

# Accounting policies

## (a) Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Accounting Standards Board (IASB) as endorsed by the European Union (EU) and with those parts of the Companies Act 1985 applicable to companies reporting under IFRS.

The principal accounting policies set out below have been consistently applied to all financial reporting periods presented in these financial statements, unless otherwise stated.

## (i) New standards, interpretations and amendments to published standards that have been adopted by the Company

IFRS 7 *Financial Instruments: Disclosures* and a complementary amendment to IAS 1 *Presentation of Financial Statements* and complementary revisions to IFRS 4 *Insurance Contracts* have been adopted by the Company from 1 January 2007. The standard has no financial impact but changes the disclosures surrounding the Company's financial instruments and insurance contracts in both 2006 and 2007.

The Company has early adopted International Financial Reporting Interpretations Committee (IFRIC) 11 IFRS 2 *Group and treasury share transactions*. The interpretation provides guidance on accounting for share-based transactions involving treasury shares or involving group entities and considers accounting for such transactions as equity-settled and as cash-settled share-based payment transactions. IFRIC 11 was adopted by the EU regulators on 1 June 2007. The impact of adoption on the Company's financial statements has not been significant.

## (ii) Standards, interpretations and amendments to published standards that are not yet effective and have not been early adopted by the Company

Certain new standards, amendments and interpretations to existing standards have been published that are mandatory for the Company's accounting periods beginning on or after 1 January 2008 or later periods. The Company has not early adopted the standards, amendments and interpretations described below:

### Amendment to IAS 1 *Presentation of financial statements* (effective from 1 January 2009)

The revised standard will prohibit the presentation of items of income and expenses in the statement of changes in equity, requiring 'non-owner changes in equity' to be presented separately from 'owner changes in equity'. All 'non-owner changes in equity' will be required to be shown in a performance statement but there will be a choice as to whether to present only the statement of comprehensive income or both the income statement and statement of comprehensive income. The revised standard also requires that, where restatements or reclassifications of comparative information are made, a restated balance sheet must be presented as at the beginning of the comparative period. The Company will apply the revisions to IAS 1 from 1 January 2009. The revisions will have an impact on the presentation of owner changes in equity and of comprehensive income but will not have a financial impact on the Company's financial statements.

### Amendment to IAS 23 *Borrowing costs* (effective from 1 January 2009 – prospective application)

The publication of the revised standard has followed the joint short-term convergence project between the IASB and the US Financial Accounting Standards Board. Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset are required to be capitalised as part of the cost of that asset. The option of immediately expensing those borrowing costs has been removed. The Company will apply the revisions to IAS 23 from 1 January 2009, but it is not expected to have an impact on the Company's financial statements.

### Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements* – Puttable Financial Instruments and Obligations Arising on Liquidation (effective for annual periods beginning on or after 1 January 2009)

The amendments require certain puttable financial instruments, and certain financial instruments that impose on the Company an obligation to deliver to another party a pro rata share of net assets of the Company only on liquidation, to be classified as equity. Management have assessed that the expected impact of adoption of the amendments on the Company's financial statements will be minimal.

### Amendment to IFRS 2 *Share based payments* (effective for annual periods beginning on or after 1 January 2009)

The amendment addresses vesting conditions and cancellations, clarifying that vesting conditions are service conditions and performance conditions only and that other features of a share-based payment are not vesting conditions. As such these features would need to be included in the grant date fair value for transactions with employees and others providing similar services, that is, these features would not impact the number of awards expected to vest or valuation thereof subsequent to grant date. The amendment also specifies that all cancellations, whether made by the Company or by other parties, should receive the same accounting treatment. Management are considering the expected impact of adoption of the amendments on the Company's financial statements.

**IFRS 3 (Revised) *Business combinations* (applicable to business combinations occurring in accounting periods beginning on or after 1 July 2009)**

The revised standard continues to apply the acquisition method to business combinations, with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at the acquisition date, with some contingent payments subsequently re-measured at fair value through profit or loss. Goodwill may be calculated based on the parent company's share of net assets or it may include goodwill related to the minority interest. All transaction costs will be expensed. Management will give consideration to the application of the requirements of the revised standard in respect of business combinations occurring in accounting periods beginning prior to 1 July 2009.

