



European Financial Reporting Advisory Group ■

ANNUAL REVIEW

■ 2005



EFRAG Objectives

Proactive input to IASB and IFRIC
Endorsement advice to the EU Commission
Advice on EU Accounting Legislation

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Report of the Chairman of the Supervisory Board □

Göran Tidström
Chairman of the EFRAG
Supervisory Board



Europe is currently undergoing a period of considerable change, with the vision to strengthen the region's economy by enhancing the capital markets. Improvements are being made to the requirements for prospectuses, accounting, auditing, corporate governance, enforcement and banking capital requirements and steps are being taken at the same time to achieve global convergence of some of those rules. It is understandable in the circumstances that the parties that are implementing these new requirements are struggling at the moment under the weight of change. At such times it is important to remind ourselves of the vision that underlies the changes: thriving integrated European capital markets that are based on high quality requirements and standards, transparency and enforcement. Such markets will be highly beneficial for the region's economy in this increasingly globalised world.



In particular, on financial reporting - EFRAG's area of interest - introducing a requirement that all listed European companies preparing consolidated financial statements should prepare those statements in accordance with IFRS was a bold step which will enable Europe to benefit from harmonised, transparent, high quality financial reporting. Now, in the spring of 2006, we are seeing many financial statements complying for the first time with IFRS being issued all over Europe and in many other parts of the world - although unfortunately not in the US. To get this far

has required a significant investment of time and other resources by preparers, users, auditors and regulators and has made accounting an issue to be discussed at many European Board meetings and in governments.

Throughout all of this, EFRAG has been providing pan-European input to the IASB on its published proposals and giving technical advice to the European Commission on the adoption of individual IFRSs and IFRIC interpretations for use in Europe. And, as accounting standards received more attention in Europe, the importance and range of EFRAG's work have also increased.

With Europe starting to get to grips with IFRS, there has been much talk about the possible need for European interpretations of IFRS to ensure that the standards are applied consistently in Europe. EFRAG organised a public debate on the subject. It issued a discussion paper in July and held an Advisory Forum (roundtable discussion) in September. The outcome of this debate was clear: European interpretations are not the way forward, because IFRIC should be the only body to issue interpretations.

More generally, EFRAG has continued to meet regularly with the European national standard setters and is increasing the range of meetings it holds with other stakeholders in Europe. EFRAG has always placed great emphasis on the transparent and consultative nature of its processes, and these meetings help to reinforce those processes.



□ Report of the Chairman of the Supervisory Board



During the year the EFRAG Supervisory Board and the European Commission had lengthy discussions about EFRAG's role and its relationship with other European bodies that have roles in connection with the IFRS implementation in Europe (including, for example, CESR). The eventual outcome of these discussions was a new written "Working Arrangement" between the Commission and EFRAG. This Working Arrangement, which was signed on 23 March 2006, is, I believe, a very positive development for EFRAG because it formalises EFRAG's role as technical adviser

to the Commission on all issues relating to the application of IFRS in Europe in respect of endorsement advice and proactive views. The Working Arrangement is already operating well with a high level of mutual trust.

On finalising the Working Arrangement, EFRAG was invited by the IASB to meet regularly with IASB Board members to discuss the IASB/FASB convergence project. This is also a positive development for the European Union because it provides an opportunity to engage constructively in a project that has enormous implications for Europe.

So, over the last twelve months EFRAG has been working hard to ensure that Europe is more fully and effectively engaged in the global financial reporting debate than ever before. However, the additional work that this entails cannot be maintained without an increase in the EFRAG staff that supports the TEG. The IASB is now working on a number of projects that will determine the future direction of financial reporting in Europe as well as in the rest of the world. In my opinion this is the very moment at which Europe's views most need to be heard. It is crucial for the success of the IASB's work that it is influenced in a balanced way by stakeholders around the world and in particular by Europe, the largest economy using IFRS.

The Supervisory Board is committed to increase EFRAG's funding significantly over the next two years in order to increase its technical resources. The Board also expects the cooperation with national standard setters to continue developing with joint projects and further integration of resources.

It is clear that the importance of EFRAG is increasing, as is its visibility in Europe; this helps in getting our messages heard. I am particularly pleased that we are receiving very positive comments indeed on the quality of our technical work over the last year; the more credible and coherent our views are, the more influential they will be.

I would like to express my appreciation to the members of EFRAG TEG and EFRAG's Working Groups, both for their efforts and for what they have achieved during the year. It is clear that, as a result, Europe is participating more effectively in the global accounting debate than ever before.

Göran Tidström
19 April 2006

EFRAG - European Financial Reporting Advisory Group - was set up in 2001 to assist the European Commission in the endorsement of International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) by providing advice on the technical quality of IFRS. It is a private sector body set up by the European organisations prominent in European capital markets, known collectively as the 'Founding Fathers' or Member body organisations (see Table 1).

In the IAS Regulation (N° 1606/2002) that requires all European listed companies to apply IFRS from 2005 in their consolidated financial statements, there is reference to the European Commission seeking advice from a technical committee prior to endorsing standards. EFRAG fulfils the role of that technical committee. In addition to taking advice from EFRAG, the European Commission seeks advice from Member states through the Accounting Regulatory Committee (ARC), in which EFRAG participates as an official observer.



EFRAG's role has recently been formalised in a Working Arrangement with the European Commission, which states that "EFRAG will provide advice to the Commission on all issues relating to the application of IFRS in the EU".

The work of EFRAG is overseen by a Supervisory Board drawn from the Member body organisations of EFRAG and chaired by Göran Tidström, independent from Sweden (see Table 2). The European Commission is an observer at the Supervisory Board Meetings.

EFRAG operates through a Technical Expert Group (TEG), which takes its decisions independently of

the Supervisory Board and all other interests. The 11 voting members of TEG (see Table 3) are drawn from throughout Europe and from a variety of backgrounds. The chairmen of the French, German and UK Standard Setters are non-voting members of TEG, and representatives of the European Commission and CESR attend TEG meetings as observers.

The chairman of TEG - Stig Enevoldsen, auditor from Denmark - is full time, and the other voting members devote 30 to 50% of their time to EFRAG. All the members of TEG and its working groups (see below) provide their time without charge to EFRAG.

TEG has set up working groups to provide it with advice on the following specialist areas:

- Insurance Accounting
- Financial Instruments
- Small and Medium sized Entities (SMEs)
- Revenue Recognition
- Service Concessions Arrangements
- Venture Capital Investments

Reports on the working groups' activities are set out in this annual review.

EFRAG's offices are staffed by a secretariat which provides all the papers and the technical support for TEG. The current members of the secretariat are listed in Table 5.

