 2001, and the amounts are fixed in the Rules relating to Fees of 20 October 1977 (as last amended on 15 December 2005).

**Principles of revenue recognition for searches and preliminary examinations for international applications:**

The EPO does not start performing the service until the fee involved has been received.

As in the EPC and Euro-PCT procedure, revenue is recognised in the income statement after the service related to each fee has been fully performed by the EPO.

International search and examination fees are initially booked in the income statement upon receipt of payment. To ensure that the income statement shows only revenue for services actually rendered within the accounting period, the initially posted cash-based revenue is adjusted for prepaid fees at the closing date.

The prepaid fees, recognised in the balance sheet as liabilities, are carried forward and released to current revenue as follows:

- *International search fee and international-type search fees:* the file is considered completed when the search report has been dispatched.

- *PCT Chapter II examination fees:* The file is considered completed when the examining division has finalised its work.

The amount of prepaid fees at year-end closing is calculated using a statistical method based on the stock of non-completed work.

#### 2.5.1.3. National renewal fees for granted European patents

After a European patent has been granted, renewal fees for subsequent years during its term are payable to the designated Contracting States, which remit to the EPO a proportion (currently 50%) of each fee received. The national offices make these payments on a quarterly basis for the amount corresponding to the EPO accrued by the national office during the quarter.

**Principles of revenue recognition for national renewal fees for granted European patents:**

*National renewal fees for granted patents* for the first three quarters of the year (due dates 30 April, 31 July and 30 October) are recognised as revenue upon receipt of payment. National renewal fees for the fourth quarter (due date 31 January) are accrued on the basis of cash received before year-end closure. Amounts not received by that date are accrued using estimates based on the average amount received in the three first quarters of the year.

### 2.5.2. OTHER REVENUE

"Other revenue" includes *revenue from searches for national offices, third-party searches, patent information services* and *sales of patent information products,* with the following principles of revenue recognition:

- *Revenue from searches for national offices, third-party searches and patent information services* are recorded upon performance of the corresponding service and issue of the invoice involved.

- For *sales of patent information products*, the revenue is recognised when ownership of the goods is transferred to the buyer.

### 2.5.3. POTENTIAL NATIONAL FUTURE RENEWAL FEES FOR EUROPEAN PATENTS

The costs of the EPO are covered only partly by its own procedural fees, the remainder being financed from national renewal fees for granted European patents, payable for each year the patent is maintained in force.

It is possible that these annual national future renewal fees will not cover the EPO's remaining costs in granting the patent. As such future operating losses do not meet the criteria of a liability, the EPO recognises no provision.

Since there is no legal obligation on the patentee to maintain the patent for the maximum term (20 years) and to pay the renewal fees involved, the net present value of expected future national renewal fees on granted patents is not included in the financial statements.

That value is calculated on the basis of estimated cash-flows per Contracting State and year. These cash-flows are discounted in line with their expected timing using the discount rates from the zero-coupon yields curve extrapolated from the Euro iBoxx® indices for corporates with an AA rating.

The estimated cash flows are based on the actual number of granted patents until year-end, and their life expectancy in the different countries where they have been validated.

Life expectancy and national validations are estimated using historical statistics for each Contracting State.

The current renewal-fee distribution key and the fee amounts laid down by the Contracting States are taken as constant values over the expected term of the patents.

## 2.6. INTEREST REVENUE

*Interest revenue* is recognised on an accrual basis using the effective interest method.

## 2.7. LEASES

A lease is classified as a finance lease if it transfers to the lessee substantially all of the risks and rewards incidental to ownership. All other leases are treated as operating leases. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the legal form of the contract.

An item under finance lease is capitalised at the inception of the lease at its fair value or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are directly expensed.

Capitalised leased assets are depreciated over the estimated useful life of the asset.

Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

## 2.8. INCOME TAXES

In accordance with Article 4 of the Protocol on Privileges and Immunities of the European Patent Organisation of 5 October 1973, the EPO and its property and income are exempt from all direct taxes within the scope of its official activities.

## 2.9. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

| | |
|---|---|
| Land | not depreciated |
| Building components | 10-50 years |
| Office equipment | 3-20 years |

The expected useful life of property, plant and equipment is reviewed at each year-end and adjusted if necessary.

The EPO accounts for buildings applying the component approach. The parts of the buildings with different useful lives are depreciated separately. In the IFRS opening balance, the buildings were split into components based on a chartered surveyor's report. The depreciation period for the components is as follows:

| | |
|---|---|
| Construction of buildings | 50 years |
| Facade | 30 years |
| Fitting out | 20 years |
| Technical installations | 20 years |
| Electrical installations | 10 years |

If a part of a component is replaced, the new investment is added to the existing component's value, subject to meeting the IFRS recognition criteria, and the useful life of the component is extended accordingly. The carrying amount of the replaced part is derecognised. Repairs and maintenance are charged to the income statement during the financial period in which they incurred.

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If any indication that carrying value may not be recoverable exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount.

For the purpose of assessing impairment, assets are grouped at the lowest level for which there are separately identifiable cash flows (cash generating units).

Property, plant and equipment that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date. Specific rules relating to the impairment of intangible assets are described in point 2.10 below.

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use and subsequent disposal. Any gain or loss arising on derecognition of the asset is included in the income statement in the year the item is derecognised.

If an asset is kept with the intention to sell and is available for immediate sale in its present condition then it is reclassified to "assets held for sale". After reclassification the asset is no longer depreciated. Assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

## 2.10. INTANGIBLE ASSETS

Intangible assets acquired separately are capitalised at cost. Following initial recognition, an intangible asset is carried at its cost less any accumulated amortisation. The depreciable amount of an intangible asset is allocated on a straight-line basis over its useful life of 3-20 years. The amortisation period and method are reviewed at least at each financial year-end. If the expected useful life of the asset is significantly different from previous estimates, the amortisation period is changed accordingly.

Internal and external development costs of the intangible assets generated by the EPO are capitalised if they meet the recognition criteria:
(a) completion of the asset is technically feasible
(b) the EPO intends to complete the asset and use or sell it
(c) the EPO is able to use or sell the asset
(d) the asset is expected to generate future economic benefits

(e) the financial and technical resources necessary to complete the asset are available
(f) the costs attributable to the asset during its development can be measured reliably

The costs incurred in the research phase of internal projects are expensed.

The costs of capitalised internally generated intangible assets comprise:

- the cost of services used in generating the asset
- the cost of internal employees involved in generating the asset
- other internal costs of materials, services and depreciation incurred in generating the asset

According to the accounting policy of the EPO, the costs of internal development of intangible assets or significant, separately identifiable enhancement are capitalised if the total internal and external costs over the whole project life exceed EUR 3 million.

The internal costs for generating the asset include salaries allocated to the project based on the time used by internal staff for development activities and any other directly attributable expenditure. For certain projects the time used was recorded in a time reporting system which also allows to distinguish between different types of activities.

Where no time records were available, the time of the internal staff involved in the development was established in the process of individual analysis performed by the respective project manager. This process involved splitting the time of the internal staff between development related activities, other activities and work not related to the project in question.

External costs of included in the capitalised projects comprise fees for EDP consultants. For certain projects the consultants time was recorded in a time reporting system.

Where no time records were available, the external costs relating to the development were established based on individual analysis of invoices and order letters. The fixed price contracts were analysed with respect to meeting the recognition criteria of intangible assets.

No costs for the internal projects were recognised prior to the date of transition to IFRS due to a lack of an appropriate time recording system and, thus, the inability to measure the costs of the asset reliably.

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The asset concerned is impaired only if it is no longer in use. This policy is applied for two reasons:

(a) the intangible assets owned by the EPO are not traded in an active market, which renders any reliable calculation of the recoverable amount impossible

(b) the smallest cash-generating unit to which these intangible assets belong is the EPO as a whole. No reliable estimate of the value in use by the EPO can be made because the EPO is a non-profit institution and its mission contains non-measurable goals (like promoting a knowledge based society in Europe).

Intangible assets that have suffered impairment are reviewed for possible reversal of the impairment at each reporting date.

An intangible asset is derecognised on disposal or when no future economic benefits are expected from its use and subsequent disposal. Gains or losses arising from the retirement or disposal of an intangible asset are determined as the difference between the net disposal proceeds and the carrying amount of the asset and should be recognised as income or expense in the income statement.

### 2.11. OTHER ASSETS - EX-IIB INSURANCE FUNDS

The repurchase value of insurance contracts agreed between the former Institut International des Brevets (ex-IIB) and several insurance companies are presented as separate assets - ex-IIB insurance funds - if the criteria for a qualifying insurance policy are met. The Organisation classifies as a qualifying insurance policy all insurance contracts issued by an insurer that is not a related party of the EPO, if the proceeds of the policy can be used only to pay or fund employee benefits under a defined benefit plan, are not available to the Organisation's own creditors and cannot be paid to the EPO, unless either the proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations or are returned to the reporting entity to reimburse it for employee benefits already paid. Only if it is virtually certain that an insurance company will reimburse some or all of the expenditure required to settle the defined benefit obligation is the right to reimbursement recognised as a separate asset. The Organisation measures these assets at fair value. In all other respects they are treated as plan assets. In the income statement, the expense relating to a defined benefit plan is presented net of the amount recognised for a reimbursement.

### 2.12. FINANCIAL INSTRUMENTS

A financial instrument is any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial assets and liabilities are recognised in the balance sheet when the EPO becomes a party to the contractual provisions of the instrument.

Initially, financial instruments are recognised at their fair value. Transaction costs directly attributable to the acquisition or issue of financial instruments are recognised in determining the carrying amount only if the financial instruments are not measured at fair value through profit or loss.

Purchase and sale of financial assets are recognised using settlement-date accounting. The settlement date is the day on which the asset is delivered to or by the EPO.

For the purpose of measurement at subsequent reporting dates, the EPO classifies its financial assets according to IAS 39 in the following categories: at fair value through profit or loss; available-for-sale; and loans and receivables. The classification depends on the purpose for which the financial assets were acquired. The classification of financial assets is determined at initial recognition and re-evaluated at every reporting date.

A financial asset is derecognised when the contractual rights to its cash flows have expired. A financial liability is derecognised when the obligation specified in the contract is discharged, cancelled or expired.

**Marketable securities**

**a) Available-for-sale**
Available-for-sale investments are measured after initial recognition at fair value without any deduction for transaction costs on sale or disposal. Gains and losses arising from a change in fair value are recognised as a separate component of equity until the investment is derecognised or until the investment is found to be impaired, at which time the cumulative gain or loss in equity previously reported is included in the income statement.

Available-for-sale marketable securities are debt instruments actively traded in organised financial markets and their fair value is determined by reference to quoted market bid prices at the close of business on the balance sheet date.

The EPO assesses at each balance sheet date whether there is any objective evidence that an available-for-sale security is to be impaired. If any such evidence exists, an amount comprising the difference between its acquisition cost and its current fair value, less any impairment loss previously recognised in profit or loss, is transferred from equity to the income statement. Reversals of impairment losses on debt instruments are reversed through profit or loss, if the increase in fair value of the instrument can be objectively related to an event occurring after the impairment loss was recognised in profit or loss.

Available-for-sale marketable securities are included in non-current assets unless management intends to dispose of the investments within 12 months of the balance sheet date or the investment is due during that period.

**b) At fair value through profit or loss**
This category includes debt instruments designated by the EPO upon initial recognition at fair value through profit or loss.

