

Summary of main accounting principles and policies

Group activities

Benetton Group S.p.A. (the "Parent Company") and its subsidiary companies (hereinafter also referred to as the "Group") primarily manufacture and market fashion apparel in wool, cotton and woven fabrics, as well as sportswear and leisurewear. The manufacture of finished articles from raw materials is undertaken partly within the Group and partly using subcontractors, whereas selling is carried out through an extensive commercial network both in Italy and abroad, consisting mainly of stores operated and owned by third parties.

The legal headquarters and other such information are shown on the first page of this document. The Parent Company is listed on the Milan, Frankfurt, and New York stock exchanges.

These consolidated financial statements were approved by the Board of Directors of Benetton Group S.p.A. on March 30, 2006.

Form and content of the consolidated financial statements

The consolidated financial statements of the Group include the financial statements as of December 31 of Benetton Group S.p.A. and all Italian and foreign companies in which the Parent Company holds, directly or indirectly, the majority of the voting rights. The consolidated financial statements also include the accounts of certain 50%-owned companies over which the Group exercises a significant influence such that it has control over them. In particular:

- a. Benetton Korea Inc., since the effective voting rights held by Benetton Japan Co., Ltd. (a company indirectly wholly-owned by Benetton Group S.p.A.) total 51% of all voting rights;
- b. Benetton Giyim Sanayi ve Ticaret A.S. (a Turkish company), since the licensing and distribution agreements grant Benetton Group S.p.A. a dominant influence over the company, as well as the majority of risks and rewards linked to its business activities.

Financial statements of subsidiaries have been reclassified, where necessary, for consistency with the format adopted by the Parent Company. Such financial statements have been adjusted so that they are consistent with the reference international accounting and financial reporting standards.

These financial statements have been prepared on a "going concern" basis, matching costs and revenues to the accounting periods to which they relate. The reporting currency is the euro and all values have been rounded to thousands of euro.

Consolidation criteria

The method of consolidation adopted for the preparation of the consolidated financial statements is as follows:

- a. Consolidation of subsidiary companies' financial statements according to the line-by-line method, with elimination of the carrying value of the shareholdings held by the Parent Company and other consolidated companies against the relevant shareholders' equity.

- b. When a company is consolidated for the first time, any positive difference emerging from the elimination of its carrying value on the basis indicated in a. above, is allocated, where applicable, to the assets and liabilities of the subsidiary. The excess of the cost of acquisition over the net assets is recorded as "Goodwill and other intangible assets of indefinite useful life". Negative differences are recorded in the income statement as income.
- c. Intercompany receivables and payables, costs and revenues, and all significant transactions between consolidated companies, including the intragroup payment of dividends, are eliminated. Unrealized intercompany profits and gains and losses arising from transactions between Group companies are also eliminated.
- d. Minority interests in shareholders' equity and the result for the period of consolidated subsidiaries are classified separately as "Minority interests" under shareholders' equity and as "Income attributable to minority interests" in the consolidated income statement.
- e. The financial statements of foreign subsidiaries are translated into euro using period-end exchange rates for assets and liabilities and average exchange rates for the period for income statement, with the exception of companies operating in economies subject to hyperinflation. Differences arising from the translation into euro of foreign currency financial statements are reflected directly in consolidated shareholders' equity as a separate component.

Accounting standards and policies

Application of IFRS. Up to first quarter 2005, the Group prepared its consolidated financial statements and other periodic information (quarterly and half-yearly) in accordance with Italian accounting standards (Italian GAAP).

