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This study compares the accounting standards of three different entities, the United Kingdom Generally Accepted Accounting Principles, the domestic accounting standards of France, and the International Financial Reporting Standards (IFRS). The analysis consists of a comparison between two companies, British Airways and Air France – KLM, for FY 2005, specifically examining differences in the treatments of pension plans, negative goodwill, and presentation. The primary reasons for differences between the domestic standards and IFRS are explained from a descriptive standpoint. The goal of the study is to provide support for the hypothesis that reporting under IFRS will increase the comparability between international corporations, and thus provide stockholders with comparable information with which to make decisions.

Key Words: IFRS, Comparability, Pensions, Negative Goodwill

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An Analysis of the Comparability between International Corporations Resulting from International Accounting Standards

by

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I understand that my project will become part of the permanent collection of Oregon State University, University Honors College. My signature below authorizes release of my project to any reader upon request.

Joy M. Gibbons, Author

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1 Introduction

The need for international financial reporting standards (IFRS) is increasingly apparent in today's global economy. A harmonized set of accounting standards will improve the consistency and comparability of the financial statements of multinational companies. Research over the past four decades addresses the need for uniformity between the nations of the world, and substantial progress towards a set of international accounting standards has been made. This paper analyzes the causes for differences in the treatment of pensions, negative goodwill, and presentation between the domestic standards of two countries and IFRS, as well as attempts to provide support for the hypothesis that IFRS will increase comparability between international corporations.

I chose to analyze the primary differences between domestic standards and IFRS for a Common Law country, the United Kingdom, and a Code Law country, France. The three items of most significance are pension plans, negative goodwill, and presentation. I use this information to examine whether IFRS improves comparability between international organizations. The rest of the paper proceeds as follows. Section 2 details the development of accounting systems and of IFRS. Section 3 demonstrates the necessity of comparability between international corporations and offers potential benefits of IFRS. Section 4 presents the numerical analysis and tests the hypothesis of this study, and

Section 5 concludes the paper. Supplemental information and exhibits are included in the appendix.

2 Background

2.1 Development of Accounting Standards

Financial accounting systems have their roots deep in history, and, in the primitive sense, appear during the time of the ancient Roman Empire. They are the rules, regulations, and professionals that drive the financial components of business and provide information to those who request it and are necessary for the business world to run smoothly. There have been many articles written by researchers that attempt to define accounting and accounting systems. Gernon and Meek (2001, 11) say "accounting exists because it fulfills a need, and as long as accounting satisfies the needs of its user groups, it is doing what it is supposed to do." Jindřichovská (2004, 2) describes the goal of accounting as "the figures accountants should provide to people are the figures they need to know for their own practical purposes." Over time, accounting systems develop and adapt along with the needs of those who use them. In order to be truly effective, a good accounting system must facilitate comparability between international corporations. One way to achieve this is to require all companies to report under identical standards.

Accounting systems evolved based on the information needs of those who utilize the financial statements. The users of the financial statements include a "multitude of individual and institutional providers of capital," (Pagiavlas 2003, 4). Since the users of financial information can be different between countries, the required information and accounting systems evolved differently. Since each group using financial information requires different information, a company financing operations through debt will present different financial information than a company financing operations through equity. Thus, one of the challenges to harmonizing international standards is to devise a system in which information is transparent and comparable to both equity and debt holders.

Culture has a strong influence on the creation and implementation of accounting standards because of its far-reaching abilities and underlying importance in almost every decision made within a society. It is increasingly important to understand a country's culture in the attempt to implement IFRS under which many different countries, societies, and cultures will be required to operate. As Hope (2003, 219) states, "standard setters should be aware of variations in national culture when attempting to make changes to accounting infrastructure." Doupnik (2004, 45) also comments on the importance of understanding cultural differences: "Understanding the impact culture has on financial reporting can provide insights into its importance as a determinant of worldwide accounting harmonization and cross-national comparability of financial reports."

Although created for similar purposes, accounting systems develop independently of one another and thus, differ across countries. Since the accounting system of a country is a product of the various environments in which it operates, countries with similar environments tend to have similar accounting systems. However, if environments differ greatly between countries, as is often the case, the accounting systems of each will be quite diverse (Doupnik 2004, 4). Therefore, as countries around the world become increasingly global in their business operations, the accounting systems of these countries will need to include a more global approach to maintain comparability between international companies.

2.2 The IASB and benefits of IFRS

Based in London, the International Accounting Standards Board (IASB) is responsible for setting international accounting standards. It operates independently of all countries and is privately funded. IASB Board Members have strong backgrounds in accounting and standard setting and represent member countries such as the US, Germany, France, Sweden, South Africa, Australia, Canada, Japan, and China. In its mission statement, the IASB states it is "Committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements." (IASB 2006a).

Despite its relatively short life, the IASB has made extensive progress toward its goal of harmonization. It has completed a set of international standards under which the European Union required its member countries to follow beginning in the 2005 fiscal year.

The goal of financial reporting is to provide reliable information to investors from which they can make decisions. In order to fulfill this need, the information provided must be understandable and comparable. Currently, the financial accounting standards vary between each country, which makes this goal difficult to achieve. The differences in reporting requirements complicate reporting for the multi-national companies listing their stocks on foreign exchange markets since these companies must frequently restate their financial statements to comply with each country's listing requirements (Gernon/Meek 2001, 31). International markets are excellent ways for multinational companies to reach different investor groups, gain greater access to funding, and reduce their cost of capital. The implementation of IFRS should eliminate some of the hurdles associated with listing on foreign exchanges, such as financial report restatements.

IFRS will also benefit investors who face difficulties understanding and comparing the financial statements of companies in different countries. The financial statements are similar in appearance for companies around the globe, yet the presentation of information varies. Some multi-national companies attempt to reduce this information asymmetry for investors by including a statement of reconciliation between two countries' standards and highlighting the major reasons for such differences (Gernon/Meek 2001, 32). For example, multinational corporations wishing to list their stock on the NYSE provide reconciliations between home country standards and US standards. As the differences in accounting standards between countries diminish, and companies around the world begin to report under IFRS, investors will make better comparisons across country borders and companies can easily list their stocks on foreign exchanges (Pagiavlas 2003, 5). Thus, increased comparability can eliminate some of the most significant barriers to international investment.

2.3 Section Summary

In summary, this section details the development of accounting standards and which needs accounting standards attempt to fulfill. It addresses the need for international accounting standards, specifically, greater comparability between internationally traded companies which will be obtained through the requirement to report under uniform international standards.

3 Need for IFRS - Comparability

3.1 Global Operations

As countries around the world become more economically dependent on one another, the need for comparability between companies has risen dramatically. Since companies list their stocks on multiple exchanges, the domestic standards of their countries become less relevant to foreign investors. Thus, a country's level of globalization influences the successful adoption of an international set of accounting standards. A company will see the greatest benefit of the transition to IFRS if it operates on a global level. The company's stakeholders, including stockholders, lenders, creditors, lessors, and vendors, can then compare the company's performance not only to its domestic competitors but also to international competitors as alternative investments.

