

## Part M) The Transition to IFRS

(amounts in thousands of €)

Under EU Regulation 1606 issued on 19 July 2002, the UniCredit Group is required to prepare its consolidated accounts in accordance with the IFRS issued by the IASB.

This section gives, as required by IFRS 1 (First-time Adoption of International Financial Reporting Standards):

- reconciliations of its equity as reported under Italian GAAP (Legislative Decree 87/92) to its equity under IFRS as at 1 January 2004, 31 December 2004 and 1 January 2005;
- a reconciliation of its profit or loss as reported under Italian GAAP (Legislative Decree 87/92) to its profit or loss under IFRS as at 31 December 2004 and
- explanatory notes on the main material adjustments to the balance sheet and income statement for the specified periods.

This information has been prepared as part of the IFRS transition process and for the preparation of consolidated accounts starting with the 2005 financial year, in accordance with the IFRS adopted by the EU.

(€ '000)

|   | SHAREHOLDERS' EQUITY AS AT |                   |                   |
|---|----------------------------|-------------------|-------------------|
|   | 1 JAN. 2004                | 31 DEC. 2004      | 1 JAN. 2005       |
| <b>Shareholders' equity under current GAAP (DL 87/92)</b>               | <b>13,012,557</b>          | <b>14,035,345</b> | <b>14,035,345</b> |
| Business combinations   | 37,519                     | 302,000           | 302,000           |
| Property, plant and equipment   | 74,587                     | 53,947            | 53,947            |
| Intangible assets   | -12,904                    | -10,142           | -10,142           |
| General banking risk reserve  | -8,408                     | -                 | -                 |
| Loan loss provision   | 46,116                     | -                 | -                 |
| Provision for risks and charges   | 64,346                     | 39,914            | 39,914            |
| Employee benefits   | -49,098                    | -38,476           | -38,476           |
| Share-based payments  | -30,537                    | -62,642           | -62,642           |
| Treasury shares   | -                          | -                 | -358,416          |
| Deferred tax assets   | 160,453                    | 11,407            | 11,407            |
| Recognition of revenue  | -189,452                   | -116,374          | -116,374          |
| Consolidation   | 48,677                     | 55,046            | 32,026            |
| Equity investments  | -                          | -                 | 1,081,331         |
| Loans and receivables and other financial instruments at amortised cost | -                          | -                 | -607,373          |
| Other financial instruments at fair value                               | -                          | -                 | 25,428            |
| Other effects   | 15,132                     | 34,458            | 36,612            |
| Minorities  | -48,162                    | -55,370           | -51,878           |
| <b>Total effects of Transition to IFRS</b>                              | <b>108,269</b>             | <b>213,768</b>    | <b>337,364</b>    |
| <b>Shareholders' equity under IFRS</b>                                  | <b>13,120,826</b>          | <b>14,249,113</b> | <b>14,372,709</b> |



(€ '000)

| <b>RECONCILIATION OF NET PROFIT UNDER ITALIAN GAAP (LD 87/92) TO NET PROFIT UNDER IFRS FOR THE 2004 FINANCIAL YEAR</b> |                  |
|--|------------------|
|  | <b>2004</b>      |
| <b>Net profit under Italian GAAP (LD 87/92)</b>  | <b>2,130,516</b> |
| Business combinations  | 283,013          |
| Property, plant and equipment  | -18,555          |
| Intangible assets  | 2,252            |
| General banking risk reserve   | -124,593         |
| Loan loss provision  | -46,116          |
| Provision for risks and charges  | -24,454          |
| Employee benefits  | 10,622           |
| Share-based payments   | -40,253          |
| Deferred tax assets  | -149,047         |
| Recognition of revenue   | 73,412           |
| Consolidation  | 2,193            |
| Other effects  | -29,400          |
| Minorities   | -859             |
| <b>Total effects of Transition to IFRS</b>   | <b>-61,785</b>   |
| <b>Net profit under IFRS</b>   | <b>2,068,731</b> |

## Description of items included in reconciliation of Italian GAAP to IFRS

### FIRST-TIME ADOPTION OF IFRS

#### GENERAL PRINCIPLE

The IFRS in force as at 30 June 2005 have been applied retrospectively to the opening balance sheet on the transition dates of 1 January 2004 and 1 January 2005 (date of first application of IAS 39 – Financial Instruments: Recognition and Measurement, and IAS 32 – Financial Instruments: Disclosure and Supplemental Information) in accordance with the provisions of IFRS 1 and subject to certain exemptions as described below.

