



IFRS



Lifetime Performance

Financial information for 2004 according to IFRS standards

Wärtsilä's financial information for 2004 according to IFRS standards

Wärtsilä Corporation has adopted the International Financial Reporting Standards (IFRS) in the preparation and presentation of its interim and annual financial statements as of 1 January 2005. This review describes the preliminary main impacts of the transition to IFRS on the financial information for 2004, which was originally reported according to the Finnish Accounting Standards (FAS) set for public listed companies in Finland. The IFRS accounting principles are included as an appendix to this review. The FAS accounting principles are published in the Financial Review section of Wärtsilä's Annual Report 2004.

Wärtsilä publishes its financial statements for 2004 according to IFRS in its interim reports, i.e. for the first three, six and nine months of the year, and for the full year 2004.

The financial statements according to IFRS have been drawn up using the standards in force in December 2004. Under the transition provisions for IAS 32 and IAS 39 covering the treatment of financial instruments, no comparative data need be prepared according to these standards for 2004. Instead, IAS 32 and IAS 39 will be applied from 1 January 2005, when the translation adjustments will be entered directly under shareholders' equity.

Segments

Wärtsilä Group's primary segments under IFRS are its Power Businesses and Imatra Steel. These segments supply various products and services with differing risks and returns and are therefore reported separately. The Power Businesses operate in two market segments, ship propulsion systems and onshore power plants. The two are interconnected, however, offering customers applications and service based on the same basic product. The main products in both the ship power and onshore power plant markets are diesel and gas engines and their service. R&D, design and manufacturing of these engines take place in the same R&D centres and factories, and the manufacturing process is the same for both markets. Similarly, the products are distributed and serviced through the same Wärtsilä subsidiaries. A proportion of total capacity costs cannot be allocated directly to specific market segments. This proportion is significant and varies throughout the year's interim reporting periods, and for this reason cannot be reasonably allocated. Customers in both market segments operate globally and are capital-intensive corporations. Trends in these two markets are strongly dependent on global economic development.

Imatra Steel's customers belong to the automotive and mechanical engineering industries. The company manufactures special engineering steels and forged steel components.

Employee benefits

Under FAS pension obligations were reported in accordance with local legislation and practice in each operating country. The adoption of IFRS increases the pension obligation arising from defined benefit plans by EUR 32.7 million in the opening balance sheet at 1 January 2004. Most of this increase is due to the need to enter the disability pension obligation under the Finnish pension system (Employees' Pensions Act, TEL) in the opening balance sheet at 1 January 2004. Changes in the system's calculation principles, due to come into force on 1 January 2006, will mean that a one-time item of EUR 27.3 million arising from the disability pension is entered in the fourth-quarter interim accounts for 2004. Under the new calculation principles the disability part of TEL pensions will be treated as a defined contribution plan in the IFRS statements.

The other employee benefit obligations on the transition date total EUR 8.0 million. These apply mainly to compensation for long-term employment in the company. Under previous local practice, these obligations were not included in provisions because they were previously treated as defined contribution plans.

Interest-bearing loans

The EUR 10.0 million conditional state development credit granted in the Netherlands is treated under IFRS as an interest-bearing loan. Under FAS it was entered as a contingent liability.

Goodwill

On the transition date 1 January 2004 goodwill totalling EUR 362.0 million was reviewed for each cash-generating unit to determine any need for write-downs, based on discounted future cash flows. The review resulted in a EUR 3.4 million write-down on the Biopower business. Biopower was part of the Power Plants business and under FAS valuation principles no write-down was considered necessary in the 2003 financial statements.

Goodwill totalling EUR 8.1 million arising from the acquisition of assets has been transferred from intangible assets to goodwill.

Goodwill has not been amortized from the transition date. Amortization of goodwill under FAS in 2004, EUR 27.4 million, is entered in the income statement.