EFRAG's role is both proactive and reactive. In particular:

- it provides advice to the European Commission on the endorsement of new or amended IFRSs and IFRIC interpretations;
- it comments on proposed IFRSs and IFRIC interpretations, IASB discussion papers and other consultative documents;
- its representatives attend various IASB Working Group meetings as observer (see below);
- it maintains regular contacts with IASB through meetings with its chairman. IASB Board members and senior staff participate in each TEG meeting;
- it works closely with European national Standard Setters on various activities designed to encourage the debate in Europe on

□ About EFRAG

accounting matters, to develop European views on issues of importance and to enhance generally the quality of Europe's input to the IASB. (These 'Proactive Accounting Activities in Europe' are discussed in more detail below);

- it meets quarterly with the European national Standard Setters to exchange views;
- Its representatives also participate in the World Standard Setters meetings (organised by the IASB);
- It participates in the meetings of the former IASB Liaison Standard Setters where technical issues of proactive nature are discussed.

In addition EFRAG has recently been invited by the IASB to give input to the IASB/FASB convergence work.

EFRAG has been granted observer status in the IASB working groups on:

- Financial Instruments
- Insurance Accounting
- Performance Reporting
- SME Accounting
- Interest Rate Margin Hedge

EFRAG maintains contacts with the European Commission directly and through Commission representatives participating as observers in all TEG meetings and working groups.

The members of TEG are appointed by the Supervisory Board, with the assistance of a Nominating Committee, following an open call for candidates. The Supervisory Board looks primarily to the qualifications of the TEG candidates in terms of knowledge and experience but endeavours to ensure a broad geographical balance together with experience from preparers, the accounting profession, users and academics.

In the same way, members of working groups are appointed following a call for candidates published on our website with the aim of ensuring an appropriate professional and geographical balance.

Due process and transparency are important features of EFRAG's work. For example, the monthly meetings of TEG are open to the public. In addition,

when preparing comment letters on exposure drafts, discussion papers and other consultative documents and when preparing endorsement advice to the European Commission, EFRAG seeks - via our website - input from organisations, companies and the public on TEG's draft views.

In 2005, EFRAG reached an understanding with the European national standard setters that EFRAG and the national Standard Setters should work much more closely together to improve the input from Europe to the global standard-setting process. It was also agreed to pool resources on the proactive work in order to stimulate, carry out and manage proactive development activities designed to encourage the debate in Europe on accounting matters and designed to enhance the quality of the proactive input to the IASB.

- The 'Proactive Accounting Activities in Europe' (PAAinE) is coordinated by a Coordinators committee consisting of the chairmen from the Dutch, French, German, Polish, Spanish, Swedish and UK Standard Setters with EFRAG as chair.

EFRAG is funded by the Member body organisations which pay subscriptions on a half-yearly basis. In 2005 the total subscription income was 1 million Euros. (Financial highlights for 2005 are included in this report.) In order to enable it to carry out the range of activities described above more comprehensively, EFRAG is seeking to increase its funding significantly over the next two years.



The EFRAG Staff

Report of the Chairman of the EFRAG Technical Expert Group □

Stig Enevoldsen
Chairman of the EFRAG TEG



Introduction

The year 2005 was the first full year after EFRAG increased its staff resources and got a full time chairman. These changes made it possible for us to address more issues in more detail, and to participate in more meetings and conferences than before. This in turn has meant, I believe, that EFRAG has become more visible and effective as the accounting technical focal point in Europe.

The Working Arrangement with the European Commission that Göran Tidström refers to in his report represents a further very positive and important step in EFRAG's evolution. It provides helpful backing for EFRAG in many respects - including our relationship with the IASB - and has also led to an improvement in what was already a good relationship with the staff of the Commission; we are now working very closely with them.

It is pleasing to see that EFRAG's work is being recognised. We have particularly appreciated the positive statements made by Josep Borrell Fontelles, the President of the European Parliament to the President of the European Commission in his letter of 18th October 2005 relating to the IAS Regulation.

"EFRAG's role and operation should be enhanced in order to respond to the current challenges at European and at worldwide level."

We also appreciate the very positive statements made by Mrs P. Beres, chairwoman of the Economics and Monetary Affairs Committee, in the European Parliament in her speech at the FEE conference on 1st December 2005.

"Debates (...) on the future role of EFRAG represent an outstanding opportunity to strengthen the voice and the role of Europe."

Requiring European listed companies to prepare their financial statements in accordance with standards made by a global committee, the IASB, of course means it is very important that Europe is properly involved in the development of those standards to ensure that they take account of the European business environment and practice. That has become even more important in the last couple of years because the IASB and the accounting standard setter from the US, the FASB, are working more and more closely together in their convergence programme. The IASB deserves much credit therefore for inviting EFRAG to participate in preliminary talks on issues considered under the convergence programme. We have of course accepted this invitation. There will be a lot of complex work to be done in a very short timeframe, but EFRAG is looking forward to the challenge. We intend to work closely with the national Standard Setters on this, so as to ensure a robust pan-European input to the IASB.

EFRAG will have meetings with the IASB on the convergence agenda issues

It has for many years been burdensome for European companies listed in the US to have to reconcile their financial statements (prepared in accordance with local accounting requirements) to US GAAP, whereas foreign companies, including US companies, filing in Europe normally have not been required to reconcile. This is even more annoying now that those European companies are using global accounting standards (IFRS), but are still required to prepare reconciliations. There have been a number of attempts in the past to get rid of the reconciliation requirement, and they have come to nothing. Now, thanks to the intervention of the European Commission, we have the so-called 'Roadmap' that it is hoped will lead to the abolition of the reconciliation requirement. The development of the Roadmap is good news for European companies, even though the objective at this point in time is only

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to abolish the reconciliation requirement by 2009 at the latest.

The roadmap indicates that, in addition to a programme to converge accounting standards, robust implementation and consistent application of IFRS, high quality audits and more consistent enforcement from the EU regulators are all needed if the reconciliation requirement is to be eliminated. One might say that it is a lot to try to achieve in a very few years. The efforts should be encouraged, and we look forward to a positive outcome.

The IASB and FASB have entered into a Memorandum of Understanding that supports the Roadmap by setting out the work that the two Standard Setters have agreed needs to be undertaken to ensure that accounting standards themselves are not a reason for retaining the reconciliation requirement. That Memorandum was published in late February 2006. It has some very positive elements, including a commitment to have a comprehensive public debate on "...issues relating to measurement attributes (including cost and fair value)...beginning in 2006." EFRAG has for a long time encouraged the IASB to hold such a debate to ensure that the IASB is not moving too far ahead of its constituents. Many believe that the IASB has decided to move to full fair value, even though the IASB itself denies that such a decision has been taken. A comprehensive debate on measurement should enable that concern to be addressed. It would also enhance understanding of the measurement issue and thereby also increase the probability of an outcome supported by most of the parties involved.