3.2 Lesser Developed Countries

Developing countries have great incentives to adopt IFRS not only to eliminate the costs associated with developing standards domestically but also because reporting under international standards will increase their companies' exposure to foreign financial markets. Adopting international standards also ensures a country has a complete set of accounting standards, and that the standards are comparable to those of other countries. For example, the developing country of Fiji depends heavily on the standards of other countries because it does not have the funds available to create its own domestic standard. In order to address all the accounting issues within the country, Fiji borrowed standards from countries all around the world including the United States (US), the United Kingdom (UK), and New Zealand. In doing so, Fiji combined the necessary elements of a comprehensive accounting system as well as increased the systems' comparability to systems of other countries. (Chand, 2001). From a stakeholder standpoint, this will increase the comparability of different economies, potentially increasing foreign direct investment in developing countries.

3.3 Common Law/Code Law Countries

3.3.1 Common Law Overview

The term "Common Law" is used to group countries which have accounting standards aimed at providing information to external investors. Due to its emphasis on transparent reporting, the Common Law grouping is sometimes referred to as the "Fair Presentation" or the "Full Disclosure Model." Common Law characteristics are most often found in countries with strong British influence because the Common Law model originated in Great Britain. A few examples of Common Law countries are the United States, Australia, and Canada. Because it originated in Great Britain, the Common Law model is also called the "Anglo-Saxon" or "British-American Model."

There are several distinguishing characteristics of Common Law countries. The need for financial reporting in Common Law countries results from the primary method of funding of stock issuances which creates external users of financial information. According to Gernon/Meek (2001, 10), the main objective of financial reporting in Common Law countries is to provide reliable information to investors so they can "judge managerial performance and predict future cash flows and profitability." In order to accomplish this assurance of reliable information, companies in Common Law countries are required to provide extensive disclosures in their financial statements. These disclosures provide additional information relevant to investor decisions and reduce the costs associated with monitoring managers to ensure they act in the best interests of the stakeholders.

As stated in Ball et al (2000, 13), "perhaps the most fundamental institutional variable causing accounting income to differ internationally is the extent of political influence on standard setting and enforcement." The legal regulations and requirements regarding accounting systems and standards have a significant impact on the development and effectiveness of those systems and standards. In most cases, the term "Common Law" also describes the name of the legal system of each country within the classification. The lack of strict regulations and procedures allows the legal system to remain flexible and change with the environment in which it operates. The Common Law legal system develops over time on a case-by-case basis through the judicial court systems. Once an issue has been decided in a court of law, the judicial ruling becomes commonly accepted in practice and treated as a law. The accounting standards of Common Law countries develop in a similar fashion.

The primary purpose of financial reporting in the United States is to protect the stakeholders of the company who may otherwise have little influence over the operations of the company. Common Law civil litigation is legal action an individual in the private sector takes. Since judicial rulings in civil litigation follow legal precedence rather than explicit rules, laws evolve over time. (Ball et al 2000, 13) Securities litigation is frequent in a Common Law country because the country's political environment is conducive to this kind of litigation.

3.3.2 Code Law Overview

In comparison, Code Law countries emphasize satisfying governmental regulations and requirements regarding taxation and compliance with the national macroeconomic plan (Gernon/Meek 2001, 10). Because of this legal focus, the Code Law grouping is sometimes referred to as the "Legal Compliance Model." Code Law characteristics are not easily identified with a particular geographical region, but the model most likely originated in Roman law and then spread into continental Europe. Countries inheriting this Roman system include Germany, France, and Italy. It also spread to Japan through German influence and on to Central and South America. (Gernon/Meek 2001, 10).

The distinguishing characteristics of Code Law countries are often opposite of Common Law countries. One of these characteristics is that since Code Law companies typically raise funds through the issuance of debt, the primary users of accounting information are debt holders, not stockholders as in Common Law countries. The users of the accounting systems are mainly bank lenders who already have close ties and interests within the company. Because of this, the bank lenders often receive the information they need directly from management throughout the year. Another major user of the financial statements in Code Law countries is the government. Therefore, the government in Code Law countries can be viewed as a stakeholder of the firm and the tax payments from the firm are considered the government's dividends or share of the firm's income (Ball et al 2000, 31). Because of the unique characteristics of the stakeholders, the need for financial statements in Code Law countries is different from that of Common Law countries as the financial statements focus on complying with tax regulations and present the necessary information to do so.

The term "Code Law" also describes the legal system of those countries in the group. These legal systems are formed around strict codified regulations which leave little room for interpretation or flexibility. Instead, the legal system includes a long set of rules designed to provide answers for all possible situations, similar to the tax code of the United States. Included in the legal system is a set of corporate laws under which all companies much comply. Civil securities litigation in Code Law countries is rare when compared to Common Law countries, perhaps because companies in Code Law countries have fewer stakeholders than the Common Law countries.

3.3.3 Summary of Common Law and Code Law Differences

In summary, five primary factors distinguish Common Law and Code Law countries. The first is the place of origin of a country's infrastructure. The second is the method with which companies seek financing. Companies in Common Law countries typically receive funding from external equity offerings whereas companies in Code Law countries rely more on debt. The choice of financing leads to the third factor: the stakeholders of the company. As companies in Common Law countries use external funding, their stakeholders are frequently outside the company. Code Law companies, however, have fewer stakeholders who, through their close ties to management, have easier access to company information. The fourth factor is the legal system and the fifth is the risk of civil securities litigation. As Code Law countries have fewer stakeholders, the litigation environment is less complex and costly than that of Common Law countries.

Table 1: Summary of Common Law and Code Law Differences

	Common Law	Code Law
Also known as:	"Fair Presentation Model" "Full Disclosure Model" "Anglo-Saxon Model"	"Legal Compliance Model"
Origins:	British	Roman
Source of Finance:	External equity markets	Debt holdings
Stakeholders:	Stockholders	Mainly banks
Legal Structure:	Precedence	Codified Regulations
Standard Setting Body:	PCAOB	Public Sector

3.3.4 Increased Comparability with IFRS

As the accounting standards between Common Law and Code Law countries develop in such different environments and serve different investor groups, the standards also differ in their treatment of accounting issues. Thus, financial statements could report similar transactions very differently depending on the country. If all companies in Code Law and Common Law countries report under consistent standards, stakeholders can more easily compare international companies and make well-educated investment decisions.

4 Testing

4.1 Overview of project

This section analyzes the differences between the accounting treatment of two key standards under international financial reporting standards (IFRS) and domestic standards in an attempt to demonstrate the benefits of IFRS, specifically related to comparability. I analyze these differences for a Common Law and a Code Law company. In order to do so, I select a comparable company within each type of country, research the domestic standards prior to IFRS, and demonstrate the differences through comparative financial statements (Exhibits 1-6) and analysis of the effects of implementation.

4.1.1 Objectives in conducting research

By comparing financial reports of two multi-national firms from different countries in the European Union, I provide descriptive evidence to support the hypothesis that the transition to IFRS will increase the comparability of international companies. Also, I hope to demonstrate that IFRS will benefit not only the stakeholders making investment decisions about those companies, but will also benefit management in benchmarking its firm to others within the global industry.

