



Europäisches
Patentamt
European
Patent Office
Office européen
des brevets

Financial Statements

Accounting Period **2007**

AUDIT OPINION	6
----------------------	----------

FINANCIAL STATEMENTS	8
-----------------------------	----------

Income Statement	9
Balance Sheet	10
Statement of Changes in Equity	11
Cash Flow Statement	12

NOTES	13
--------------	-----------

1. General information	14
2. Summary of significant accounting policies	15
2.1. Basis of preparation	15
2.1.1. Standards effective in 2007	15
2.1.2. Standards, amendments and interpretations effective in 2007 but not relevant	15
2.1.3. Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Organisation	16
2.2. Consolidation	17
2.3. Foreign currency translation	17
2.4. Significant accounting judgements and estimates	17
2.5. Revenue recognition	18
2.5.1. Revenue from patent and procedural fees	18
2.5.1.1. Patent granting, opposition and appeal procedures (EPC and Euro-PCT)	18
2.5.1.2. Searches and preliminary examinations on international applications (PCT procedure)	20
2.5.1.3. National renewal fees for granted European patents	21
2.5.2. Other revenue	21
2.5.3. Potential national future renewal fees for European patents	22
2.6. Interest revenue	22
2.7. Leases	22
2.8. Income taxes	23
2.9. Property, plant and equipment	23
2.10. Intangible assets	24

2.11.	Other assets – ex-IIB insurance funds	25
2.12.	Financial instruments	26
2.12.1.	Marketable securities	26
2.12.1.1.	Available-for-sale	26
2.12.1.2.	At fair value through profit or loss	27
2.12.2.	Home loans	27
2.12.3.	Trade and other current receivables	27
2.12.4.	Cash and cash equivalents	28
2.12.5.	Trade and other payables	28
2.13.	Equity	28
2.14.	Employee benefits	28
2.14.1.	Pension obligations	29
2.14.2.	Other post-employment obligations	30
2.14.3.	Termination benefits	31
2.15.	Provisions	31
2.16.	Prepaid fees	31
3.	Revenue	32
3.1.	Revenue	32
3.2.	Procedural fees related to the patent grant process	32
4.	Potential future national renewal fees for European patents	33
5.	Other operating income	33
6.	Employee benefit expenses	34
7.	Other operating expenses	34
8.	Finance revenue	35
9.	Finance costs	35
10.	Property, plant and equipment	35
11.	Intangible assets	37
12.	Other assets – ex-IIB insurance funds	38
13.	Marketable securities	39
14.	Home loans to staff	40
15.	Trade and other receivables	40
16.	Other financial assets	41
17.	Cash and cash equivalents	41

18.	Net defined benefit liability	42
18.1.	Explanations of the actuarial assumptions	46
18.2.	Main characteristics of the Organisation's defined benefit pension scheme	47
18.3.	Main characteristics of the Organisation's other post-employment benefit plans	48
18.3.1.	Sickness insurance	48
18.3.2.	Long-term care insurance	48
18.3.3.	Death and invalidity insurance	49
19.	Trade and other payables	49
20.	Finance lease liabilities	50
21.	Provisions	51
22.	Prepaid fees	52
23.	Commitments	52
24.	Contingencies	53
25.	Related party disclosures	53
25.1.	Related parties to the Organisation	54
25.1.1.	Members of key management	54
25.1.2.	Close family members of key managers	54
25.1.3.	Contracting States	54
25.2.	Transactions and outstanding balances with related parties	55
25.2.1.	Compensation of key managers (MAC members and Fund Administrator) and close family members of key managers	55
25.2.2.	Expenses with related parties other than compensation of key managers and their close family members	55
25.2.3.	Revenues from patent and procedural fees and other revenues from related parties	56
25.2.4.	Loans, receivables and other assets due from related parties	56
25.2.5.	Payables and other liabilities	56
26.	Events after the Balance Sheet date	57
27.	Additional disclosures on financial instruments	57
28.	Financial risk management	59
28.1.	Financial instruments	59
28.1.1.	Cash flow, foreign exchange and fair value interest rate risk	59
28.1.2.	Liquidity risk	60
28.1.3.	Credit risk	61
28.2.	Capital management	61

Audit opinion

We have audited the financial statements of the European Patent Organisation (EPO) for the accounting period 1 January to 31 December 2007. Under Article 1 FinRegs, the EPO's generally accepted accounting principles are the International Financial Reporting Standards (IFRS), except for the IAS 19.7 provisions governing plan assets.

Our audit has not led to any reservations.

On the basis of the findings of our audit, the financial statements comply with the legal requirements of the EPC and the FinRegs and give a true and fair view of the net assets, financial position and results of operations of the EPO in accordance with accounting principles laid down in Article 1(3) FinRegs.

Without qualifying this opinion, we would point out that the EPO applied IFRS 1 as of the transition date 1 January 2005, despite not being a first-time adopter within the meaning of that standard. In line with the FinRegs but not in accordance with IAS 19.7, the EPO has netted out its plan assets and defined benefit obligations, although not entitled to do so because the plan assets are not held legally separate. The EPO is therefore unable to give a valid explicit and unreserved statement of IFRS compliance pursuant to IFRS 1.3. So as of the transition date 1 January 2005 the EPO was not a first-time adopter within the meaning of IFRS 1 and, since the FinRegs allow it to depart from IAS 19.7 only, cannot apply the exemptions and concessions available under IFRS 1. However, and despite using the corridor approach for its employee benefits, the EPO has nonetheless applied the exemption under IFRS 1.20 and recognised, as at the transition date 1 January 2005, all cumulative actuarial gains and losses since the start of the plan.

Munich, 15 June 2008

The Board of Auditors

Financial Statements

Income Statement for the year ended 31 December 2007

	Notes	2007	2006
in '000 EUR			
Revenue			
Revenue from patent and procedural fees	(3)	1 047 143	982 011
Other revenue	(3)	44 482	36 583
Other operating income	(5)	13 048	12 142
Work performed by the entity and capitalised	(11)	2 153	2 016
Employee benefit expenses	(6)	(1 531 636)	(900 754)
Depreciation and amortisation expenses	(10) (11)	(59 082)	(58 661)
Other operating expenses	(7)	(197 775)	(187 200)
Operating result		(681 667)	(113 863)
Finance revenue	(8)	283 511	244 076
Finance costs	(9)	(221 186)	(198 829)
Financial result		62 325	45 247
Profit/(loss) for the year		(619 342)	(68 616)

The notes are an integral part of the financial statements. Regarding the potential national future renewal fees, see Notes 2.5.3 and 4.

Balance Sheet as of 31 December 2007

in '000 EUR

Assets	Notes	2007	2006
Non-current assets			
Property, plant and equipment	(10)	730 808	725 947
Intangible assets	(11)	35 784	32 084
Marketable securities	(13)	81 505	298 734
Home loans to staff	(14)	94 554	90 441
Other assets	(12)	45 553	44 491
Total non-current assets		988 204	1 191 697
Current assets			
Trade and other receivables	(15)	130 583	129 346
Marketable securities	(13)	231 699	46 563
Home loans to staff	(14)	4 269	2 872
Other financial assets	(16)	89 850	79 000
Cash and cash equivalents	(17)	216 193	81 954
Total current assets		672 594	339 735
Total assets		1 660 798	1 531 432
Equity and liabilities			
		2007	2006
Equity			
Retained earnings		(1 844 499)	(1 225 157)
Other reserves		(2 011)	(2 627)
Total equity		(1 846 510)	(1 227 784)
Non-current liabilities			
Net defined benefit liability	(18)	2 488 078	1 829 325
Trade and other payables	(19)	5 975	5 232
Finance lease liabilities	(20)	7 696	11 329
Provisions	(21)	11 109	11 798
Prepaid fees	(22)	477 027	439 207
Total non-current liabilities		2 989 885	2 296 891
Current liabilities			
Trade and other payables	(19)	188 163	164 322
Finance lease liabilities	(20)	4 129	7 838
Provisions	(21)	2 451	1 645
Prepaid fees	(22)	322 680	288 520
Total current liabilities		517 423	462 325
Total liabilities		3 507 308	2 759 216
Total equity and liabilities		1 660 798	1 531 432

The notes are an integral part of the financial statements. Regarding the potential national future renewal fees, see Notes 2, 3 and 4.