The balance sheet figures resulting from the application of IFRS on the above dates will be used for comparison purposes in the preparation of consolidated accounts as at 31 December 2005. These amounts could be subject to other changes that may be necessary if any international accounting standard is revised or modified during the second half of 2005. New versions or interpretations of IFRS may be issued prior to the publication of the consolidated accounts as at 31 December 2005 with a potential retroactive impact. In this case, there could be an impact on the balance sheet and profit and loss account for 2004, which were restated according to the IFRS presented in this report.

The opening balance sheet as at 1 January 2004 and 1 January 2005 (the latter for IAS 32 and 39 only) reflects the following differences in treatment from the closing consolidated accounts for the preceding period (31 December 2003 and 31 December 2004 respectively) prepared under Italian GAAP:

- all assets and liabilities that shall be reported according to IFRS, including those not required by Italian GAAP, were recognised and measured under IFRS;
- all assets and liabilities that shall be reported under Italian GAAP but are not allowed under IFRS have been derecognised;
- certain items have been reclassified in accordance with IFRS.

The effects of these adjustments have been recognised directly in the opening shareholders' equity on the date of the first application of IFRS (1 January 2004 and 1 January 2005).

### FIRST-TIME ADOPTION OF IFRS

IFRS 1 (First-time Adoption of IFRS) allows for certain exemptions when IFRS are applied in full for the first time.

This option was used in the following instances:

- Business combinations – The rules for business combination transactions that occurred prior to the transition date (1 January 2004) were not applied retroactively; the latest carrying amount of goodwill was maintained under previous GAAP.
- Property – On the date of first adoption, property was reported at purchase cost less accumulated depreciation and any impairment losses, including any revaluations applied in the past. The exemption allows for maintaining any revaluations made in the past as an integral cost component at the time of initial adoption.
- Recognition of previously derecognised financial assets – IAS 39 permits the derecognition of financial assets only under certain conditions. At the time of the first-time adoption of IFRS, IAS 39 indicates that loans securitised under transactions entered into before 1 January 2004 do not need to be reported again even though IAS 39 requires loans of this type to be repeated in accounts.

- Stock option plans and transactions with share-based payment settled using equity instruments – The Group took advantage of the option not to apply IFRS 2 (Share-Based Payment) to equity instruments allocated before 7 November 2002 or accrued prior to transition to IFRS.
- Employee benefits: IAS 19 (Employee Benefits) allows for the usage of the ‘corridor’ approach, and thus, a portion of actuarial gains and losses does not have to be reported. This exemption allows for the use of this method only for periods following the first application, and thus, all accumulated actuarial gains and losses as at 1 January 2004 were recognised at the time IAS was first adopted.
- Financial instruments: IAS 32 and 39 were applied effective from 1 January 2005.

## TANGIBLE AND INTANGIBLE ASSETS

### Business Combinations

As indicated above, the use of the exemption provided under IFRS 1 regarding business combinations that occurred prior to the date of the first adoption of IFRS (1 January 2004) made it possible to maintain existing goodwill amounts based at their latest carrying value under previous GAAP. However, in accordance with IFRS 3, the goodwill reported in accounts is not subject to regular straight-line amortisation but is instead subject to a periodic impairment test with the aim of determining the recoverable value of goodwill based on the provisions of IAS 36. The outcome of this test on goodwill reported resulted in a decrease of €26.5 million in shareholders’ equity as at 1 January 2004. In addition, the amortisation reported in 2004 was reversed, with a related positive impact on net profit and shareholders’ equity at the end of the period.

In addition, IFRS specify that any positive difference between the value of assets acquired and the cost of the equity investment shall be recognised directly in profit or loss. Thus, negative consolidation differences, which under previous GAAP was reported as a balance sheet liability, was transferred to a income-related reserve on the transition date of 1 January 2004.