**IAS 27 (Revised) *Consolidated and separate financial statements* (effective for annual periods beginning on or after 1 January 2009)**

The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and goodwill or gains and losses will no longer be recognised. The standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value and any resulting gain or loss is recognised in the income statement. Management are considering the expected impact of adopting the revised standard on the Company's financial statements.

**(iii) Interpretations to existing standards that are not yet effective and not relevant for the Company's operations**

**IFRIC 13, *Customer loyalty programmes relating to IAS 18 Revenue* (effective for annual periods beginning on or after 1 July 2008)**

The interpretation clarifies that where goods or services are sold together with a customer loyalty incentive, the arrangement is a multiple-element arrangement and the consideration receivable from the customer should be allocated between the components of the arrangement in proportion to their fair values. IFRIC 13 has not yet been adopted by the EU regulators. The interpretation is not deemed relevant to the Company's operations due to the nature of the Company's business.

**IFRIC 14, IAS 19 *The limit on a defined benefit asset, minimum funding requirements and their interaction* (effective from 1 January 2009)**

The interpretation provides guidance on assessing the limit in IAS 19, *Employee benefits* on the amount of the surplus that can be recognised as an asset and explains how the pension asset or liability may be affected by a statutory or contractual minimum funding requirement. IFRIC 14 has not yet been adopted by the European Union (EU) regulators. The Company is not required to adopt this standard since it treats its participation in the Group's defined benefit plan as a defined contribution plan.

**(b) Subsidiaries, associates and joint ventures**

Subsidiaries are all entities, including special purpose entities, over which the Company has the power to govern the financial and operating policies. Such power, generally but not exclusively, accompanies a shareholding of more than one half of the voting rights.

Associates are entities over which the Company has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights.

Joint ventures are entities whereby the Company and other parties undertake an economic activity, which is subject to joint control arising from contractual agreement.

The Company uses the purchase method of accounting for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition.

#### **(b) Subsidiaries, associates and joint ventures** *continued*

The Company has two categories of investments in subsidiaries: operating subsidiaries that undertake the activities of the Group and investment subsidiaries whose primary function is to generate capital or income growth through holding investments. Operating subsidiaries are held at cost less any impairment charge. The Company recognises income from its operating subsidiaries only to the extent that it receives distributions from accumulated profits of the subsidiary arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment. Investment subsidiaries are held at fair value through profit or loss (FVTPL) since they are managed on a fair value basis.

Investments in subsidiaries includes loans to subsidiaries that are classified as equity instruments by the subsidiary.

Associates and joint ventures are held at cost less any impairment charge.

#### **(c) Foreign currency translation**

The financial statements are presented in millions pounds Sterling, which is the Company's presentation currency.

Foreign currency transactions are translated at the exchange rate prevailing at the date of the transaction. Gains and losses arising from such transactions and from the translation at year end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

Translation differences on non-monetary items, such as equities held at FVTPL, are reported as part of the fair value gain or loss in the income statement. Translation differences on financial assets and liabilities held at amortised cost are included in foreign exchange gains or losses in the income statement.

#### **(d) Revenue recognition**

Realised and unrealised gains and losses resulting from changes in both market value and foreign exchange on investments classified as FVTPL, including investment income received (such as dividends and interest payments) are recognised in the income statement in the period in which they occur.

Changes in the fair value of derivative financial instruments that are not hedging instruments are recognised immediately in the income statement.

For loans and receivables measured at amortised cost, interest income recognised in the income statement is calculated using the Effective Interest Rate (EIR) method.

Dividend income and interest income from securities that are classified by the issuer as equity instruments is recognised when the right to receive payment is established.

#### **(e) Impairment of non-financial assets**

The carrying amounts of non-financial assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, at least at each balance sheet date. An impairment loss is recognised in the income statement for the amount by which the asset's carrying amount exceeds its recoverable amount.

The recoverable amount of an asset is the greater of its net selling price (fair value less costs to sell) and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash generating unit, or group of units, to which the asset belongs.

#### **(f) Income tax**

The current tax expense is based on the taxable profits for the year, after adjustments in respect of prior years. Amounts are charged or credited to the income statement or equity as appropriate.

Deferred tax is provided using the balance sheet liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities.

Temporary differences arising from investments in subsidiaries and associates give rise to deferred tax only to the extent that it is probable that the temporary difference will reverse in the foreseeable future or the timing of the reversal of that difference cannot be controlled.

Deferred tax is recognised in the income statement except when it relates to items recognised directly in equity.