The work programme set out in the IASB/FASB Memorandum of Understanding also makes it clear that convergence of the FASB and the IASB standards is a very important objective. EFRAG has consistently stated that it supports convergence as a matter of principle but not at any cost, because we believe that new or revised standards have to benefit preparers and users in the European capital markets without imposing excessive costs on European companies. It is also important to note that the work programme will mean that very many of the line items in the financial statements will be the subject of

change over the next years and the cost of that high level of change will mainly fall on all listed companies.

It is therefore very important that we in Europe engage ourselves in the global accounting debate and EFRAG is ready to take a leading role in stimulating the debate.

Working with the National Standard Setters in Europe

EFRAG and the National Standard Setters in Europe (NSS) appreciate that, if we are to utilise the limited resources available in Europe in the most efficient way possible, we need to work together more closely. This is also important because a great deal of technical knowledge and in-depth understanding of local issues resides in the standard-setting bodies, and it is important that Europe as a whole makes full use of that knowledge and understanding. In addition the NSS have well-developed contacts with their national IFRS stakeholders and therefore represent an important and valuable two-way link between the international environment and the country.

At a meeting in June 2005 EFRAG reached an understanding with the 17 NSS present that EFRAG and the NSS should work much more closely together to improve the input from Europe to the global standard-setting process. By working more closely together, it ought to be possible to enable some of the resources EFRAG and the NSS currently allocate to pro-active work to be pooled, thus enabling duplication to be eliminated and the range of pro-active work Europe as a whole carries out to be extended. It also is expected that this increased co-operation will encourage the development of common views and therefore will help to ensure, as far as is practicable, that the messages Europe gives the IASB are consistent.

We decided to call this initiative the 'Proactive Accounting Activities in Europe' (PAAinE) initiative. It was agreed that a key objective of the PAAinE should be to stimulate, carry out and manage proactive development activities that will encourage the debate in Europe on accounting matters and enhance the quality of proactive input to the IASB. A Coordinators

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committee - consisting of the chairmen from the Dutch, French, German, Polish, Spanish, Swedish, and UK Standard Setters with EFRAG chairing the activities - was formed to manage the process. That committee has decided that work should commence on four joint proactive projects:

- the Accounting Framework - to be led by France
- the classification of instruments between 'equity' and 'liabilities' - to be led by Germany
- Pension accounting - to be led by the UK
- Performance reporting - to be led jointly by Spain and EFRAG

Work on the first three of these PAAinE projects has started, and the fourth started in spring 2006. All the projects are led by staff from the standard setters involved and supported by national and international advisory groups. EFRAG is represented on all the international advisory groups, and is also providing staff support.

The progress of the projects is monitored by the Coordinators, who meet regularly to coordinate and manage the work. EFRAG also receives reports from all the meetings and debates the key issues arising on a timely basis.

In this context, it is relevant to note that even before the PAAinE initiative the German standard setter and EFRAG were working together on a proactive project funded by the Germans on revenue recognition. The objective of this work is to develop a discussion paper that will stimulate debate on the subject in Europe ahead of an IASB/FASB discussion paper that is expected to be issued later in 2006. The project has taken longer than expected, and our paper is now expected to be finalised sometime during the summer.

It was also agreed last year that the PAAinE initiative should include working together in relation to meetings with the IASB on the IASB/FASB convergence programme. Therefore EFRAG has asked the chairmen of some of the NSS to join the EFRAG delegation that has been invited to meet with the IASB to discuss convergence. Because of the amount of work that is likely to be involved, EFRAG has asked those NSS that have the resources necessary to provide robust and technical high quality input

to the IASB, but all European standard setters and others will be able to provide input. This European input will as far as possible be based on consultation but as the specific format of the meetings has not been agreed at the time of writing, it is not yet possible to determine how the work will be carried out.

Relationship with the IASB

I think EFRAG has always had a good working relationship with the IASB. However, over the last six months it has become even better and Sir David Tweedie and I now meet every three months to update each other on developments and views. These meetings are very important now that EFRAG is no longer meeting IASB board members at meetings of the Standards Advisory Council.

Meetings of former Liaison Standard Setters

When the IASB was reconstituted, seven of its Board members were designated as 'liaison board members' and the bodies with which they liaised were known as the 'Liaison Standard Setters'. The chairmen of the Liaison Standard Setters used to meet with the IASB board periodically. The notion of 'Liaison Standard Setters' no longer exists, but the former Liaison Standard Setters still meet periodically with representatives of the IASB under the chairmanship of Ian Mackintosh, the chairman of the UK Standard Setter. The agenda is technical and the meetings are in principle open to any standard setter that is willing to commit sufficient resources to participate fully in the discussions. We participate in these meetings, because it is important for EFRAG also to discuss accounting issues with players outside Europe to get a better understanding of views from other parts of the world including Japan, Canada and Australia who are all one way or the other moving towards IFRS.

The interpretation situation

The issue on interpretations was a very hot topic in 2005. Many commentators in Europe claimed that, if Europe was to implement IFRS consistently, there needed to be many more

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interpretations than IFRIC is capable of delivering. EFRAG thought this raised many fundamental questions, such as whether the objective behind Europe's move to IFRS would be defeated if European national interpretations bodies issued their own interpretations and whether an additional 'layer' of interpretations was consistent with Europe's decision to adopt a principles-based set of standards. And most important of all, was this demand for more interpretations based in fact or just a myth. The issues were discussed at a number of private meetings involving the key stakeholders, including the Commission, CESR, the big accounting firms, representatives of preparers and standard setters. The EFRAG Supervisory Board then issued a discussion paper to get a feeling of what direction Europe would like to go. In addition an EFRAG Advisory Forum (a public roundtable) was held to discuss the issue.

From the comments received on the paper and the comments made at the roundtable, it is clear that there are very divergent views. However on one matter commentators were clear: Europe does not want to have European interpretations. IFRIC should be the only body to issue interpretations. This conclusion is strongly supported by EFRAG.

Another practical outcome of EFRAG's work in this area is that the Commission has decided to set up a temporary informal roundtable that will meet on a quarterly basis to identify implementation issues that would benefit from an IFRIC interpretation. These issues would then be brought to the attention of IFRIC. This is a very similar idea to what the EFRAG Supervisory Board suggested in its discussion paper.