4.1.2 Choice of Countries

I elect to study the United Kingdom and France for my research for a number of reasons. In order to conduct the desired analysis, it is necessary to have the same financial information prepared under both domestic standards and IFRS. Since all publicly-traded companies within the European Union (EU) were required to report under IFRS beginning in the 2005 fiscal year, I narrowed my search to the member countries of the EU. I also wanted countries which have relatively stable governments, are well-established, and free from significant corruption. In order to conduct the analysis of comparability between companies in different countries, the selected countries needed international corporations. Again, the European Union fit these requirements.

Once focused on the member countries of the European Union, another factor came into play. Part of my discussion regarding IFRS and its effects has been on the difference of Common Law and Code Law countries. Thus, I wanted to analyze the ways that a Common Law country and a Code Law country were affected by the same standard, and the challenges each must go through to comply with IFRS. In the end, I settled on the United Kingdom as my Common Law country and France as my Code Law country.

4.1.3 Choice of Companies

After deciding on the UK and France as my countries of interest, I next chose two similar companies within my selected countries. The desired attributes of the companies included that they be publicly traded internationally, be comparable in size, and have similar operations. I decided to use the airline industry and ultimately chose British Airways as the Common Law company from the UK, and Air France - KLM as the Code Law company from France.

Since I examine whether IFRS increases comparability between international companies, the selected companies must be publicly traded in more than one country. Although primarily traded on the London Stock Exchange, British Airways also trades extensively on the NYSE and other smaller markets. Air France – KLM stock also trades in a number of markets with the majority of its trade volume on the NYSE and the Amsterdam Stock Exchange. Thus, the stockholders of both companies are affected by the change to IFRS and the issue of whether IFRS increases comparability is relevant.

This study is most effective if the two sample companies are of similar size. To examine size and revenue composition, I compare the restated FY 2005 total revenues. Total revenues for British Airways are approximately € 11,269, while Air France – KLM total revenues for the same period are € 18,983. Although Air France – KLM is much larger, the companies are still comparable as each is the largest airline in its respective country.

The three largest publicly traded airline companies in the EU, respectively, are Air France – KLM, Lufthansa, and British Airways (Reuters). Lufthansa and Air France – KLM are both located in Code Law countries, whereas British Airways is in a Common Law country. Therefore, British Airways was the best choice for the Common Law company and, as Lufthansa and Air France – KLM are so similar in size, either of the Code Law companies would be acceptable.

I also compared the companies based on revenue composition. British Airlines and Air France - KLM total European Revenues are € 7,364 and € 13,041, respectively, for the restated 2005 fiscal year. The European revenues represent 65% of total revenues for British Airways and 68% for Air France – KLM. Thus, the two airlines are comparable based on the total revenues within Europe, their primary market. The companies are also similar in the ratio of passenger revenue to total revenue. British Airways' passenger revenue for restated FY 2005 was € 9,425, which is approximately 83% of its total revenues of € 11,269. In the same period, the Air France – KLM financial statements show that the company generated € 18,983 total revenue, € 15,033, or about 79%, of which was from passenger travel. Since the ratios for British Airways and Air France – KLM are within 5% of each other, I determine the companies are similar in revenue composition for comparison purposes in this study.

4.1.3.1 Overview of British Airways

British Airways is the primary airline serving the United Kingdom. It is the largest airline in the UK, flying to over 550 destinations (About British Airways) and is the third largest airline serving Europe behind Air France – KLM and Lufthansa. With its primary operations out of London's two main airports, London Gatwick and Heathrow, the airline carried about 877,000 tons of cargo and 36 million passengers worldwide in FY 2005

(Corporate Profile). British Airlines is a member of the OneWorld Alliance, along with American Airlines and Finn Air, which serves 18% of the world's air travel passengers (Member Airlines).

4.1.3.2 Overview of Air France - KLM

Headquartered in Paris, Air France – KLM is the result of an acquisition of KLM (a Dutch airline) by Air France (a French airline) on May 1, 2004. The current structure of the combined company is a holding company with two subsidiaries: Air France and KLM airlines. 41% of passenger revenues are European flights (KLM Profile). It is the largest airline company in the world in terms of total operating revenues and in terms of international passenger traffic (KLM Profile). Air France – KLM has three primary businesses: passenger transportation, cargo transportation, and aircraft maintenance services. The airline is a member of SkyTeam, the world's second largest airline alliance including Delta Airlines and Korean Air.

4.1.4 Choosing standards to examine

In order to observe the most significant impact the change from domestic standards to IFRS would have on the two companies I chose, I prepared comparative balance sheets and income statements for the two companies for FY 2005 (Exhibits 1-6), the year before the EU mandated reporting under IFRS. I chose this year because in addition to reporting under domestic standards in the FY 2005 financial statements, each company was also required to restate to IFRS as part of the 2006 reporting procedures. Thus, I had access to the original FY 2005 financial statements under domestic standards as well as the restated FY 2005 financial statements under IFRS. The differences between the values in each line item in the comparative financial statements indicate the accounts in which each company experiences the greatest change between its domestic standards and IFRS.

4.1.4.1 Standard Setting Practices

The United Kingdom

The private sector of Common Law countries is generally responsible for setting and enforcing the standards of the accounting system. Common Law countries create committees such as the Financial Accounting Standards Board (FASB) in the United States to research issues and make recommendations on the appropriate treatment of those issues. The structure of this system mimics that of the legal system in that the recommendation of the committee is then incorporated into what is known in the United States as Generally Accepted Accounting Principles (GAAP).

The Accounting Standards Board (ASB) is responsible for setting accounting standards under UK GAAP. The ASB adopted many of the standards created by its predecessor, the Accounting Standards Committee (ASC), but also enacted 19 financial reporting standards which superseded a few of the ASC’s standards.

France

Alternatively, the public sector of Code Law countries sets and enforces the standards of the accounting system through governmental agencies such as the tax authorities. The high political influence regarding the corporate law of these countries allows public entities to establish accounting standards. Parties commonly involved in this process include the government, banks, and business associations (Ball et al 2000, 3). Due to the government's extensive involvement in regulating and enforcing the accounting sector, financial reporting is "often reduced to complying with a set of very detailed legal rules," (Jindřichovská 2004, 4).

French accounting standards are not set by a specific entity, but are included in the business law determined by the government. As the regulations around certain accounting issues are quite complex and not adequately covered in the business law, the French created the *Comité de la Réglementation Comptable* (CRC) to make regulations that are more specific. (IAS – UK vs. France)

4.1.4.2 Comparative Balance Sheet Analysis

The comparative balance sheets for British Airways and Air France - KLM for FY 2005 are shown in the Appendix as Exhibit 1 and Exhibit 2. In addition, a Balance Sheet for British Airways converted to Euros is included in the Appendix as Exhibit 5. The line item with the most significant impact (Difference A) is highlighted and labeled and will be discussed further in the following sections.

British Airways

The highlighted line item in the British Airways comparative balance sheet (Exhibit 1) is a result of the switch from British GAAP to IFRS. The largest difference (Difference A) results from the implementation of IAS 19: Employee Benefits. Prior to adopting IFRS, British companies were not required to list pension liabilities on the balance sheet but included this information as a note to the financial statements. IAS 19, however, requires companies list the pension surplus or deficit on the balance sheet. Thus, the £ 1,280 or € 2,639 difference in the British Airways balance sheet (Difference A) is due to the inclusion of the pension surplus or deficit. This issue is discussed in more detail in Section 4.2.1.