The income tax expense is determined using rates enacted or substantively enacted at the balance sheet date.

#### **(g) Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than those that the Company intends to sell in the short term or that it has designated as FVTPL. Financial assets classified as loans and receivables include deposits with credit institutions, and loans to subsidiaries when the loan is classified as a financial liability by the subsidiary.

Loans and receivables are initially measured at fair value less directly attributable transaction costs. Subsequently, they are measured at amortised cost, using the EIR method, less any impairment losses. Revenue from financial assets classified as loans and receivables is recognised in the income statement on an EIR basis.

Impairment on individual loans is determined at each reporting date. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Company. This would include the disappearance of an active market for that financial asset because of financial difficulties and observable data indicating that there is a measurable decrease in the estimated future cash flow from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group. The Company first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant.

If there is objective evidence that an impairment loss has been incurred on loans and receivables carried at amortised cost, the amount of the impairment loss is calculated as the difference between the present value of future cash flows, discounted at the loan's original effective rate, and the loan's current carrying value. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. Subsequent recoveries are credited to the income statement.

If there is no evidence of impairment on an individual basis, a collective impairment review is undertaken whereby the assets are grouped together, on the basis of similar credit risk characteristics, in order to calculate a collective impairment loss. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognised are not included in a collective assessment of impairment.

Loans and receivables which are subject to collective impairment assessment and whose terms have been renegotiated are no longer considered to be past due but are treated as new loans after the minimum number of payments under the renegotiated terms have been collected. Individually significant loans whose terms have been renegotiated are subject to ongoing review to determine whether they remain impaired or past due.

#### **(h) Investment securities and derivatives**

Management determines the classification of investment securities and derivatives at initial recognition. The Company has designated its investment securities as FVTPL. Investment securities are designated at FVTPL where the asset or liability is part of a group of assets that are evaluated and managed on a fair value basis.

The Company uses derivative financial instruments including forwards, swaps, futures, and options for the purposes of matching contractual liabilities, reducing investment risks and for efficient portfolio management activities. In accordance with its treasury policy, the Company does not hold or issue derivative financial instruments for speculative trading purposes.

The Company recognises investment securities and derivatives at fair value on the trade date of the transaction. In the case of derivatives where no initial premium is paid or received the initial measurement value is nil. Directly attributable transaction costs are not included in the initial measurement value but are recognised in the income statement.

Fair values are based upon the current quoted bid price where an active market exists. Where a quoted price in an active market cannot be obtained an appropriate market consistent valuation technique (for example discounted cash flows and recent market transactions) is used to determine fair value. If a price/technique is not available to provide a reliable fair value the investment is carried at cost less a provision for impairment.

#### **(h) Investment securities and derivatives** *continued*

Where a valuation technique is used to establish the fair value of a financial instrument, a difference could arise between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. When unobservable market data have an impact on the valuation of derivatives, the entire initial change in fair value indicated by the valuation technique is recognised over the life of the transaction on an appropriate basis, or when the inputs become observable, or when the derivative matures or is closed out.

#### **(i) Embedded derivatives**

Options, guarantees and other derivatives embedded in a host contract are separated and recognised as a derivative unless they are either considered closely related to the host contract, meet the definition of an insurance contract or if the host contract itself is measured at fair value with changes in fair value recognised in income.

#### **(j) Financial guarantee contracts**

A financial guarantee contract is a contract that requires the Company to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

The Company recognises and measures financial guarantee contracts in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The Company initially recognises and measures a financial guarantee contract at its fair value. At each subsequent reporting date, the Company measures the financial guarantee contract at the higher of the initial fair value recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue* and the best estimate of the expenditure required to meet the obligations under the contract at the reporting date.

#### **(k) Insurance contracts**

An insurance contract is a contract under which the Company accepts significant insurance risk from another party by agreeing to compensate that party if a specified uncertain future event adversely affects them. Insurance risk is the risk transferred from the holder of the contract to the Company, excluding financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party of contract. The Company considers insurance risk to be significant if an insured event could cause the Company to pay significant additional benefits to those payable if no insured event occurred, in any scenario, excluding scenarios that lack commercial substance. The Company measures an insurance contract at the best estimate of future cash flows that will arise on the contract. Changes in this amount are immediately recognised in the income statement. Insurance contract liabilities are included in other liabilities.