The reason why a debate about interpretations took place in Europe was that IFRIC has to date issued very few interpretations and each interpretation has taken more than six months to develop. Some commentators thought IFRIC should be producing more interpretations and should be producing more quickly. Regardless of the outcome of the debate in Europe, it was clear that IFRIC had to increase its capacity, find ways to move more quickly, and ensure that it focuses on the right issues - and not take on wider issues that in reality should be solved by standards rather than interpretations (such as

Service Concessions). A more transparent and streamlined agenda process was also needed.

During the course of 2005 IFRIC has addressed many of these concerns. Its staff resources have, for example, now been increased, and IFRIC is now publishing explanations when it decides not to take items onto its agenda. This is all very positive. However, we continue to have concerns. It is, for example, not satisfactory that a solution for service concessions is still not in place despite the length of time for which IFRIC has been working on the issue.

Technical agenda

SME Accounting

EFRAG has been putting a lot of effort into the IASB's project on Small and medium sized entity (SME) accounting. We initiated a Joint Working Group (JWG) with other European organisations interested in the matter and a joint chairmanship between EFRAG and



Paul Ebling -
Technical Director

FEE was established. FEE is providing the administrative support and EFRAG the technical staff support. The JWG has come quite far in its deliberations over the years it has existed and the group has some very good discussions and has responded in a very progressive way to the IASB public documents. The work in the JWG has been the basis for TEG's own deliberations on SME accounting.

One of the problems that the IASB seems to be encountering in this project is that, although everyone seems to agree that SME accounting should be based on a simplified version of IFRS, there is no agreement on what those simplifications should be. In order to help the IASB by providing it with a more consistent message from Europe, EFRAG has provided proposals for simplifications and in addition we have organised meetings of the European members of the IASB Advisory Group on the SME project. There have been some good exchanges of views at these meetings and, we

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understand, a greater degree of agreement amongst the Advisory Group members has resulted. Unfortunately, lately the IASB project has developed in a way that many think could make the resulting standard inappropriate for use in Europe. The European members of the Advisory Group have therefore encouraged the IASB to reconsider some of the tentative decisions it has taken. EFRAG has supported these efforts by writing to the IASB outlining our proposals as to the way forward.

The SME project is very important to Europe because SME accounting affects very many enterprises in Europe and nowadays many SMEs are involved in cross-border transactions and therefore converged rules for SME accounting will be beneficial for the economy. Various European countries have issued new standards for SME accounting and other countries have implemented the EU's Accounting Directives differently for SMEs. As a result, the accounting rules for SMEs in Europe differ from country to country. The most obvious set of accounting rules for Europe to adopt for convergence purposes are those developed by the IASB for use by SMEs. However to move in the direction of implementing an IASB standard in Europe for SMEs is not without complications from a legal point of view, which makes it important that the standard clearly meets European needs if it is to be worthwhile overcoming the other obstacles. It is clear that those needs include more simplifications than the IASB has to date tentatively decided to permit. The objective of such simplifications should be to make the financial statements a lot easier to prepare (compared to full IFRS financial statements) while still showing a true and fair view of the entity's result and the economic position.

Financial Instruments

In my last report I discussed at some length financial instruments. The IASB has been less active in this area in 2005. That is primarily because the IASB has decided that it does not want to continue to make piecemeal amendments ('repair work') to IAS 39.

To some extent this decision is understandable - the IASB has only a limited amount of resources

and will not be able to progress other parts of its agenda as quickly if it is continually making minor amendments to IAS 39. It is nevertheless unfortunate that the IASB is reluctant to undertake repair work in the first year in which the most complex of all its standards is being used extensively for the first time, even though experience shows that it is in the first year that most of the practical problems tend to be identified. IAS 39 is based on a US standard that was developed for use in a US environment and might therefore be more suited to the US banking environment than to the European banking environment. Bearing in mind that possibility, I would have thought it appropriate not to rule out repair work at this point in time.

When IAS 39 was endorsed for use in the EU, two sections of it were excluded ('carved out') from the endorsed standard. The carved out sections related to the 'fair value option' and the hedge accounting requirements. The fair value option was subsequently amended by the IASB and in effect 'carved back in' when the revised fair value option was endorsed.

The amendment was supported by all the involved parties and was seen as an acceptable basis for making the fair value option available, whilst at the same time addressing concerns expressed about the unrestricted nature of the original option. The IASB should be praised for its commitment and determination in resolving the European problem on this issue. The IASB reacted with impressive speed and determination in its attempt to support the European adoption.

EFRAG views it as regrettable that discussion on hedge accounting has not yet resulted in a proposal that would enable the hedging carve



TEG

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out to be removed. It would therefore encourage discussions to be continued between key stakeholders, including the IASB and the European Banking Federation, on the issues involved in order to find a solution that satisfies the banks generally and of course the users of financial reports.

Service concessions

Accounting for service concessions also needs to be mentioned. Europe has been asking for some definitive material on the subject from the IASB or IFRIC agenda almost from the very day the Regulation was approved. IFRIC has been working on the issue for a long time - surely a sign that the existing standards are not well suited to service concession arrangements - and in the mean time companies involved in service concessions have been left to find their own way through those standards. That seems very unsatisfactory.



TEG

Business combinations

In July 2005 the IASB issued jointly with the FASB an Exposure Draft on Business Combinations (the so-called phase II Business Combinations project). The Exposure Draft proposed one of the biggest changes in accounting in the history of the international standards issued at the time we in Europe are implementing the IFRS in our reporting framework. It is unfortunate that the IASB is proposing, at this particular point in time, to move the frontiers of accounting so significantly, especially when the necessary discussions have not taken place on the underlying concepts - such as fair value, full

goodwill, the entity concept, and stand ready obligations - in the context of the accounting framework overall. We also have very significant reservations about the proposals.

We are - as mentioned above - in favour of fundamental debates taking place about measurement and the other issues mentioned above, although we are not in favour of any major changes to IFRS being implemented at the current time because we think that what European companies need now most of all is a period of stability.

*European companies
and auditors need a period
of stability*

Performance reporting

Since the end of 2005 the IASB has issued ED 9 Performance Reporting. Initially the IASB had intended to propose in this exposure draft that companies prepare a single performance statement covering income, expenses and other comprehensive income, but eventually decided for the time being to allow companies the choice of presenting one or two statements.

The matter will now be addressed in a discussion paper expected at the end of 2006. This is a very controversial issue in Europe and, for that reason, we have decided to start a PAAInE project on the subject so that Europe can start debating the issues now and provide high quality input in the future debate.