### Property, plant and equipment

IFRS specify that items of property, plant and equipment shall be depreciated as a function of their useful life taking into account, if applicable, any individual components of such assets which have a different useful life. This made it necessary to separate the value of land from the buildings on the land. This is because land has an unlimited useful life that should not be depreciated. Depreciation attributable to the land component was restored with a resulting positive impact on shareholders’ equity as at 1 January 2004 and on the net profit for 2004 and shareholders’ equity as at 31 December 2004. Adjustments to the carrying amount of property, plant and equipment include the effect of deferred tax.

### Derecognition of Capitalised Costs

IFRS specify that intangible assets may continue to be recognised in the balance sheet if they are related to controllable resources and capable of generating future economic benefits, and if their cost can be reliably determined. The application of this principle resulted in the derecognition of certain categories of intangible assets that were previously capitalised with a resulting negative impact on shareholders’ equity as at 1 January 2004 and on the related amortisation for the 2004 reporting year.

## FINANCIAL INSTRUMENTS

### Loans and receivables

Loans and receivables with banks and customers are classified as such under IFRS (from 1 January 2005) with the following exceptions:

- the portions of loans and receivables resulting from repo transactions and interbank time deposits are classified as HfT financial assets;
- loans and receivables related to certain 'large corporate' loans are classified as HfT or AfS financial assets;
- the FIAT convertendo bond and its embedded option rights are recognised as FlaFV through profit or loss. The negative impact on shareholders' equity is €252.7 million, about €71.7 million more than allowances made under previous GAAP as at 31 December 2004 (€181 million, included in adjustments to the carrying amount of performing loans).

Loans and receivables with customers also included the amount of assets leased under finance leases.

Accounts as at 1 January 2005 also include about €3 billion in loans securitised in 2004, since the securitisation did not meet the conditions specified in IAS 39 for the derecognition of financial assets.

Due to the valuation of this item at amortised cost, accrued interest as well as related accrued and deferred fees that were accruing on 31 December 2004 were allocated to these loans.

In addition, when measured under IFRS, these loans give rise to a writedown, in contrast to calculations made under previous GAAP, due to the impact of the specific measurement of bad and doubtful debts. This allowance was made taking into account the time value of money in respect of recovery of the debt.

In particular, for non-performing loans, assumptions were made on recovery times based on historical information and on other significant characteristics. The related recovery amounts were then discounted at the original actual interest rate, or if not available, at an interest rate calculated using lending rates for the year the loan was classified as non-performing.

With regard to doubtful loans, on the basis of past experience, assumptions were made as to the time necessary to transfer them to non-performing loans or for them to return to the performing category, and on the resulting recovery period.

The overall impact of discounting problem loans as at 1 January 2005 was about €607 million, which will be recovered in future periods as a function of time value of money, with a positive impact on profit or loss.

### **Securities**

Investment securities were treated as follows:

- securities hedged using IRS contracts, equity securities and securities that are likely to be sold were recognised as AfS Financial Assets;
- other unquoted debt securities were recognised as loans to customers and banks;
- all remaining debt securities, given the intention and objective ability to hold the financial instrument until its natural maturity, were recognised as HtM financial assets.

Trading securities were recognised as HfT financial assets and FlaFV with the exception of a residual portion recognised as AfS financial assets.

The carrying value of the securities portfolio rose overall due to unrealised gains on securities hedged using IRSs. Limited losses on the related derivatives were recognised in relation to these gains.

### Equity Investments

Investments in subsidiaries, associates and joint ventures are included under Equity investments. Other equity investments were reclassified under AfS financial assets and measured at fair value with a balancing entry in equity, with the exception of stakes held in the Bank of Italy and other smaller companies which continue to be reported at cost.

The fair value measurement of equity investments recognised as AfS financial assets resulted in a positive impact on shareholders' equity as at 1 January 2005 totalling €1,081 million.

### Deposits and financial liabilities

Deposits and financial liabilities were reported under "Deposits from banks" and "Deposits from customers" with the exception of certain liabilities in the form of repo transactions and interbank deposits that were recognised as HfT financial liabilities. This item also includes non-hedging derivatives, which were previously allocated to other liability items.

Offsetting previously securitised loans that are again recognised, all related deposits are now recognised.

### Derivatives

Derivatives held for trading and hedging derivatives in which the hedging instrument has turned out to be ineffective were recognised as HfT financial assets and liabilities. Derivatives for which the hedging instrument has turned out to be effective were recognised as hedging instruments.