They are initially recognised at fair value, transaction costs being expensed in the income statement.

Gains or losses arising from changes in the fair value at the balance sheet date, including interest revenue, are presented in the income statement within "Losses from marketable securities" in the period in which they arise.

Since there is no active market for instruments in this category, the fair value is determined using standard valuation techniques on the basis of the market parameters at the balance sheet date. For a detailed description of the valuation technique used, see Note 27.

**Home loans**
Home loans are granted to permanent staff for building, purchase or conversion of residential propriety at an interest rate lower than the prevailing market one. Therefore, the fair value at initial recognition is estimated as the present value of all future cash receipts discounted using the prevailing market rate of interest for a similar instrument with a similar credit rating.
After initial recognition, home loans are measured at amortised cost using the effective interest method. They are split into non-current and current, based on the remaining maturity of the loan.

**Trade and other current receivables**
After initial recognition, trade and other receivables are measured at amortised cost using the effective interest method, and discounted only if they are due in more than one year.
Bad debts are written off when they become uncollectible, mainly due to insolvency of the client.

**Cash and cash equivalents**
Cash and cash equivalents in the balance sheet comprise cash at banks and in hand and short-term deposits with an original maturity of three months or less; they are measured at amortised cost.
For the purpose of the cash flow statement, cash and cash equivalents are as defined above, net of outstanding bank overdrafts which are shown as bank overdrafts in the balance sheet.

Fixed-term deposits with a maturity longer than 3 months and up to 12 months are shown under other financial assets.

**Trade and other payables**
Trade and other liabilities are initially recognised at fair value. They are subsequently measured at amortised cost under the effective interest method, if applicable.
Trade payables also include liabilities for goods received or services already performed but not yet invoiced.

## 2.13. EQUITY

In compliance with the EPC, no issued capital is designated.

## 2.14. EMPLOYEE BENEFITS

"Employee benefits" comprise any benefits given by an employer to actual or former employees for past services rendered. Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity and will have no legal obligation to pay further contributions if the separate entity does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. A defined benefit plan is a pension plan that is not a defined contribution plan. Typically, defined benefit plans define an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and pay.

The Organisation operates four defined benefit plans for its employees. The assets for the pension and long-term care (LTC) insurance schemes are invested by the RFPSS.

**Pension obligations**

The liability recognised in the balance sheet in respect of the defined benefit pension plan is the present value of the defined benefit obligation (DBO) at the balance sheet date less the fair value of plan assets, together with adjustments - if any - for unrecognised actuarial gains or losses and past service costs.

The DBO is calculated annually by independent actuaries at the OECD's Joint Pension Administrative Section (JPAS) using the projected unit credit method, taking into account not only the pension obligations and vested pension rights known at the balance sheet date but also expected future salary increases and demographic assumptions about mortality, employee turnover and invalidity. The present value of the DBO is also determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits will be paid and that have terms to maturity approximating to the terms of the related pension liability. The increase in the present value of the DBO resulting from the employees' service in the current period is classified as service costs.

The plan assets comprise assets held by a long-term employee benefit fund as well as the return of qualifying insurance policies.

The expected return on plan assets is based on market expectations. The calculation also takes administrative costs into account, including custodian fees, taxes on income (Non-EPO-Contracting States) and other expenses such as bank charges.

Actuarial gains and losses arising from changes in actuarial assumptions in excess of the greater of 10% of the value of plan assets or 10% of the DBO are charged or credited to income over the employees' expected average remaining working lives (corridor approach). As the Organisation's transition date is 1 January 2005, unrecognised gains and losses are calculated beginning with the fiscal year 2005.

Due to the exception to the Financial Regulations as regards non-adoption of the criteria for plan assets as defined in IAS 19.7, the Organisation is not an IFRS first-time adopter within the meaning of IFRS 1. However, the Organisation is applying IFRS 1 to recognise the cumulative actuarial gains and losses from all defined benefit plans directly in equity at the date of transition.

The interest component of the addition to provisions contained in pension expenses is classified as interest costs. The return on plan assets is classified as interest revenue. Service costs are classified as employee benefit costs.

**Other post-employment obligations**

The Organisation provides health and LTC insurance for its pensioners. There is also insurance cover for the risks of death and invalidity for former staff members who have not yet reached the age of 60. The expected costs of these benefits are accrued over the period of employment using the same accounting methodology as for defined benefit pension plans.

Actuarial gains and losses arising from changes in actuarial assumptions in excess of the greater of 10% of the value of the plan assets - if any - or 10% of the DBO, are charged or credited to income over the expected average remaining working lives of the employees concerned. These obligations are valued annually by independent qualified actuaries.

Post-employment health insurance is a defined benefit plan managed by the insurance broker Vanbreda International Antwerp, Belgium (Vanbreda). The obligation for this insurance is calculated on the basis of the anticipated medical costs and the EPO's estimated future contributions to the insurance contracts given the actual population of pensioners. Payments to beneficiaries are carried out directly by Vanbreda on behalf of the EPO, against an insurance premium. The benefits paid are calculated taking into account the graph of refunds by age, based on the refunds made to the pensioners by the insurance company.

Post-employment LTC insurance is also classified as a defined benefit plan. Insured on a compulsory basis are former employees and their dependent children, former employees in receipt of an invalidity pension or an outright retirement pension and their dependent children and dependent children in receipt of an orphan's pension following the death of the insured person. There are also persons who may be insured on a voluntary basis. The LTC insurance benefits are calculated in proportion to salaries. Depending on the degree of reliance on LTC identified, the monthly benefit paid corresponds to defined percentages of the monthly basic salary.

Death and invalidity insurance is a defined benefit plan and is managed by the Organisation. Under this plan, former staff members receive a lump sum, based on their last salary, in case of death or invalidity. The benefits are calculated in proportion to salaries. Payments to beneficiaries are carried out directly by the Organisation financed by the contributions of the staff members and the Organisation.

### 2.15. PROVISIONS

Provisions are recognised when the Organisation has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

If the effect is material, a provision is determined by discounting the expected future cash outflow using a rate that reflects current market assessments of the time value of money and the risks specific to the obligation. This increase in the provision due to passage of time is recognised as finance costs.

### 2.16. PREPAID FEES

Prepaid fees are recognised to record cash received in the accounting records of the periods to which the payments relate. Reference is made to Note 2.5 above.

# 3. REVENUE

## 3.1. REVENUE

The revenue breaks down into the following categories:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Procedural fees related to the patent grant process **(Note 3.2)** | 701 284 | 661 517 |
| National renewal fees for granted patents | 280 727 | 268 939 |
| **Revenue from patent and procedural fees** | **982 011** | **930 456** |
| | | |
| Searches for national offices and third parties | 27 153 | 25 494 |
| Patent information services and products | 5 929 | 5 611 |
| Administrative fees | 3 501 | 3 085 |
| **Other revenue** | **36 583** | **34 190** |

## 3.2. PROCEDURAL FEES RELATED TO THE PATENT GRANT PROCESS

The different categories of services related to the grant of patents contributed to patent fee income as follows:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Procedural fees for filing and search - EPC and Euro-PCT | 120 284 | 104 979 |
| Procedural fees for international searches - PCT | 104 723 | 107 436 |
| Procedural fees for examination and grant - EPC and Euro-PCT | 159 090 | 150 640 |
| Procedural fees for international preliminary examinations - PCT | 18 073 | 31 648 |
| Procedural fees for opposition, appeal and protest | 3 535 | 3 329 |
| Designation and renewal fees for patent applications | 295 579 | 263 485 |
| | **701 284** | **661 517** |

The amount of revenue from procedural fees related to the patent grant process is shown after deduction of the variation in the amount of prepaid fees.

# 4. POTENTIAL FUTURE NATIONAL RENEWAL FEES FOR EUROPEAN PATENTS

The net present value of potential future national renewal fees for European patents by Contracting State amounts to KEUR 2 303 951 (2005: KEUR 1 930 980) and results in a change in the net present value of KEUR 372 971 (2005: KEUR 130 904).

The expected cash-flows have been estimated individually per Contracting State and year over the 18-year term typically remaining after grant.

The discount rates applied in line with the term of the expected cash-flows range between 4.08% and 4.69% in 2006 (2005: 2.95% and 4.14%). A one percentage point of increase (decrease) of the applied discount rates would result in a net present value of potential national future renewal fees amounting KEUR 2 190 104 (KEUR 2 427 647).

For further information see Note 2.5.3.

## 5. OTHER OPERATING INCOME

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Third-party project funding | 3 044 | 2 862 |
| Miscellaneous income from valuation of insurance funds | 2 688 | 1 376 |
| Rental income | 1 495 | 1 784 |
| Realised gains from marketable securities | 56 | 588 |
| Other income relating to the current and prior periods | 4 859 | 3 110 |
| | **12 142** | **9 720** |

Third-party project funding income concerns the reimbursement of expenses related to projects partly or totally financed by third parties. The corresponding expenses are shown under other operating expenses.

Gains from marketable securities relate to sales.

### OPERATING LEASE - THE EPO AS LESSOR

The EPO has entered into a number of minor lease agreements concerning office premises. The income from the operating lease for the year 2006 was as follows:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Netherlands Patent Office | 706 | 1 070 |
| Other | 789 | 714 |
| | **1 495** | **1 784** |

The future lease payments for rental of office premises in The Hague to the Netherlands Patent Office are as follows:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Not later than one year | 706 | 1 070 |
| Later than one year and not later than five years | 2 824 | 4 280 |
| Later than five years | 706 | 2 140 |
| | **4 236** | **7 490** |

## 6. EMPLOYEE BENEFIT EXPENSES

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Basic salaries permanent employees | 471 502 | 442 683 |
| Social security | 249 985 | 196 770 |
| Allowances and other benefits | 125 639 | 116 127 |
| Remuneration of other employees | 19 296 | 22 827 |
| School and day-care centres | 18 024 | 17 275 |
| Training | 7 619 | 8 587 |
| Other | 8 689 | 9 358 |
| | **900 754** | **813 627** |

## 7. OTHER OPERATING EXPENSES

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| EDP maintenance | 67 357 | 67 685 |
| Property and equipment maintenance | 46 664 | 44 928 |
| Consultancy and other external services | 13 937 | 11 624 |
| Co-operation and meetings | 13 198 | 14 037 |
| Patent information and public relations | 12 990 | 12 505 |
| Documentation | 8 512 | 7 338 |
| Travel | 7 340 | 6 772 |
| Postage and telecomunication | 5 534 | 5 379 |
| Other | 11 668 | 13 312 |
| | **187 200** | **183 580** |

## 8. FINANCE REVENUE

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Expected return on plan assets | 225 745 | 183 487 |
| Interest income on marketable securities | 8 625 | 7 117 |
| Interest income from home loans | 5 182 | 5 480 |
| Interest income from bank accounts, deposits and others | 4 524 | 3 695 |
| | **244 076** | **199 779** |

## 9. FINANCE COSTS

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Interests costs on defined benefit obligations | 197 120 | 188 174 |
| Interest costs finance lease | 1 426 | 1 675 |
| Other interest costs | 283 | 296 |
| | **198 829** | **190 145** |

## 10. PROPERTY, PLANT AND EQUIPMENT

The reconciliation of the carrying amount of property, plant and equipment for the year 2006 is as follows:

| in '000 EUR | Land | Buildings | Office equipment | Total |
|---|---|---|---|---|
| Cost at 1 January 2006 | 174 732 | 697 766 | 140 391 | 1 012 889 |
| Additions | 0 | 43 390 | 11 186 | 54 576 |
| Disposals | 0 | (7 858) | (10 296) | (18 154) |
| Transfers | 0 | 0 | 0 | 0 |
| Cost at 31 December 2006 | **174 732** | **733 298** | **141 281** | **1 049 311** |
| | | | | |
| Accumulated depreciation 1 January 2006 | 0 | (185 463) | (87 191) | (272 654) |
| Depreciation for the year | 0 | (30 182) | (19 627) | (49 809) |
| Disposals | 0 | 2 202 | 9 716 | 11 918 |
| Transfers | 0 | 0 | 0 | 0 |
| Accumulated depreciation 31 December 2006 | **0** | **(213 443)** | **(97 102)** | **(310 545)** |
| | | | | |
| Impairment loss for the year | 0 | 0 | 0 | 0 |
| Accumulated impairment 31 December 2006 | (12 819) | 0 | 0 | (12 819) |
| | | | | |
| Net carrying value 1 January 2006 | 161 913 | 512 303 | 53 200 | 727 416 |
| Net carrying value 31 December 2006 | **161 913** | **519 855** | **44 179** | **725 947** |
| | 0 | 0 | 0 | 0 |
| | | | | |
| Construction in progress 1 January 2006 | 0 | 55 539 | 0 | 55 539 |
| Construction in progress 31 December 2006 | 0 | 88 065 | 0 | 88 065 |

Land and buildings are located at three EPO sites: Munich, The Hague and Vienna.