IFRIC 3 Emission Rights

IFRIC issued IFRIC 3 Emission Rights in early 2005. At an early stage of the project we had told the IASB/IFRIC that we had serious doubts about the direction in which the then draft interpretation was moving and we had numerous discussions with the IASB to try to ensure our concerns were understood but nevertheless the interpretation was issued. We then evaluated the interpretation against the endorsement criteria and decided that we could not recommend to the European Commission that IFRIC 3 should be endorsed. Fortunately the IASB then decided to withdraw IFRIC 3.

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The endorsement situation

During 2005 several standards and interpretations were issued by the IASB and IFRIC and recommended by EFRAG for endorsement. However, for various reasons the endorsement of a number of these standards and interpretations was delayed. Companies have to plan and execute the implementation of new standards and interpretations and this can be a very demanding and time consuming process for international groups. It may also be difficult if not impossible to capture all the necessary data to be able to comply fully with a new standard. As a result, it is important that there is as much certainty as possible about when standards will be endorsed and also plenty of time to implement the standards. Towards the end of 2005 delays in the endorsement process created uncertainty and gave companies little time to plan ahead.

We made the Commission aware of the situation and encouraged it to find ways of speeding the process up both for the last months of 2005 and permanently. The Commission found ways of endorsing all the material issued for use in 2005 and of making it possible for companies with December 2005 year-ends to use standards endorsed in January 2006 in their 2005 financial statements. We commend the Commission for finding a satisfactory solution to this issue. EFRAG started to post an 'Endorsement Status Report' on its website so that constituents are regularly updated on the endorsement situation. We continue to update the report on a regular basis.

***EFRAG issues an 'Endorsement Status Report' on its website
(www.efrag.org)***

As already mentioned, one of the two IAS 39 carve-outs was resolved during the year when the IASB issued and the Commission endorsed an amendment to IAS 39's fair value option. EFRAG also worked hard to ensure that the amended option was endorsed in time for it to be implemented in 2005 financial statements, proposing in particular the use of a fast track endorsement procedure that was supported by all parties.



TEG

Administrative issues

In summer 2005 EFRAG moved into new offices in Avenue des Arts 13-14. The new offices meet EFRAG's needs very well and provide a pleasant working environment. Furthermore, we can now host the meetings of the TEG, the Supervisory Board and our working groups in the offices, which makes the organisation of meetings much easier.



We are in the process of engaging additional staff, which will ensure that we can deal with more issues in greater depth. However, to be sure of meeting expectations it is important that the additional funding for EFRAG is put in place very soon. In spite of the small number of staff we currently have, I believe that the quality of the technical work has been very high over the last year and I would like to thank the staff for a very strong performance in 2005. The positive spirit in the secretariat is a credit to the whole team.

Stig Enevoldsen
19 April 2006

□ EFRAG Publications and Activities 2005

EFRAG Publications 2005	Draft Comment Letter	Final Comment Letter	Draft Endorsement Advice	Final Endorsement Advice
IFRSs				
Amendments IAS 19 - Employee Benefits				17-Jan
IFRS 6 - Exploration for and Evaluation of Mineral Resources				10-Feb
IFRS 7 - Financial Instruments: Disclosures			8-Sept	10-Oct
IAS 39 - Transition and Initial Recognition of Financial Assets and Financial Liabilities				11-Feb
IAS 39 - Cash Flow Hedge Accounting				22-June
IAS 39 - Fair Value Option			20-Apr	20-June
Amendments to IFRS 1 and IFRS 6	12-May	3-June	14-July	16-Sept
IFRS 3 - Business Combinations Phase II	5-Aug	28-Nov		
Amendments to IAS 37 and IAS 19 (Business Combinations Phase II)	5-Aug	28-Nov		
Amendments to IAS 1 - Presentation of Financial Statements: Capital Disclosures			8-Sept	10-Oct
Amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts			13-Sept	24-Oct
IFRICs				
IFRIC 2 - Co-operative Entities				17-Jan
IFRIC 3 - Emission Rights			22-Feb	6-May
IFRIC 4 - Determining a Lease				15-Feb
IFRIC 5 - Interests in Decommissioning Funds				15-Feb
IFRIC 6 - Waste Electrical and Electronic Equipment		11-Feb	9-Sept	10-Oct
IFRIC 7 - Applying the Restatement Approach under IAS 29			9-Dec	
IFRIC D7 - Scope of SIC12				4-Jan
IFRIC D11 - Changes in Contributions to ESPPs				
IFRIC D12 - D14 - Service Concession Arrangements	22-Mar	24-May		
IFRIC D15 - Reassessment of Embedded Derivatives	6-May	21-June		
IFRIC D16 - Scope Of IFRS 2	1-June	18-July		
IFRIC D17 IFRS 2 - Group and Treasury Share Transactions	1-June	18-July		
Other Publications				
SME questionnaire on Possible Recognition and Measurement Modifications	19-May	7-July		
CESR Recommendation on Alternative Performance Indicators	1-June	20-July		
CESR Technical Advice on Equivalence	3-June	20-July		
IFRIC Review of Operations	3-June	2-Aug		
Due Process of IASB	3-June	2-Aug		
MoU Role of Accounting Standard Setters	3-June	2-Aug		
Draft Technical Correction 1: proposed amendments to IAS 21	12-Oct	14-Nov		
Publications without full due process				
CESR Equivalence Project		3-Jan		
IASCF Constitutional Review		11-Mar		
FEE paper on IFRS Reporting Issues		31-May		
Proactive Activities in Europe		27-June		
Achieving Consistent Application of IFRS in the EU		27-July		
IASB Work Programme		30-Sept		
IASB [proposed] Policy on Technical Corrections		3-Oct		

Letters issued in 2005		Activities		
Draft comment letter	14	Technical Meetings	TEG	11
Final comment letter	19		Standard setters	5
Draft endorsement letter	8		Working groups	23
Final endorsement letter	15		Others	30
Discussion papers	1	Speeches/Meetings/Events	Chairman	52
Others	2		TEG members	14
TOTAL	59		Staff	17

Financial Instruments Working Group

2005 was another busy year for financial instruments accounting, with the IASB issuing several amendments to and interpretations of IAS 39, a new disclosure standard (IFRS 7), and commencing new projects on fair value measurement guidance and the equity/liability split. In addition, work has been carried out directed towards eliminating the hedge accounting carve out.

EFRAG's Financial Instruments Working Group has been active on all these issues and met five times in 2005. For example, it took part in EFRAG's consultation process on the IASB's various proposals for new standards, amendments to standards and IFRIC interpretations. It also provided advice to TEG on the endorsement of the various final statements issued by the IASB and IFRIC. This included the fair value option amendment to IAS 39, the endorsement of which enabled one of the two sections of IAS 39 that were not endorsed for use in the EU (the carve outs) to be endorsed in its amended form. The Group has also been monitoring closely the ongoing discussions between the FBE and the IASB on the former's interest rate margin hedging proposals, and has met several times with the FBE to discuss the proposals.