Statement of Changes in Equity for the year ended 31 December 2007

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 2006	–	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)
Changes in equity for 2007				
Available for sale investments				
Valuation gains/(losses) taken to equity		199		199
Transferred to profit or loss on sale		417		417
Profit (loss) for the period			(619 342)	(619 342)
Balance at 31 December 2007	–	(2 011)	(1 844 499)	(1 846 510)

The notes are an integral part of the financial statements. Regarding the potential national future renewal fees, see Notes 2, 3 and 4.

Cash Flow Statement for the year ended 31 December 2007

in '000 EUR

Cash flows from operating activities	Notes	2007	2006
Profit/loss of the year		(619 342)	(68 616)
Adjustments for:			
Depreciation and amortisation	(10) (11)	59 082	58 661
Disposal of property, plant and equipment	(10)	(6)	(24)
Other gains and losses		(799)	3 076
Net interest		(17 415)	(14 755)
Changes in net defined benefit liability	(18)	658 752	91 907
Changes in provisions	(21)	117	(413)
Changes in prepaid fees	(22)	71 980	76 539
Changes in other assets and liabilities carried as working capital		10 379	(80 194)
Total		162 748	66 181
Cash flows from investing activities		2007	2006
Proceeds from disposal of:			
Property, plant and equipment		10	33
Marketable securities		47 000	40 000
Purchases of:			
Property, plant and equipment		(54 673)	(37 585)
Intangible assets		(6 801)	(7 445)
Marketable securities		(11 942)	(128 515)
Home loans granted to staff		(16 800)	(16 800)
Repayment of staff home loans		10 728	12 160
Interest received		19 284	16 370
Total		(13 194)	(121 782)
Cash flows from financing activities		2007	2006
Interest paid		(1 470)	(1 613)
Repayment of lease liabilities		(13 914)	(6 952)
Total		(15 384)	(8 565)
Net increase/decrease in cash and cash equivalents	(17)	134 170	(64 166)
Cash and cash equivalents net of bank overdrafts at the beginning of period		81 954	145 947
Effect of exchange rate changes on cash and cash equivalents		69	173
Cash and cash equivalents net of bank overdrafts at the end of period		216 193	81 954

The notes are an integral part of the financial statements. Regarding the potential national future renewal fees, see Notes 2.5.3 and 4.

Notes

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 unitary patent system in Europe.

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

The Organisation is 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 were authorised for issue by the President on 15 June 2008.

With respect to the information provided in the Income Statement and Balance Sheet, it should be noted that

- as an intergovernmental organisation, the EPO cannot become insolvent because according to the EPC its Contracting States are obliged to finance any deficit;
- the value of national future renewal fees cannot be shown as an asset but is an essential factor for the Organisation's actual financial position.

For more details, see Notes 2.5.3. and 4 on future renewal fees for European patents and Note 28.2. on capital management.

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.

Due to the exception in the Financial Regulations as regards non-adoption of the criteria for plan assets as defined in IAS 19.7 (see Note 1.), the Organisation was not an IFRS first-time adopter within the meaning of IFRS 1. However, the Organisation had applied IFRS 1 as of the transition date 1 January 2005 to be comparable with other IFRS first-time adopters and fulfilled the disclosure requirements of IFRS 1.

In accordance with **IAS 14 Segment Reporting** (replaced by **IFRS 8, Operating Segments**, effective for annual periods beginning 1 January 2009) 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.

2.1.1. Standards effective in 2007

IFRS 7, Financial instruments: Disclosures, and the complementary amendment to **IAS 1, Presentation of financial statements – Capital disclosures** (effective from 1 January 2007), introduces new disclosures relating to financial instruments, mainly related to qualitative and quantitative information about exposure to risks arising from financial instruments including sensitivity analysis to market risk. The amendment to IAS 1 introduces disclosures about the level of an entity's capital and how it manages capital. Neither new requirement has any impact on the classification and valuation of the Organisation's financial instruments or the disclosures relating to trade and other payables.

2.1.2. Standards, amendments and interpretations effective in 2007 but not relevant

The following standards, amendments and interpretations to published standards are mandatory for accounting periods beginning on or after 1 January 2007 but they are not relevant to the Organisation's operations:

- **IFRS 4, Insurance contracts**
- **IFRIC 7, Applying the restatement approach under IAS 29, Financial reporting in hyperinflationary economies**
- **IFRIC 8, Scope of IFRS 2, Share-based payment**
- **IFRIC 9, Re-assessment of embedded derivatives**
- **IFRIC 10, Interim financial reporting and impairment and**
- **IFRIC 11, IFRS 2 – Group and treasury share transactions**

2.1.3. Standards, amendments and interpretations to existing standards that are not yet effective and have not been adopted early by the Organisation

IAS 1 (revised 2007), Presentation of financial statements (effective from 1 January 2009) requires information in financial statements to be aggregated on the basis of shared characteristics. It introduces a statement of comprehensive income to enable readers to analyse changes in a company's equity resulting from transactions with owners in their capacity as owners separately from 'non-owner' changes. The revised standard gives preparers of financial statements the option of presenting items of income and expense and components of other comprehensive income either in a single statement of comprehensive income with subtotals, or in two separate statements (a separate Income Statement followed by a statement of comprehensive income). The revision also includes changes in the titles of some of the financial statements to reflect their function more clearly. The new titles will be used in accounting standards, but are not mandatory for use in financial statements. These revised standards will have an impact on the presentation of the Organisation's financial information. The Organisation will apply IAS 1 (revised 2007) from 1 January 2009 at the latest.

IAS 23 (Amendment), Borrowing cost (effective from 1 January 2009) requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing those borrowing costs will be removed. The Organisation will apply IAS 23 (Amendment) from 1 January 2009, if applicable. Currently borrowing costs are recognised as an expense in the period in which they are incurred.

IFRS 8, Operating segments (effective from 1 January 2009) replaces IAS 14 and aligns segment reporting with the requirements of the US standard SFAS 131. 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 14, IAS 19, The limit on a defined benefit asset, minimum funding requirements and their interaction (effective from 1 January 2008) provides guidance on assessing the limit in IAS 19 on the amount of the surplus that can be recognised as an asset. It also explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. IFRIC 14 is currently not relevant to the Organisation's operations because the EPO does not report a defined benefit asset.

IFRIC 12, Service concession arrangements (effective from 1 January 2008). IFRIC 12 applies to contractual arrangements whereby a private-sector operator participates in the development, financing, operation and maintenance of infrastructure for public-sector services. IFRIC 12 is not relevant to the Organisation's operations.

IFRIC 13, Customer loyalty programmes (effective from 1 July 2008) clarifies that where goods or services are sold together with a customer loyalty incentive (for example, loyalty points or free products), the arrangement is a multiple-element arrangement and the consideration receivable from the customer is allocated between the components of the arrangement in using fair values. IFRIC 13 is not relevant to the Organisation's operations because the EPO does not operate any loyalty programmes.

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, because under IFRS the Organisation constitutes a single entity.

2.3. FOREIGN CURRENCY TRANSLATION

The financial statements are presented in EUR, 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 on 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, future pension increases and other actuarial parameters. Due to the long-term nature of these plans, such estimations are subject to significant uncertainties.

In 2007 the Administrative Council adopted comprehensive amendments to the Office's Service Regulations with effect from 1 January 2008. As the Council represents the Contracting States it is assumed that the decisions taken are compliant with national jurisdictions in each Contracting State with no consequent risk for the Organisation.