As from the half-year report for 2005, periodic consolidated reports are being prepared in accordance with IFRS, while, in the case of the annual report of the Parent Company Benetton Group S.p.A. these standards will be adopted as from financial year 2006. Considering this and taking into account the recommendations of the CESR (Committee of European Securities Regulators) published on December 30, 2003 containing the guidelines for listed companies in the EU concerning methods for the transition to IFRS, as well as the Regolamento Emittenti (Issuers' Regulations), as modified by CONSOB (the Italian Stock Exchange Authority) by Resolution no. 14990 of April 14, 2005, following, among other things, adoption of International Accounting Standards for interim reporting, the information required by IFRS 1 - regarding the impact of adopting IFRS on the 2004 consolidated balance sheet and financial position, the consolidated income statement and consolidated cash flow - are fully discussed in the section entitled "Transition to IFRS". The financial statements as of December 31, 2005, have been drawn up in accordance with the International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB) applicable as of the date of preparation (March 2006) and on the basis of Appendix 3D to the Issuers' Regulations no. 11971 of May 14, 1999, and subsequent amendments and additions, and in compliance with IAS 1 provisions in particular.

No accounting principles or interpretations with effect from January 1, 2005, and resulting in a significant impact on the Group's consolidated financial statements have been reviewed or issued. Specifically:

- in December 2004, the IASB issued an amendment to IAS 19 - Employee Benefits
- allowing the option of recognizing gains and losses in full in the period in which they

occur, outside profit or loss, in a statement of recognized income and expense. The amendment also provides a guideline for the allocation of a defined benefit plan across the various companies belonging to the Group. This amendment is effective as of January 1, 2006. The Group is currently evaluating its impact;

- in April 2005, the IASB issued an amendment to IAS 39 - Financial Instruments: Recognition and Measurement - which permits the foreign currency risk of a highly probable intragroup transaction to qualify as the hedged item in a cash flow hedge in consolidated financial statements, provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and that the foreign currency risk will affect consolidated financial statements. The amendment also specifies that if the hedge of a forecasted intragroup transaction qualifies for hedge accounting, any gain or loss that is recognized directly in shareholders' equity in accordance with the rules in IAS 39 must be reclassified onto income statement in the same period during which the foreign currency risk of the hedged transaction affects the consolidated income statement. The Group already uses this approach;
- in June 2005, the IASB issued its final amendment to IAS 39 - Financial Instruments: Recognition and Measurement - to restrict the use of the option to designate any financial asset or any financial liability to be measured at fair value through profit or loss (the fair value option). This revision limits the use of the option to those financial instruments that meet the following conditions:
 - the fair value option designation eliminates or significantly reduces an accounting mismatch;
 - a group of financial assets, financial liabilities, or both are managed and their performance is evaluated on a fair value basis in accordance with a documented risk management or investment strategy;
 - an instrument contains an embedded derivative that meets particular conditions.

This amendment to IAS 39 is effective from January 1, 2006. The Group is evaluating any impact this change may have;

- in August 2005, the IASB issued the new standard IFRS 7 - Financial Instruments: Disclosures - and a complementary amendment to IAS 1 - Presentation of Financial Statements: Capital Disclosures. IFRS 7 adds certain new disclosures regarding the relevance of financial instruments to an entity's performance and financial position. These disclosures include some requirements previously encapsulated in IAS 32 - Financial Instruments: Disclosure and Presentation. The new standard also requires disclosures on the degree of risk exposure linked to the use of financial instruments and a description of financial risk management objectives, policies and procedures implemented by management. The amendment to IAS 1 adds requirements for disclosures of quantitative data as to what the entity regards as capital. IFRS 7 and the amendment to IAS 1 are effective as of January 1, 2007. The Group is evaluating any impact these changes may have;
- in August 2005, the IASB issued an amendment to IAS 39 and IFRS 4 for the accounting treatment of issued financial guarantees. On the basis of the amendment, losses due to issued financial guarantees contracts must be recognized in the guarantor's financial statements and valued as follows:
 - initially at fair value;
 - subsequently at the higher of (a) the amounts determined in accordance with IAS 37 - Provisions, Contingent Liabilities and Contingent Assets - to fulfill the obligation at the reference

date, or (b) the amount initially recognized less, where appropriate, cumulative amortization recognized in accordance with IAS 18 - Revenue.

These amendments are effective from January 2006. The Group is evaluating any impact these changes may have.

Valuation criteria

The financial statements have been prepared on a historical cost basis, with the exception of the valuation of certain financial instruments. The principal accounting policies applied are detailed below:

Revenues. Revenues arise from ordinary company operations and include sales revenues and service revenues.