As indicated in the description of accounting principles, when a derivative is embedded in a hybrid instrument, it may be separated from the host contract and recognised separately. This situation, which occurred on certain existing contracts, resulted in a negative impact on shareholders' equity as at 1 January 2005, which was largely offset by the positive impact of related derivatives classified under HfT financial assets.

Under previous GAAP, the carrying amount of hedging instruments related solely to premiums paid and collected, accrued interest, prepaid charges and deferred income, while the book value of derivatives held for trading also included value components.

IFRS require fair value measurement of all derivatives whether hedging instruments or held for trading, which takes into account the credit risk of the counterparty and the bid-offer spread for unsettled transactions.

For the sake of consistent measurement, IFRS require that hedging instruments be measured under the same criteria as the hedged item; a cash flow hedge is only measured at the fair value applied to the hedging instrument.

## RESERVES AND PROVISIONS

### Reserve for general banking risk

In 2004 the Group decided to utilise the reserve and transferred its balance to the profit and loss account.

At the time these principles were first adopted, the change posted to the profit and loss account in 2004 was reversed. This adjustment had a negative impact only on the profit and loss account in 2004 since the amount of the reserve was already incorporated in the determination of shareholders' equity under Italian GAAP.

### **Loan loss provisions**

As in the situation above, the provisions in question were posted to the profit and loss account in 2004 following the introduction of Legislative Decree 37/2004 which eliminated the ability to take writedowns and provisions solely in accordance with tax regulations, and thus made it impossible to leave the previously established provisions in place. As a result, at the time of the first adoption of IFRS, these provisions were reversed and the relevant amount posted to the 2004 profit and loss account. The adjustment generated a positive impact on shareholders' equity as at 1 January 2004 and a corresponding negative impact on the profit and loss account.

### **Provisions for risks and charges**

IFRS permit the creation of provisions only to cover existing obligations for which it is possible to make a reliable estimate, and for which the company has no realistic alternative to settlement. In addition, the provision shall, in the case of liabilities with a deferred maturity, take into account the impact of the time value of money on the estimated amounts needed to settle the obligation. Thus, certain provisions that did not meet the reporting requirements specified in IFRS were reversed and the amount of those remaining in the accounts was recalculated in order to take into account the impact of discounting. This resulted in a positive adjustment to shareholders' equity as at 1 January 2004, but had a negative impact on the profit and loss account for 2004 since certain provisions, which were considered excessive, were reallocated during that period.

### **Employee benefits**

In addition to employee severance pay, the Group pays certain benefits to its employees that take the form of a defined benefit retirement plan and long-service bonuses to be paid to entitled individuals if they remain at the company for a predetermined number of years.

With regard to defined benefit retirement plans, IFRS specify that the company's liability shall be posted to the accounts on the basis of an actuarial valuation of the amount that will be paid on the date the right accrues. The provision for employee severance pay, which is recognised on the basis of specific Italian legislation that is still in force, is similar to a defined benefit plan, and thus it too is to be determined on the basis of an actuarial assessment.

As in the case of the provision for employee severance pay (*TFR*), liabilities for long-service payments (the cost of which had, until now, been recognised at the time the bonus accrued or was paid) are subject to actuarial calculations by an independent actuary. This calculation is based on assumptions related to future bonuses to be paid to active employees, current length of service, retirement age limitations and the estimated rate at which employees leave the Group and is also based on an estimate of the annual increase in the average bonus per person.

The actuarial recalculation of liabilities for future benefits to be paid to employees generated mixed effects on shareholders' equity as at 1 January 2004 and on the net profit for 2004. An increase in shareholders' equity was recognised for retirement plans and the *TFR* reserve, while there was a decrease in shareholders' equity due to the measurement of long-service payments. The recalculation of the *TFR* reserve and long-service payments produced a positive impact on the profit and loss account, while the recalculation of the defined benefit retirement plans generated a small negative effect.

### **Share-based Payment**

The Group pays additional benefits to employees in the form of stock option plans. In accordance with Italian accounting principles, on the date stock options are allocated, no obligation or cost for compensation is recognised, but IFRS 2 (Share-based

payments) specifies that the total amount of fair value on the date the stock options are allocated should be divided into equal portions during the vesting period and recognised in the profit and loss account with a balancing entry in the form of a liability for options settled in cash, and recognised in equity for options settled with the issuance of shares.