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, or 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 Financial Instruments: Recognition and Measurement 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, opposition and appeal procedures (EPC and Euro-PCT)

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:

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

Principles of revenue recognition for fees from patent granting, 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 (as revised by the Act revising Article 63 EPC of 17 December 1991 and the Act revising the EPC of 29 November 2000) and its Implementing Regulations (as last amended on 7 December 2006) and Rules relating to Fees of 20 October 1977 (as last amended on 7 December 2006).

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 does not start performing the service related to each step until the applicant has paid the fees involved.

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.
 - Limitation fees: the underlying service is fully performed when the examining division's decision as to whether or not the request for limitation is allowable has been communicated to the requester (came into force with the EPC 2000).

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

- Filing fees: the underlying service, comprising 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 or 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 four 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. Therefore, a deferral of the amount for renewal fees for patent applications covering two financial periods is not recognised. 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 post-grant, see Note 2.5.1.3. below (national renewal fees for granted patents).

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 7 December 2006).

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 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.

As of 31.12.2006, the amount for prepaid fees for the PCT international procedure was calculated using a statistical method based on the stock of non-completed work at directorate level. This method was chosen due to the lack of an integrated IT system matching the individual payments made with the individual applications.

During the reporting period, the EPO developed an interface between the international dossiers administration databases (ADM and MACH2) and the EPASYS module used for the payment registration, thereby enabling it to substantially increase the accuracy of the prepaid fees calculations and to bring them into line with the ones already in use for European and Euro-PCT applications. The calculations for both PCT and for EP and Euro-PCT prepaid fees include now cross-checks with the individual status of completion of the corresponding applications, the identification of prepayments related to dossiers not yet assigned and a common assessment of the work completion date. The work of the EPO is regarded as completed as soon as all due actions have been performed (see also Note 2.5.1.).

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. 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 (since 1984: 50%) and which may not exceed 75% and is the same for all Contracting States. 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. The structure and level of national renewal fees are fixed by the Contracting States.

The national patent offices of the Contracting States make these payments to the EPO on a quarterly basis.

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 first three 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 EPO's costs related to the patent granting process from filing up to grant 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 (see also Note 2.5.1.3.). Further information on the financing of the EPO is provided in Note 28.2. on capital management.

This is 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 for granted patents are explicitly taken into account.

Since there is no legal obligation on the patentee to maintain the patent for the maximum term (20 years) by paying the renewal fees involved, and since the structure and level of the fees are defined by the Contracting States, the net present value of expected future national renewal fees on granted patents is not included in the financial statements. It is also possible that EPO income from these fees will not cover its remaining costs in granting the patent. As such future operating losses do not meet the criteria of a liability, the EPO recognises no provision.

The net present value of potential national future renewal fees for European patents 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 start 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 EPO's Protocol on Privileges and Immunities, 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.

For its buildings, the EPO applies the component approach, and depreciates parts of buildings with different useful lives separately. The depreciation periods for the components are 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 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 were incurred.

Assets that are subject to depreciation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If such an indication exists and the carrying value exceeds the estimated recoverable amount, 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 Note 2.10. below. These rules are also valid to property, plant and equipment.

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 cost 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:

- completion of the asset is technically feasible
- the EPO intends to complete the asset and use or sell it
- the EPO is able to use or sell the asset
- the asset is expected to generate future economic benefits
- the financial and technical resources necessary to complete the asset are available
- 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.

EPO accounting policy is to capitalise the costs of internal development of intangible assets or significant, separately identifiable enhancement 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. External costs included in the capitalised projects comprise fees for IT consultants. During the reporting period, the EPO introduced for all projects a system for recording staff time.

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:

- the intangible assets owned by the EPO are not traded in an active market, which renders any reliable calculation of the recoverable amount impossible
- 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 is presented as a separate asset – 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 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 Financial Instruments: Recognition and Measurement 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 or cancelled or expires.

2.12.1. Marketable securities

2.12.1.1. 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. Interest income on these instruments is shown under finance revenues.

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 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 performed 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 they are disposed of within 12 months of the Balance Sheet date or the investment is due during that period.

2.12.1.2. 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. These debt instruments are hybrid contracts that contain an embedded derivative (underlying interest-rate option) as stated in Note 13. As the two conditions of IAS 39.11A are not met (i.e. the embedded derivative can significantly modify the cash flows of the instrument and it is not clear with little or no analysis that a separation of the embedded derivative is prohibited), this type of contract qualifies for designation upon initial recognition at fair value through profit or loss.

These instruments 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 are shown in the Income Statement as other operating income/expenses in the period in which they arise. Interest income is shown separately in the Income Statement under finance revenues.

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.

2.12.2. Home loans

Home loans are granted to EPO staff for the building, purchase or conversion of residential property 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 term of the loan.

2.12.3. 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, usually due to insolvency of the client.

2.12.4. 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 any outstanding bank overdrafts, which are shown as such 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.

2.12.5. 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. Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment. 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. Assets held to fund parts of the pension obligations and the long-term care (LTC) insurance are invested by the RFPSS. For some members of its key management the Organisation operates a defined contribution plan under which it pays fixed contributions to an external insurance company.

2.14.1. 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, invalidity and other actuarial parameters. 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. Past-service costs are recognised immediately in the Income Statement, unless the changes to the pension plan are conditional on the employees remaining in service for a specified period of time (the vesting period). In this case, the past-service costs are amortised on a straight-line basis over the vesting period.

The plan assets comprise assets held by a long-term employee benefit fund as well as the return on 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 employee benefit expenses over the employees' expected average remaining working lives (corridor approach). 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 was not an IFRS first-time adopter within the meaning of IFRS 1. However, the Organisation applied IFRS 1 as of the transition date 1 January 2005 to recognise the cumulative actuarial gains and losses from all defined benefit plans directly in equity at the date of transition.

The recipient of a pension who takes up duty before 1 January 2009 is entitled to an adjustment (“tax adjustment”) applying to the Contracting State of the Organisation in which the pension and adjustment relating thereto are chargeable to income tax under the tax legislation in force in that state. The adjustment is equal to 50% of the amount by which the recipient’s pension would theoretically need to be increased, were the balance remaining after deduction of the amount of national income tax or taxes on the total to correspond to the amount of the pension calculated without income taxes. For such purpose, the Organisation uses tables of equivalence specifying, for each amount of pension and each country of residence, the amount of the adjustment to be added thereto. Until the end of the accounting period 2008 the tax adjustment will be borne by the state in which the recipient is subject to taxes on income for the period considered. In June 2007 the Administrative Council decided to transfer the obligation for the tax adjustment from the Contracting States to the Organisation. This decision will enter into force on 1 January 2009. Before the Administrative Council’s decision on tax adjustments, the obligation for tax adjustments and the corresponding compensations by the Contracting States were netted out. For the accounting period 2007 the EPO takes the abolishment of future compensations for tax adjustment payments into account by increasing the DBO for pensions. This increase is assessed as past service costs.

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. Current service costs and past service costs are classified as employee benefit expenses.

For defined contribution plans, the Organisation pays contributions to externally administered pension insurance plans on a contractual basis. The EPO has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expenses when they are due.

2.14.2. 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 or 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, non-active 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 and financed by the contributions of the staff members and the Organisation.

2.14.3. Termination benefits

Termination benefits are payable when employment is terminated by the Organisation before the normal retirement date and the EPO is contractually committed to such payments. Benefits due more than 12 months after the Balance Sheet date are discounted to their present value.

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. See Note 2.5. above.

3. REVENUE

3.1. REVENUE

The revenue breaks down into the following categories:

in '000 EUR		
	2007	2006
Revenue from patent and procedural fees		
Procedural fees related to the patent grant process (Note 3.2)	746 888	701 284
National renewal fees for granted patents	300 255	280 727
Total	1 047 143	982 011
Other revenue		
Searches for national offices and third parties	33 463	27 153
Patent information services and products	6 949	5 929
Administrative fees	4 070	3 501
Total	44 482	36 583

3.2. PROCEDURAL FEES RELATED TO THE PATENT GRANT PROCESS

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

in '000 EUR		
	2007	2006
Procedural fees for filing and search – EPC and Euro-PCT	141 569	120 284
Procedural fees for international searches – PCT	102 260	104 723
Procedural fees for examination and grant – EPC and Euro-PCT	160 856	159 090
Procedural fees for international preliminary examinations – PCT	14 215	18 073
Procedural fees for opposition, appeal and protest	6 768	3 535
Designation and renewal fees for patent applications	321 220	295 579
Total	746 888	701 284

The amount of revenue from these procedural fees 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 2 231 119 (2006: KEUR 2 303 951) and results in a change in the net present value of KEUR 72 832 (2006: KEUR 372 971).