Revenues from product sales net of any discounts are recognized when the company transfers the main risks and rewards associated with ownership of the goods and when collection of the relevant receivables is reasonably certain. Revenues from sales by directly operated stores are recognized when the customer pays. Revenues from services are recorded with reference to the stage of completion of the transaction as of the financial statement date. Revenues are recorded in the financial year in which the service is provided, based on the percentage of completion method. If revenues from the services cannot be estimated reliably, they are only recognized to the extent that the relative costs are recoverable. Recognizing revenues using this method makes it possible to provide suitable information about the service provided and the economic results achieved during the financial year. Royalties are recognized on an accruals basis in accordance with the substance of the contractual agreements.

Interest income. Interest income is recorded on a time-proportion basis, taking account of the effective yield of the asset to which it relates.

Dividends. Dividends from third parties are recorded when the shareholders' right to receive payment becomes exercisable, following a resolution of the shareholders of the company in which the shares are held.

Expense recognition. Expenses are recorded on an accruals basis.

Income and costs relating to lease contracts. Income and costs from operating lease contracts are recognized on a straight-line basis over the duration of the contract to which they refer.

Income taxes. Current income taxes are calculated on the basis of taxable income, in accordance with applicable local regulations.

Italian Group companies have made a group tax election under Article 117 et seq. of the Tax Consolidation Act DPR 917/86, based on a proposal by the consolidating parent company Edizione Holding S.p.A., which decided to opt for this type of tax treatment on December 30, 2004. The election lasts for three years starting from the 2004 fiscal year. The relationships arising from participation in the group tax election are governed by specific Rules, approved and signed by all participating companies.

This participation enables the companies to identify, and then transfer current taxes, even

when the taxable result is negative, recognizing a corresponding receivable due from Edizione Holding S.p.A.; conversely, if the taxable result is positive, the current taxes transferred give rise to a payable in respect of the consolidating parent company Edizione Holding S.p.A.

The relationship between the parties, governed by contract, provides for the transfer of the full amount of tax calculated on the taxable losses or income at current IRES (corporation tax) rates. The net balance of deferred tax assets and liabilities is also recorded.

Deferred tax assets are recorded for all temporary differences to the extent it is probable that taxable income will be available against which the deductible temporary difference can be utilized. The same principle is applied to the recognition of deferred tax assets on the carryforward of unused tax losses.

The carrying value of deferred tax assets is reviewed at every balance sheet date and, if necessary, reduced to the extent that it is no longer probable that sufficient taxable income will be available to recover all or part of the asset. The general rule provides that, with specific exceptions, deferred tax liabilities are always recognized.

Deferred tax assets and liabilities are calculated using tax rates which are expected to apply in the period when the asset is realized or the liability settled, using the tax rates and tax regulations which are in force at the balance sheet date.

Tax assets and liabilities for current taxes are only offset if there is a legally enforceable right to set off the recognized amounts and if it is intended to settle or pay on a net basis or to realize the asset and settle the liability simultaneously. It is possible to offset deferred tax assets and liabilities only if it is possible to offset the current tax balances and if the deferred tax balances refer to income taxes levied by the same tax authority.

Earnings per share. Basic earnings per share are calculated by dividing income attributable to Parent Company shareholders by the weighted average number of ordinary shares outstanding during the period. Diluted earnings per share are calculated by dividing the income or loss attributable to Parent Company by the weighted average number of outstanding shares, taking account of all potential ordinary shares with a dilutive effect (for example employee stock option plans).