The Working Group also met with European Association of Corporate Treasurers to consider some non-banking issues arising from the application of IAS 39 and how those issues might be addressed. The Group will continue following the developments in this area.

Insurance Accounting Working Group

The key objectives of EFRAG's Insurance Accounting Working Group are to help EFRAG contribute pro-actively to the work of the IASB and IFRIC based on a European background and to identify interpretation and implementation issues on insurance specific matters. The working group met 6 times in 2005.

IFRS currently does not deal comprehensively with insurance accounting. (The IASB has issued IFRS 4 Insurance Contracts, but that is an interim standard designed to enable insurance companies to transition to IFRS with the minimum number of changes in

accounting practice pending the development of a comprehensive standard.) EFRAG believes that the development of that comprehensive standard should be regarded as a priority by the IASB. The first step will be the publication of an IASB discussion paper (perhaps by the end of 2006), a final standard is still some time off.

The EFRAG Working Group has been following closely the work of the IASB and its Insurance Working Group, and at the same time has been studying the views being expressed by other influential commentators. During this process the objective has been to understand the issues involved, the approach being taken by the IASB and any alternative approaches that perhaps merit consideration. From mid-2006 the Working Group will start discussing the issues with EFRAG TEG so that the TEG will be in a position to respond to the discussion paper when it is issued.

In 2005 the EFRAG Insurance Accounting Working Group also took part in EFRAG's consultation process on insurance-related issues, including, for example, Amendments to IAS 39 and IFRS 4 Financial Guarantee Contracts and Amendments to IAS 39 Fair Value Option.

Revenue Recognition Working Group

In 2004 EFRAG together with the German Standard Setter DRSC (Deutsches Rechnungslegungs Standards Committee) set up a working group on this fundamental project. There is a need to modernise the existing literature and fill gaps currently in IAS 18 and IAS 11. It is very likely that a new approach will be in line with the existing Framework - which is also undergoing a revision - and will be based on an asset and liability concept.

EFRAG's objective is to develop a discussion paper in time for the European community to become familiar with the issues discussed and stimulate a pan-European debate at an early stage. This work can be seen as part of EFRAG's pro-active role.

The working group had six meetings in 2005 directed towards the issue of a discussion paper before the late summer. As often, things have proved to be more complicated - also for the IASB and FASB - so that the timetable has had to be revised. In addition, the working structure has been adjusted in so far as a larger portion of the drafting work is now done by the staff of EFRAG and the DRSC.

□ Report on the EFRAG Working Groups

The main working principle remains unchanged: a future standard on revenue recognition will not only have to be conceptually well founded, but also will have to be based on clear principles that are capable of being applied in a consistent manner to all revenue-generating transactions and arrangements.

Service Concessions Working Group

The Service Concessions working group aims to assist at an early stage to IFRIC's work by formulating technical input on this complex issue. The group met twice in 2005.

As an outcome of these working group meetings and deliberations at TEG, EFRAG sent a comment letter to the IFRIC draft Interpretations D12-D14.

Despite the specialised nature of the subject, Concessions is seen by many as a priority for the Board's or IFRIC's attention. There is much activity in this field in many different countries; the activity is growing and the arrangements take many different forms.

The key concerns expressed in the different comment letters were:

- The scope of the interpretations is too narrow
- Basis for recognition of property, plant and equipment
- Dividing line between the financial and intangible models, ie the determination of the appropriate accounting model being dependent on whether the grantor or a third party has primary responsibility to pay
- The 'double' recognition of revenue

SME Joint Working Group

The SME Joint Working Group was established in 2004 as a joint working group of several organisations with FEE and EFRAG as the leaders. The group represents users, preparers, accountants, the European Commission and National Standard Setters. The working group's aim is to contribute to the development of accounting standards for SMEs that are suitable for use in Europe.

The group met twice in 2005. The objective of the meetings was mainly to discuss the IASB Board's tentative decisions on recognition and measurement simplifications for IFRS for SMEs

and to decide whether or not EFRAG should concur with them.

The main concerns from EFRAG run as follows:

- (a) the direction in which the project is presently heading would result in a standard which is far too lengthy and complex; and
- (b) more simplification is needed than has to date been proposed in order to meet constituents' expectations.

This project is very important for Europe and EFRAG will continue to contribute to it, in order to have easy to understand and comprehensive stand-alone standards for SMEs.

Venture Capital Investments Working Party

The Working Party established in 2004 continued its work in 2005 considering various alternatives to account for investments made by venture capital companies and similar companies. The Working Party substantially completed its work in late March 2005 and concluded that there were several reasons for not consolidating venture capital investments. Both conceptual and practical reasons were highlighted. Also convergence reasons were mentioned, as both US GAAP and Canadian GAAP exempt venture capital investments from consolidation.

These and other reasons were developed by the staff in a draft document setting out various alternatives as to how to best serve user needs when accounting for venture capital investments. After further input from the Working Party the draft document was discussed in the TEG in the middle of April 2005. The TEG was broadly supportive of the document, but highlighted a couple of points that needed to be tidied up.

Staff continued working with the document, which was discussed with the liaison standard setters with a view thereafter to be handed over to the IASB for consideration. The liaison standard setters have generally found the document not to be convincing enough and have indicated that further work would be needed to strengthen the arguments supporting the tentative positions taken in the document. The staff has continued working with the document.

EUROPEAN FINANCIAL REPORTING ADVISORY GROUP (EFRAG)
Abbreviated Financial Statements as of 31 December 2005

Income Statement	2005 '000 €	Restated 2004 '000 €
Members' Contributions	1050	1000
Personnel costs	-909	-814
Office costs (restated 2004 with - 95,000 €)	-90	-112
Meeting costs	-40	-50
Other costs	-77	-40
Operating Expenses	-1116	-1016
Operating Loss	-66	-16
Financial Result (2004 restated with 10,000 €)	11	12
Net Loss/Profit	-55	-4

Balance Sheet	31 Dec. 2005 '000 €	31 Dec. 2004 '000 €
Total Fixed Assets	73	10
Total Current Assets	912	1012
Total Assets	985	1022
Accumulated surplus before restatement	790	610
Restatement	-	235
Accumulated surplus restated	790	845
Creditors (2004 restated)	195	177
Total Liabilities	985	1022

The financial highlights are based on statutory financial statements audited by Deloitte, Belgium.