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

The discount rates applied in line with the term of the expected cash flows range between 4.79 % and 5.53 % in 2007 (2006: between 4.08 % and 4.69 %). 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 of KEUR 2 124 502 (2006: KEUR 2 347 054).

For further information see Note 2.5.3.

5. OTHER OPERATING INCOME

in '000 EUR		
	2007	2006
Other income relating to the current and prior periods	3 898	4 859
Third-party project funding	3 679	3 044
Gains from marketable securities	2 162	56
Miscellaneous income from valuation of insurance funds	1 854	2 688
Rental income	1 455	1 495
Total	13 048	12 142

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 in 2007 arise from changes in fair value on the Balance Sheet dates.

Operating leases – the EPO as lessor

The EPO has entered into a number of minor lease agreements concerning office premises. The income from these was as follows:

in '000 EUR		
	2007	2006
Netherlands Patent Office	688	706
Other	767	789
Total	1 455	1 495

Future payments for renting office premises in The Hague to the Netherlands Patent Office are as follows:

	in '000 EUR	
	2007	2006
Not later than one year	688	706
Later than one year and not later than five years	2 752	2 824
Later than five years	0	706
Total	3 440	4 236

6. EMPLOYEE BENEFIT EXPENSES

	in '000 EUR	
	2007	2006
Past service costs for "tax adjustments"	606 585	–
Basic salaries permanent employees	494 861	471 502
Social security incl. recognised actuarial gains	237 928	249 985
Allowances and other benefits	137 277	125 639
School and day-care centres	18 289	18 024
Remuneration of other employees	16 554	19 296
Training	8 647	7 619
Other	11 495	8 689
Total	1 531 636	900 754

7. OTHER OPERATING EXPENSES

	in '000 EUR	
	2007	2006
IT maintenance	79 986	67 357
Property and equipment maintenance	46 396	46 664
Consultancy and other external services	16 389	13 937
Patent information and public relations	13 294	12 990
Co-operation and meetings	12 157	13 198
Travel	7 924	7 340
Documentation	7 781	8 512
Postage and telecommunications	5 277	5 534
Other	8 571	11 668
Total	197 775	187 200

8. FINANCE REVENUE

	in '000 EUR	
	2007	2006
Expected return on plan assets	260 092	225 745
Interest income on marketable securities	8 359	8 625
Interest income from home loans	5 256	5 182
Interest income from bank accounts, deposits and others	9 804	4 524
Total	283 511	244 076

9. FINANCE COSTS

	in '000 EUR	
	2007	2006
Interest costs on defined benefit obligations	219 230	197 120
Interest costs finance lease	1 241	1 426
Other interest costs	715	283
Total	221 186	198 829

10. PROPERTY, PLANT AND EQUIPMENT

The reconciliation of the carrying amount of property, plant and equipment for the year 2007 is as follows:

	in '000 EUR			
	Land	Buildings	Office equipment	Total
Cost at 1 January 2007	174 732	733 298	141 281	1 049 311
Additions	–	48 513	12 333	60 846
Disposals	–	(7 018)	(11 008)	(18 026)
Transfers	–	–	–	–
Cost at 31 December 2007	174 732	774 793	142 606	1 092 131
Accumulated depreciation 1 January 2007	–	(213 443)	(97 102)	(310 545)
Depreciation for the year	–	(34 396)	(16 259)	(50 655)
Disposals	–	1 847	10 849	12 696
Transfers	–	–	–	–
Accumulated depreciation 31 December 2007	–	(245 992)	(102 512)	(348 504)
Impairment loss for the year	–	–	–	–
Accumulated impairment 31 December 2007	(12 819)	–	–	(12 819)
Net carrying value 1 January 2007	161 913	519 855	44 179	725 947
Net carrying value 31 December 2007	161 913	528 801	40 094	730 808
Including construction in progress				
1 January 2007	–	88 065	–	88 065
31 December 2007	–	3 178	–	3 178

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

As at 31 December 2007, property, plant and equipment includes EUR 9.5 m of the asset retirement obligation relating to renovation of the Isar building in Munich due to asbestos contamination (2006: EUR 10.6 m).

The construction of the new EPO building – PschorrHöfe Phase 8 in Munich – was completed on 31 December 2007. The EPO has further contractual commitments of EUR 7.3 m for outstanding works on this building.

The EPO building at 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 11 698 (2006: KEUR 16 860).

The comparative figures for the year 2006 are presented in the table below:

in '000 EUR				
	Land	Buildings	Office equipment	Total
Cost at 1 January 2006	174 732	697 766	140 391	1 012 889
Additions	–	43 390	11 186	54 576
Disposals	–	(7 858)	(10 296)	(18 154)
Transfers	–	–	–	–
Cost at 31 December 2006	174 732	733 298	141 281	1 049 311
Accumulated depreciation 1 January 2006	–	(185 463)	(87 191)	(272 654)
Depreciation for the year	–	(30 182)	(19 627)	(49 809)
Disposals	–	2 202	9 716	11 918
Transfers	–	–	–	–
Accumulated depreciation 31 December 2006	–	(213 443)	(97 102)	(310 545)
Impairment loss for the year	–	–	–	–
Accumulated impairment 31 December 2006	(12 819)	–	–	(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
Including construction in progress				
1 January 2006	–	55 539	–	55 539
31 December 2006	–	88 065	–	88 065

11. INTANGIBLE ASSETS

The reconciliation of the balances of intangible assets for the year 2007 is as follows:

in '000 EUR				
	Acquired software	Acquired information systems	Internally generated systems	Total
Cost at 1 January 2007	7 393	54 633	13 287	75 313
Additions	463	–	6 338	6 801
Disposals	(996)	–	–	(996)
Transfers	–	–	–	–
Cost at 31 December 2007	6 860	54 633	19 625	81 118
Accumulated amortisation 1 January 2007	(6 157)	(36 612)	(460)	(43 229)
Amortisation for the year	(523)	(2 114)	(460)	(3 097)
Amortisation disposals	992	–	–	992
Accumulated amortisation 31 December 2007	(5 688)	(38 726)	(920)	(45 334)
Net carrying value 1 January 2007	1 236	18 021	12 827	32 084
Net carrying value 31 December 2007	1 172	15 907	18 705	35 784
Including construction in progress				
1 January 2007	–	–	10 529	10 529
31 December 2007	–	–	16 867	16 867

The comparative figures for 2006 are 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	–	6 748	7 446
Disposals	(583)	–	–	(583)
Transfers	–	–	–	–
Cost at 31 December 2006	7 393	54 633	13 287	75 313
Accumulated amortisation 1 January 2006	(6 167)	(34 497)	–	(40 664)
Amortisation for the year	(573)	(2 115)	(460)	(3 148)
Amortisation disposals	583	–	–	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	–	–	3 781	3 781
31 December 2006	–	–	10 529	10 529

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 employees. This includes salaries, office space, equipment and other costs necessary to develop the system. The capitalised internal costs amounting to KEUR 2 153 (2006: KEUR 2 016) 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:

	in '000 EUR	
Construction in progress	2007	2006
Epodos	5 663	2 093
Epoque	5 057	3 219
Docarea	4 957	4 508
European Machine Translation	1 190	709
Total	16 867	10 529

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 44 390 (2006: KEUR 43 251). In 2007 the EPO received a total amount of KEUR 648 (2006: KEUR 2 560). The number of pensioners concerned is 243 (2006: 234).