Property, plant and equipment. These are recorded at purchase or production cost, including the price paid to buy the asset (net of discounts and rebates) and any costs directly attributable to the purchase and commissioning of the asset. The cost of a commercial property purchased is the purchase price or equivalent of the price in cash including all other directly attributable expenses such as legal costs, registration taxes and other transaction costs. The cost of internally produced assets is the cost at the date of completion of work. Property, plant and equipment are shown at cost less accumulated depreciation and impairment losses, plus any recovery of asset value. Plant and machinery may have components with different useful lives. Depreciation is calculated on the useful life of each individual component. In the event of replacement, new components are capitalized to the extent that they satisfy the criteria for recognition as an asset, and the carrying value of the replaced component is eliminated from the balance sheet. The residual value and useful life of an asset is reviewed at least at every financial year-end and if, regardless of depreciation already recorded, an impairment loss occurs determined under the criteria contained in IAS 36, the asset is correspondingly written down in value;

if, in future years, the reasons for the write-down no longer apply, its value is restored. Ordinary maintenance costs are expensed in full to the income statement as incurred, while maintenance costs which increase the value of the asset are allocated to the related assets and depreciated over their residual useful lives. The value of an asset is systematically depreciated over its useful life, on a straight-line basis, indicatively as shown below:

	Useful life (years)
Buildings	33 - 50
Plant and machinery	4 - 12
Industrial and commercial equipment	4 - 10
Other assets:	
- office and store furniture, furnishings and electronic machines	4 - 10
- vehicles	4 - 5
- aircraft	15 - 16

Land is not depreciated.

From the 2005 financial year, all commercial properties are depreciated over 50 years, following a review of their useful life.

Leasehold improvement costs are depreciated over the shorter of the period during which the improvement may be used and the residual duration of the lease contract. Assets acquired under finance leases are recognized at their fair value at the start of the lease, while the corresponding lease installments are recorded as a liability to the leasing company; assets are depreciated at the normal depreciation rate used for similar assets. In the case of sale and leaseback transactions resulting in a finance lease, any gain resulting from the sale and leaseback is deferred and released to income over the lease term. Leaseholds where the lessor effectively maintains all risks and rewards linked to asset ownership are classified as operating leases. Costs pertaining to operating leases are recorded on the income statement on a line-by-line basis throughout the length of the leasing agreement.

Intangible assets. Intangible assets are measured initially at cost, normally defined as their purchase price, inclusive of any import duties and non-refundable purchase taxes and less any trade discounts and rebates; also included is any directly attributable expenditure on preparing the asset for its intended use, up until the asset is capable of operating. The cost of an internally generated intangible asset includes only those expenses which can be directly attributed or allocated to it as from the date on which it satisfies the criteria for recognition as an asset. After initial recognition, intangible assets are carried at cost, less accumulated amortization and any accumulated impairment losses calculated in accordance with IAS 36.

Goodwill is recognized initially by capitalizing, in intangible assets, the excess of the purchase cost over the fair value of the net assets of the newly acquired, incorporated or merged company. As required by IAS 38, at the time of recognition, any intangible assets that have been generated internally by the acquired entity are eliminated from goodwill. Goodwill not allocated to specific items is not amortized, but is submitted to an impairment test annually to identify any reductions in value, or more often whenever there is any evidence of impairment loss (see impairment of assets).

Research costs are charged to the income statement in the period in which they are incurred.

Items which meet the definition of “assets acquired as part of a business combination” are only recognized separately if their fair value can be measured reliably.

Intangible assets are amortized unless they have indefinite useful lives. Amortization is applied systematically over the intangible asset's useful life, which reflects the period it is expected to benefit. The residual value at the end of the useful life is assumed to be zero, unless there is a commitment by third parties to buy the asset at the end of its useful life or there is an active market for the asset. Management reviews the estimated useful lives of intangible assets at every financial year end.

Normally, the amortization period for brands ranges from 15 to 25 years; patent rights are amortized over the duration of their rights of use, while deferred and commercial expenses are amortized over the remaining term of the lease contracts, with the exception of “fonds de commerce” of French and Belgian companies, which are amortized over 20 years.

Impairment losses for non-financial assets. The carrying amounts of the Benetton Group's property, plant and equipment and intangible assets are submitted to impairment testing whenever there are obvious internal or external indicators indicating that the asset or group of assets (defined as Cash-Generating Units or CGUs) may be impaired. In the case of goodwill, other intangible assets with indefinite lives and intangible assets not in use, the impairment test must be carried out at least annually and, anyway, whenever there are indicators of possible impairment.