The construction in progress as of 31.12.2006 includes EUR 68.3m (EUR 44.7m as of 31.12.2005) for investment in the new building - PschorrHöfe BA8, in Munich. The EPO is contractually committed to invest a further EUR 42.4m in this building in the period 2007-2008.

The EPO building at the Erhardtstrasse 27 in Munich was constructed under the hereditary building lease granted to the EPO by the German government in 1980 and ending on 8 August 2075. The Hinge building in The Hague is constructed on land leased from the Netherlands in 1988 for a period of 80 years ending on 30 May 2068, for the token amount of EUR 0.45 per year.

Office equipment contains assets under finance lease to the value of KEUR 16 860 (and KEUR 18 058 as per 31.12.2005).

The comparative figures for the year 2005 are presented in the table below.

| in '000 EUR | **Land** | **Buildings** | **Office equipment** | **Total** |
|---|---|---|---|---|
| Cost at 1 January 2005 | 130 304 | 647 592 | 145 948 | 923 844 |
| Additions | 44 428 | 50 983 | 12 438 | 107 849 |
| Disposals | 0 | (363) | (18 441) | (18 804) |
| Transfers | 0 | (446) | 446 | 0 |
| Cost at 31 December 2005 | **174 732** | **697 766** | **140 391** | **1 012 889** |
| | | | | |
| Accumulated depreciation 1 January 2005 | 0 | (156 570) | (85 813) | (242 383) |
| Depreciation for the year | 0 | (29 000) | (19 791) | (48 791) |
| Disposals | 0 | 190 | 18 330 | 18 520 |
| Transfers | 0 | (83) | 83 | 0 |
| Accumulated depreciation 31 December 2005 | **0** | **(185 463)** | **(87 191)** | **(272 654)** |
| | | | | |
| Impairment loss for the year | (12 819) | 0 | 0 | (12 819) |
| Accumulated impairment 31 December 2005 | (12 819) | 0 | 0 | (12 819) |
| | | | | |
| Net carrying value 1 January 2005 | 130 304 | 491 022 | 60 135 | 681 461 |
| Net carrying value 31 December 2005 | **161 913** | **512 303** | **53 200** | **727 416** |
| Including construction in progress | 0 | 0 | 0 | 0 |
| | | | | |
| Construction in progress 1 January 2005 | 0 | 104 621 | 0 | 104 621 |
| Construction in progress 31 December 2005 | 0 | 55 539 | 0 | 55 539 |

The impairment loss of EUR 12.8m in the year 2005 relates to the site purchased for construction of the new building - PschorrHöfe BA8 in Munich. The site price was negotiated and agreed with the seller in 2004. Since then, the property prices have fallen. Following further valuations by external experts, the EPO has concluded that the decrease in value of the site occurred in 2005 and had to be shown as an impairment charge for that year.

## 11. INTANGIBLE ASSETS

The reconciliation of the balances of intangible assets is as follows:

| in '000 EUR | Acquired software | Acquired information systems | Internally generated systems | Total |
|---|---|---|---|---|
| Cost at 1 January 2006 | 7 278 | 54 633 | 6 539 | **68 450** |
| Additions | 698 | 0 | 6 748 | **7 446** |
| Disposals | (583) | 0 | 0 | **(583)** |
| Transfers | 0 | 0 | 0 | **0** |
| Cost at 31 December 2006 | **7 393** | **54 633** | **13 287** | **75 313** |
| | | | | |
| Accumulated amortisation 1 January 2006 | (6 167) | (34 497) | 0 | **(40 664)** |
| Amortisation for the year | (573) | (2 115) | (460) | **(3 148)** |
| Amortisation disposals | 583 | 0 | 0 | **583** |
| Accumulated amortisation 31 December 2006 | (6 157) | (36 612) | (460) | **(43 229)** |
| Net carrying value 1 January 2006 | 1 111 | 20 136 | 6 539 | **27 786** |
| Net carrying value 31 December 2006 | **1 236** | **18 021** | **12 827** | **32 084** |
| | | | | |
| Including construction in progress | | | | |
| 1 January 2006 | 0 | 0 | 3 781 | **3 781** |
| 31 December 2006 | 0 | 0 | 10 529 | **10 529** |

The comparative figures for 2005 are as follows:

| in '000 EUR | Acquired software | Acquired information systems | Internally generated systems | Total |
|---|---|---|---|---|
| Cost at 1 January 2005 | 6 953 | 54 432 | 0 | **61 385** |
| Additions | 327 | 201 | 6 539 | **7 067** |
| Disposals | (2) | 0 | 0 | **(2)** |
| Transfers | 0 | 0 | 0 | **0** |
| Cost at 31 December 2005 | **7 278** | **54 633** | **6 539** | **68 450** |
| | | | | |
| Accumulated amortisation 1 January 2005 | (5 294) | (32 383) | 0 | **(37 677)** |
| Amortisation for the year | (875) | (2 114) | 0 | **(2 989)** |
| Amortisation disposals | 2 | 0 | 0 | **2** |
| Accumulated amortisation 31 December 2005 | (6 167) | (34 497) | 0 | **(40 664)** |
| Net carrying value 1 January 2005 | 1 659 | 22 049 | 0 | **23 708** |
| Net carrying value 31 December 2005 | **1 111** | **20 136** | **6 539** | **27 786** |
| | | | | |
| Including construction in progress | | | | |
| 1 January 2005 | 0 | 0 | 0 | **0** |
| 31 December 2005 | 0 | 0 | 3 781 | **3 781** |

The acquired software is amortised over the period of 3-5 years.

The amortisation period of acquired information systems is determined individually, depending on the expected useful life of the system. Some intangible assets are amortised over 20 years, including databases used by EPO examiners for the patent granting procedure.

The EPO invests in the development of information systems to support its operations. These internally generated systems include both external and internal costs. The external development costs are recognised based on the amounts invoiced for the services rendered by external contractors. The internal costs are calculated based on the number of staff involved in the project multiplied by the average annual cost of the employee. This includes salaries, office space, equipment and other costs necessary to develop the system. The capitalised internal costs amounting to KEUR 2 016 (2005: KEUR 1 641) are presented in the income statement as "Work performed by the entity and capitalised".

The internally generated systems that are still in the development phase (construction in progress) include:

**Construction in progress**

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Docarea | 4 508 | 2 102 |
| Epoque | 3 219 | 1 468 |
| Epodos | 2 093 | 0 |
| European Machine Translation | 709 | 211 |
| | **10 529** | **3 781** |

## 12. OTHER ASSETS - EX-IIB INSURANCE FUNDS

The EPO holds contracts concluded by the ex-IIB with several insurance companies. The main ones are as follows:

**Caisse Nationale de Prévoyance, Paris, France**
The repurchase value of the contract amounts to KEUR 43 251 (2005: KEUR 43 233). In 2006 the EPO received a total amount of KEUR 2 560 (2005: KEUR 2 497) on a quarterly basis. The number of pensioners concerned is 234 (2005: 253).

**Fortis AG, Brussels, Belgium**
The repurchase value of this contract is KEUR 1 240 (2005: KEUR 1 289). In 2006 the EPO received a total amount of KEUR 153 (2005: KEUR 164), transferred on a monthly basis. The number of pensioners concerned is 22 (2005: 24).

These contracts fulfil the requirements for qualifying insurance because the received payments are transferred to the RFPSS on a monthly basis and are consequently not available to the reporting entity's own creditors. The payments qualify as plan assets as they will be used only to pay or fund employee benefits under a defined benefit plan.

## 13. MARKETABLE SECURITIES

The EPO's marketable securities include the following:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Interest-bearing bonds - quoted | 241 333 | 155 689 |
| Interest-bearing bonds - unquoted | 103 964 | 106 912 |
| **Total marketable securities** | **345 297** | **262 601** |
| Current | 46 563 | 40 196 |
| Non-current | 298 734 | 222 405 |

The current portion comprises only available-for-sale marketable securities.

Available-for-sale financial assets are fixed-interest bearing bonds **quoted** in active markets with nominal interests ranging from 2.10% to 5.75% (2005: 2.10% to 5.25%) and maturity dates between June 2007 and October 2009 (2005:January 2006 and June 2009), the majority being due in 2008 (KEUR 134 079; 2005: KEUR 75 752).

Marketable securities designated at fair value through profit or loss are structured interest-bearing bonds with a capital guarantee that are **not quoted** in active markets. They accrue a higher yield, for a comparable duration, than fixed-interest-bearing bonds if the embedded interest-rate option underlying the bond remains within a specified range of the 6- or 12-month EURIBOR. If the option falls out of the range, no interest is achieved for that period. The nominal invested capital is returned integrally to the EPO at maturity. Maturity dates range between January 2008 to May 2010, the majority being due in 2008 (KEUR 95 121; 2005: KEUR 97 374).

Net losses of KEUR 2 826 (2005: KEUR 1 326) from re-measurement at fair value of available-for-sale securities have been recognised in equity.
Net losses of KEUR 247 (2005: KEUR 957) recorded in equity were reclassified to the income statement on sale or maturity.

Fair-value losses on marketable securities designated at fair value through profit or loss amounting to KEUR 2 948 (2005: KEUR 3 089) are shown in the income statement under other operating expenses.

No impairment provisions are required on marketable securities in 2006 or in 2005.

## 14. HOME LOANS TO STAFF

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Home loans non-current | 90 441 | 84 438 |
| Home loans current | 2 872 | 4 709 |
| | **93 313** | **89 147** |

Home loans to staff are initially recognised at fair value. This is estimated as the present value of all future cash receipts discounted using the prevailing market rate for a similar financial instrument of a similar duration.
The EPO adds the discount to profit or loss using the effective interest rate method.