Fortis AG, Brussels, Belgium

The repurchase value of this contract is KEUR 1163 (2006: KEUR 1 240). In 2007 the EPO received a total amount of KEUR 139 (2006: KEUR 153), transferred on a monthly basis. The number of pensioners concerned is 22 (2006: 22).

13. MARKETABLE SECURITIES

The EPO's marketable securities include the following:

	in '000 EUR	
	2007	2006
Interest-bearing bonds – quoted	207 079	241 333
Interest-bearing bonds – unquoted	106 125	103 964
Total	313 204	345 297
Current	231 699	46 563
Non-current	81 505	298 734

Interest-bearing bonds quoted in active markets are classified as available-for-sale bearing nominal interest in the range from 2.10% to 5.75% (2006: 2.10% to 5.75%) and maturity dates between January 2008 and October 2009 (June 2007 and October 2009), the majority being due in 2008 (KEUR 134 417, 2006: KEUR 134 079).

Total interest income on available-for-sale marketable securities was KEUR 8 097 (2006: KEUR 6 737).

Marketable securities designated at fair value through profit or loss are unquoted structured interest-bearing bonds with a capital guarantee. 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 to the EPO in full at maturity. Maturity dates range between January 2008 to May 2010, the majority falling in 2008 (KEUR 97 282, 2006: KEUR 95 121).

Net gains of KEUR 199 (2006: losses of KEUR 2 826) from re-measurement at fair value of available-for-sale securities have been recognised in equity. Net gains of KEUR 417 (2006: losses of KEUR 247) recorded in equity were reclassified to the Income Statement on sale or maturity.

Fair value gains on marketable securities designated at fair value through profit or loss amounting to KEUR 2 162 (2006: losses KEUR 2 948) are shown in the Income Statement under other operating income.

No impairment provisions are required on marketable securities in 2007 (2006: Nil).

14. HOME LOANS TO STAFF

	in '000 EUR	
	2007	2006
Home loans non-current	94 554	90 441
Home loans current	4 269	2 872
Total	98 823	93 313

Home loans to staff are initially recognised at fair value. This is estimated at 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	
	2007	2006
Trade receivables		
Trade receivables – Contracting States	85 440	92 160
Trade receivables – clients	4 993	3 640
Total	90 433	95 800
Other receivables		
Other receivables – tax	28 719	24 393
Other receivables – staff and related accounts	295	295
Other receivables – others	11 136	8 858
Total	40 150	33 546
Total trade and other receivables	130 583	129 346

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:

	in '000 EUR	
	2007	2006
Net carrying amount, trade receivables – clients	4 993	3 640
Of which neither impaired nor past due on the reporting date	4 759	3 421
Of which not impaired as of the reporting date and past due in the following periods:		
Less than 135 days	223	203
More than 135 days	11	16

During 2007, the EPO wrote off uncollectible receivables amounting to KEUR 2 (2006: KEUR 2) 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. In 2007 an open amount for accounts receivable from Italian renewal fees 2006 was derecognised in the amount of KEUR 12 110 due to the receipt of revised patent data.

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

Fixed-term deposits with an initial maturity over three months after the Balance Sheet date are reported as other financial assets (2007: EUR 89.9 m; 2006: EUR 79.0 m).

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	
	2007	2006
Short-term bank deposits	195 270	65 960
Cash at bank and in hand	20 923	15 994
Total	216 193	81 954

The effective interest rate achieved in 2007 on short-term deposits was 4.09 % (2006: 2.92 %).

18. NET DEFINED BENEFIT LIABILITY

in '000 EUR

Accounting for 2007	Pension obligation	Long-term care insurance	Sickness insurance	Death and invalidity	Total
Discount rate	5.53%	5.54%	5.52%	5.46%	
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%			
Medical costs inflation			from 5.5% in year 1 to 2.5% in year 15 and beyond		
The Organisation is expected to contribute EUR 152 m in 2008					
Expected average remaining working lives	20	20	20	20	
Present value of obligation 1 January 2007	3 732 658	121 668	552 753	101 685	4 508 764
Interest cost	181 793	6 055	26 822	4 560	219 230
Current service cost	206 038	5 339	34 707	9 856	255 940
Past service costs	720 208	–	–	–	720 208
Transfer of pension rights	9 051	–	–	–	9 051
Benefits paid	(75 340)	(2 102)	(10 738)	(5 120)	(93 300)
Actuarial (gain) loss on obligation	(508 370)	(12 532)	(79 952)	(11 469)	(612 323)
Present value of obligation 31 December 2007	4 266 038	118 428	523 592	99 512	5 007 570
Fair value of plan assets 1 January 2007	3 135 153	36 477	–	–	3 171 630
Expected return on plan assets	256 923	3 169	–	–	260 092
Contributions	135 457	7 399	7 208	–	150 064
Transfer of pension rights	9 051	–	–	–	9 051
Benefits paid	(71 026)	(2 102)	(10 738)	–	(83 866)
Actuarial gain (loss) on plan assets	(136 134)	(1 781)	3 530	–	(134 385)
Fair value of plan assets 31 December 2007	3 329 424	43 162	–	–	3 372 586
Limits of corridor	373 266	12 167	55 275	10 169	
Unrecognised actuarial gains (losses) 1 January 2007	439 601	(11 222)	57 204	6 607	
Actuarial gain (loss) for the year – obligation	508 370	12 532	79 952	11 469	
Actuarial gain (loss) for the year – plan assets	(136 134)	(1 781)	3 530	–	
Subtotal	811 837	(471)	140 686	18 076	
Actuarial (gain) loss recognised	(3 317)	–	(96)	–	
Unrecognised actuarial gains (losses) 31 December 2007	808 520	(471)	140 590	18 076	
Amounts recognised in the Balance Sheet					
Present value of funded obligation as at 31 December 2007	3 439 453	118 428	523 592	–	4 081 473
Fair value of plan assets 31 December 2007	(3 329 424)	(43 162)	–	–	(3 372 586)
Subtotal	110 029	75 266	523 592	–	708 887
Unfunded obligation	826 586	–	–	99 511	926 097
Unrecognised actuarial gains (losses)	808 521	(471)	140 590	18 076	966 716
Unrecognised past service costs	(113 622)	–	–	–	(113 622)
Liability recognised in the Balance Sheet	1 631 514	74 795	664 182	117 587	2 488 078
Amounts recognised in the Income Statement					
Interest cost	181 793	6 055	26 822	4 560	219 230
Current service cost	206 038	5 339	34 707	9 856	255 940
Past service costs	606 585	–	–	–	606 585
Expected return on plan assets	(256 923)	(3 169)	–	–	(260 092)
Net actuarial (gains) or losses recognised in year 2007	(3 317)	–	(96)	–	(3 413)
Expense recognised in the Income Statement	734 176	8 225	61 433	14 416	818 250
Actual return on plan assets					
Expected return on plan assets	256 923	3 169	–	–	260 092
Actuarial gain on plan assets	(136 134)	(1 781)	–	–	(137 915)
Actual return on plan assets	120 789	1 388	–	–	122 177