The impairment test is carried out by comparing the carrying amount of the asset or CGU with the recoverable value of the same, defined as the higher of fair value (net of any costs to sell) and its value in use. Value in use is determined by calculating the present value of future net cash flows expected to be generated by the asset or CGU. If the carrying amount is higher than the recoverable amount, the asset or CGU is written down by the difference.

The conditions and methods applied by the Group for reversing impairment losses, excluding in any case those relating to goodwill that may not be reversed, are as set out in IAS 36.

The Benetton Group has identified assets and CGUs (for example: stores operated directly and by third parties, and textile segment factories) to be submitted to impairment testing as well as the test methodology: for real estate and some categories of asset (for example: “fonds de commerce” associated with French and Belgian stores) fair value is used, while value in use is adopted for most of the other assets.

Financial assets. All financial assets are measured initially at cost, which corresponds to the consideration paid including transaction costs (such as advisory fees, stamp duties and payment of amounts required by regulatory authorities).

Classification of financial assets determines their subsequent valuation, which is as follows:

- financial assets held for trading: these are recorded at fair value, unless this cannot be determined reliably, in which case they are valued at cost as adjusted for any impairment losses. Gains and losses associated with these assets are booked to the income statement;

- held-to-maturity investments, loans receivable and other financial receivables: these are recorded at amortized cost, less any write-downs carried out to reflect impairment losses. Gains and losses associated with this type of asset are recognized in the income statement when the investment is removed from the balance sheet on maturity or if it becomes impaired;
- available for sale financial assets: these are recorded at fair value, and gains and losses deriving from subsequent measurement are recognized in shareholders' equity. If the fair value of these assets cannot be determined reliably, they are measured at cost, as adjusted for any impairment.

If it is no longer appropriate to classify an investment as "held-to-maturity" following a change of intent or ability to hold it until maturity, it must be reclassified as "available for sale" and remeasured to fair value. The difference between its carrying amount and fair value remains in shareholders' equity until the financial asset is sold or otherwise transferred, in which case it is booked to the income statement.

Investments in subsidiaries that are not consolidated on a line-by-line basis because they are not yet operative or are in liquidation as of the balance sheet date, and investments in associates are valued at cost and adjusted for any impairment losses.

The amount by which cost exceeds shareholders' equity of subsidiary companies at the time they are acquired is allocated on the basis described in paragraph b) of the consolidation methods. Investments of less than 20% in other companies are carried at cost, written down for any permanent losses in value. The original value of these investments is reinstated in future accounting periods should the reasons for such write-downs no longer apply.

All financial assets are recorded as of the date of negotiation, i.e. the date on which the Group undertakes to buy or sell the asset. A financial asset is removed from the balance sheet only if all risks and rewards associated with the asset are effectively transferred together with it or, should the transfer of risks and rewards not occur, if the Group no longer has control over the asset.

Inventories. Inventories are valued at the lower of purchase or manufacturing cost, generally determined on a weighted average cost basis, and their market or net realizable value.

Manufacturing cost includes raw materials and all attributable direct and indirect production-related expenses.

The calculation of estimated realizable value includes any manufacturing costs still to be incurred and direct selling expenses. Obsolete and slow-moving inventories are written down in relation to their possibility of employment in the production process or to realizable value.

Trade receivables. These are recorded at estimated realizable value, which is face value less write-downs which reflect estimated losses on receivables; the provisions for doubtful accounts are included among other operating costs on the income statement. Any medium/long-term receivables that include an implicit interest component are discounted to present value using an appropriate market rate. Receivables discounted without recourse, for which all risks and rewards are substantially transferred to the assignee, are derecognized from the financial statements at their nominal value.

Commissions paid to factoring companies for their services are included in service costs.

Accruals and deferrals. These are recorded to match costs and revenues within the accounting periods to which they relate.