Restructuring provisions

A EUR 130 million restructuring provision and write-down was entered in the FAS financial statements for 2003 based on a restructuring programme approved by the Board of Directors in December 2003. Negotiations with personnel were completed during the first quarter of 2004 and it was only then that the IFRS criteria for

provisions were considered to have been met. Accordingly, EUR 66.0 million of the restructuring provision at the transition date, 1 January 2004, has been reversed. Of this amount, EUR 63.8 million has been entered as a provision and one-time item in the first-quarter accounts for 2004. The provision was increased by EUR 2.1 million in the fourth quarter after completion of the restructuring programme in the Netherlands.

Capitalization of R&D costs

The research and development costs of new products and technologies have been capitalized, once the IAS capitalization criteria have been met, from the year in which it has been possible to establish their technical feasibility and future economic benefits. Development costs totalling EUR 27.0 million between 1999 and 2003 were capitalized on 1 January 2004 after deductions for planned depreciation.

Assets available for sale

Other shares are classified as assets available for sale. Under the transition exemptions permitted by the IAS 32 and IAS 39 standards on financial instruments, comparative IFRS figures for financial instruments are not calculated since IAS 39 only took effect on 1 January 2005. Hence the IFRS values of Wärtsilä's shares shown here correspond with the figures in the original financial statements. Application of IAS 39 to Wärtsilä's shares available for sale would have increased the opening balance sheet by EUR 146.9 million.

Other changes

Valuation of inventories

Further clarification of the valuation principles has been provided. The main impact of the change is to systematically include freight and cash discounts in inventories.

Tangible fixed assets

The value of tangible fixed assets has increased as a result of more systematic finance leasing capitalization and the consolidation of small companies. Under FAS these small companies were not considered significant.

Properties totalling EUR 20.7 million and not used by the Group have been transferred to investment properties.

Deferred taxes

Deferred taxes have been entered under IFRS adjustments in the opening balance sheet to the extent that they have created taxable or tax-deductible temporary differences between the closing of the accounts and the taxation date. Deferred tax assets on confirmed losses have been adjusted if it is sufficiently probable that the losses can be used in the future. Deferred tax adjustments at the transition date totalled EUR 28.4 million.

The IFRS reconciliation calculation is unaudited.