Net defined benefit liability

in '000 EUR

Accounting for 2006	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%		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 beyond		
The Organisation is expected to contribute EUR 99 m in 2007					
Expected average remaining working lives	20	20	20	20	
Present value of obligation 1 January 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
Past service costs	–	–	–	–	–
Transfer of pension rights	12 215	–	–	–	12 215
Benefits paid	(64 353)	(1 896)	(9 192)	(5 555)	(80 996)
Actuarial (gain) loss on obligation	(248 112)	4 915	(105 395)	(9 843)	(358 435)
Present value of obligation 31 December 2006	3 732 658	121 668	552 753	101 685	4 508 764
Fair value of plan assets 1 January 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 (loss) on plan assets	119 546	1 314	3 002	–	123 862
Fair value of plan assets 31 December 2006	3 135 153	36 477	–	–	3 171 630
Limits of corridor	366 614	10 882	59 868	10 282	
Unrecognised actuarial gains (losses) 1 January 2006	71 943	(7 621)	(51 193)	(3 236)	
Actuarial gain (loss) for the year – obligation	248 112	(4 915)	105 395	9 843	
Actuarial gain (loss) for the year – plan assets	119 546	1 314	3 002	–	
Subtotal	439 601	(11 222)	57 204	6 607	
Actuarial (gain) loss recognised	–	–	–	–	
Unrecognised actuarial gains (losses) 31 December 2006	439 601	(11 222)	57 204	6 607	
Amounts recognised in the Balance Sheet					
Present value of funded obligation as at 31 December 2006	3 622 948	121 668	552 753	–	4 297 369
Fair value of plan assets 31 December 2006	(3 135 153)	(36 477)	–	–	(3 171 630)
Subtotal	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
Unrecognised past service costs	–	–	–	–	–
Liability recognised in the Balance Sheet	1 037 107	73 969	609 957	108 292	1 829 325
Amounts recognised in the Income Statement					
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
Past service costs	–	–	–	–	–
Expected return on plan assets	(223 302)	(2 443)	–	–	(225 745)
Net actuarial (gains) or losses recognised in year 2006	–	–	–	–	–
Expense recognised in the Income Statement	143 470	7 390	68 660	14 262	233 782
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

Net defined benefit liability

in '000 EUR

Accounting for 2005	Pension obligation	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 beyond		
The Organisation is expected to contribute EUR 135 m in 2006					
Expected average remaining working lives	20	20	20	20	
Present value of obligation 1 January 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
Past service costs	-	-	-	-	-
Transfer of pension rights	13 530	-	-	-	13 530
Benefits paid	(56 385)	(1 555)	(8 054)	(6 869)	(72 863)
Actuarial (gain) loss on obligation	187 244	10 040	53 936	3 236	254 456
Present value of obligation 31 December 2005	3 666 136	108 816	598 680	102 821	4 476 453
Fair value of plan assets 1 January 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 (loss) on plan assets	259 187	2 419	2 744	-	264 350
Fair value of plan assets 31 December 2005	2 721 322	27 608	-	-	2 748 930
Limits of corridor	320 185	9 201	49 625	9 313	
Unrecognised actuarial gains (losses) 1 January 2005	-	-	-	-	
Actuarial gain (loss) for the year – obligation	(187 244)	(10 040)	(53 936)	(3 236)	
Actuarial gain (loss) for the year – plan assets	259 187	2 419	2 744	-	
Unrecognised actuarial gains (losses) 31 December 2005	71 943	(7 621)	(51 192)	(3 236)	
Amounts recognised in the Balance Sheet					
Present value of funded obligation as at 31 December 2005	3 542 560	108 816	598 680	-	4 250 056
Fair value of plan assets 31 December 2005	(2 721 322)	(27 608)	-	-	(2 748 930)
Subtotal	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
Unrecognised past service costs	-	-	-	-	-
Liability recognised in the Balance Sheet	1 016 758	73 587	547 488	99 585	1 737 418
Amounts recognised in the Income Statement					
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
Past service costs	-	-	-	-	-
Expected return on plan assets	(181 783)	(1 704)	-	-	(183 487)
Net actuarial (gains) or losses recognised in year 2005	-	-	-	-	-
Expense recognised in the Income Statement	138 114	6 620	56 551	13 328	214 613
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

Post-employment medical benefits	2007	2006
Defined benefit obligation	523 592	552 753
Experience adjustment on plan liabilities	13 980	(42 347)

in '000 EUR

Defined benefit plans other than medical benefits	2007	2006
Defined benefit obligation	(4 483 978)	(3 956 011)
Plan assets	3 372 585	3 171 630
Surplus/(deficit)	(1 111 393)	(784 381)
Experience adjustment on plan liabilities	(47 380)	141 819
Experience adjustment on plan assets	(137 915)	120 860

For the fiscal year 2007 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	18 883	(13 875)
Effect on DBO	139 068	(105 952)

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)

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

	in '000 EUR	
	2007	2006
Pension benefits		
Office contributions	89 451	77 817
Staff contributions	44 686	38 881
LTC benefits		
Office contributions	4 879	4 605
Staff and pensioners' contributions	2 527	2 383
Post-employment medical care		
Office contributions	40 613	37 285
Staff and pensioners' contributions	13 954	13 254
Death and invalidity		
Office contributions	3 567	4 773
Staff contributions	41	2 404
Total	199 718	181 402

The major categories of plan assets are as follows:

	as %	
	2007	2006
Domestic bonds	26	25
Domestic equities	25	26
Foreign equities	22	22
Emerging markets	8	8
Real estate	7	8
Commodities	5	4
Foreign bonds	3	3
Cash	4	4
Total	100	100

18.1. Explanations of the actuarial assumptions

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 3.1% (2006: 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.

EPO employees who have previously worked for government departments, national or international organisations or in industry may arrange for inward transfer to the EPO pension scheme of retirement pension rights accrued under their previous schemes (provided the latter schemes allow such transfers). In such cases, the EPO determines the number of years' reckonable service credited under its own pension scheme. An amount of KEUR 6 783 (2006: KEUR 3 515) resulting from inward transfers is taken into account as actuarial loss.

The obligations for the "tax adjustment" amounting to KEUR 720 208 (2006: Nil) and for the allowance payments to non-active staff amounting to KEUR 106 378 (2006: KEUR 109 711) are presented as an unfunded pension obligation as these obligations are not covered by the assets of the RFPSS.

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

18.2. Main characteristics of the Organisation's defined benefit pension scheme

Type of benefit	Beneficiary	Calculation of the benefit
Retirement pension	Staff member from age of 60 with at least 10 years total 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% (80% for some key managers)
Reversion of retirement pension	Surviving spouse/husband	60% of the retirement pension
Invalidity	Staff member	Allowance at the amount of the 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, 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 and one month and a half of final monthly basic salary multiplied by the number of reckonable years of service
Tax adjustment	Pensioners and dependants	50% of income taxes on retirement pensions calculated by use of standardised tables of equivalence specifying the amount of the adjustment to be added to the pension
Family allowances	Pensioners and dependants	Same as for active staff

18.3. Main characteristics of the Organisation's other post-employment benefit plans

18.3.1. Sickness insurance

An employee who has remained in EPO service until retirement or is in receipt of an invalidity allowance, 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 of the pension (max. 2.4%) is charged to the employee. As from 2008, a spouse in employment outside the EPO and whose salary exceeds a certain level will be subject to an additional contribution.

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.

18.3.2. Long-term care insurance

A permanent employee, a former employee in receipt of an invalidity allowance 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 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 2007 and 2006.
- 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.

18.3.3. 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 sickness insurance. 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 basic salary).

A permanent employee who has been in EPO service for at least two years and whose service terminates for reasons other than retiring or drawing an invalidity allowance 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 5 975 (2006: KEUR 5 232) 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	
	2007	2006
Employee-related liabilities	66 280	57 763
Current deposit accounts by patent applicants	59 891	54 760
Payables to suppliers and trade creditors	58 494	49 491
Other	3 498	2 308
Total	188 163	164 322

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

Employee-related liabilities mainly include accrued liabilities for untaken annual leave amounting to KEUR 39 060 (2006: KEUR 33 161) and home leave of KEUR 23 360 (2006: KEUR 22 070).

20. FINANCE LEASE LIABILITIES

The EPO has entered into three finance lease contracts:

The Open Infrastructure Offering contract (OIO2, replacing the previous OIO contract with IBM) was signed with IBM companies in the Netherlands, Germany and Austria. It came into force in December 2007 and will terminate by the end of 2012. The total value of deliverables and services under this contract over the 5-year period is EUR 90 m; they will start being supplied in 2008.

The contract signed with Telematics S.A. Brussels, Belgium, relates to the delivery, configuration and maintenance of storage capacity. As at 31 December 2007, the total value of the contract was EUR 31.8 m (2006: EUR 28.6 m), including equipment amounting to EUR 17.0 m (2006: EUR 15.2 m). This is expected to increase in future years as further storage capacity is 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 total value of the equipment delivered under the contract is EUR 8.3 m.