Cash and cash equivalents. These are liquid funds held to meet short-term cash commitments and are characterized by high liquidity, easily convertible to cash for a known amount, with an insignificant risk of change of value. Cash equivalents are mostly temporary surpluses of liquid funds invested in financial instruments that can be readily converted to cash (maturities of the instrument at time of purchase being less than three months).

Retirements benefit obligations. The provision for employee termination indemnities (TFR) falls within the scope of IAS 19 (Employee benefits) being like a defined benefit plan. The amount recorded in the balance sheet is valued on an actuarial basis using the projected unit credit method. The process of discounting to present value uses a rate of interest which reflects the market yield on securities issued by leading companies with a similar maturity to that expected for this liability. The calculation considers TFR to be already mature for employment services already performed and includes assumptions concerning future increases in wages and salaries.

Accrued actuarial gains and losses not recognized at the beginning of the financial year which exceed 10% of the Group's defined benefit obligation are recorded on the income statement in the period in which they occur (the "corridor approach").

Provisions for contingent liabilities. The Group makes provisions only when a present obligation exists for a future outflow of economic resources as a result of a past event, and when it is probable that this outflow will be required to settle the obligation and a reliable estimate can be made of the same. The amount recognized as provision is the best estimate of the expenditure required to settle the present obligation completely, discounted to present value using a suitable pre-tax rate.

Any provisions for restructuring costs are recognized when the Group has drawn up a detailed restructuring plan and has announced it to the parties concerned.

In the case of onerous contracts where the unavoidable costs of meeting the contractual obligations exceed the economic benefits expected to be received under the contract, the present obligation is recognized and measured as a provision.

Trade payables. These are stated at face value. The implicit interest component included in medium/long-term payables is recorded separately using an appropriate market rate.

Financial liabilities. Financial liabilities are divided into two categories:

- liabilities acquired with the intention of making a profit from short-term price fluctuations or which form part of a portfolio which has the objective of short-term profit-taking. These are recorded at fair value, with the related gains and losses booked to the income statement;
- other liabilities, which are recorded on the basis of amortized cost.

Foreign currency transactions and derivative financial instruments. Transactions in foreign currencies are recorded using the exchange rates on the transaction dates. Exchange gains or losses realized during the period are booked to the income statement. At the balance sheet date, the Group companies have adjusted receivables and payables

in foreign currency using exchange rates ruling at period-end, booking all resulting gains and losses to the income statement. Fair value hedge instruments for specific assets and liabilities are recorded in assets and liabilities; the hedging instrument and the underlying item are measured at fair value and the respective changes in value (which generally offset each other) are recognized in the income statement.

Cash flow hedge instruments are recorded under assets and liabilities; the hedging instrument is measured at fair value and the effective portion of changes in value are recognized directly in an equity reserve, which is released to the income statement in the financial periods in which the cash flows of the underlying item occur; the ineffective portion of the changes in value is recognized on the income statement.

The shareholders' equity of foreign subsidiaries is subject to hedging in order to protect investments in foreign companies from fluctuations in exchange rates (foreign exchange translation risk). Exchange differences resulting from these hedging transactions are debited or credited directly to shareholders' equity as an adjustment to the translation differences reserve; which are recognized on the income statement at the time of disposal or settlement.

Derivative instruments for managing interest and exchange rate risks, which do not meet the formal requirements to qualify for IFRS hedge accounting, are recorded under financial assets/liabilities with changes in value reported through the income statement.

Share-based payments (stock options). The Group stock option plan provides for the physical delivery of the shares on the date of exercise. Share-based payments are measured at fair value on the grant date. This value is booked to the income statement on a straight-line basis over the period during which the options vest and it is offset by an entry to a reserve in shareholders' equity; the amount booked is based on a management estimate of the stock options which will effectively vest for staff so entitled, taking into account the attached conditions not based on the market value of the shares. Fair value is calculated using the Black & Scholes method.

Capital grants. Any capital grants are presented on the income statement by recording the grant as an adjusting entry for the carrying value of the asset.

Financial risk management

The Benetton Group has always paid special attention to the identification, valuation and hedging of financial risk. In November 2005, the Board of Directors of the Benetton Group approved the new "Group Financial Policy" aimed at defining general principles and guidelines on financial management and the management of financial risks, such as interest rate risk, foreign exchange rate risk, and financial counterparty credit risk.