Air France - KLM

In my initial analysis of the comparative balance sheet for Air France – KLM (Exhibit 2), I encountered the following difficulties. The drastic changes in presentation from French standards to IFRS requirements made it difficult to present the pre- and post- 2005 information in a consistent manner. In creating the comparative balance sheet, I consolidate some items as well as seek further detail in others. A complete discussion of how I determined the values listed in the Air France – KLM comparative financial statements (Exhibits 2 and 4) is included in the appendix to this paper (Section 7.3).

4.1.4.3 Comparative Income Statement Analysis

The comparative income statements for each company are listed as Exhibit 3 and Exhibit 4. In addition, an income statement for British Airways converted to Euros is included as Exhibit 6. The line item with the most significant difference of € 1,354 (Difference B) is highlighted and labeled and will be discussed further in the following sections.

British Airways

The comparative income statement for British Airways (Exhibit 3) does not highlight any significant impacts of the adoption of IFRS. Thus, I have chosen not to investigate any income statement line items further. As discussed in the previous section, it appears as though the most significant change for British Airways is the change in pension requirements on the balance sheet.

Air France - KLM

Negative goodwill is the most significant income statement difference for Air France – KLM (Difference B). In its bargain purchase of KLM, Air France recognized a substantial amount of negative goodwill. IFRS requires Air France – KLM to recognize the entire amount of negative goodwill as a one time gain. Prior to IFRS, French companies amortized negative goodwill to the income statement over a period of time determined by the company upon acquisition. As this is the most significant difference for Air France – KLM in both the balance sheet and the income statement, I discuss this item in the following sections.

4.1.4.4 Results of Comparison

I selected two line items from the comparative balance sheets (Exhibits 1 and 2) and comparative income statements (Exhibits 3 and 4) to analyze further. Since the goal of this paper is to examine whether the implementation of IFRS improves comparability between internationally traded companies, I chose to focus on the most significant changes between the standards: accounting for pensions and negative goodwill. Since presentation should influence comparability, I investigate the presentation requirements for IFRS and comment on the benefits a universal presentation style.

4.2 Comparison of UK & France domestic standards to IFRS

This section provides an overview of each country's domestic standard on the issues identified in the previous sections and compares the domestic requirements to those of the IASB. This comparison should shed light on the potential increased comparability of companies reporting under IFRS.

4.2.1 Pensions

The most significant change between domestic standards and IFRS for the United Kingdom (Difference A) results from the inclusion of the company's pension surplus or deficit in its balance sheet. Since France adopted the international standard on pensions

(IAS 19) soon after its creation, the change in pensions for Air France – KLM was relatively small.

International Accounting Standard on Pensions (IAS 19)

The international financial reporting standard which details the international rules regarding employee benefits is IAS 19. The primary principle of IAS 19 is that the "cost of providing employee benefits should be recognized in the period in which the benefit is earned by the employee, rather than when it is paid or payable," (IAS Plus – IAS 19). The regulation requires different treatments for defined contribution and defined benefit pension plans.

In defined contribution plans, the employer contributes a set amount to its employees' pension funds over the life of their employment. The pension fund for each employee is typically managed and held by a brokerage company. Thus, the employer has no assets related to the plan on its books, nor any further obligation to pay its employees should the plan fall short of the employees' needs, placing the responsibility of funding on the employee. Because of these attributes, defined contribution plans are appealing to firms providing pension plans. IAS 19 requires firms to expense the costs related to defined contribution plans in the period during which the employee renders service.

Under a defined benefit plan, the company holds the pension assets and commits to pay its employees set payments in retirement based upon employee service and salary. The amount of the future liability is difficult to determine because it takes into account the expected life of the employee. To estimate these values, companies often seek the advice of actuaries, individuals who calculate unknown values using statistics and past events. The value that actually appears on the balance sheet under IAS 19 is the present value of the company's expected future payments to its employees *less* the fair value of plan assets as of the balance sheet date. Thus, the surplus or deficit of the plan is the only number required on the balance sheet, and the total values of the pension assets and liability are disclosed in the notes to the financial statements.

British Standard on Pensions (SSAP 24 and FRS 17)

Most British companies provide pensions as a part of their employee benefits. The two main plans used in the UK are defined contribution plans and defined benefit plans, with the majority of companies currently offering only defined contribution plans. British Airways is no exception to this trend as it ceased offering its defined benefit plans at the conclusion of FY 1985 and FY 2004. Currently, the only pension plan available to new employees is the British Airways Retirement Plan (BARP), a defined contribution plan. Until the European Union mandated the UK to report under IFRS, reporting for pension plans under its domestic standard differed significantly from the rest of the world.

The original standard for accounting for pension plans under UK GAAP was SSAP 24. Under this standard, the costs of defined benefit pension plans are charged to the income statement, while any differences arising between the contributions paid and the amount charged to income are treated as prepayments or accruals. The most significant difference between SSAP 24 and IAS 19 is that under SSAP 24 companies do not include the pension surplus or deficit on the balance sheet. Instead, the companies disclose the total pension assets and liabilities in a note.

To respond to the differences in its own standards and the forthcoming IFRS standard, the UK issued a new standard in 2000, FRS 17, which more closely mirrors IFRS in that FRS 17 also requires companies include the pension surplus or deficit on the balance sheet. The issuance this standard prepared UK companies for the transition to IFRS. However, FRS 17 had a long implementation period which allowed British companies to use SSAP 24 until fiscal periods beginning after January 1, 2005. British Airways continues to report under SSAP 24 for its original FY 2005 financial statements. In the notes to the financial statements, British Airways includes the required disclosures for FRS 17 and depicts the effects of FRS 17 as if it included the pension assets and liabilities on the balance sheet. However, no accounts related to the pension assets or liabilities appear on the balance sheet.

As required by FRS 17 and IAS 19, in its 2006 financial statements British Airways complies with the requirement to report its pension surplus or deficit on the balance sheet, and to disclose the assets and liabilities relating to a company's pension plans within the notes to the financial statements. The impact of the change from SSAP 24 to IAS 19 (Difference A) results from the requirement in IAS 19 to record the pension surplus or deficit in the balance sheet.

French Standard on Pensions

The French standards account for retirement benefits in a very different way than the British. The culture of France has an ideal that the government takes care of all French retirees. Companies expense the payments they make directly to the government. Since the government has the responsibility for retiree payments, French companies do not have future obligations. Thus, it is relatively uncommon for a French company to have significant pension assets and liabilities on its financial statements. As such, the French do not have official standards regarding the accounting for pension assets and liabilities and implemented IFRS 19 soon after its creation.

Air France – KLM has a small pension liability balance which results from a program terminated in 1993, the year Air France incorporated into the national retirement plan. Air France is still responsible for liabilities to retirees who retired prior to January 1, 1993. Thus, Air France must include this obligation in its liabilities. The present value of Air France's FY 2005 total pension obligation is relatively small at 16% of total liabilities compared to British Airways at 68%. Calculations of these ratios are in the Appendix (Section 7.4).