Details of the EPO's financial lease agreements are as follows:

	in '000 EUR	
	2007	2006
Assets value		
Office equipment	11 698	16 860
Future lease payments		
Not later than one year	4 727	8 964
Later than one year and not later than five years	8 215	11 768
Later than five years	–	449
Total future lease payments	12 942	21 181
Future interest payable	1 117	2 014
Present value of future lease payments	11 825	19 167

21. PROVISIONS

	in '000 EUR			
	Asset retirement obligation	Litigation risks	Other	Total
1 January 2007	12 198	852	393	13 443
Use	349	852	393	1 594
Reversal	–	–	–	–
Addition	–	772	428	1 200
Interest effect	511	–	–	511
Other	–	–	–	–
31 December 2007	12 360	772	428	13 560
Current	1 251	772	428	2 451
Non-current	11 109	–	–	11 109
Total	12 360	772	428	13 560

The Organisation recognises an asset retirement obligation amounting to KEUR 10 722 (2006: KEUR 10 623) for renovating one of the buildings it owns in Munich (Erhardtstraße) due to asbestos contamination. The corresponding debit is treated as part of the costs of the building. It is expected that the remaining related costs will occur between 2008 and 2010. A provision amounting to KEUR 1 638 (2006: KEUR 1 575) is recognised due to a contractual obligation for dismantling and renovating a leased office building in Munich (Westsite). The amount to settle this obligation depends on when the Organisation vacates the building. It is expected that these costs will occur in 2013 at the latest. Although contractual obligations for dismantling and renovation are usual in the ordinary course of business, the Organisation recognises no provisions for its other leased buildings as it is highly unlikely that it 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 months after the Balance Sheet date.

Other provisions are recognised for obligations to fulfil requirements of the EPC mainly due to external audit of financial statements, adherence to budgetary regulations and internal controls. 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 January 2007	Increase/ (decrease)	Ending balance 31 December 2007
Searches – EPC and Euro-PCT	155 329	11 120	166 449
International searches – PCT	26 688	24 873	51 561
Examination – EPC and Euro-PCT	527 262	34 930	562 192
International preliminary examination – PCT	5 492	2 637	8 129
Opposition	8 654	(2 393)	6 261
Appeal	4 302	801	5 103
Others	–	12	12
Total	727 727	71 980	799 707

in '000 EUR			
	Opening balance 1 January 2006	Increase/ (decrease)	Ending balance 31 December 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
Total	651 188	76 539	727 727

23. COMMITMENTS

in '000 EUR		
	2007	2006
Purchase commitments fixed assets	7 354	49 395
thereof payable within one year	6 664	43 115

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 the lease term, the agreement is extended for another 5 years. The total value of the contract over 10 years is EUR 44 m.

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 the lease term, the agreement is extended for another 5 years. The total value of the contract over 10 years is EUR 14.7 m.

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 over 15 years is EUR 49 m.

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 December 2010. The total value of the contract over 10 years is EUR 42 m.

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

The total operating lease expense recognised in the Income Statement for 2007 amounts to KEUR 16 445 (2006: KEUR 17 734).

In 2007 there were no extensions to the existing operating lease contracts. No new contracts were signed.

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

in '000 EUR		
	2007	2006
Not later than one year	13 164	13 114
Later than one year and not later than five years	42 390	47 823
Later than five years	10 945	18 442
Total	66 499	79 379

The Organisation has other commitments of EUR 115 m (2006: EUR 103 m) 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 2007, it has not made any provisions for doubtful debts concerning amounts owed by related parties (2006: Nil).

25.1. RELATED PARTIES TO THE ORGANISATION

25.1.1. Members of 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.

25.1.2. 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.

25.1.3. Contracting States

The Administrative Council of the Organisation is made up of representatives of the Contracting States to the EPC. As the EPO's supervisory body, it exercises legislative powers, decides policy issues and oversees the Office's activities. 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 appoint their representatives on the Administrative Council and can determine how they vote, the Contracting States themselves are also considered to be related parties to the EPO.

25.2. TRANSACTIONS AND OUTSTANDING BALANCES WITH RELATED PARTIES

25.2.1. Compensation of key managers (MAC members and Fund Administrator) and close family members of key managers

	in '000 EUR	
	2007	2006
Compensation of key managers		
Short-term employee benefits ¹	1 904	1 866
Post-employment benefits, service costs	604	582
Post-employment benefits, past service costs	1 409	–
Post-employment benefits, defined contribution plans	58	–
Termination benefits	858	–
Total	4 833	2 448

¹ 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 and past service costs) for close family members of key managers are KEUR 414 for the fiscal year 2007 (2006: KEUR 205). The compensation is granted under regular employment contracts.

The Organisation recognises a defined benefit obligation for post-employment benefits amounting to KEUR 7 475 (2006: KEUR 7 672) for the key managers and to KEUR 787 (2006: KEUR 885) for close family members.

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

	in '000 EUR	
	2007	2006
MAC members and Fund Administrator	–	–
Close family members of key managers	–	–
Contracting States		
Co-operation with national offices	3 848	4 949
Rent office building Berlin	2 575	2 551
Work by national offices	2 331	2 239
Total	8 754	9 739

25.2.3. Revenues from patent and procedural fees and other revenues from related parties

	in '000 EUR	
	2007	2006
MAC members and Fund Administrator	3	3
Close family members of key managers	3	3
Contracting States		
Renewal fees for granted patents	300 255	280 727
Searches on behalf of ex-IIIB member states	30 705	24 316
Other revenue	3 906	3 474
Reimbursement rent office building Berlin	1 092	1 108
Rental income Netherlands patent office	688	706
Searches on behalf of other Contracting States	22	20
Total	336 674	310 357

25.2.4. Loans, receivables and other assets due from related parties

	in '000 EUR	
	2007	2006
MAC members and Fund Administrator	85	91
Close family members of key managers	68	74
Contracting States		
Renewal fees	85 440	92 157
Tax adjustments	14 834	13 956
VAT and other taxes	13 885	10 437
Other	4 742	3 383
Total	119 054	120 098

In June 2007 the Administrative Council, made up of representatives of the Contracting States, decided to transfer the Contracting States' obligation for the tax adjustments to the Organisation (see Note 2.14.). This decision leads to past service costs amounting to KEUR 606 858 in 2007 and will lead to additional past service costs of KEUR 113 622 until all respective pension entitlements are vested. In addition, this decision will have a negative impact on the EPO's income due to higher current service costs and interest costs for pensions in the future. For the periods 2008 to 2013 the Organisation expects to recognise additional expenses due to the decision on tax adjustments amounting to KEUR 623 288 in total. For the reporting periods 2014 and beyond no reliable data are available yet.

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 EPO employees.

25.2.5. Payables and other liabilities

	in '000 EUR	
	2007	2006
MAC members and Fund Administrator	-	-
Close family members of key managers	-	-
Contracting States	33	16
Total	33	16

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

In January 2008, the Organisation assigned an amount of EUR 300 m to the RFPSS. This transaction within the Organisation decreases the financial assets of the Office and increases the plan assets managed by the RFPSS by the same amount. The overall positive impact on the Organisation's income as of 31 December 2008 is expected to be approximately EUR 10 m.