Foreign exchange rate risk. The Group is exposed to exchange rate fluctuations, which can impact on its economic results and the value of shareholders' equity. Specifically, based on the type of exposure, the Group identifies the following classes of risk:

Exposure to economic exchange risk. The Group's companies may have:

- costs and revenues denominated in currencies other than the reporting currency or other currency (usually Usd or Eur) normally used in the companies' reference market and whose exchange rate fluctuations can impact on the operating income;

- trade payables or receivables denominated in currencies other than the functional currency of the company to which they refer, where an exchange rate fluctuation can determine the realization or the ascertaining of positive or negative exchange rate differences.

Exposure to transaction exchange risk. The Group's companies may have financial payables or receivables denominated in currencies other than the functional currency of the company to which they refer and whose exchange rate fluctuations can cause the realization or the ascertaining of positive or negative exchange rate differences.

Exposure to exchange translation risk. Some of the Group's subsidiaries are located in countries which do not belong to the European Monetary Union and their functional currency differs from the euro, which is the Group's reference currency:

- the income statements of these companies are translated into euro using the period's average exchange rate, and, with revenues and margins being the same in local currency, exchange rate fluctuations can impact on the value in euro of revenues, costs and economic results;
- assets and liabilities of these companies are converted at the year-end exchange rate and therefore can have different values depending on exchange rate fluctuations. As provided for by the accounting standards adopted, the effects of such variations are recognized directly in shareholders' equity among translation provisions.

It is the Group's policy to manage foreign exchange risk through derivative financial instruments such as currency forwards, currency swaps, currency spots and currency options; speculative trading is not allowed.

Interest rate risk. The Group's companies use external financial resources in the form of loans and invest available liquidity in money-market and capital-market instruments. Variations in market interest rates influence the cost and revenue of different funding and investment instruments, thus impacting on the Group's financial income and expenses.

Credit risk. The Group shows different concentrations of credit risk depending on the nature of the activities which have generated the receivables.

The Group has policies in place to ensure that wholesale sales of products are made to customers with an appropriate credit history. Sales to retail customers are made in cash or via major credit cards.

Receivables which are partially or totally irrecoverable, if sufficiently significant, are written off on an individual basis. The write-off amount takes into account a forecast of recoverable cash flows and their relevant collection date, as well as the fair value of warranties. Collective provisions are made for receivables which are not subject to individual write-off, taking into account bad debt history and statistical data.

Financial credit risk lies in the counterpart's or the issuer's inability to settle its financial obligations.

The Group invests available liquidity in money-market and capital-market instruments. These instruments must have a minimum long-term issuer and/or counterpart rating of S&P's "A-" (or equivalent) and/or a minimum short-term issuer and/or counterpart rating of S&P's "A-2" (or equivalent).

With the exception of bank deposits, the maximum investment allowed in all other instruments may not exceed 10% of the Group's liquidity investments, with a ceiling of 20 million euro for each issuer/counterpart, in order to avoid excessive concentration in

a single issuer for sovereign issuers with rating lower than "A" (or equivalent) and for all other issuers with rating lower than "AA" (or equivalent).

As of December 31, 2005 the Group's available liquidity was mainly invested in bank deposits with main financial institutions.

Liquidity risk. Liquidity risk can be represented by the inability to access, at economically viable conditions, the financial resources needed to guarantee the Group's ability to operate.

The two main factors influencing the Group's liquidity position are the resources generated or used by operating and investment activities, and the characteristics maturity and renewal of credit line or the liquidity of financial investments.

The classification of financial assets and liabilities by maturity date as of December 31, 2005, is reported in the explanatory notes.

Liquidity requirements are monitored by the Parent Company's central functions in order to guarantee effective access to financial resources or adequate investment of liquidity.

As of December 31, 2005, the Group had unutilized "committed" credit lines in the amount of 500 million euro and "uncommitted" credit lines in the amount of 400 million euro.