Note: The statutory financial statements for 2005 include certain items related to 2004 or earlier years. The Financial Highlights above have been adjusted for these errors and the 2004 figures have been restated in order to present the actual result of the year(s).

□ Appendices

■ TABLE 1

EFRAG Founding Fathers / Member Bodies ¹	
UNICE	Union of Industrial and Employers' Confederations of Europe
ERT	European Round Table
FEE	European Federation of Accountants
FESE	Federation of European Securities Exchanges
EFFAS	European Federation of Financial Analysts Societies
CEA	European Insurance Organisation
FBE	European Banking Federation
ESBG	European Savings Banks Group
EACB	European Association of Co-operative Banks
UEAPME	European Association of Craft Small- and Medium-sized Enterprises
EFAA	European Federation of Accountants and Auditors

■ TABLE 2

EFRAG Supervisory Board Members ¹			
Göran Tidström, Chairman	PWC Sweden	John Glen, Deputy Chairman	UNICE/ERT
Paul Arlman	FESE	Chris de Noose	ESBG/WSBI
Philippe Crouzet / Patrice Marteau	UNICE/ERT	Guido Ravoet	FBE
David Devlin	FEE	Peter Sampers	UNICE/ERT
Javier de Frutos	EFFAS	Jos Streppel	CEA
Hervé Guider	EACB	Maija Torkko	UNICE/ERT
Klaus-Günther Klein	FEE	Hans van Damme	FEE
David Lindsell	FEE	Jan Verhoeve	EFAA/UEAPME

Advisors

Jérôme Chauvin	UNICE	Patricia Plas	CEA
Paul Chisnall	FBE	Marcel Roy	EACB
Robin Jarvis	EFAA/UEAPME	Saskia Slomp	FEE
Simon Recker	ESBG/WSBI	Wilfried Wilms Secretary to the SB	FBE

Observer

European Commission

¹ The CFA Institute joined at the beginning of 2006.

■ TABLE 3

EFRAG TEG Members ²		
Stig Enevoldsen, Chairman	Denmark	Auditor
Mike Ashley	UK	Auditor, Member of the UK ASB
Françoise Flores	France	Industry
Catherine Guttmann	France	Insurance Advisor
Hans Leeuwerik	The Netherlands	Industry
Ugo Marinelli	Italy	Auditor / Academic
Thomas Naumann	Germany	Banker
Thomas Seeberg	Germany	Industry
Friedrich Spandl	Austria	Financial Analyst
Mike Starkie	UK	Industry
Dominique Thouvenin	France	Auditor

NON VOTING MEMBERS AT TEG MEETINGS (Chairmen of large National Standard Setters):

Klaus Pohle	GASB
Antoine Bracchi	CNC
Ian Mackintosh	ASB

NON VOTING OBSERVERS INVITED AT TEG MEETINGS

European Commission
CESR

² End of March 2006, Anna Sirocka (auditor, Poland) and Manuel García-Ayuso (academic, Spain) succeeded Ugo Marinelli and Friedrich Spandl. On 1 January 2006 Harald Wiedmann succeeded Klaus Pohle as Chairman of the German standard setter (GASB).

TABLE 4

EFRAG Members of IASB Working Groups	
Financial Instruments	Thomas Naumann
Insurance	Catherine Guttmann
Interest Rate Margin Hedge	Stig Enevoldsen / Paul Ebling
Performance Reporting	Françoise Flores
SME	Gerhard Prachner

TABLE 5

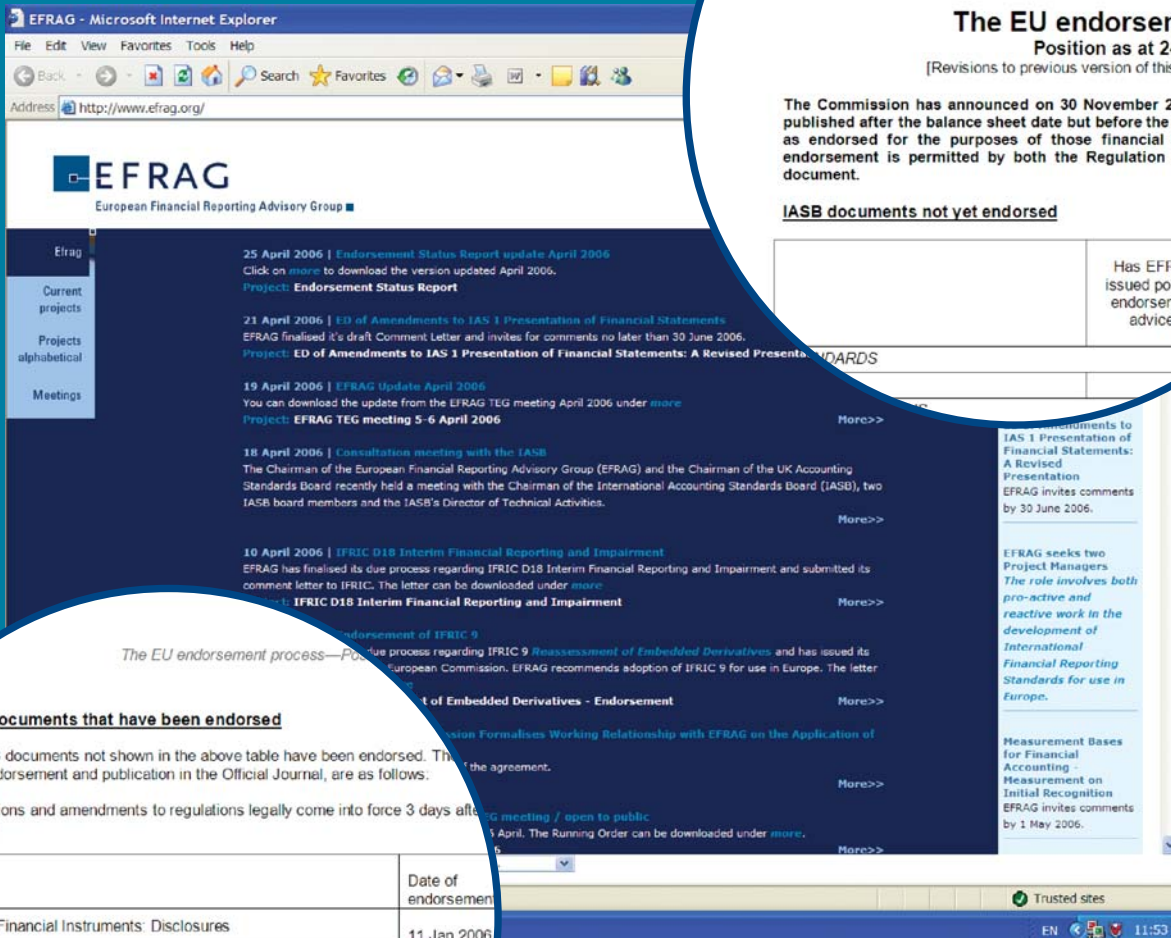
EFRAG Secretariat*	
Stig Enevoldsen, Chairman	stig@efrag.org
Paul Ebling, Technical Director	paul@efrag.org
Reinhard Biebel, Assistant Technical Director	reinhard.biebel@efrag.org
Sigvard Heurlin, Senior Project Manager	sigvard.heurlin@efrag.org
Svetlana Boysen, Project Manager	svetlana.boysen@efrag.org
Bart De Leeuw, Project Manager	bart.de.leeuw@efrag.org
Nathalie Saintmard, Office Assistant	nathalie.saintmard@efrag.org

* In March 2006, Svetlana Pereverzeva and Knut Tonne joined the team on secondment as project managers.