INCOME STATEMENT				OPERATING INCOME BY SEGMENT			
EUR million	FAS	IFRS	IFRS	EUR million	FAS	IFRS	IFRS
	1-3/2004	adjustment	1-3/2004		1-3/2004	adjustment	1-3/2004
Net Sales	521.7		521.7				
Other operating income	111.4	-107.7	3.7	Power-businesses	-2.2	-63.9	-66.1
Expenses	-508.5	-62.8	-571.3	Imatra Steel	2.9		2.9
Depreciations and write-downs	-16.1	-1.2	-17.3	Investments available for sales	107.7	-107.7	
Operating income before goodwill amortisation				Total	108.5	-171.7	-63.2
Goodwill amortisation	108.5	-171.7	-63.2				
Operating income	101.5	-164.7	-63.2				
Share of income from associates	0.0						
Net income from assets available for sales		107.7	107.7				
Financial income and expenses	-4.1	-0.3	-4.3				
Income before taxes	97.4	-57.2	40.1				
Income taxes	-26.7	6.8	-19.9				
Minority interests	-0.2		-0.2				
Net income	70.5	-50.5	20.1				
Earnings per share	0.79		0.22				
Diluted earnings per share	0.78		0.21				
INCOME STATEMENT				OPERATING INCOME BY SEGMENT			
EUR million	FAS	IFRS	IFRS	EUR million	FAS	IFRS	IFRS
	1-6/2004	adjustment	1-6/2004		1-6/2004	adjustment	1-6/2004
Net Sales	1,103.0		1,103.0				
Other operating income	115.1	-107.8	7.3	Power-businesses	25.9	-64.9	-38.9
Expenses	-1,042.3	-62.4	-1,104.8	Imatra Steel	8.6		8.6
Depreciations and writedowns	-33.5	-2.4	-35.9	Investments available for sales	107.7	-107.7	
Operating income before goodwill amortisation				Total	142.3	-172.6	-30.3
Goodwill amortisation	142.3	-172.6	-30.3				
Operating income	128.4	-158.8	-30.3				
Share of income from associates	0.2		0.2				
Net income from assets available for sales		107.7	107.7				
Financial income and expenses	0.9	-0.3	0.6				
Income before taxes	129.6	-51.3	78.2				
Income taxes	-36.8	4.2	-32.6				
Minority interests	-0.3		-0.3				
Net income	92.5	-47.1	45.4				
Earnings per share	1.03		0.50				
Diluted earnings per share	1.02		0.49				
INCOME STATEMENT				BALANCE SHEET			
EUR million	FAS	IFRS	IFRS	EUR million	FAS	IFRS	IFRS
	1-9/2004	adjustment	1-9/2004		31.12.2003	adjustment	31.12.2003
Net Sales	1,662.0		1,662.0	Assets			
Other operating income	119.5	-107.7	11.8	Intangible assets	37.3	19.0	56.3
Expenses	-1,548.0	-63.2	-1,611.2	Goodwill	354.0	4.6	358.6
Depreciations and write-downs	-51.0	-3.5	-54.5	Property, plant and equipment	389.3	-18.9	370.5
Operating income before goodwill amortisation				Investment properties		20.7	20.7
Goodwill amortisation	182.5	-174.5	8.0	Equity in associates	2.7		2.7
Operating income	161.8	-153.8	8.0	Shares available for sales	96.8	-0.3	96.5
Share of income from associates	0.2		0.2	Interest-bearing investments	11.5		11.5
Net income from assets available for sales		107.7	107.7	Other long-term receivables	70.3	34.5	104.7
Financial income and expenses	-0.8	-0.5	-1.3	Inventories	555.5	0.2	555.7
Income before taxes	161.2	-46.5	114.7	Interest-bearing receivables	9.7	0.0	9.6
Income taxes	-49.7	2.7	-47.0	Other receivables	705.8	6.4	712.2
Minority interests	-0.6		-0.6	Cash and cash equivalents	150.0	1.5	151.5
Net income	111.0	-43.8	67.1	Total assets	2,382.9	67.5	2,450.4
Earnings per share	1.22		0.74	Shareholders' equity and liabilities			
Diluted earnings per share	1.22		0.74	Share capital	208.8		208.8
				Other shareholders' equity	568.3	69.0	637.3
				Minority interests	6.1		6.1
				Convertible subordinated debentures	27.5		27.5
				Long-term interest-bearing debt	288.2	0.5	288.7
				Other long-term liabilities	101.1	42.3	143.4
				Interest-bearing current debt	208.6	10.5	219.1
				Other current liabilities	974.2	-54.7	919.5
				Total shareholders' equity and liabilities	2,382.9	67.5	2,450.4
INCOME STATEMENT				BALANCE SHEET			
EUR million	FAS	IFRS	IFRS	EUR million	FAS	IFRS	IFRS
	1-12/2004	adjustment	1-12/2004		31.03.2004	adjustment	31.03.2004
Net Sales	2,478.2		2,478.2	Assets			
Other operating income	135.2	-108.3	26.9	Intangible assets	54.1	18.0	72.1
Expenses	-2,289.5	-40.6	-2,330.1	Goodwill	348.0	14.0	362.0
Depreciations and write-downs	-58.1	-5.0	-63.0	Property, plant and equipment	367.5	-18.8	348.8
Operating income before goodwill amortisation				Investment properties		20.3	20.3
Goodwill amortisation	265.8	-153.8	112.0	Equity in associates	2.7		2.7
Operating income	238.4	-126.4	112.0	Shares available for sales	71.7	-0.3	71.4
Share of income from associates	1.4		1.4	Interest-bearing investments	10.0		10.0
Net income from assets available for sales		107.7	107.7	Other long-term receivables	69.2	40.4	109.6
Financial income and expenses	-3.3	-0.5	-3.7	Inventories	550.8	0.3	551.1
Income before taxes	236.5	-19.1	217.3	Interest-bearing receivables	6.5	0.0	6.5
Income taxes	-74.9	-11.1	-86.1	Other receivables	687.5	6.9	694.5
Minority interests	-1.3		-1.3	Cash and cash equivalents	149.2	1.5	150.7
Net income	160.3	-30.3	130.0	Total assets	2,317.3	82.3	2,399.6
Earnings per share	1.75		1.42	Shareholders' equity and liabilities			
Diluted earnings per share	1.75		1.42	Share capital	208.8		208.8
				Other shareholders' equity	597.1	18.5	615.6
				Minority interests	6.6		6.6
				Convertible subordinated debentures	26.4		26.4
				Long-term interest-bearing debt	298.6	0.4	299.1
				Other long-term liabilities	103.7	43.4	147.2
				Interest-bearing current debt	112.2	10.4	122.7
				Other current liabilities	963.7	9.5	973.2
				Total shareholders' equity and liabilities	2,317.3	82.3	2,399.6