Management feels that currently available funds and credit lines, apart from those which will be generated by operating and financing activities, will allow the Group to satisfy its requirements as far as investment, working capital management, and debt repayment at natural maturity are concerned.

Supplementary information

Identification of segments. The Group has identified "business" as the primary reporting basis for its segment information, since this is the primary source of risks and rewards; geographic area is the basis for its secondary segment reporting.

The Group's activities are divided into three segments in order to provide the basis for effective administration and decision-making, and to supply representative and significant information about company performance to financial investors.

The business segments are as follows:

- apparel, represented by casualwear, carrying the United Colors of Benetton, Undercolors and Sisley brands, and sportswear, with the Playlife and Killer Loop brands; the information and results relating to the real estate companies are also included in this segment;
- textile, consisting of production and sales activities for raw materials (fabrics, yarns and labels), semi-finished products and industrial services;
- other and unallocated, includes activities relating to sports equipment produced for third parties by a Group manufacturing company.

The geographic areas defined by the Group for the purposes of secondary sector disclosure in compliance with IAS 14 on the basis of significance are as follows:

- Italy;
- Rest of Europe;
- Asia;
- The Americas;
- Rest of the world.

Cash flow statement. In compliance with IAS 7, the cash flow statement, prepared using the indirect method, highlights the Group's ability to generate cash and cash equivalents. Cash equivalents comprise short-term highly liquid financial investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value. An investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition. Bank overdrafts are also part of the financing activity, unless they are payable on demand and form an integral part of an enterprise's cash and cash equivalents management, in which case they are classified as a component of cash and cash equivalents. Cash and cash equivalents included in the cash flow statement comprise the balance sheet amounts for this item at the reporting date. Cash flows in foreign currencies are translated at the average exchange rate for the period. Income and expenses relating to interest, dividends received and income taxes are included in cash flow from operating activities.

The layout adopted by the Group reports separately:

- **operating cash flow:** operating cash flows are mainly linked to revenue-generation activities and are presented by the Group using the indirect method; this method adjusts, on an accruals basis, net profit or loss for the effects of items which did not result in cash outflows or generate liquidity (i.e. non-cash transactions);
- **investing cash flow:** investing activities are reported separately because, amongst other things, they are indicative of investments/divestments aimed at the future generation of revenues and positive cash flows;
- **financing cash flow:** financing activities consist of the cash flows which determine a change in the entity and composition of shareholders' equity and loans granted.

Use of estimates. The preparation of the consolidated financial statements and related notes under IFRS has required management to make estimates and assumptions regarding assets and liabilities reported in the balance sheet and the disclosure of potential assets and liabilities at the reporting date. The final results could be different from the estimates. The Group has used estimates for valuing assets subject to impairment testing as previously described, for valuing share-based payments, provisions for doubtful accounts, depreciation and amortization, employee benefits, deferred tax assets and other provisions. The estimates and assumptions are reviewed periodically and the effects of any changes are immediately reflected in the income statement.

Accounting treatment of enterprises operating in economies subject to hyperinflation (Turkey). The Turkish subsidiary's financial statements are expressed in new Turkish lira (local currency and reporting currency) at historic cost, in the unit of measurement applicable on the closing date of the reference period. The values relevant to non-cash balance sheet items are revalued applying the variation of the general price index which has occurred between the capture date and the closing date of the reference period. The statements revalued in this way are then converted into the presentation currency of the consolidated income statement (euro) using the method described in the paragraph "Consolidation methods" for companies using a reporting currency other than the euro, with the exception of balance sheet items which are converted at the period-end exchange rate. The profit or loss on the cash position is attributed to the income statement, as financial income or a financial expense.

Minority shareholders. Transactions between the Group and minority shareholders are regulated in the same way as transactions with parties external to the Group. The sale of shareholding interests to minority shareholders by the Group generates gains or losses recorded on the income statement. The purchase of interests by minority shareholders is translated into goodwill, calculated as the excess of the amount paid over the share of the carrying value of the subsidiary's net assets.