## 15. TRADE AND OTHER RECEIVABLES

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Trade receivables - Contracting States | 92 160 | 80 332 |
| Trade receivables - clients | 3 640 | 5 158 |
| **Total trade receivables** | **95 800** | **85 490** |
| Other receivables - tax | 24 393 | 20 913 |
| Other receivables - staff and related accounts | 295 | 294 |
| Other receivables - others | 8 858 | 5 347 |
| **Other receivables** | **33 546** | **26 554** |
| **Total trade and other receivables** | **129 346** | **112 044** |

All trade and other receivables are expected to be recovered or settled within 12 months after the balance sheet date and are therefore classified as current assets.

The analysis of trade receivables - clients that were past due but not impaired is as follows:

**2006**

| in '000 EUR | | | **Of which not impaired as of the reporting date and past due in the following periods:** | |
|---|---|---|---|---|
| | **Net carrying amount, trade receivables - clients** | **Of which neither impaired nor past due on the reporting date** | **Less than 135 days** | **More than 135 days** |
| Trade receivables - clients | **3 640** | 3 421 | 203 | 16 |

**2005**

| in '000 EUR | | | **Of which not impaired as of the reporting date and past due in the following periods:** | |
|---|---|---|---|---|
| | **Net carrying amount, trade receivables - clients** | **Of which neither impaired nor past due on the reporting date** | **Less than 135 days** | **More than 135 days** |
| Trade receivables - clients | **5 158** | 5 028 | 92 | 38 |

During 2006, the EPO wrote off uncollectible receivables amounting to KEUR 2 (2005: KEUR 1) which are shown in the income statement under other operating expenses.

Trade receivables - Contracting States include the renewal fees payable by the Contracting States under Article 39(1) EPC. These mainly relate to the last quarter of the reported year, due on 31 January of the following year.

Other receivables - tax comprise VAT and pensioners' income tax payable to the EPO by the Contracting States.

Other receivables - other mainly consist of accrued income on marketable securities and fixed-term deposits and advance payments to various suppliers.

## 16. OTHER FINANCIAL ASSETS

Under other financial assets are shown fixed-term deposits with an initial maturity over three months after the balance sheet date.

## 17. CASH AND CASH EQUIVALENTS

The assets reported under this category have an original maturity of three months or less and comprise the following:

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Short-term bank deposits | 65 960 | 127 606 |
| Cash at bank and in hand | 15 994 | 18 525 |
| | **81 954** | **146 131** |

The effective interest rate achieved during 2006 on short-term deposits was 2.92% (2005: 2.21%).
Cash, cash equivalents and bank overdrafts include the following for the purpose of the cash-flow statement:

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Cash and cash equivalents | 81 954 | 146 131 |
| Bank overdrafts | 0 | (184) |
| | **81 954** | **145 947** |

# 18. NET DEFINED BENEFIT LIABILITY

| | Accounting for 2006 | | | | |
|---|---|---|---|---|---|
| in '000 EUR | Pension obligation | Long-term care insurance | Sickness insurance | Death and invalidity | TOTAL |
| Discount rate | 4,92% | 5,00% | 4,90% | 4,60% | |
| Expected return on plan assets | 8,10% | 8,10% | | | |
| Future salaries increase | 2,50% | 2,50% | | | |
| Future pensions increase | 2,50% | 2,50% | | | |
| Medical costs inflation | | | from 5,5% in year 1 to 2,5 in year 15 and further | | |
| The Organisation is expected to contribute EUR 99m in 2007 | | | | | |
| Expected average remaining working lives | 20 | 20 | 20 | 20 | |
| | | | | | |
| Present value of obligation 01.01.2006 | 3 666 136 | 108 816 | 598 680 | 102 821 | 4 476 453 |
| Interest cost | 161 711 | 5 070 | 26 437 | 3 902 | 197 120 |
| Current service cost | 205 061 | 4 763 | 42 223 | 10 360 | 262 407 |
| Transfer of pension rights | 12 215 | — | — | — | 12 215 |
| Benefits paid | (64 353) | (1 896) | (9 192) | (5 555) | (80 996) |
| Actuarial loss on obligation | (248 112) | 4 915 | (105 395) | (9 843) | (358 435) |
| **Present value of obligation 31.12.2006** | **3 732 658** | **121 668** | **552 753** | **101 685** | **4 508 764** |
| | | | | | |
| Fair value of plan assets 01.01.2006 | 2 721 322 | 27 608 | — | — | 2 748 930 |
| Expected return on plan assets | 223 302 | 2 443 | — | — | 225 745 |
| Contributions | 119 333 | 7 008 | 6 190 | — | 132 531 |
| Transfer of pension rights | 12 215 | — | — | — | 12 215 |
| Benefits paid | (60 565) | (1 896) | (9 192) | — | (71 653) |
| Actuarial gain on plan assets | 119 546 | 1 314 | 3 002 | — | 123 862 |
| **Fair value of plan assets 31.12.2006** | **3 135 153** | **36 477** | **—** | **—** | **3 171 630** |
| | | | | | |
| Limits of corridor as at 01.01.2006 | 366 614 | 10 882 | 59 868 | 10 282 | |
| Unrecognised actuarial gains(losses) as at 01.01.2006 | 71 943 | (7 621) | (51 193) | (3 236) | |
| Actuarial loss on obligation | 248 112 | (4 915) | 105 395 | 9 843 | |
| Actuarial gain on plan assets | 119 546 | 1 314 | 3 002 | — | |
| **Unrecognised actuarial gains(losses) as at 31.12.2006** | **439 601** | **(11 222)** | **57 204** | **6 607** | |
| | | | | | |
| Amounts recognised in the Balance Sheet | | | | | |
| Present value of funded obligation as at 31.12.2006 | 3 622 948 | 121 668 | 552 753 | — | 4 297 369 |
| Fair value of plan assets 31.12.2006 | (3 135 153) | (36 477) | — | — | (3 171 630) |
| | 487 795 | 85 191 | 552 753 | — | 1 125 739 |
| Unfunded obligation | 109 711 | — | — | 101 685 | 211 396 |
| Unrecognised actuarial gains(losses) | 439 601 | (11 222) | 57 204 | 6 607 | 492 190 |
| **Liability recognised in the balance sheet** | **1 037 107** | **73 969** | **609 957** | **108 292** | **1 829 325** |
| | | | | | |
| Amounts recognised in the income and expenditure account | | | | | |
| Interest cost | 161 711 | 5 070 | 26 437 | 3 902 | 197 120 |
| Current service cost | 205 061 | 4 763 | 42 223 | 10 360 | 262 407 |
| Staff contributions | (38 881) | (2 383) | — | (2 404) | (43 668) |
| Expected return on plan assets | (223 302) | (2 443) | — | — | (225 745) |
| Net actuarial (gains) or losses recognised in year | — | — | — | — | — |
| **Expense recognised in the income and expenditure account** | **104 589** | **5 007** | **68 660** | **11 858** | **190 114** |
| | | | | | |
| Actual return on plan assets | | | | | |
| Expected return on plan assets | 223 302 | 2 443 | — | — | 225 745 |
| Actuarial gain on plan assets | 119 546 | 1 314 | — | — | 120 860 |
| **Actual return on plan assets** | **342 848** | **3 757** | **—** | **—** | **346 605** |

| in '000 EUR | Pension obligation | Accounting for 2005<br>Long-term care insurance | Sickness insurance | Death and invalidity | TOTAL |
|---|---|---|---|---|---|
| Discount rate | 4,45% | 4,70% | 4,45% | 3,90% | |
| Expected return on plan assets | 8,10% | 8,10% | | | |
| Future salaries increase | 2,50% | 2,50% | | 2,50% | |
| Future pensions increase | 2,50% | 2,50% | | 2,50% | |
| Medical costs inflation | | | from 5,5% in year 1 to 2,55 in year 15 and further | | |
| The Organisation is expected to contribute EUR 135m in 2006 | | | | | |
| Expected average remaining working lives | 20 | 20 | 20 | 20 | |
| | | | | | |
| Present value of obligation 01.01.2005 | 3 201 850 | 92 007 | 496 247 | 93 126 | 3 883 230 |
| Interest cost | 155 509 | 4 653 | 24 119 | 3 893 | 188 174 |
| Current service cost | 164 388 | 3 671 | 32 432 | 9 435 | 209 926 |
| Transfer of pension rights | 13 530 | — | | — | 13 530 |
| Benefits paid | (56 385) | (1 555) | (8 054) | (6 869) | (72 863) |
| Actuarial loss on obligation | 187 244 | 10 040 | 53 936 | 3 236 | 254 456 |
| **Present value of obligation 31.12.2005** | **3 666 136** | **108 816** | **598 680** | **102 821** | **4 476 453** |
| | | | | | |
| Fair value of plan assets 01.01.2005 | 2 208 122 | 18 586 | — | — | 2 226 708 |
| Expected return on plan assets | 181 783 | 1 704 | — | — | 183 487 |
| Contributions | 111 841 | 6 454 | 5 310 | — | 123 605 |
| Transfer of pension rights | 13 530 | — | — | — | 13 530 |
| Benefits paid | (53 141) | (1 555) | (8 054) | — | (62 750) |
| Actuarial gain on plan assets | 259 187 | 2 419 | 2 744 | — | 264 350 |
| **Fair value of plan assets 31.12.2005** | **2 721 322** | **27 608** | **—** | **—** | **2 748 930** |
| | | | | | |
| Limits of corridor as at 01.01.2005 | 320 185 | 9 201 | 49 625 | 9 313 | |
| Actuarial loss on obligation | (187 244) | (10 040) | (53 936) | (3 236) | |
| Actuarial gain on plan assets | 259 187 | 2 419 | 2 744 | — | |
| **Unrecognised actuarial gains(losses) as at 31.12.2005** | **71 943** | **(7 621)** | **(51 192)** | **(3 236)** | |
| | | | | | |
| Amounts recognised in the Balance Sheet | | | | | |
| Present value of funded obligation as at 31.12.2005 | 3 542 560 | 108 816 | 598 680 | — | 4 250 056 |
| Fair value of plan assets 31.12.2005 | (2 721 322) | (27 608) | — | — | (2 748 930) |
| | 821 238 | 81 208 | 598 680 | — | 1 501 126 |
| Unfunded obligation | 123 577 | — | — | 102 821 | 226 398 |
| Unrecognised actuarial gains(losses) | 71 943 | (7 621) | (51 192) | (3 236) | 9 894 |
| **Liability recognised in the balance sheet** | **1 016 758** | **73 587** | **547 488** | **99 585** | **1 737 418** |
| | | | | | |
| Amounts recognised in the profit and loss | | | | | |
| Interest cost | 155 509 | 4 653 | 24 119 | 3 893 | 188 174 |
| Current service cost | 164 388 | 3 671 | 32 432 | 9 435 | 209 926 |
| Staff contributions | (36 325) | (2 212) | — | (2 315) | (40 852) |
| Expected return on plan assets | (181 783) | (1 704) | — | — | (183 487) |
| Net actuarial (gains) or losses recognised in year | — | — | — | — | — |
| **Expense recognised in the income and expenditure account** | **101 789** | **4 408** | **56 551** | **11 013** | **173 761** |
| | | | | | |
| Actual return on plan assets | | | | | |
| Expected return on plan assets | 181 783 | 1 704 | — | — | 183 487 |
| Actuarial gain on plan assets | 259 187 | 2 419 | — | — | 261 606 |
| **Actual return on plan assets** | **440 970** | **4 123** | **—** | **—** | **445 093** |

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Defined benefit obligation | (3 956 011) | (3 877 773) |
| Plan assets | 3 171 630 | 2 748 930 |
| Surplus/(deficit) | **(784 381)** | **(1 128 843)** |
| | | |
| Experience adjustment on plan liabilities | 141 819 | 78 808 |
| Experience adjustment on plan assets | 120 860 | 261 606 |

**Post-employment medical benefits**

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Defined benefit obligation | 552 753 | 598 680 |
| Experience adjustment on plan liabilities | (42 347) | (197 314) |

The price inflation hypothesis reflects expected price inflation in the Euro zone, in accordance with the European Central Bank's inflation target of 2%. The assumed future annual benefit and salary increase is 0.5% above price inflation.
The mortality table in use at the EPO is regularly adjusted to both serving staff and pensioners. The table is adopted with a 2-year adjustment for active staff to take into account a probable future increase in life expectancy.
The medical costs inflation applied is 3% in real terms for the five coming years; the rate is then reduced to 0.5% on a linear basis for the 10 following years.
The weighted average of purely medical inflation concerning the actual liability structure is 3.3%.
The expected return on plan assets is based on expected long-term development, using the 10-year average rate of return of the past as a plausibility reference. It is intended to amend the expected return on plan assets as soon as the asset allocation is amended or an updated asset allocation study results in a different rate of return.