BALANCE SHEET	FAS	IFRS	IFRS
EUR million	30.06.2004 adjustment		30.06.2004
Assets			
Intangible assets	52.2	17.4	69.6
Goodwill	344.8	20.6	365.4
Property, plant and equipment	365.5	-18.4	347.1
Investment properties		19.8	19.8
Equity in associates	2.9		2.9
Shares available for sales	71.6	-0.3	71.2
Interest-bearing investments	7.7		7.7
Other long-term receivables	76.3	36.7	113.1
Inventories	572.0	0.4	572.4
Interest-bearing receivables	2.0	0.0	2.0
Other receivables	716.5	7.5	724.0
Cash and cash equivalents	150.7	1.5	152.2
Total assets	2,362.2	85.2	2,447.4
Shareholders' equity and liabilities			
Share capital	216.0		216.0
Other shareholders' equity	633.0	22.0	655.0
Minority interests	7.9		7.9
Long-term interest-bearing debt	297.0	0.4	297.4
Other long-term liabilities	90.9	43.6	134.4
Interest-bearing current debt	134.7	10.1	144.8
Other current liabilities	982.9	9.0	991.9
Total shareholders' equity and liabilities	2,362.2	85.2	2,447.4

BALANCE SHEET	FAS	IFRS	IFRS
EUR million	30.09.2004 adjustment		30.09.2004
Assets			
Intangible assets	50.0	16.6	66.6
Goodwill	338.3	27.8	366.2
Property, plant and equipment	356.9	-14.8	342.1
Investment properties		16.0	16.0
Equity in associates	1.8		1.8
Shares available for sales	71.1	-0.3	70.7
Interest-bearing investments	7.1		7.1
Other long-term receivables	72.4	35.3	107.7
Inventories	610.2	0.7	610.9
Interest-bearing receivables	2.5	0.0	2.4
Other receivables	671.1	7.0	678.1
Cash and cash equivalents	144.0	1.5	145.5
Total assets	2,325.4	89.8	2,415.1
Shareholders' equity and liabilities			
Share capital	216.0		216.0
Other shareholders' equity	651.4	25.3	676.6
Minority interests	7.7		7.7
Long-term interest-bearing debt	270.7	0.4	271.1
Other long-term liabilities	90.1	44.9	135.0
Interest-bearing current debt	68.8	9.9	78.7
Other current liabilities	1,020.7	9.3	1,029.9
Total shareholders' equity and liabilities	2,325.4	89.8	2,415.1

BALANCE SHEET	FAS	IFRS	IFRS
EUR million	31.12.2004 adjustment		31.12.2004
Assets			
Intangible assets	56.8	19.4	76.2
Goodwill	328.3	31.3	359.6
Property, plant and equipment	355.7	-13.0	342.8
Investment properties		14.2	14.2
Equity in associates	2.8		2.8
Shares available for sales	68.7	-0.3	68.4
Interest-bearing investments	6.9	0.0	6.9
Other long-term receivables	59.0	22.2	81.2
Inventories	564.5	0.6	565.1
Interest-bearing receivables	1.9	0.0	1.9
Other receivables	713.5	-4.8	708.7
Cash and cash equivalents	168.5	1.1	169.6
Total assets	2,326.7	70.7	2,397.3
Shareholders' equity and liabilities			
Share capital	323.9		323.9
Other shareholders' equity	529.0	39.8	568.8
Minority interests	7.8		7.8
Long-term interest-bearing debt	271.0	0.3	271.2
Other long-term liabilities	87.6	21.4	109.0
Interest-bearing current debt	48.5	0.2	48.8
Other current liabilities	1,058.8	9.0	1,067.8
Total shareholders' equity and liabilities	2,326.7	70.7	2,397.3