As a result, the application of this principle had a negative impact:

- on the profit and loss account for 2004 for both types of plans;
- on shareholders' equity as a result of stock option plans settled in cash at the time of the first adoption of IFRS and on subsequent dates.

Plans settled with shares have no impact on shareholders' equity since the increase in shareholders' equity is cancelled by the corresponding decrease in profit.

#### **OTHER EFFECTS**

##### **Treasury shares**

The Group has treasury shares which were purchased in 2004 following a plan approved by the Ordinary Shareholders' Meeting of 4 May 2004. With the adoption of IFRS, it is no longer permitted to report treasury shares under assets and record the related specific reserve in shareholders' equity items, which should instead be directly subtracted from shareholders' equity. Thus, the corresponding amount was removed from shareholders' equity with a negative impact on the latter effective 1 January 2004. This adjustment had no impact on profit for 2004.

##### **Deferred Tax assets**

The accounting procedure used by the Group until the 2003 reporting period called for conservatively posting deferred tax income to the accounts only for temporary deductible differences, which, on the basis of business plans, could be used over the following three years, and only for deferred tax income related to expenses which were already posted to the profit and loss account and were already known with certainty in the period in which they would have been deducted from taxable income.

In 2004, the above limitations were eliminated, and the Group complied with the widely accepted practice. This approach resulted in the posting of higher deferred tax income in the profit and loss account for 2004.

For the first adoption of IFRS, this effect was moved forward to 1 January 2004 with a positive impact of €160 million on shareholders' equity as of that date, and a negative impact of €149 million on net profit for 2004.

##### **Revenue Recognition**

In light of the different emphasis that IFRS place on revenue reporting, certain types of up-front income collected was recognised as a function of the term of the underlying products. In particular, this income is in the form of arrangement fees on term loans, for which the accrual basis for reporting was already accepted in 2004 with the resulting debit to the profit and loss account of the related extraordinary charges. This income also includes fees related to the placement of products of affiliate companies operating in non-banking sectors such as fees from the sale of insurance policies. As a result, on the transition date to IFRS, profits for previous periods were adjusted in respect of the portion of those revenues that had not accrued on the basis of the term of the underlying products, and only for the products of affiliates, pro-rata to the stake held in those companies. As a result, there was a negative impact on shareholders' equity and a positive impact on net profit, also taking into account the reversal of the extraordinary charge already recognised during the period.

### Scope of Consolidation

The adoption of IFRS and the resulting elimination of the distinction between subsidiary ancillary companies, consolidated on a line-by-line basis, and non-ancillary companies, accounted for using the equity method, resulted in the revision of our scope of consolidation with the inclusion of certain companies that were previously excluded and a different recognition method for others.

As a result of this adjustment, as at 1 January 2004, shareholders' equity was increased by €49 million and net profit for 2004 rose by €2 million.

### Tax

The impact on shareholders' equity of the application of IFRS was recognised net of tax, determined on the basis of regulations in effect in the countries in which the Group's companies are headquartered. In particular, for companies with head office in Italy:

- provisions for corporate income taxes were determined using a rate of 33%;
- provisions for IRAP (regional tax on productive activities) were determined using a rate of 4.25% increased as necessary to take into account regional add-ons for the banking industry.

Finally, it should be noted that deferred tax liabilities were not recognised since it is believed that on the basis of the overall amount of shareholders' equity reserves, including those already subject to taxation, no action will be taken involving the payment of taxes.

### SUMMARY

- Thus, as indicated above, first-time adoption of IFRS resulted in an increase in shareholders' equity as at 1 January 2004 of €108 million, and at 1 January 2005 of €337 million, net of tax.
- Net profit for 2004, restated under IFRS, was lower by €62 million net of tax as compared with previous GAAP.

### AUDIT OF RECONCILIATIONS REQUIRED BY IFRS 1

The reconciliations of balance sheet figures to IFRS figures as at 1 January 2004, 31 December 2004 and 1 January 2005, as well as the reconciliation of profit and loss for 2004, along with the related explanatory notes, have been audited by KPMG S.p.A.; the auditor's report has been issued on 4<sup>th</sup> October 2005.

Managing Director/CEO  
PROFUMO

Chief Accountant  
LECCACORVI