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					
	Available for sale	At fair value through profit or loss	Loans and receivables	Financial liabilities carried at amortised cost	Net carrying amount 31 December 2007	Fair value 31 December 2007
Financial assets						
Non-current						
Marketable securities						
Fixed interest-bearing bonds – quoted	72 662				72 662	72 662
Structured interest-bearing bonds – unquoted		8 843			8 843	8 843
Home loans to staff			94 554		94 554	94 355
Current						
Trade and other receivables			130 583		130 583	130 583
Marketable securities						
Fixed interest-bearing bonds – quoted	134 417				134 417	134 417
Structured interest-bearing bonds – unquoted		97 282			97 282	97 282
Home loans to staff			4 269		4 269	4 260
Other financial assets			89 850		89 850	89 850
Cash and cash equivalents			216 193		216 193	216 193
Total	207 079	106 125	535 449		848 653	848 445
Financial liabilities						
Non-current						
Trade and other payables				5 720	5 720	5 720
Finance lease liabilities				7 696	7 696	7 696
Current						
Bank overdrafts				-	-	-
Trade and other payables				183 693	183 693	183 693
Finance lease liabilities				4 129	4 129	4 129
Total				201 238	201 238	201 238

in '000 EUR						
	Available for sale	At fair value through profit or loss	Loans and receivables	Financial liabilities carried at amortised cost	Net carrying amount 31 December 2006	Fair value 31 December 2006
Financial assets						
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
Total	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						
				11 329	11 329	11 329
Current						
Bank overdrafts						
				–	–	–
Trade and other payables						
				164 322	164 322	164 322
Finance lease liabilities						
				7 838	7 838	7 838
Total				188 721	188 721	188 721

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 assumptions about 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 to 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

28.1. FINANCIAL INSTRUMENTS

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:

28.1.1. Cash flow, foreign exchange and fair value interest rate risk

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 (see Note 13.), the fair value interest risk has an effect on both fixed and structured interest-bearing bonds.

The EPO manages 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.

At 31 December 2007, if the EUR had weakened/strengthened by 10% against the pound sterling (GBP) and Swiss franc (CHF) with all other variables held constant the result for the year would have been higher/lower, mainly as a result of foreign exchange gains/losses on translation of GBP/CHF-denominated accounts receivable. The impact on the income would have been as follows:

in '000 EUR		
	2007	2006
GBP	893	939
CHF	200	208
Total	1 093	1 147

Interest rate risks are presented by way of sensitivity analyses in accordance with IFRS 7. These show the effects of changes in market interest rates on profit or loss in the case of structured interest-bearing bonds and on equity in the case of fixed-interest bearing bonds. The sensitivity analysis is based on the calculation of the modified duration of the EPO portfolio of marketable securities. The effect of convexity has no significant bearing on the sensitivity analysis and has therefore not been taken into account.

If the market interest rates had been 100 basis points higher (lower), the profit for the year would have been KEUR 652 lower (higher) (31 December 2006: KEUR 1658) as a result of a decrease (increase) in the fair value of structured interest-bearing bonds classified at fair value through profit or loss.

If market interest rates had been 100 basis points higher (lower) at 31 December 2007, equity would have been KEUR 1621 (31 December 2006: KEUR 3644) lower (higher) as a result of a decrease (increase) in fair value of fixed interest-bearing bonds classified as available-for-sale.

The Organisation has not performed a sensitivity analysis for granted home loans as fair value changes due to lower (higher) interest rates would not have an impact on the EPO's profit or loss and equity.

28.1.2. 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 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 its operations more than covers its liquidity needs for both operational and capital expenditure.

Liquidity surpluses not needed in the short term are invested in non-current marketable securities with maturities of 2 to 5 years in line with estimated cash outflows according to the 5-year budget planning.

In order to maximise the return on its liquidity surpluses, the EPO tries to maintain a balance between short-term deposits (up to one year) and non-current marketable securities. Based 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.

28.1.3. 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 repayments are withheld from salary. No home-loan borrower has ever defaulted.

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.

28.2. CAPITAL MANAGEMENT

The EPO is a non-profit organisation and the main objectives of its capital management are to ensure the continuity of its tasks as defined in the EPC – in particular the grant of European patents – and to meet its obligations to its stakeholders.

The stakeholders are the Contracting States, patent applicants and their representatives, serving and former EPO staff, and its product- and/or service-providers.

The Organisation is financed from its own resources, from its share of national renewal fees and, if need be, from special contributions by the Contracting States. Any liquidity deficits would be financed by its Contracting States, so the Organisation has no risk of insolvency.

According to Article 38 EPC, the Organisation's own resources comprise

- all income from fees and other sources, and the Organisation's reserves
- the resources of the RFPSS which are a special class of assets to support the Organisation's pensions and social security scheme (PSSS) by providing the appropriate reserves.

The Organisation's main assets are those of the RFPSS (included as plan assets in the net defined benefit liability), the investments in property, plant and equipment, and financial assets other than plan assets.

For managing the Organisation's capital, two substantial liabilities are to be addressed. Firstly, the EPO is a labour-intensive organisation based on intellectual human capital, so its main obligation concerns the pay and post-employment benefits of its staff. Its second large obligation concerns the prepaid fees it has already received in cash but for which it has not yet provided the services involved.

EPO capital management is based on financial planning for a period of five years, including a forecast of budgeted cash flows and of IFRS statements for each of these years. Both are based on a five-year business plan for all EPO services. Thorough analyses of possible developments in demand for European patents and in applicant behaviour are conducted in close consultation with the relevant stakeholders.

Actual developments during the year are closely monitored, in the form of monthly financial management reports to EPO management and quarterly reports to the Budget and Finance Committee and the Administrative Council.

This planning and monitoring of EPO business and finances ensure that any necessary action (e.g. efficiency measures) can be prepared and taken in good time. This minimises any risk of the EPO not being able to finance its operations from its own resources. In addition, the EPO has taken measures to avoid the risk of sudden increases in its procedural fees or of special contributions from the Contracting States being needed to finance its long-term liabilities (especially for pensions and social security).

Since 1984, the EPO has been setting aside reserves in the RFPSS so that it can pay its pensions. This also minimises the risk of the Contracting States being asked to cover the financing of these pensions in accordance with the guarantee laid down in Article 40 of the Pension Scheme Regulations.

Since 2001, it has also been building up a reserve fund for LTC insurance, and in 2008 it plans to start funding other post-employment benefit schemes.

Another instrument to manage coverage for post-employment benefits is the three-yearly actuarial study to assess whether these obligations are sufficiently funded. If required, measures are then taken. For example, the actuarial study as per 31 December 2005 resulted in the pension scheme contribution being revised from 24% to 27.3%.

The monitoring of the development of assets and liabilities is an important task of the Asset Liability Management (ALM) Committee, which reports direct to the President and makes recommendations on all substantial investments and/or changes in liabilities.

The policy and measures described above are part of EPO management's strategy to ensure that the Organisation can continue as a going concern without any risk of needing to draw on special contributions from the Contracting States.

EPO capital management takes account of how the Organisation is financed. As described in Note 2.5.3, the value of future national renewal fees, which cannot be shown as an asset and is therefore not included in EPO equity, is nonetheless an essential factor when considering the Organisation's financial position on the Balance Sheet date.

At the end of the accounting period 2007, the EPO had negative equity of EUR 1.85 bn, i.e. EUR 600 m more than at the Balance Sheet date 2006 (EUR 1.23 bn).

The net present value of future renewal fees for European patents granted up to 31 December 2007 amounts to EUR 2.2 bn, a decrease of EUR 73 m during the year 2007.

The main reason for the increase in negative equity is the Council's decision that, from 1 January 2009 onwards, the Organisation must finance the reimbursements on national tax for EPO pensioners previously paid by the Contracting States. The related liability as at 31 December 2007 amounts to EUR 720 m. The annual reimbursements to EPO pensioners are expected to increase from EUR 12.5 m in 2008 to EUR 18 m in 2012 and will be financed within the Organisation's operations without an assigned funding by the RFPSS.

The EPO's annual financial planning and the regular actuarial studies will continue to consider what measures may be necessary to ensure that the Organisation can meet its financial obligations to its stakeholders, especially the EPC Contracting States and serving and retired EPO staff.

Published and edited by
European Patent Office
Munich
Germany
© EPO 2008

An online version of this report
is available on our website at:
www.epo.org/annual-report

Responsible for content
Johan van Leuven
Principal Director Finance

Design
ANZINGER | WÜSCHNER | RASP
Munich

Printing
Dinauer GmbH
Munich