The pension assets and liabilities reported on the balance sheet also result from the merger between Air France & KLM. Prior to the merger, KLM maintained pension plans for its employees and recorded these plans under Dutch standards. The successor company still has an obligation to pay these retirement benefits; therefore, the accounts remain on the financial statements of the combined company. The existence of these accounts further reduces the significance of the pension liability on the financial statements for comparison purposes as it includes not only the remaining obligation to Air France retirees but also the obligation to KLM retirees. A discussion of the differences between Dutch treatment of pensions and the treatment under IAS 19 is beyond the scope of this paper and not discussed further.

4.2.2 Negative Goodwill

The comparative income statement analysis conducted in Section 4.1.4.2 identifies the most significant difference for Air France – KLM resulted from the inclusion of negative goodwill on its income statement. This section discusses the € 1,354 difference (Difference B) in the comparative income statement for Air France – KLM (Exhibit 4).

International Accounting Standard on Negative Goodwill (IFRS 3)

IFRS 3 regulates the accounting treatment of Business Combinations, which includes the treatment of negative goodwill. Negative goodwill results "when the fair value of the assets acquired is higher than the purchase price of the assets" (Kieso). In more everyday terms, negative goodwill is thought of as the discount one receives if an item is on sale. Thus, for Air France – KLM, the negative goodwill is the difference between the purchase price of KLM and the fair value of KLM's assets acquired net of liabilities assumed.

If a company appears to pay less for a target firm than the fair value of the target's net assets, IFRS 3 requires that the acquirer reassess the values assigned to each identifiable asset and liability. In addition, the company must revalue the cost of the acquisition. If negative goodwill exists after further analysis, it is recognized immediately in the income statement as a gain (IAS Plus IFRS 3).

British Standard on Negative Goodwill (FRS 10)

Although the change from UK GAAP to IFRS did not have a significant impact for British Airways, I analyze the differences between the two standards in this section. As in IFRS 3, the accounting treatment of negative goodwill under UK GAAP (FRS 10) is straightforward. The value of negative goodwill is determined as the difference between the purchase price of the company and the fair value of the net non-monetary assets obtained through the business combination. Upon acquisition of another company, any negative goodwill arising from the transaction is initially recorded as a negative asset on the balance sheet and netted against the value of positive goodwill. As negative goodwill is expected to occur infrequently, FRS 10 does not require a certain method of recognition (Primary Diff – Goodwill). Compared to the previous discussion on IFRS 3, the two standards are quite similar; thus, if British Airways did have negative goodwill in its financial statements, we would not expect a significant difference between its domestic standards and IFRS 3.

French Standard on Negative Goodwill (Règlement 99-02)

The French standard treats negative goodwill differently than both IFRS and British GAAP. Under the French standard, negative goodwill arises not only from the purchase of a company at a price less than the fair value of its net assets but also from the expectation of future losses for the company purchased in the transaction. The negative goodwill for Air France – KLM, arises from its bargain purchase of KLM. After revaluing the negative goodwill associated with the KLM purchase, the restated FY 2005 financial statements list the purchase price of KLM at € 831 million and the fair value of its net assets at € 2,183 million. Thus, the total value of negative goodwill is € 1,352.

Once a company is acquired at a bargain price, the negative goodwill is recorded as a provision for liabilities and remains on the balance sheet. The negative goodwill is amortized to the income statement over a period of time determined on the date of the acquisition. The French standard does not specify the amortization period or method of amortization. Although not encouraged, the standard also allows companies to charge negative goodwill directly to equity.

Difference B in Exhibit 4 results from the difference between Règlement 99-02 and the IFRS 3 requirement to recognize negative goodwill immediately in the income statement. Since the merger between Air France and KLM occurred prior to the implementation of IFRS, the company properly recorded negative goodwill on its books as a liability in FY 2005, as per the French standard, and amortizes it to the income statement.

4.2.3 Presentation

One goal of this paper is to examine whether the transition to international accounting standards improves the comparability of two similar companies operating internationally. Thus far, I have analyzed the differences between the domestic standards for two countries and IFRS for two standards. To supplement this analysis and demonstrate the benefits of IFRS, this section discusses the differences in the financial statement presentation requirements outlined in IAS 1.

IAS Presentation Requirements (IAS 1)

As demonstrated through the analysis of pensions for British Airways, the line items presented (or not presented) in the financial statements can make a significant difference in the appearance of a company's financial position. Thus, the requirement of all companies to report under the same format and include the same accounts increases comparability between companies.

IAS 1 outlines the requirements for the presentation of a company's financial information. A company must provide information for six categories: assets, liabilities, equity, income and expenses, changes in equity, and cash flows. The standard stipulates that the financial statements include a balance sheet, income statement, statement of changes in equity, cash flow statement, and notes to the financial statements. IAS 1 provides more detail regarding the minimum requirements of accounts listed in the financial statements and includes a suggested format to present the information.

Although a seemingly small detail, consistent presentation of financial information can make comparisons between two companies exceedingly easier. For example, in compiling the Comparative Financial Statements (Exhibits 1-6), I had difficulty determining the best way to present the information, as accounts were different between the domestic standard and IFRS. To prepare comparative information, I consolidated some accounts and separated information in others. This required assumptions to determine certain line items within these statements. Had the statements been presented under the same format, this problem would not be as significant.

Consistent presentation increases the comparability of two companies. In glancing at the numbers of British Airways and Air France – KLM prepared under domestic standards, it is difficult for one to compare the relative success of each company. Part of consistent presentation should include presentation in comparable currencies. I have demonstrated this benefit in Exhibit 9 which depicts the original FY 2005 Balance Sheets of both British Airways and Air France – KLM, using consistent currency and presentation. Compared to their individual financial statements prepared under domestic GAAP, differences between the two companies are easier to identify. Perhaps this is the best demonstration of the primary differences between British GAAP and French standards.

5 Results

This study examines whether the transition from domestic accounting standards to International Financial Reporting Standards (IFRS) increases comparability between similar internationally traded organizations. It examines the two standards which have the most impact in the financial statements for a Common Law company, British Airways, and a Code Law company, Air France – KLM. It also discusses the potential for increased comparability due to uniform presentation requirements.

The results of this study find that British Airways was impacted most in the change to IFRS due to the inclusion of the pension surplus or deficit in its financial statements. French companies should not be impacted significantly in the switch to IFRS in accounting for pensions as its socialist culture relies on the government for retirement support and the majority of French companies do not have pension assets or liabilities on their books.

The most significant factor for Air France – KLM in the switch to IFRS is the recognition of negative goodwill in the income statement. It is important to note here that this is not likely the most significant change for all French companies, as many do not have negative goodwill on their books. British companies are not likely to be affected regardless of the existence of negative goodwill because its domestic standard resembles that of the IFRS.

This study provides support for the hypothesis that requiring global companies to report under IFRS will increase comparability between companies and provide better information to stockholders. Consistent treatment of accounting issues across the globe, coupled with a uniform presentation style, will increase an investor's ability to make correct comparisons between global corporations.