An employee who enters the service of the Organisation after leaving the service of a government department, a national organisation, an international organisation or a firm, may arrange for payment to the Organisation of any amounts corresponding to the retirement pension rights accrued under the previous pension schemes (transfer of pension rights), provided that those schemes allow such transfers to be made. In such cases, the Organisation determines the number of years' reckonable service credited under its own pension scheme. An amount of KEUR 3 515 (2005: KEUR 8 063) resulting from pension right transfers in is taken into account as actuarial loss.

The Organisations receives reimbursements for ex-IIB employees from external insurance companies as disclosed in Note 12.

For the fiscal year 2006 a one percentage point change in assumed health care cost trends would have the following effects:

| in '000 EUR | One percentage point increase | One percentage point decrease |
|---|---|---|
| Effect on the aggregate of service costs and interest costs | 18 821 | (13 616) |
| Effect on DBO | 136 082 | (102 449) |

For the fiscal year 2005 a one percentage point change in assumed health care cost trends would have the following effects:

| in '000 EUR | One percentage point increase | One percentage point decrease |
|---|---|---|
| Effect on the aggregate of service costs and interest costs | 22 504 | (16 672) |
| Effect on DBO | 158 134 | (122 167) |

The contributions to the post-employment benefit plans are as follows:

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Pension benefits | | |
| • Office contributions | 77 817 | 72 714 |
| • Staff contributions | 38 881 | 36 325 |
| LTC benefits | | |
| • Office contributions | 4 605 | 4 256 |
| • Staff and pensioners' contributions | 2 383 | 2 212 |
| Post-employment medical care | | |
| • Office contributions | 37 285 | 33 528 |
| • Staff and pensioners' contributions | 13 254 | 12 303 |
| Death and invalidity | | |
| • Office contributions | 4 773 | 4 548 |
| • Staff contributions | 2 404 | 2 315 |
| | **181 402** | **168 201** |

The major categories of plan assets are as follows:

| in % | 2006 | 2005 |
|---|---|---|
| Domestic equities | 26 | 29 |
| Domestic bonds | 25 | 26 |
| Foreign equities | 22 | 25 |
| Emerging markets | 8 | 7 |
| Real estate | 8 | 8 |
| Commodities | 4 | 0 |
| Foreign bonds | 3 | 3 |
| Cash | 4 | 2 |
| | **100** | **100** |

**Main characteristics of the Organisation's defined benefit pension scheme:**

| Type of benefit | Beneficiary | Calculation of the benefit |
|---|---|---|
| Retirement pension | Staff member from the age of 60 with total at least 10 years of service (reduced pension possible from the age of 50) | 2% of last monthly basic salary per reckonable year of service, subject to a maximum of 70%. |
| Reversion of retirement pension | Surviving spouse/husband | 60% of the retirement pension. |
| Invalidity pension | Staff member | Retirement pension to which the staff member would have been entitled at the age of 65, without the need for a minimum of ten years of service |
| Survivor's pension | Surviving spouse/husband | 60% of the retirement pension to which the staff member would have been entitled at the time of his death, without the need for a minimum of ten years of service |
| Orphan's pension | Dependent child,<br>subject to age and education status | 40% of the survivor's /reversionary pension (80% if there is no survivor's/reversionary beneficiary) |
| Severance grant | Staff members | Aggregate amount deducted from salary pension contributions, plus 4% p.a. compound interest<br>and<br>one month and a half of final monthly basic salary multiplied by the number of reckonable years of service |
| Family allowances | Pensioners and dependants | Same as for active staff |

**Main characteristics of the Organisation's other post-employment benefit plans:**

**Sickness insurance:**
An employee who has remained in EPO service until retirement or is in receipt of an invalidity pension, his spouse, his children and other dependants are insured against expenditure incurred in case of sickness, accident, pregnancy and confinement. One third of the contribution involved, calculated as a percentage (max. 2.4%) of the pension is charged to the employee.
Benefits also apply to the person entitled to a survivor's pension following the death of an employee who was in active employment or who remained in EPO service until retirement or following the death of a person entitled to an invalidity pension. The contribution is calculated as a percentage of the survivor's pension.
A person entitled to an orphan's or dependant's pension may also be covered, but only on request. The contribution is calculated as a percentage of the orphan's or dependant's pension.
Where the total medical expenditure not reimbursed for any period of twelve months exceeds half the pension paid, special reimbursement is allowed by the President. In addition, in the case of medical expenditure which exceeds one fifth but is less than one half of the pension, an additional reimbursement is allowed.

**Long-term care insurance**
A permanent employee, a former employee in receipt of an invalidity or retirement pension, his spouse, his former spouse, his dependent children and other dependants are insured on either a compulsory or a voluntary basis against expenditure arising from reliance on long-term care. This insurance is intended to provide a fixed amount of financial support to defray some of the expenses incurred if an insured person's autonomy becomes seriously impaired on a long-term basis and he therefore requires help to carry out everyday activities; it does not include any expenditure on medical fees associated with the treatment of an illness or resulting from pregnancy or an accident.
The following contributions are paid:

(a) a contribution by the Office proportional to the basis formed by the sum of the basic salaries and basic pensions paid to the insured persons plus 6% for those insured persons who have opted for voluntary insurance of their spouse, and the sum of the survivor's pensions. The rate of this contribution is equal to two thirds of a reference rate determined on the basis of an actuarial study carried out by independent experts and fixed at 1.2% for the fiscal years 2005 and 2006.
(b) a contribution by the insured persons. The rate of this contribution is equal to one third of the reference rate. However, during periods in which a person insured is not in active employment, this rate is equal to the reference rate defined.

For employees joining the EPO after the age of 55 the Office and staff contributions are reduced to one third of those defined above.

**Death and invalidity insurance**

The benefits payable are a fixed amount for funeral expenses incurred for the permanent employee himself, his spouse and, where appropriate, his dependants. In the event of death of the permanent employee, or of permanent invalidity totally preventing him from performing duties corresponding to his level of employment in the Organisation, the benefits payable are a lump sum equal to 2.75 times his annual basic salary. For permanent employees recruited after 9 June 1983 the lump sum is reduced by:

| | |
|---|---|
| 20% | at the age of 56 |
| 40% | at the age of 57 |
| 60% | at the age of 58 |
| 80% | at the age of 59 |
| 100% | at the age of 60 |

The contribution which is required to meet the insurance for funeral expenses is included in the contribution provided for under the provisions for long-term care. One third of the contribution, calculated by reference to the basic salary of the permanent employee, which is required to meet the insurance of the risks of death and invalidity is charged to the employee (max. 0.6% of his basic salary).

A permanent employee who has been in EPO service for at least two years and whose service terminates for reasons other than regular or invalidity retirement may on request continue to be insured in the event of death, but must then bear the total contribution. The benefits payable are calculated on the basic salary received when service terminated. The insurance ends at the end of the month during which he reaches the age of 65 years.

## 19. TRADE AND OTHER PAYABLES

Of total trade and other payables, KEUR 5 232 (KEUR 6 010) is non-current and mainly includes an obligation for long-term employee benefits due to long-service leave and gratuities.

The current portion of trade and other liabilities is as follows

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Employee related liabilities | 57 763 | 51 378 |
| Current deposit accounts by patent applicants | 54 760 | 53 341 |
| Payables to suppliers and trade creditors | 49 491 | 47 705 |
| Other | 2 308 | 1 514 |
| | **164 322** | **153 938** |

With My.epoline®, applicants can debit online the *current deposit accounts* kept by the Organisation for fee payments relating to their applications. A liability is recognised for inpayments of applicants to replenish their deposit accounts at the Organisation.

*Employee related liabilities* mainly include accrued liabilities for untaken annual leave amounting to KEUR 33 161 (2005: KEUR 29 672) and home leave of KEUR 22 070 (2005: KEUR 19 289).

## 20. FINANCE LEASE LIABILITIES

The EPO has entered into three finance lease contracts:

The Open Infrastructure Offering (OIO) contract was signed with IBM companies in The Netherlands, Germany and Austria. It came into force in 2004 and will terminate by the end of 2008. The total value of deliveries under this contract over the 5-year period is EUR 90m. EUR 17m is for the delivery of hardware (mainly servers), and in view of their characteristics has been identified and classified as finance lease. Remaining costs cover services, maintenance and software.

The contract signed with Telematics S.A. Brussels, Belgium, relates to the delivery, configuration and maintenance of storage capacity. As at 31.12.2006, the total value of the contract was EUR 28.6m, including equipment amounting to EUR 15.2 m. This value is expected to increase in future years as further storage capacities will be ordered. The first deliveries under this agreement were made in May 2003.

The contract with T-Systems Business Services GmbH, Bonn, Germany, signed in August 2006, relates to the supply, installation, connection, configuration and management of the LAN infrastructure consisting of new hardware and related software. The contract period is 6 years. First installations under the contract took place in October 2006. The estimated total value of the equipment delivered under the contract is EUR 5.4m.

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Assets value | | |
| Office equipment | 16 860 | 18 058 |
| | | |
| Future lease payments | | |
| Not later than one year | 8 964 | 8 265 |
| Later than one year and not later than five years | 11 768 | 14 538 |
| Later than five years | 449 | 0 |
| Total future lease payments | **21 181** | **22 803** |
| Future interest payable | 2 014 | 2 532 |
| Present value of future lease payments | **19 167** | **20 271** |

## 21. PROVISIONS

| in '000 EUR | Asset retirement obligation | Litigation risks | Other | Total |
|---|---|---|---|---|
| 1.1.2006 | 2 374 | 466 | 393 | 3 233 |
| Use | — | 466 | 393 | 859 |
| Reversal | 881 | — | — | 881 |
| Addition | 10 623 | 852 | 393 | 11 868 |
| Interest effect | 82 | — | — | 82 |
| Other | — | — | — | — |
| **31.12.2006** | 12 198 | 852 | 393 | **13 443** |
| Current | 400 | 852 | 393 | 1 645 |
| Non-current | 11 798 | — | — | 11 798 |
| | 12 198 | 852 | 393 | 13 443 |

The Organisation recognises in 2006 an *asset retirement obligation* amounting to KEUR 10 623 (discounted) for the renovation of an owned office building in Munich (Erhardstrasse) due to a contamination with asbestos. The corresponding debit is treated as part of the costs of the related building. It is expected that the related costs will occur between 2007 and 2010.
In prior years, a provision was recognised due to a contractual obligation for dismantling and renovation of a leased office building in Munich (Westsite). The amount to settle this obligation depends on when the Organisation vacates the building. It was expected that these costs would be incurred in fiscal year 2008. Due to a revised medium-term business plan, the Organisation decided to extend the lease, so the relevant provision was partly released in December 2006.
Although contractual obligations for dismantling and renovations are usual in the ordinary course of business, the Organisation recognises no provisions for its other leased buildings as it is highly unlikely that the Organisation will terminate these lease contracts.