ANALYSIS OF NET INCOME ADJUSTMENTS				
EUR million	1-3/2004	1-6/2004	1-9/2004	1-12/2004
Net income under FAS	70.5	92.5	111.0	160.3
IFRS adjustments				
IFRS 3 Business combination	7.0	13.8	20.7	27.4
IAS 12 Income Taxes	6.8	4.2	2.7	-11.6
IAS 19 Employee Benefits	-1.2	-1.7	-3.0	20.4
IAS 20 Accounting for Government Grants	0.0	0.2	0.4	1.4
IAS 37 Provisions	-64.3	-64.7	-64.9	-67.2
IAS 38 Intangible assets	1.4	0.5	0.1	-0.1
Other adjustments	-0.1	0.5	0.2	-0.6
Total IFRS adjustments	-50.5	-47.1	-43.8	-30.3
Net income under IFRS	20.1	45.4	67.1	130.0

Changes in shareholders' equity	31.12.2003	31.03.2004	30.06.2004	30.09.2004	31.12.2004
EUR million	2003	2004	2004	2004	2004
Shareholders' equity under FAS	777.1	805.9	848.9	867.3	853.0
Effects of adopting IFRS					
IFRS 3 Business combination		7.0	13.8	20.7	27.4
IAS 12 Income taxes	28.4	35.2	32.6	31.1	16.8
IAS 19 Employee benefits	-40.7	-41.9	-42.4	-43.7	-20.3
IAS 20 Accounting for Government Grants	-10.0	-10.0	-9.8	-9.7	-8.7
IAS 36 Impairment of Assets	-3.4	-3.4	-3.4	-3.4	-3.4
IAS 37 Provisions	67.1	2.8	2.4	2.2	-0.1
IAS 38 Intangible Assets	27.0	28.5	27.5	27.2	26.9
Other adjustments	0.6	0.5	1.2	1.0	1.1
Total IFRS adjustments	69.0	18.5	22.0	25.3	39.8
Shareholders' equity under IFRS	846.1	824.4	870.9	892.6	892.7

STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY					
EUR million	Share capital	Share premium	Translation differences	Retained earnings	Total
Shareholders' equity on December 31, 2003					
(FAS)	208.8	117.9	-19.3	469.8	777.1
IFRS adjustments			19.3	49.7	69.0
Shareholders' equity on January 1, 2004					
(IFRS)	208.8	117.9	0.0	519.5	846.1
Conversion of subordinated debentures	7.2	17.5			24.6
Bonus issue	108.0	-108.0			0.0
Translation differences			-1.0		-1.0
Dividends paid				-106.4	-106.4
Other changes				-0.6	-0.6
Net income for the period				130.0	130.0
Shareholders' equity on December 31, 2004 (IFRS)	323.9	27.3	-1.0	542.5	892.7

KEY FIGURES	1-3/2004		1-6/2004	
	FAS	IFRS	FAS	IFRS
Earnings per share, EUR	0.79	0.22	1.03	0.50
Book value of equity per share, EUR	9.01	9.21	9.17	9.41
Solvency %	37.3	36.8	39.0	38.5
Net debt to equity	0.35	0.36	0.33	0.33
	1-9/2004		1-12/2004	
	FAS	IFRS	FAS	IFRS
Earnings per share, EUR	1.22	0.74	1.75	1.42
Book value of equity per share, EUR 9.65		9.37	9.64	9.22
Solvency %	41.6	41.1	40.3	40.8
Net debt to equity	0.22	0.23	0.18	0.17

Accounting principles

Wärtsilä Corporation is a Finnish listed company domiciled in Helsinki. The 2005 annual financial statements for the Wärtsilä Group will be prepared in accordance with IFRS (International Financial Reporting Standards).

The annual financial statements will be prepared in euro and reported in millions of euro. Reporting is based on original cost unless otherwise specified in the accounting principles below or in the notes to the financial statements.