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7 Appendix

7.1 Tables and Exhibits

Exhibit 1: British Airways Comparative Balance Sheet

British Airways Comparative Balance Sheet			
in Sterling millions	British GAAP 2005	IFRS 2005	Net Change
Assets			
Current assets and receivables			
Expendable spares and other inventories	£84	£84	£0
Trade receivables	1,078	685	393
Other current assets	0	301	-301
Other current interest bearing deposits	1,604	1,133	471
Cash and cash equivalents	78	549	-471
Total current assets and receivables	£2,844	£2,752	£92
Non-Current Assets			
Property, plant and equipment			
Fleet	£6,748	£6,944	-£196
Property	959	1,000	-41
Equipment	445	385	60
Total PP&E	8,152	8,329	-177
Goodwill	88	72	16
Landing rights	102	122	-20
Other intangible assets	0	60	-60
Total Intangible Assets	190	254	-64
Investments in subsidiaries			
Investments in associates	120	126	-6
Other investments	30	30	0
Employee benefit assets	0	137	-137
Other financial assets	0	38	-38
Total Investments	150	331	-181
Total non-current assets	£8,492	£8,914	-£422
Non-current assets held for sale	£0	£5	-£5
Total assets	£11,336	£11,671	-£335

British Airways Comparative Balance Sheet, ctd.	British GAAP 2005	IFRS 2005	Net Change	
Liabilities and Shareholders' Equity				
Current liabilities				
Current portion of long-term borrowings	£0	£447	-£447	
Convertible borrowings	112	112	0	
Trade and other payables	2,868	2,642	226	
Current tax payable	0	36	-36	
Short-term provisions	0	32	-32	
Total current liabilities	2,980	3,269	-289	
Non-Current liabilities				
Interest bearing long-term borrowings	£4,346	£4,045	£301	
Employee benefit obligations	0	1,820	-1,820	**A**
Provisions for deferred tax	1,243	816	427	
Other provisions	83	112	-29	
Other long-term liabilities	0	212	-212	
Total non-current liabilities	5,672	7,005	(1,333)	
Total Liabilities	£8,652	£10,274	-1,622	
Shareholders' equity				
Issued share capital	£271	£271	£0	
Share premium	788	788	0	
Investment in own shares	-26	-26	0	
Other reserves	1,432	152	1,280	
Total shareholders' equity	2,465	1,185	1,280	
Minority interest				
Equity minority interest	12	12	0	
Non-equity minority interest	207	200	7	
Minority interests	219	212	7	
Total Equity and Minority Interests	£2,684	£1,397	£1,287	
Total equity and liabilities	£11,336	£11,671	-£335	

Exhibit 2: Air France – KLM Comparative Balance Sheet

Air France - KLM Comparative Balance Sheet

in Euro millions	French GAAP 2005	IFRS 2005	Net Change
Assets			
Current Assets			
Other short term financial assets	€ 153	€ 654	(€ 501)
Inventories	389	382	7
Account receivables	2,272	2,272	0
Income tax receivables	97	6	91
Other current assets	823	969	(146)
Cash and cash equivalents	2,487	2,047	440
Total current assets	€ 6,221	€ 6,330	(€ 109)
Non-Current Assets			
Goodwill	€ 83	€ 205	(€ 122)
Intangible assets	159	437	(278)
Flight equipment	10,917	10,394	523
Other property, plant and equipment	1,837	1,895	(58)
Investments in equity associates	564	577	(13)
Pension assets	1,178	1,767	(589)
Other financial assets	548	1,113	(565)
Deferred tax assets	0	140	(140)
Other non current assets	0	336	(336)
Total non current assets	€ 15,286	€ 16,864	(€ 1,578)
Total assets	€ 21,507	€ 23,194	(€ 1,687)

Air France - KLM Comparative Balance Sheet, ctd

Liabilities and Shareholders' Equity	French GAAP 2005	IFRS 2005	Net Change
Liabilities			
Current Liabilities			
Provisions	€ 915	€ 863	€ 52
Short term portion of long-term debt	1,056	1,044	12
Trade payables	1,905	1,901	4
Deferred revenue on ticket sales	1,656	1,656	0
Current tax liabilities	242	242	0
Other current liabilities	1,130	1,004	126
Bank overdrafts	0	262	(262)
Total current liabilities	€ 6,904	€ 6,972	(€ 68)
Non-Current Liabilities			
Provisions and retirement benefits	€ 1,250	€ 1,519	(€ 269)
Negative Goodwill	842	0	842
Long-term debt	7,212	7,889	(677)
Deferred tax	73	313	(240)
Other non-current liabilities	0	481	(481)
Total non-current liabilities	€ 9,377	€ 10,202	(€ 825)
Total Liabilities	€ 16,281	€ 17,174	(€ 893)
Shareholders' Equity			
Issued capital	€ 2,290	€ 2,290	€ 0
Additional paid-in capital	390	384	6
Treasury shares	0	(19)	19
Cumulative translation adjustment	(9)	0	(9)
Reserves and retained earnings	2,490	3,254	(764)
Equity attributable to holders of Air France-KLM	5,161	5,909	(748)
Minority interests	65	111	(46)
Total Equity	€ 5,226	€ 6,020	(€ 794)
Total liabilities and equity	€ 21,507	€ 23,194	(€ 1,687)

Exhibit 3: British Airways Comparative Income Statement

British Airways Comparative Income Statement

in Sterling millions	British GAAP 2005	IFRS 2005	Net Change
Revenues	£7,813	£7,772	£41
COGS	-7,136	-7,216	80
Gross Profit	£677	£556	£121
Administrative Expenses	-137	0	-137
Operating Profit	£540	£556	-£16
Income relating to fixed asset investments	3	3	0
Gain/Loss on sale of fixed assets/investments	-26	71	-97
Other Profit/Expenses	-102	-117	15
Profit Before Tax	£415	£513	-£98
Taxes	-149	-121	-28
Profit After Tax	£266	£392	-£126
Minority Interests	-15	0	-15
Profit for the year	£251	£392	-£141
Earnings per share			
Basic	23.4p	35.2p	-11.8p
Diluted	23.0p	34.1p	-11.1p

Exhibit 4: Air France – KLM Comparative Income Statement

Air France - KLM Comparative Income Statement

in Euro millions	French GAAP 2005	IFRS 2005	Net Change	
Revenues	€ 19,078	€ 18,983	€ 95	
External expenses	(10,687)	(10,629)	(58)	
Salaries and related costs	(5,922)	(5,994)	72	
Taxes other than income taxes	(226)	(225)	(1)	
Gross Profit	€ 2,243	€ 2,135	€ 108	
Depreciation and Amortization	(1,586)	(1,561)	(25)	
Provisions	(134)	(28)	(106)	
Other income and expenses	(34)	8	(42)	
Negative goodwill	0	1,354	(1,354)	**B**
Gain on disposal of flight equipment	8	19	(11)	
Operating Profit	€ 497	€ 1,927	(€ 1,430)	
Gains in disposal/Share in net income of affiliates	140	0	140	
Amortization of goodwill	58	0	58	
Restructuring costs	(21)	0	(21)	
Other financial income and expenses	(219)	(230)	11	
Profit Before Tax	€ 455	€ 1,697	(€ 1,242)	
Taxes	(96)	(133)	37	
Profit After Tax	€ 359	€ 1,564	(€ 1,205)	
Minority Interests/Associates	(8)	87	(95)	
Profit for the year	€ 351	€ 1,651	(€ 1,300)	
Net income from discontinued operations	0	59	(59)	
Net Income for the year	€ 351	€ 1,710	(€ 1,359)	
Earnings per share				
Basic	€ 1.36	€ 6.33	(€ 4.97)	
Diluted	€ 1.36	€ 6.32	(€ 4.96)	