The provisions for *litigation risks* mainly include provisions for staff appeals pending at the Administrative Tribunal of the International Labour Organization. The EPO expects a settlement within twelve moths after the balance sheet date.

*Other provisions* are recognised for obligations to fulfil requirements of the EPC mainly due to external audit. These provisions are classified as current as the outflow of resources is expected within twelve months.

## 22. PREPAID FEES

The total amount of prepaid fees relating to the patent grant procedure has developed as follows (divided by type of services):

| in '000 EUR | Opening balance 1.1.2005 | Increase/ (decrease) | Ending balance 31.12.2005 |
|---|---|---|---|
| Searches - EPC and Euro-PCT | 118 918 | 15 850 | 134 768 |
| International searches - PCT | 23 890 | (4 627) | 19 263 |
| Examination -EPC and Euro-PCT | 446 309 | 33 830 | 480 139 |
| International preliminary examination - PCT | 16 316 | (11 071) | 5 245 |
| Opposition | 7 272 | 783 | 8 055 |
| Appeal | 3 508 | 210 | 3 718 |
| | **616 213** | **34 975** | **651 188** |

| in '000 EUR | Opening balance 1.1.2006 | Increase/ (decrease) | Ending balance 31.12.2006 |
|---|---|---|---|
| Searches - EPC and Euro-PCT | 134 768 | 20 561 | 155 329 |
| International searches - PCT | 19 263 | 7 425 | 26 688 |
| Examination -EPC and Euro-PCT | 480 139 | 47 123 | 527 262 |
| International preliminary examination - PCT | 5 245 | 247 | 5 492 |
| Opposition | 8 055 | 599 | 8 654 |
| Appeal | 3 718 | 584 | 4 302 |
| | **651 188** | **76 539** | **727 727** |

## 23. COMMITMENTS

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Purchase commitments fixed assets | 49 395 | 67 419 |
| thereof payable within one year | 43 115 | 37 979 |

The EPO has entered into several operating lease contracts. The major contracts are described below.

The contract for the lease of office space in the Le Croisé building in The Hague was signed with Eurocommerce Robex Groep B.V. The agreement covers a period of 10 years ending on 31 August 2013. If the agreement is not terminated by giving notice at least twelve months prior to the expiry of lease term, the agreement is extended for another 5 years. The total value of the contract for 10 years is EUR 44m.

The contract for the lease of office space in the Rijsvoort building in The Hague was signed with Rijsvoort Holding B.V. The agreement covers a period of 10 years ending on 31 August 2011. If the agreement is not terminated by giving notice at least twelve months prior to the expiry of lease term, the agreement is extended for another 5 years. The total value of the contract for 10 years is EUR 14.7m.

The contract for the lease of office space in the Capitellum building in Munich was signed with Alterra Immobilienverwaltungs GmbH. The agreement covers a period of 15 years ending on 30 June 2015. The total value of the contract for 15 years is EUR 49m.

The contract for the lease of office space in the Westsite building in Munich was signed with Hochtief Projektentwicklung GmbH. The agreement covers a period of 10 years ending on 31 January 2013. The EPO has the option to terminate the contract at 31.12.2010. The total value of the contract for 10 years is EUR 42m.

The contract signed in 2002 with Schuyffel Vastgoed Exploitatie V B.V. to rent office space in Kantorenpark Hardenburch, The Hague. The agreement covers a period of 5 years ending on 31 March 2012 and can be extended by another 5 years. The total value of the contract is EUR 1.8m.

The total of the operating lease expense recognised in the income statement for the year 2006 amounts to KEUR 17 734 (2005: KEUR 17 412).

Future minimum rentals payable under non-cancellable operating leases are as follows:

| in '000 EUR | **2006** | **2005** |
|---|---|---|
| Not later than one year | 13 114 | 12 957 |
| Later than one year and not later than five years | 47 823 | 33 361 |
| Later than five years | 18 442 | 11 647 |
| | **79 379** | **57 965** |

The increase in future rentals payable is due to extending the contract periods for leasing the Capitellum and Westsite offices.

The Organisation has other commitments of EUR 103m to external companies mainly for IT-related services, buildings maintenance and outsourced services.

## 24. CONTINGENCIES

The Organisation has contingencies arising in the ordinary course of business, mainly due to disputed invoices or appeals by staff members. It is not anticipated that these will give rise to any material liabilities other than those for which provision has been made (Note 21).

## 25. RELATED PARTY DISCLOSURES

The Organisation has entered into transactions with members of the EPO's key management personnel, their close family members and the Contracting States. For the year ended 31 December 2006, the Organisation has not made any provisions for doubtful debts concerning amounts owed by related parties (2005: Nil).

## 1. Related Parties to the Organisation

### 1.1 Members of the key management

Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of an entity, directly or indirectly. This applies to the Management Committee of the Office and the Fund Administrator of the RFPSS.

The EPO has five directorates-general, each headed by a vice-president who together, along with the President, the head of the President’s Office, the Controller and the head of Communication, form the executive body (Management Committee or MAC) of the EPO. For the purpose of this note to the financial statements, the members of the MAC are considered to be related parties.

Besides the MAC members, the RFPSS Fund Administrator is also considered to be a related party. The importance and the size of the funds, combined with his functions, put him on a par with the members of the MAC.

### 1.2 Close family members of key managers

Close family members of a key manager are those family members who may be expected to influence, or be influenced by, that individual in their dealings with an entity. For the purpose of this note to the financial statements, the partner, children and dependants of the MAC members and the Fund Administrator are considered to be related parties.

### 1.3 Contracting States

The Administrative Council of the Organisation is made up of representatives of the Contracting States to the EPC. The Administrative Council exercises legislative powers on behalf of the Organisation, is responsible for policy issues relating to the Organisation and supervises the Organisation’s activities and is therefore considered as the supervisory body of the EPO. Furthermore, Article 37(c) EPC provides that the budget of the Organisation is financed, where necessary, by financial contributions from the Contracting States. If the Organisation is unable to balance its budget in accordance with Article 40(1) EPC, then under Article 40 (2) to (7) EPC the Contracting States must remit special financial contributions to the Organisation, the amount of which is determined by the Administrative Council for the accounting period concerned. In Article 40(2) to (4) Pension scheme regulations, the Contracting States jointly guarantee payment of the benefits to be paid under the pension scheme. As the Contracting States announce their representatives on the Administrative Council and can determine in advance how these representatives vote, the Contracting States themselves are also considered to be related parties to the EPO.

## 2. Transactions and outstanding balances with related parties

### Compensation of key managers (MAC members and Fund Administrator) and close members of the family of key managers

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| Compensation of key managers: | | |
| Short-term employee benefits* | 1 866 | 1 810 |
| Post-employment benefits, service costs | 582 | 581 |
| Termination benefits | 0 | 0 |
| | **2 448** | **2 391** |

***** The salaries included in the short-term employee benefits are reported after deduction of internal tax.

The compensation (short-term employee benefits and post-employment benefits, service costs) for close family members of key managers are KEUR 205 for the fiscal year 2006 (2005: KEUR 197). The employee benefits are granted under regular employment contracts.
The Organisation recognises a defined benefit obligation for post-employment benefits amounting to KEUR 7 672 (2005: KEUR 7 370) for the key managers and to KEUR 885 (2005: KEUR 818) for close family members.

### Expenses with related parties other than compensation of key managers and their close family members

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| MAC members and Fund Administrator | 0 | 0 |
| Close family members of key managers | 0 | 0 |
| Contracting states | | |
| • Co-operation with national offices | 4 949 | 5 022 |
| • Rent office building Berlin | 2 551 | 2 575 |
| • Work by national offices | 2 239 | 2 278 |
| | **9 739** | **9 875** |

### Revenues from patent and procedural fees and other revenues from related parties

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| MAC members and Fund Administrator | 3 | 3 |
| Close familiy members of key managers | 3 | 3 |
| Contracting states | | |
| • Renewal fees for granted patents | 280 727 | 268 939 |
| • Searches on behalf of Ex-IIB member states | 24 316 | 22 917 |
| • Other revenue | 3 474 | 2 887 |
| • Reimbursement rent office building Berlin | 1 108 | 1 133 |
| • Rental income Netherlands patent office | 706 | 1 070 |
| • Searches on behalf of other Contracting States | 20 | 18 |
| | **310 357** | **296 970** |

### Loans, receivables and other assets due from related parties

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| MAC members and Fund Administrator | 91 | 98 |
| Close familiy members of key managers | 74 | 80 |
| Contracting states | | |
| • Renewal fees | 92 157 | 80 329 |
| • Tax adjustments | 13 956 | 11 120 |
| • VAT and other taxes | 10 437 | 9 793 |
| • Other | 3 383 | 4 685 |
| | **120 098** | **106 105** |

The amounts due from key management personnel and their close family members result from home loans granted by the Organisation. The terms for granting home loans are the same as for other permanent employees.

### Payables and other liabilities

| in '000 EUR | 2006 | 2005 |
|---|---|---|
| MAC members and Fund Administrator | 0 | 0 |
| Close familiy members of key managers | 0 | 0 |
| Contracting states | 16 | 12 |
| | **16** | **12** |

The post-employment benefit obligation for key managers and their close family members is disclosed in the section "Compensation of key managers (MAC members and Fund Administrator) and their close family members ".

## 26. EVENTS AFTER THE BALANCE SHEET DATE

The Administrative Council expressed its intention to transfers the payment of the tax adjustment on EPO pensions away from the Contracting States towards the Organisation by amending the Implementing Rules to the Pension Scheme Regulations. The Office management is of opinion that - in accordance with the acquired rights principle - staff employed before a change of the Pension Scheme Regulations, including those already drawing a pension will continue to be treated in accordance with the pension scheme effective in March 2007. A final decision is expected during 2007, which will be decisive for the resulting future impact on the Organisation’s financial position. During the fiscal year 2006 the Contracting States' payments for tax adjustments amounted to KEUR 8 177 (2005: KEUR 6 953).