On 1 January 2005 the Group switched to reporting in accordance with IFRS. IFRS 1 was applied at the time of transition. Up to 31 December 2004 the Group's annual financial statements were drawn up in accordance with Finnish Accounting Standards (FAS), which differ in certain respects from IFRS. The Group's accounting principles have been updated to comply with IFRS. The comparative figures for 2004 and the opening balance sheet on 1 January 2004 have been adjusted in accordance with IFRS. These adjustments are indicated in the report providing comparative information.

Use of estimates

Applicable regulations and generally accepted accounting principles require management to make estimates and assessments in drawing up annual financial statements that affect the valuation of the reported assets and liabilities and other information, such as contingent liabilities and the recognition of income and expenses in the income statement. The final outcomes may thus differ from the estimated values.

Principles of consolidation

The consolidated annual financial statements include the parent company Wärtsilä Corporation and all subsidiaries in which the parent company directly or indirectly holds more than 50 per cent of the votes, as well as the Group's associated companies (20 to 50 per cent voting control as well as considerable influence over the company). The Group's equity in associated companies is reported in the consolidated annual financial statements applying the equity method. If the Group's share of the associated company's losses exceeds the acquisition cost of its equity interest, the reported value is written down to zero. After this losses are only reported if the Group has undertaken to be responsible for the obligations of the associated company.

Acquired or created subsidiaries and associated companies are included in the consolidated financial statements from the day the company was acquired or created until ownership of the company legally terminates.

Intra-group transactions, dividend distributions, receivables and liabilities and

unrealized margins are eliminated in the consolidated annual financial statements. In the income statement, minority interests have been separated from the income for the reporting period and are reported as a separate item after tax. In the Group's balance sheet minority interests are shown as a separate item under shareholders' equity.

The consolidated annual financial statements are drawn up using the purchase method of accounting where the acquired company's identifiable assets and liabilities are valued at fair value on the date of acquisition. The difference between the purchase price and the company's net assets is reported as goodwill. In accordance with the exemptions permitted by IFRS 1, acquisition analyses have not been revised for acquisitions completed before the transition date of 1 January 2004. The goodwill values reported in the 31 December 2003 consolidated annual financial statements prepared in accordance with FAS have been retained, except where the company's assessment of the recoverable amount resulted in a write-down. Prior to the transition date goodwill was amortized over its expected useful life, subject to a maximum of 20 years. Goodwill is not amortized under IFRS. The recoverable amount is instead reviewed annually for any write-down requirements.

Foreign subsidiaries

In the consolidated annual financial statements, the income statements of foreign subsidiaries are translated into euro at the quarterly average exchange rates. Balance sheet items are translated into euro at the exchange rates in effect on the balance sheet date. Translation differences are reported as part of consolidated shareholders' equity. Translation differences arising after the transition to IFRS are reported under changes in shareholders' equity, whereas translation differences that arose prior to the transition have been transferred to retained earnings as permitted by the exemptions in IFRS 1.

Transactions in foreign currencies

Transactions denominated in a foreign currency are recorded at the exchange rate in effect on the transaction date. Balance sheet assets and liabilities are valued at the exchange rate in effect on the balance sheet date. Operations-related exchange rate differences are reported on the applicable line in the income statement and are included in operating income. Exchange rate differences related to financial receivables and financial liabilities are reported as financial items in the income statement.

Derivatives

Derivatives are initially reported at cost in the balance sheet and are thereafter valued

at their fair value on each balance sheet date.

Certain derivatives are eligible for hedge accounting in accordance with IAS 39. Changes in the fair value of derivative contracts that have been signed to hedge future cash flows (cash flow hedge) are reported under shareholders' equity (difference in spot prices), provided that they meet the requirements for hedge accounting. Any accrued profit or loss in the hedge reserve under shareholders' equity is reported as an adjustment to selling proceeds or transaction costs in the same period as any transactions relating to the hedged obligations or estimates.