TABLE 6

Members of EFRAG Working Groups
<p>Financial Instruments</p> <p>Thomas Naumann - Preparer (KG Allgemeine Leasing), David Bradbery - Preparer (UBS Investment Bank), Isabelle Collignon - Preparer (Crédit Agricole SA), Petri Hofste - Auditor (KPMG), Gordon Ireland - Auditor (PWC), Victor Jimenez - Preparer (Banco Bilbao Vizcaya Argentaria), Ingvar Linse - Preparer (Swedbank), Helmut Ortolf - Preparer (DZ Bank AG), Massimo Romano - Preparer (Assicurazioni Generali), Hugh Shields - Preparer (Barclays Capital), Agnes Tardos - Auditor (PWC), Paul Ebling (EFRAG), Svetlana Boysen (EFRAG). In addition, the EU Commission, CESR and CEBS attend the meetings as observers.</p>
<p>Insurance Accounting</p> <p>Benoit Jaspas - Preparer (Assicurazioni Generali), Bernard Bolle-Reddat - Preparer (BNP-Paribas), Ruurd Van den Berg - Preparer (AEGON), Jacques LeDoutit - Preparer (AXA), Hugh Francis - Preparer (AVIVA), Catherine Guttmann - Auditor (Deloitte), Joachim Kölschbach - Auditor (KPMG), Nigel Masters - Auditor (PWC), Carsten Zielke - User (WestLB), Paul Ebling (EFRAG), Svetlana Boysen (EFRAG). In addition, the EU Commission, CESR, CEIOPS, and the CEA attend the meetings as observers.</p>
<p>Revenue Recognition</p> <p>Prof. Klaus Pohle - Standard Setter (GASB), Dr. Mareike Kühne - Standard Setter (GASB), Prof. Jens Wüstemann (University of Mannheim), Sonja Kierzek (University of Mannheim), Prof. Sven Hayn - Auditor (Ernst & Young), Andrew Lennard - Standard Setter (ASB), Patrick Petit - Standard Setter (CNC), Jerome Chevy - Standard Setter (CNC), Martin Noordzij - Preparer (CAR), Paul Ebling (EFRAG), Sigvard Heurlin (EFRAG), Reinhard Biebel (EFRAG).</p>
<p>Service Concessions</p> <p>Hans Leeuwerik - Preparer (TEG member), Hans Kurt Bergheimer - Preparer (Bilfinger Berger), Jan Backhuijs - Auditor (DASB), David Loweth - Standard Setter (ASB), Gérard Duhamel - Preparer (FIEC), Jorge Herreros - Auditor (KPMG), Annette Davis (EC), Jesus Herranz - Preparer (E-Seopan), Jean-Louis Lebrun - Auditor (Mazars), Philippe Hubert - Preparer (Veolia), Antoni Reczek - Auditor (PWC), Sigvard Heurlin (EFRAG), Bart De Leeuw (EFRAG).</p>
<p>SME Joint Working Group</p> <p>Françoise Flores - Preparer (TEG member), Hans van Damme - Auditor (FEE), Jean-Pierre Boucquet - User (Dexia), Jose Maria Bove - Auditor (Bové Montero y Cia), John Bowen-Walsh - Auditor (ICAI), Carl-Gustaf Burén - Preparer (Svenkst Näringsliv), Christine Darville - Preparer (FEB/BVO), Annette Davis (EC), Sarah De Greef - Preparer (FEB/BVO), Dirk Dekker - Preparer (SHV Holdings), Isabelle Ferrand - Preparer (CNCFM), Henri Giot - Auditor (OEC), Franz Gross - Preparer (Österreichischer Genossenschaftsverband), Signe Haakanes - Auditor (Den norske Revisorforening), Jorge Herreros - Auditor (KPMG), Robin Jarvis - Academic (ACCA), Solvy Mayr - Preparer (BDI), Felix Mayrhofer - User (Sparkassen-Prüfungsverband), Helmut Ortolf - Preparer (DZ Bank), Jens Poll - Auditor (Dres Brönner Treuhand-Revision), Gerhard Prachner - Auditor (PWC), Päivi Rätty - Preparer (Finnish Accounting Board), Simon Recker - User (ESBG), Fabienne Renaud-Aidan - Standard Setter (CNC), Stefan Reymer - Auditor (IdW), Marcel Roy - User (EACB), Isobel Sharp - Auditor (Deloitte), Saskia Slomp (FEE), Hugo C. Van Den Ende - Standard Setter (DASB), Willem H. Van Leeuwen - Preparer (SHV Holdings), Catherine Ameye (FEE), Chiara Pisano (FEE), Bart De Leeuw (EFRAG).</p>
<p>Venture Capital Investment</p> <p>Mike Brown - Preparer (3i), Annie Lambrecht - Auditor (E&Y), Pierre Hervé - Preparer (Natexis), Heidi Lepäntalo - Preparer (CapMan), Sigvard Heurlin (EFRAG), Bart De Leeuw (EFRAG).</p>

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	Date of endorsement
IFRS 7 Financial Instruments: Disclosures	11 Jan 2006
IFRIC 6 'Waste Electrical and Electronic Equipment'	11 Jan 2006
Amendments to IFRS 1 and IFRS 6	11 Jan 2006
Amendments to IAS 39 and IFRS 4: Financial Guarantee Contracts	11 Jan 2006
Amendment to IAS 1: Capital Disclosures	11 Jan 2006
Amendment to IAS 39 'Cash Flow Hedge Accounting'	27 Jan 2006
Amendment to IAS 39: The Fair Value Option	27 Jan 2006
IFRIC 5 'Interests in Decommissioning Funds'	27 Jan 2006