Exhibit 5: British Airways Comparative Balance Sheet (Euro)

British Airways Comparative Balance Sheet in Euro millions	British GAAP 2005	IFRS 2005	Net Change
Assets			
Current assets and receivables			
Expendable spares and other inventories	€ 122	€ 122	€ 0
Trade receivables	1,563	993	570
Other current assets	0	436	(436)
Other current interest bearing deposits	2,326	1,643	683
Cash and cash equivalents	113	796	(683)
Total current assets and receivables	€ 4,124	€ 3,990	€ 133
Non-Current Assets			
Property, plant and equipment			
Fleet	€ 9,785	€ 10,069	(€ 284)
Property	1,391	1,450	(59)
Equipment	645	558	87
Total PP&E	11,820	12,077	(257)
Goodwill	128	104	23
Landing rights	148	177	(29)
Other intangible assets	0	87	(87)
Total Intangible Assets	276	368	(93)
Investments in subsidiaries			
Investments in associates	174	183	(9)
Other investments	44	44	0
Employee benefit assets	0	199	(199)
Other financial assets	0	55	(55)
Total Investments	218	480	(262)
Total non-current assets	€ 12,313	€ 12,925	(€ 612)
Non-current assets held for sale	€ 0	€ 7	(€ 7)
Total assets	€ 16,437	€ 16,923	(€ 486)

* £1 = €1.45 per original 2005 financials, page 32

British Airways Comparative Balance Sheet, ctd.	British GAAP 2005	IFRS 2005	Net Change	
Liabilities and Shareholders' Equity				
Current liabilities				
Current portion of long-term borrowings	€ 0	€ 648	(€ 648)	
Convertible borrowings	162	162	0	
Trade and other payables	4,159	3,831	328	
Current tax payable	0	52	(52)	
Short-term provisions	0	46	(46)	
Total current liabilities	4,321	4,740	(419)	
Non-Current liabilities				
Interest bearing long-term borrowings	€ 6,302	€ 5,865	€ 436	
Employee benefit obligations	0	2,639	(2,639)	**A**
Provisions for deferred tax	1,802	1,183	619	
Other provisions	120	162	(42)	
Other long-term liabilities	0	307	(307)	
Total non-current liabilities	8,224	10,157	(1,933)	
Total Liabilities	€ 12,545	€ 14,897	(€ 2,352)	
Shareholders' equity				
Issued share capital	€ 393	€ 393	€ 0	
Share premium	1,143	1,143	0	
Investment in own shares	(38)	(38)	0	
Other reserves	2,076	220	1,856	
Total shareholders' equity	3,574	1,718	1,856	
Minority interest				
Equity minority interest	17	17	0	
Non-equity minority interest	300	290	10	
Minority interests	318	307	10	
Total Equity and Minority Interests	€ 3,892	€ 2,026	€ 1,866	
Total equity and liabilities	€ 16,437	€ 16,923	(€ 486)	

Exhibit 6: British Airways Comparative Income Statement (Euro)

British Airways Comparative Income Statement

in Euro millions	British GAAP 2005	IFRS 2005	Net Change
Revenues	€ 11,329	€ 11,269	€ 60
COGS	(10,347)	(10,463)	116
Gross Profit	€ 982	€ 806	€ 176
Administrative Expenses	(199)	0	(199)
Operating Profit	€ 783	€ 806	(€ 23)
Income relating to fixed asset investments	4	4	(0)
Gain/Loss on sale of fixed assets/investments	(38)	103	(141)
Other Profit/Expenses	(148)	(170)	22
Profit Before Tax	€ 601	€ 744	(€ 143)
Taxes	(216)	(175)	(41)
Profit After Tax	€ 385	€ 568	(€ 183)
Minority Interests	(21)	0	(21)
Profit for the year	€ 364	€ 568	(€ 204)
Earnings per share			
Basic	€ 0.34	€ 0.51	(€ 0.17)
Diluted	€ 0.33	€ 0.49	(€ 0.16)

* £ 1 = € 1.45 per 2005 Financials, page 32

Exhibit 7: FY 2002 British Airways Balance Sheet Presentation

Balance sheets

At March 31, 2002

£ million	Note	Group 2002	Group 2001 Restated	Company 2002	Company 2001 Restated
Fixed assets					
Intangible assets	14	105	*60*		
Tangible assets	15				
Fleet		8,672	*8,761*	8,387	*8,713*
Property		1,335	*1,418*	1,256	*1,342*
Equipment		502	*483*	398	*370*
		10,509	*10,662*	10,041	*10,425*
Investments	18				
Subsidiary undertakings and quasi-subsidiary				1,266	*1,393*
Associated undertakings		425	*381*	24	*14*
Trade investments		39	*20*	38	*19*
Investment in own shares		25	*25*	25	*25*
		489	*426*	1,353	*1,451*
		11,103	*11,148*	11,394	*11,876*
Current assets					
Stocks	25	109	*170*	91	*151*
Debtors	27	1,231	*1,444*	1,144	*1,243*
Short-term loans and deposits	28c	1,155	*865*	1,112	*808*
Cash at bank and in hand		64	*71*	4	*8*
		2,559	*2,550*	2,351	*2,210*
Creditors: amounts falling due within one year	29	(3,201)	*(3,308)*	(3,710)	*(3,957)*
Net current liabilities		(642)	*(758)*	(1,359)	*(1,747)*
Total assets less current liabilities		10,461	*10,390*	10,035	*10,129*
Creditors: amounts falling due after more than one year					
Borrowings and other creditors	30	(6,985)	*(6,788)*	(6,965)	*(6,963)*
Convertible Capital Bonds 2005	33	(112)	*(113)*		
		(7,097)	*(6,901)*	(6,965)	*(6,963)*
Provision for deferred tax	34	(1,031)	*(1,094)*	(985)	*(1,060)*
Provisions for liabilities and charges	35	(126)	*(70)*	(126)	*(69)*
		2,207	*2,325*	1,959	*2,037*
Capital and reserves					
Called up share capital	36	271	*271*	271	*271*
Reserves	38				
Share premium account		788	*788*	788	*788*
Revaluation reserve		270	*290*	270	*290*
Profit and loss account		687	*772*	630	*688*
		1,745	*1,850*	1,688	*1,766*
Total equity shareholders' funds		2,016	*2,121*	1,959	*2,037*
Minority interest		9	*18*		
Non equity minority interest	39	182	*186*		
		2,207	*2,325*	1,959	*2,037*

Exhibit 8: FY 2002 Air France – KLM Balance Sheet Presentation

ASSETS

In EUR millions	Notes	At March 31, 2002	At March 31, 2001	At March 31, 2000
Consolidation goodwill	13	125	133	52
Intangible fixed assets	13	190	206	212
Flight equipment	14	7,446	7,269	6,052
Other property and equipment	14	847	757	686
Investments in equity affiliates	15,1	303	276	232
Other investments	15	237	267	255
Total		**9,148**	**8,908**	**7,489**
Inventory	16	266	227	160
Trade receivable	17	1,495	1,549	1,402
Income tax receivable	18	80	66	18
Other accounts receivable	17	712	549	385
Marketable securities	19	1,408	942	1,818
Cash		255	216	94
Total current assets		**4,216**	**3,549**	**3,877**
Total assets		**13,364**	**12,457**	**11,366**