# 27. ADDITIONAL DISCLOSURES ON FINANCIAL INSTRUMENTS

Set out below is a comparison by category of the carrying amounts and fair values of all of the EPO's financial instruments carried in the financial statements:

| in '000 EUR | | | | | 31.12.2006 | |
|---|---|---|---|---|---|---|
| **Financial assets** | **Available for sale** | **At fair value through profit or loss** | **Loans and receivables** | **Financial liabilities carried at amortised costs** | **NET CARRYING AMOUNT** | **FAIR VALUE** |
| Non-current | | | | | | |
| Marketable securities | | | | | | |
| - Fixed interest bearing bonds - quoted | 194 770 | | | | **194 770** | **194 770** |
| - Structured interest bearing bonds - unquoted | | 103 964 | | | **103 964** | **103 964** |
| Home loans to staff | | | 90 441 | | **90 441** | **90 694** |
| Current | | | | | | |
| Trade and other receivables | | | 129 346 | | **129 346** | **129 346** |
| Marketable securities | | | | | | |
| - Fixed interest bearing bonds - quoted | 46 563 | | | | **46 563** | **46 563** |
| Home loans to staff | | | 2 872 | | **2 872** | **2 880** |
| Other financial assets | | | 79 000 | | **79 000** | **79 000** |
| Cash and cash equivalents | | | 81 954 | | **81 954** | **81 954** |
| | 241 333 | 103 964 | 383 613 | | **728 910** | **729 171** |
| **Financial liabilities** | | | | | | |
| Non-current | | | | | | |
| Trade and other payables | | | | 5 232 | **5 232** | **5 232** |
| Finance lease liabilities | | | | | **—** | |
| Current | | | | | | |
| Bank overdrafts | | | | — | **—** | **—** |
| Trade and other payables | | | | 164 322 | **164 322** | **164 322** |
| | | | | 169 554 | **169 554** | **169 554** |

| in '000 EUR | | | | | 31.12.2005 | |
|---|---|---|---|---|---|---|
| **Financial assets** | **Available for sale** | **At fair value through profit or loss** | **Loans and receivables** | **Financial liabilities carried at amortised costs** | **NET CARRYING AMOUNT** | **FAIR VALUE** |
| Non-current | | | | | | |
| Marketable securities | | | | | | |
| - Fixed interest bearing bonds - quoted | 115 493 | | | | **115 493** | **115 493** |
| - Structured interest bearing bonds - unquoted | | 106 912 | | | **106 912** | **106 912** |
| Home loans to staff | | | 84 438 | | **84 438** | **90 417** |
| Current | | | | | | |
| Trade and other receivables | | | 112 044 | | **112 044** | **112 044** |
| Marketable securities | | | | | | |
| - Fixed interest bearing bonds - quoted | 40 196 | | | | **40 196** | **40 196** |
| Home loans to staff | | | 4 709 | | **4 709** | **5 042** |
| Other financial assets | | | 6 500 | | **6 500** | **6 500** |
| Cash and cash equivalents | | | 146 131 | | **146 131** | **146 131** |
| | 155 689 | 106 912 | 353 822 | | **616 423** | **622 735** |
| **Financial liabilities** | | | | | | |
| Non-current | | | | | | |
| Trade and other payables | | | | 6 010 | **6 010** | **6 010** |
| Finance lease liabilities | | | | | **—** | |
| Current | | | | | | |
| Bank overdrafts | | | | 184 | **184** | **184** |
| Trade and other payables | | | | 153 938 | **153 938** | **153 938** |
| | | | | 160 132 | **160 132** | **160 132** |

The fair value of fixed-interest-bearing bonds classified as available-for-sales securities is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the EPO is the current bid price.

Home loans and structured interest-bearing bonds designated at fair value through profit or loss are not traded in an active market. Their fair value is determined using standard valuation techniques. Different methods are used based on the assumptions of the market conditions at each balance sheet date. The fair value of home loans is calculated as the present value of the future cash flows discounted using the prevailing market rates of interest by application of the Moosmüller method.

The fair value of structured interest-bearing bonds is determined using generally accepted mathematical models. For this calculation, the cash flows already fixed or determined by way of forward rates using the current yield curve are discounted at the measurement date using the discount factors calculated from the yield curve applicable at the reporting date. Middle swap rates are used.

Cash and cash equivalents and trade and other receivables mainly have short terms to maturity. For this reason, their carrying amounts at the reporting date approximate their fair values.

Similarly, trade and other payables and bank overdrafts also generally have short terms to maturity; so here too the values reported approximate to the fair values.

## 28. FINANCIAL RISK MANAGEMENT

The EPO has a variety of financial instruments. They comprise trade receivables and payables, cash and fixed-term deposits which arise directly from the EPO's operational activities as well as finance lease obligations that are used to finance the EPO's operations.

Liquidity surpluses not needed to cover operational short-term expenses are invested in marketable securities with the aim of maximising the returns. The EPO's long-term investment portfolio comprises fixed-interest-bearing bonds and structured interest-bearing bonds with maturities within a range of 1 to 5 years.

Additionally, home loans are granted to staff at an interest rate below the prevailing market rate.

The main risks arising from the EPO's financial instruments are interest rate risk, liquidity risk and credit risk. The Budget and Finance Committee and the Administrative Council approve the investment policies and strategy for managing the risks summarised below:

a) <u>Cash flow and fair value interest rate risk</u>
The EPO's exposure to the risk for changes in market interest rates relates primarily to its marketable securities. Whereas the cash flow interest rate risk only concerns the structured interest-bearing bonds (Note 13), the fair value interest risk has an effect on both fixed and structured interest-bearing bonds.

The EPO minimises the cash-flow interest risk by investing the liquidity surpluses using a mix of fixed and structured interest-bearing bonds with the aim of maximising the overall return on these assets.

b) Liquidity risk

Liquidity risk management implies maintaining sufficient cash and marketable securities to be able to face the entity's short- and long-term liabilities.

The EPO's treasury department monitors the risk of a shortage of funds using a daily cash management tool. This tool considers the maturity of financial investments and financial assets (e.g. marketable securities) and takes into consideration the expected cash in- and outflows from the daily operations.

The EPO has no significant liquidity risk. The cash generated by the EPO's operations overcompensates the liquidity needs of the EPO to cover both operational and capital expenditure.
Liquidity surpluses not needed in the short term are invested in long-term marketable securities with maturities within 2 to 5 years in line with the estimated cash outflows according to the 5-year budget planning.

In order to maximise the return of its liquidity surpluses, the EPO tries to maintain a balance between short-term deposits (up to one year) and longer-term marketable securities. On past experience, the appropriate ratio is 30%:70%. This ratio is reviewed regularly.

Marketable securities held by the EPO are highly liquid and can be sold at any time.

c) Credit risk

Financial instruments deriving from the EPO's operational activities are not subject to significant credit risk. The EPO has policies in place to ensure that sales of patent information services and products are made to customers with an appropriate credit history. Outstanding trade receivables are monitored continually. Trade and other receivables held with the Contracting States are not subject to credit risk.

Regarding financial investments, the internal guidelines require that fixed-term deposits up to 1 year are placed with at least four financial institutions with at least a minimum P-1 "short term debt" rating. Longer than 1 year fixed-term deposits have to be placed with financial institutions with at least an AA "issuer rating".

Also not subject to significant credit risk are the home loans. They are only granted to permanent staff, and repayment is guaranteed through the mortgage or other land charge entered in the Land Register or other appropriate public record. Interest and capital repayment are withheld from salary. No home-loan borrower has ever defaulted in the EPO's history.

Bonds and other interest-bearing securities held by the EPO have to be capital-guaranteed with at least an AA rating. If there is no rating available for the security, the rating requirement applies to the issuer of the security. Furthermore, the credit risk of securities is minimised through the setting of a maximum limit (20%) on the total marketable securities portfolio that may be invested in a single issuer.

## 29. EXPLANATION OF TRANSITION TO IFRS

As stated in Note 2.1, these are the Organisation's first financial statements prepared in accordance with IFRS (albeit excluding the criteria for plan assets as defined in IAS 19.7).

The accounting policies set out in Note 2 have been applied in preparing the financial statements for the year ended 31 December 2006, the comparative information presented in the financial statements for the year ended 31 December 2005 and an opening IFRS balance sheet as at 1 January 2005 (the Organisation's transition date).

Due to the exception to the Financial Regulations as regards non-adoption of the criteria for plan assets as defined in IAS 19.7, the Organisation is not an IFRS first-time adopter within the meaning of IFRS 1. However, the Organisation is applying IFRS 1 to be comparable with other IFRS first-time adopters and fulfils the disclosure requirements of IFRS 1.

**Explanation of exemptions applied under IFRS 1 "First-Time Adoption of International Financial Reporting Standards"**
In general, the carrying amounts of the assets and liabilities in the balance sheet under previous GAAP for the period ended 31 December 2004 must be recognised and measured retrospectively in the opening IFRS balance sheet as of 1 January 2005 on the basis of those IFRS in force at 31 December 2006. IFRS 1 provides exemptions from this principle in specific cases. If an entity elects to recognise actuarial gains and losses arising as a result of the measurement of defined-benefit plans after the date of transition to IFRS using the corridor approach permitted by IAS 19 "Employee Benefits", it may still decide not to apply the corridor approach retrospectively and to recognise all cumulative actuarial gains and losses from defined-benefit plans directly in equity at the date of transition to IFRS. The Organisation has applied this exemption.

**Explanation of the transition to IFRS**
An explanation of how the transition from previous GAAP to IFRS has affected the Organisation's financial position, financial performance and cash flows is set out in the following tables and accompanying notes.

## Reconciliation of net profit or loss for 2005

| in '000 EUR | Notes | Previous GAAP | Effect of transition to IFRS | IFRS |
|---|---|---|---|---|
| Revenue | (f)(l) | 981 318 | (16 672) | 964 646 |
| Other operating income | (c)(d)(g) | 7 756 | 1 964 | 9 720 |
| Net Income RFPSS | (g) | 207 751 | (207 751) | — |
| Capitalised work by the entity | (b) | — | 1 641 | 1 641 |
| Employee benefit expenses | (f)(g)(i) | 651 233 | 162 394 | 813 627 |
| Depreciation and amortisation expense | (a)(b) | 38 729 | 26 154 | 64 883 |
| Other operating expenses | (a)(b)(d)(f)(i)(k) | 185 832 | (2 252) | 183 580 |
| **Operating result** | | **321 031** | **(407 114)** | **(86 083)** |
| Finance revenue | (d)(f)(g) | 16 554 | 183 225 | 199 779 |
| Finance costs | (a)(d)(g)(i)(k) | 719 | 189 426 | 190 145 |
| **Financial result** | | **15 835** | **(6 201)** | **9 634** |
| **Profit / (loss) for the year** | | **336 866** | **(413 315)** | **(76 449)** |

## Reconciliation of equity at 1 January 2005

| in '000 EUR | | Reserves | | | Total equity |
|---|---|---|---|---|---|
| | Notes | Retained earnings | Net assets available for pension and long-term care benefits | Cumulative changes in equity not recognised through profit or loss | |
| **EPO-GAAP balance at 1 January 2005** | | **1 233 169** | **1 957 094** | **—** | **3 190 263** |
| Property, plant and equipment | (a) | 9 474 | | | 9 474 |
| Intangible assets | (b) | (22 652) | | | (22 652) |
| Ex-IIB insurance funds (other assets) | (c) | 45 812 | | | 45 812 |
| Marketable securities | (d) | 165 | | 2 729 | 2 894 |
| Home loans to staff | (e) | (6 373) | | | (6 373) |
| Trade and other receivables | (f) | 8 631 | | | 8 631 |
| Net defined benefit liability | (g) | (1 656 598) | | | (1 656 598) |
| Reserve funds for pension and social security | (h) | | (1 957 094) | | (1 957 094) |
| Trade and other payables | (i) | (50 932) | | | (50 932) |
| Finance lease liabilities | (j) | (21 370) | | | (21 370) |
| Provisions | (k) | (3 205) | | | (3 205) |
| Prepaid fees | (l) | (616 213) | | | (616 213) |
| **IFRS balance at 1 January 2005** | | **(1 080 092)** | **—** | **2 729** | **(1 077 363)** |