As regards equity in foreign subsidiaries situated outside the eurozone, these have largely been hedged against exchange rate fluctuations through foreign currency borrowings and foreign exchange derivatives using the equity hedging method to reduce the effect of exchange rates on the Group's equity. When a foreign subsidiary is sold, these translation differences are included in the gain or loss on disposal reported in the income statement.

For derivatives that do not satisfy the conditions for hedge accounting in accordance with IAS 39, changes in fair value are reported directly in the income statement.

The Group documents the relationship between each hedging instrument and the hedged asset upon entering into a hedging arrangement, along with the risk management objective and the strategy applied. Through this process the hedging instrument is linked to the relevant assets and liabilities, projected business transactions or binding contracts. The Group also documents its ongoing assessment of the effectiveness of the hedge as regards the relationship between a change in the derivative's fair value and a change in the value of the hedged cash flows or transactions.

The fair value of interest rate swaps is calculated by discounting the underlying future cash flows. Currency forwards are valued at existing forward rates on the balance sheet date. Currency options are valued at their market value on the balance sheet date.

Net sales and revenue recognition

Net sales are based on sales proceeds with allowances for indirect taxes and discounts, etc. Sales are recognized once the material risks and benefits associated with ownership have been transferred to the buyer. This usually means that revenue recognition occurs when a product or service is delivered to the customer in accordance with the terms of delivery. Exceptions include larger contracting projects and long-term operating and maintenance agreements, where revenue recognition occurs in accordance with the project's percentage of completion. Revenue recognition is based on the per-

centage of completion when it is possible to reliably identify the project and measure its outcome. The percentage of completion is based on costs incurred for work performed to date in the case of contracting projects, while for operating and maintenance agreements it is calculated on the basis of the proportion of the contracted services performed.

Research and development costs

Research and development costs are expensed in the reporting period during which they arise, with the exception of important development projects that can reliably be regarded as generating future economic benefits for the Group, which are reported as intangible assets in the balance sheet. These projects involve the development of new or significantly improved products or production processes. The cost of buildings, machinery and facilities is capitalized and depreciated. Grants received are reported as a reduction in costs for the period in question.

Retirement benefit agreements

Group companies around the world operate a number of pension systems that are based on local conditions and national legislation. These pension systems are classified either as defined contribution or defined benefit plans.

Defined contribution plan contributions are expensed in the income statement for the reporting period to which they relate. For defined benefit plans pension costs are calculated and reported as per the Projected Unit Credit Method. Pension plans are calculated by qualified actuaries. Pension obligations are calculated as the present value of the projected future cash outflows less the fair value of assets belonging to the pension plan on the balance sheet date. Any actuarial gain or loss is distributed over the remaining service period of employees to the extent that it exceeds the higher of 10 per cent of the present value of the defined benefit obligation or the fair value of the plan assets. In accordance with IFRS 1, all actuarial gains and losses are reported in the opening balance as per IFRS on the transition date. Pensionsarrangemang

Share-based payments

Under IFRS 2 the fair value of employee options is to be reported as an expense and an increase in shareholders' equity. This does not apply to any existing option programmes of the Group, as these were exercisable when IFRS 2 came into force.

Cash and cash equivalents

Cash and cash equivalents comprise cash resources and demand deposits at banks and similar institutions. Other liquid assets comprise liquid short-term investments that

can easily be converted into a known amount of cash and which are only subject to minor fluctuations in value.

Valuation of trade receivables and other receivables

Trade receivables and other receivables are reported at face value. Doubtful accounts are valued individually and reported at their probable value. Credit losses are expensed in the income statement.

Inventory valuation

Inventories are valued at cost, which also includes allocated purchasing and manufacturing overhead costs in addition to direct manufacturing costs.

Inventories are carried at the lower of cost or net realizable value. Inventory valuation is mainly based on the weighted average cost.

Goodwill and other intangible assets

The difference between the purchase price and the fair value of a company's net assets on the date of acquisition is reported as goodwill. Under IFRS goodwill is not amortized. The recoverable amount and any write-down requirements are instead reviewed annually.

Other intangible assets include patents, licence rights, capitalized development projects, software and other assignable intellectual property rights. These are valued at cost. Other intangible assets identified in connection with business acquisitions are valued at their fair value. Intangible assets are amortized on a straight-line basis over their estimated useful lives. Fixed-term rights are amortized over the life of the contract.