LIABILITIES AND STOKHOLDERS' EQUITY

In EUR millions	Notes	At March 31, 2002	At March 31, 2001	At March 31, 2000
Common stock	20,1	1,868	1,868	1,809
Additional paid-in capital	20,4	261	261	262
Retained earnings (accumulated deficit)	20,5	1,813	1,723	1,395
Cumulative translation adjustment		19	22	19
Stockholders' equity		**3,961**	**3,874**	**3,485**
Minority interests		29	25	22
Stockholders' equity and minority interests		**3,990**	**3,899**	**3,507**
Provisions for liabilities and charges	21	937	994	1,093
Short and long-term debt and capital leases	22	4,616	4,073	3,946
Trade payables		1,525	1,557	1,205
Income tax liability	23	22	19	–
Advance ticket sales		1,024	872	672
Other payables	24	1,250	1,043	943
Total liabilities		**9,374**	**8,558**	**7,859**
Total liabilities and stockholders' equity		**13,364**	**12,457**	**11,366**

Exhibit 9: Domestic Comparative Balance Sheet

Domestic: British Airways vs. Air France - KLM Comparative Balance Sheet

in Euro millions	British Airways 2005	Air France - KLM 2005
Assets		
Current Assets		
Other short term financial assets	€ 2,326	€ 2,254
Inventories	122	389
Account receivables	1,563	2,272
Income tax receivables	0	97
Other current assets	0	2,001
Cash and cash equivalents	113	386
Total current assets	€ 4,124	€ 7,399
Non-Current Assets		
Goodwill	€ 128	€ 83
Intangible assets	148	159
Flight equipment	9,785	10,917
Other property, plant and equipment	2,036	1,837
Investments in equity associates	174	564
Other financial assets	44	548
Total non current assets	€ 12,313	€ 14,108
Total assets	€ 16,437	€ 21,507

Domestic: British Airways vs. Air France - KLM Comparative Balance Sheet, ctd

Shareholders' Equity and Liabilities	British Airways 2005	Air France - KLM 2005
Liabilities		
Current Liabilities		
Provisions	€ 0	€ 173
Short term portion of long-term debt	0	1,056
Trade payables	4,159	1,905
Deferred revenue on ticket sales	0	1,656
Current tax liabilities	0	73
Other current liabilities	162	0
Total current liabilities	€ 4,321	€ 4,863
Non-Current Liabilities		
Provisions and retirement benefits	€ 0	€ 2,092
Long-term debt	6,302	7,212
Deferred tax	1,802	8
Other non-current liabilities	120	2,106
Total non-current liabilities	€ 8,224	€ 11,418
Total Liabilities	€ 12,545	€ 16,281
Shareholders' Equity		
Issued capital	€ 393	€ 2,290
Additional paid-in capital	1,143	390
Treasury shares	(38)	0
Cumulative translation adjustment	0	(9)
Reserves and retained earnings	2,076	2,490
Equity attributable to equity holders	3,574	5,161
Minority interests	318	65
Total Equity	€ 3,892	€ 5,226
Total liabilities and equity	€ 16,437	€ 21,507

7.2 Calculation of Air France – KLM Net Income

Air France - KLM	Restated FY 2005
Net Income	€ 1,710
Less: Negative Goodwill *	(1,046)
Net Income controlled for Negative Goodwill	€ 664

* The negative goodwill value includes only the value attributable to the acquisition of KLM and does not include the portion of negative goodwill attributable to pensions.

7.3 Line Item calculations for Comparative Financial Statements

Air France - KLM

As the FY 2005 Balance Sheet under French standards did not include detail regarding Air France – KLM's pension assets, I sought further information within the notes to the Financial Statements and found a discussion in Note 18 which listed € 1,178 as Air France – KLM's Pension Plan Assets resulting from the KLM Pension Surplus. This value was removed from the *other accounts receivable* line item and place in the *pension assets* line item.

Other items of interest which were modified in the consolidation process include the creation of additional detail for the *negative goodwill*, *other payables,* and *cash and cash equivalents* line items. Per Note 22 in the Air France - KLM FY 2005 Financial Statements, € 842 of the € 2,265 *provisions for liabilities and charges* is attributable to negative goodwill. An additional € 173 of the provisions are short term provisions. I included this detail in Exhibit 2, removing the values from the *provisions for liabilities and charges*.

I obtained further detail of the *other payables* line item in the Air France –KLM FY 2005 Note 26. From this information, I included € 742 of *employee-related liabilities* into the *current provisions* line item, and € 234 of *tax liabilities* into the *current tax liabilities* line item, resulting in a net *other payables* of € 1,130. I also redistributed the value of the *income tax liability* into current and non-current values. Per Note 24 of the FY 2005 Financial Statements, € 73 of the *income tax liability* is non-current, and € 8 is current. I allocated these values into the *deferred tax* and *current tax liabilities* line items, respectively.

The *cash* item in the Air France – KLM FY 2005 Balance Sheet represents only the cash that the company currently holds. To more accurately compare the *cash and cash equivalents* values between the two standards, I used Note 20 to detail the *cash equivalents*. From this information, I determined that Air France – KLM's *cash equivalents* (items with maturity less than three months) were € 2,101, resulting in a total of € 2,487 for the *cash and cash equivalents* line item. As this value represents of short term investments, I took the value from the *marketable securities/other short term financial assets* line item.

The only change I made for the Air France – KLM restated FY 2005 Financial Statements regards the detail of the *other current liabilities* line item. In Note 30 to the restated 2005 financial statements, the 2005 value (under IFRS) is a total of € 2,461, of which € 1,980 is related to current liabilities and € 481 is related to non-current liabilities. In order to present the statements as comparable as possible, I detail the current tax liability, and both current and non-current employee-related liabilities. Thus, I reallocated the funds included in the *other liabilities* line item as follows. The *current tax liability* increased by € 234, current *provisions* increased by € 739, and non-current *provisions and retirement benefits* increased by € 3, resulting in a total decrease of € 976 in *other liabilities*.

Overall, I made quite a few assumptions and changes to the values represented in the comparative balance sheet for Air France – KLM (Exhibit 2). However, I feel that these assumptions and subsequent changes result in a more accurate listing and comparison of the company's financial standing for FY 2005 under domestic standards and IFRS. As no line item differences appear significant after controlling for consolidation errors, I did not find any significant factors to pursue further from the balance sheet. I also did not find any significant areas within the British Airways financial statements which required further consolidation or detail. Thus, I have not included a discussion regarding the British Airways consolidated financial statement preparation.

7.4 Calculation of Ratio of Pension Liabilities to Total Liabilities

British Airways

Restated FY 2005	in Sterling millions
Present Value of the Defined Pension Obligations	£7,011
Total Liabilities	£10,274
Ratio:	68%

Air France – KLM

Restated FY 2005	in Euro millions
Present Value of the Defined Pension Obligations	€ 10,313
Less: Amount Attributable to Acquisition of KLM	(€ 7,528)
PV of Obligation for Air France	€ 2,785
Total Liabilities	€ 17,174
Ratio:	16%