## Reconciliation of equity at 31 December 2005

| in '000 € | Notes | Reserves: Retained earnings | Reserves: Net assets available for pension and long-term care benefits | Reserves: Cumulative changes in equity not recognised through profit or loss | Total equity |
|---|---|---|---|---|---|
| **EPO-GAAP balance at 31 December 2005** | | **1 285 316** | **2 241 814** | **—** | **3 527 130** |
| Property, plant and equipment | (a) | (19 858) | | | (19 858) |
| Intangible assets | (b) | (14 252) | | | (14 252) |
| Ex-IIB insurance funds (other assets) | (c) | 47 188 | | | 47 188 |
| Marketable securities | (d) | (2 621) | | 446 | (2 175) |
| Home loans to staff | (e) | (6 898) | | | (6 898) |
| Trade and other receivables | (f) | 24 621 | | | 24 621 |
| Net defined benefit liability | (g) | (1 740 286) | | | (1 740 286) |
| Reserve funds for pension and social security | (h) | | (2 241 814) | | (2 241 814) |
| Trade and other payables | (i) | (55 059) | | | (55 059) |
| Finance lease liabilities | (j) | (20 271) | | | (20 271) |
| Provisions | (k) | (3 233) | | | (3 233) |
| Prepaid fees | (l) | (651 188) | | | (651 188) |
| **IFRS balance at 31 December 2005** | | **(1 156 541)** | **—** | **446** | **(1 156 095)** |

a) The transition to IFRS has an impact on the Organisation's retained earnings resulting from changes to *property, plant and equipment* as follows:

| in '000 EUR | 31.12.2005 | 1.1.2005 |
|---|---|---|
| Application component approach | (25 097) | (10 612) |
| Capitalisation finance lease agreements | 18 058 | 20 086 |
| Impairment PschorrHöfe, BA8 | (12 819) | — |
| | **(19 858)** | **9 474** |

The retrospective application of the component approach in accordance with IAS 16 results in higher depreciation on fixed assets and causes a decrease in the net book value of property, plant and equipment. Additionally, cost for leased assets which were expensed under previous GAAP are capitalised under IFRS if meeting the criteria for finance leases. This leads to an increase in the net book value of property, plant and equipment and will cause higher depreciation and interest costs in the future. During the fiscal year 2005 an impairment test mandatory under IFRS shows an overestimation of land for the new office building "PschorrHöfe BA8" recognised at historical cost under previous GAAP. The Organisation recognises an impairment loss amounting to KEUR 12 819 which reduces the balance of property, plant and equipment.

In comparison to previous GAAP, the aforementioned changes from adopting IFRS result in an increase in *depreciation and amortisation expenses* as of 31 December 2005 of KEUR 29 078, including an impairment loss of KEUR 12 819. Additionally, the capitalisation of expenses for finance leases increases *interest costs* by KEUR 1 674 and reduces *other operating expenses* by KEUR 2 518.

b) Development costs for internally used software of KEUR 22 652 at the date of transition and KEUR 14 252 relating to the year ended 31 December 2005 qualified for recognition as *intangible assets* under previous GAAP have to be expensed under IFRS as not meeting all recognition criteria of IAS 38.

In comparison to previous GAAP, the effect on the income statement is a decrease of *other operating expenses* by KEUR 3 836 and of *depreciation* by KEUR 2 924 for the year ended 31 December 2005. Costs of KEUR 1 641 for internally used software fulfilling the capitalisation criteria for intangible assets are reclassified from other *operating expenses* to *capitalised work by the entity*.

c) Applying IFRS, the repurchase value from private insurance funds (ex-IIB) - which was only disclosed in the notes to the financial statements under previous GAAP - has to be recognised in the balance sheet to the amount of KEUR 45 812 at the transition date and KEUR 47 188 at 31 December 2005, including a reclassification within the balance sheet of KEUR 2 660 having no impact on the Organisation's equity.

The effect on the income statement is an increase of *other operating income* by KEUR 1 370.

d) Under previous GAAP, *marketable securities* classified as available-for-sale were subsequently measured following the "lower of cost or market" principle. In accordance with IFRS, after initial recognition available-for-sale securities are measured at fair value applying the effective interest method. Gains and losses arising from a change in the fair value are recognised directly in equity under certain circumstances. At the date of transition an amount of KEUR 2 729 (31 December 2005: KEUR 446) was directly recognised in equity.

The effect on the income statement for the year ended 31 December 2005 as follows:

| | **effects to the income statement** | |
|---|---|---|
| in '000 EUR | increase | decrease |
| *Other operating income* | | |
| realised gains available for sale securities | 588 | |
| *Other operating expenses* | | |
| realised losses available for sale securities | 162 | |
| fair value accounting | 3 089 | |
| *Interest revenue* | | |
| neutralisation of realised gains/losses | | 557 |
| application effective interest method | 4 | |
| *Interest costs* | | |
| neutralisation of realised gains/losses | | 431 |

e) The Organisation grants to its staff members *home loans* recognised at nominal value under previous GAAP. In accordance with IFRS, home loans are recognised at present value using the effective interest method. Granting loans with interest rates below the market rates is taken into account by adjusting the employee benefit cost. These effects reduce the Organisation's equity by KEUR 6 373 at the transition date and KEUR 6 898 at 31 December 2005.

The effect on the income statement as of fiscal year end 2005 is an increase of employee benefits by KEUR 2 161 and of interest revenue amounting to KEUR 1 636 due to application of the effective interest method.

f) The transition to IFRS has an impact on the Organisation's retained earnings resulting from changes to *trade and other receivables* as follows:

| in '000 EUR | **31.12.2005** | **1.1.2005** |
|---|---|---|
| Application accrual principle for renewal fees | 24 306 | 6 003 |
| Application accrual principle for prepaid expenses | 2 002 | 2 868 |
| Application accrual principle for interest | (1 345) | — |
| Corrrection advances to staff members | (350) | (245) |
| Other | 8 | 5 |
| | **24 621** | **8 631** |

Under previous GAAP, renewal-fee revenues from the Contracting States and other revenues were recognised when payment occurred. In accordance with the accrual principle of IFRS, the Organisation adjusted trade and other receivables at the transition date by KEUR 6 003 and KEUR 24 306 relating to the year ended 31 December 2005. For the same reason a deferral is recognised for prepaid expenses amounting to KEUR 2 868 (31 December 2005: KEUR 2 002). Additionally, certain payments to staff members amounting to KEUR 245 (31 December 2005: KEUR 350) are to be expensed under IFRS. Some minor assets amounting to KEUR 5 (31 December 2005: KEUR 8) recognised under previous GAAP were reversed. To fulfil presentation requirements under IFRS, at the date of transition reclassifications amounting to KEUR 75 (31 December 2005: KEUR 76) are necessary, which have no impact on the Organisation's equity.

The effect is to increase *revenue* classified as income from patent and procedural fees by KEUR 18 303, *employee benefit cost* by KEUR 104 and *other operating expenses* by KEUR 608 respectively for the year ended 31 December 2005. Additionally, *interest revenue* decreases by KEUR 1 345 due to a reversal of deferred interest recognised as assets under previous GAAP.

g) Under previous GAAP, pension obligations were recognised only on a cash basis. In accordance with IAS 19 the *net defined benefit obligation* is measured using the projected unit credit method reflecting future compensation and retirement trends and applying the corridor rule. A net obligation for pensions and other post-employment benefits is recognised as a liability amounting to KEUR 1 656 598 at the date of transition and KEUR 1 737 418 (impact on retained earnings: KEUR 1 740 286) at 31 December 2005.

The effect on the income statement as of 31 December 2005 is as follows:

| | **Effects on the income statement** | |
|---|---|---|
| in '000 EUR | increase | decrease |
| *Interest revenue* | | |
| expected return on plan assets | 183 487 | |
| *Interest costs* | | |
| interest costs, post-employment benefits | 188 174 | |
| *Employee benefit costs* | | |
| service costs | 209 926 | |
| neutralisation of family allowances | | 3 243 |
| contributions by staff members | | 40 853 |
| contributions by the Office not recognised as plan assets | | 9 860 |
| *Net income RFPSS net of Office contributions* | | |
| *for pension obligations and long-term care* | | 207 751 |
| *Other operating income* | | |
| payments received from external insurances | 6 | |

h) The *reserve funds for pension and social security* presented as equity under previous GAAP were reclassified against the corresponding balance sheet line item presented as an asset under previous GAAP. This reclassification has no effect on the income statement.

i) According to the cash-based accounting principles under previous GAAP, in some material cases obligations were not recognised as liabilities but were disclosed. The increase of *trade and other payables* by KEUR 50 932 at the transition date and KEUR 55 059 at 31 December 2005 mainly results from the recognition of obligations due to employees, mainly for leave not taken and long-service gratuities.

The effect on the income statement as of 31 December 2005 is an increase of *employee benefit costs* by KEUR 3 904 and an increase of *other operating expenses* by KEUR 215. Due to the unwinding of discounted non-current other liabilities, *other interest costs* increases by KEUR 8.

j) The capitalisation of leasing costs for finance leases expensed under previous GAAP results in recognition of a corresponding *finance lease liability* amounting to KEUR 21 370 at the transition date and KEUR 20 271 at 31 December 2005.

The impact on the income statement as of 31. December 2005 is shown in paragraph (a) above.

k) Recognition of *provisions* would have been incompliant with the accounting rules under previous GAAP. Under IFRS, the Organisation recognises provisions if the requirements of IAS 37 are fulfilled. This leads to a recognition of provisions with an impact on equity, mainly for the dismantling of leased buildings and litigation risks, amounting to KEUR 3 205 at the transition date and KEUR 3 233 at 31 December 2005.

The effect of KEUR 28 on the income statement as of 31 December 2005 is due to reversals of unused amounts (KEUR 52) credited to *other operating expenses* and an increase (KEUR 80) in *other interest costs* due to the unwinding of discounted non-current provisions.

l) In accordance with the accrual principle of IFRS, revenues are recognised upon performance of the corresponding services. Under previous GAAP, revenues were recorded when inpayments occurred. For payments received but services not yet performed at the balances sheet date, the Organisation is adjusting revenues by recognition of deferred income presented as *prepaid fees* amounting to KEUR 616 213 at the date of transition and KEUR 651 188 at 31 December 2005.

The corresponding effect on the income statement is to decrease *revenues* by KEUR 34 975 as of 31 December 2005.

In addition to the aforementioned reconciliation adjustments, to fulfil IFRS presentation requirements several reclassifications within the income statement are necessary. This leads as of December 2005 to an increase in *other operating expenses* (KEUR 80) and a decrease in *interest costs* (KEUR 80), but has no impact on the Organisation's equity.

**Explanation of material adjustments to the cash flow statements**

The presentation of the cash flow statement has been modified to adopt the requirements of IAS 7 "Cash Flow Statements".

The previous GAAP regulations required a cash-based accounting for some business transactions. Due to the transition to IFRS following the accrual principle, adjustments to eliminate non-cash transactions are necessary. Additionally, IFRS requires a reporting of cash flows during the period, classified by operating, investing and financing activities.

Furthermore, under previous GAAP, deposits with a maturity exceeding three months and marketable securities were included in cash and cash equivalents in the cash flow statement. Under IFRS, investments in and sales of such deposits and marketable securities are included in the cash flows from investing activities.