The general guidelines for scheduled amortization are:

Development expenditures	5–10 years
Software	3–7 years
Other intellectual property rights	5–20 years

Fixed assets and depreciation

Fixed assets acquired by Group companies are recorded in the balance sheet at their direct cost less accumulated depreciation and write-downs. The book values of certain land areas and buildings also include any write-ups recorded prior to the transition date of 1 January 2004 in accordance with IFRS 1. The fixed assets of acquired subsidiaries are valued at their fair value at the time of acquisition. Scheduled depreciation is based on the following general guidelines with respect to useful lives:

Other capitalized expenditures	3–10 years
Buildings	10–40 years
Machinery and equipment	5–20 years

Properties held for investment purposes

Properties that are not used in the Group's operating activities are classified as properties held for investment purposes. Investment properties are treated as long-term investments and are valued at cost less accumulated depreciation and write-downs.

Lease agreements

Rental and lease agreements where all material risks and future benefits associated with ownership have been transferred to the Group are classified as finance leases. Assets acquired through a finance lease are reported as fixed assets at the lower of their fair value or the present value of the required minimum lease payments. These assets are depreciated over their useful lives in accordance with the same principles that apply to other similar fixed assets.

Rental and lease agreements where risks and benefits have not effectively been transferred to the Group are classified as operating leases. Operating lease payments are reported as rental expenses.

Investments in other companies

Investments in other companies are classified as assets available for sale and are reported at fair value. Listed shares are valued at their market value. Other shares are valued at cost if no other value can be determined in a reliable manner. Changes in value are reported directly under shareholders' equity until the shares are sold or transferred, whereupon they are reported in the income statement. If the value of shares becomes permanently impaired, a write-down is reported in the income statement.

Gains on disposal and write-downs of shares that are attributable to operating activities are included in operating income, while gains and losses on the disposal of other shares are not included in operating income.

Write-downs

The book value of assets is reviewed on a regular basis to determine any write-down needs. The assets of the Group are subdivided into the smallest possible cash-generating units that are effectively independent of any other assets of the Group. The book value of assets is written down if their value in use falls short of their reported value. An asset's value in use is the higher of its net realizable value or the amount recoverable from the asset. The value in use is based on discounted future cash flows. Previously reported write-downs of tangible fixed assets are reversed if the assumptions that formed the basis for the write-down change.

Appropriations (applies only to the parent company's annual financial statements)

Appropriations consist of reserves and depreciation differences. Accumulated appropriations are divided between a deferred tax liability and shareholders' equity in the consolidated balance sheet. Changes in appropriations after deductions for tax are included in net income. The part of appropriations that is recorded under shareholders' equity is not included in the Group's distributable assets.

Provisions

Items that are based on agreements or other existing obligations, and where it is probable that an outflow of financial resources will be required to satisfy the obligation, are reported as provisions in the balance sheet if a reliable estimation of the amount can be made. Such items include warranty provisions, provisions for environmental risks, and forecast losses on projects and restructuring costs for example.

Estimated future warranty costs relating to products supplied are recorded as provisions. Realized warranty costs, together with changes in warranty liability, are expensed during the reporting period in which they occur.

Provisions for restructuring costs are made once the personnel concerned have been informed of the terms or a restructuring plan has been established. The plan

must indicate which activities and personnel will be affected and the timing and cost of implementation. Expenses relating to the Group's ongoing operations are not included.

Income tax

The income statement reflects taxes on the Group's consolidated taxable income for the reporting period in accordance with local tax regulations, tax adjustments for previous reporting periods and deferred taxes. Deferred tax liabilities or deferred tax assets are calculated based on temporary differences between taxation and the annual financial statements using the applicable tax rates for subsequent years, as available at the balance sheet date. The balance sheet reflects any deferred tax liability in its entirety and deferred tax asset at the estimated probable amount.

Distributions to shareholders

Dividends proposed by the Board of Directors are not reported in the annual financial statements. Dividends are recorded only after they have been approved by the company's annual general meeting.



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