#### **(l) Cash and cash equivalents**

Cash and cash equivalents include cash in hand, deposits held at call with banks and any highly liquid investments with less than three months to maturity from the date of acquisition. For the purposes of the cash flow statement cash and cash equivalents also include bank overdrafts, which are included in borrowings on the balance sheet.

#### **(m) Equity**

##### **(i) Share capital and treasury shares**

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Shares are classified as equity instruments when there is no contractual obligation to deliver cash or other assets to another entity on terms that may be unfavourable. The difference between the proceeds received on issue of the shares and the nominal value of the shares issued is recorded in the share premium account. Incremental costs directly attributable to the issue of new equity instruments are shown in the share premium account as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments in a business combination are included in the cost of acquisition.

If the Company purchases any of its equity instruments, the consideration paid is treated as a deduction from total equity. Where such shares are sold, if the proceeds are equal to or less than the purchase price paid, the proceeds are treated as a realised profit. If the proceeds exceed the purchase price, the excess over the purchase price is transferred to the share premium account.

##### **(ii) Merger reserve**

If the Company issues shares at a premium and the conditions for merger relief under s131 of the UK Companies Act 1985 are met, a sum equal to the difference between the issue value and nominal value is transferred to a 'merger reserve'.

#### **(n) Subordinated liabilities**

Subordinated liabilities are initially recognised at the value of proceeds received net of issue expenses. The total finance costs are charged to the income statement over the relevant term of the instrument using the EIR method. The carrying amount of the debt is increased by the finance cost in respect of the reporting period and reduced by payments made in respect of the debt in the period.

#### **(o) Pension costs and other post retirement benefits**

The Group operates a number of defined benefit and defined contribution plans, the assets of which are held in separate trustee administered funds. The pension plans are funded by payments from employees and by the Group companies, determined by periodic actuarial calculations.

The Company is unable to identify its share of the underlying assets and liabilities in the UK defined benefit scheme on a consistent and reasonable basis, therefore it treats this scheme as a defined contribution scheme. Consequently the costs of this scheme and the UK defined contribution scheme represent the contributions payable for the accounting period.

For the defined contribution scheme, the Company pays contributions to separately administered pension insurance schemes. The contributions are recognised in staff expenses when they are due.

#### **(p) Provisions and contingent liabilities**

Provisions for restructuring costs and legal claims are recognised when the Company has a present legal or constructive obligation as a result of past events, it is more likely than not that an outflow of resources will be required to settle the obligation and the amount has been reliably estimated. Provisions are not recognised for future operating losses. Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

Contingent liabilities are disclosed if the future obligation is probable and the amount cannot be reasonably estimated.

#### **(q) Dividend distribution**

Final dividends on share capital classified as equity instruments are recognised in equity when they have been approved by equity holders. Interim dividends on these shares are recognised in equity in the period in which they are paid.

#### **(r) Employee share-based payments**

The Group operates share incentive plans for all employees, share-based long-term incentive plans for senior employees and may award performance shares to all employees when the Group's profit targets are met. Further details of the schemes are set out in Note 41 of the consolidated financial statements. These schemes are treated as equity-settled share-based payment schemes under IFRS 2 *Share-based Payment*.

For equity-settled share-based payment employee transactions, the services received as compensation are measured at their fair value. This fair value is measured by reference to the fair value of the equity instruments granted. The fair value of those equity instruments is measured at the grant date, which is the date that the Group and the employees have a shared understanding of the terms and conditions of the award. If that award is subject to an approval process then the grant date is the date when that approval is obtained. The charge in respect of the services received is recharged by the Company to the subsidiary which receives the services of the employees.

If the equity instruments granted vest immediately, the employees become unconditionally entitled to those equity instruments. Therefore, the Company immediately recognises an amount due from subsidiaries in respect of the services received in full with a corresponding credit to the equity compensation reserve.

If the equity instruments do not vest until the employee has fulfilled specified vesting conditions, the Group presumes that the services to be rendered by the employee as consideration for those equity instruments will be received in the future, during the period of those vesting conditions (vesting period). Therefore, the Company recognises an amount due from subsidiaries in respect of those services as they are rendered during the vesting period with a corresponding credit to the equity compensation reserve.

At the time the equity instruments vest, the amount recognised in the equity compensation reserve in respect of those equity instruments is transferred to retained earnings.

**(s) Derecognition and offset of financial assets and liabilities**

A financial asset (or a part of a group of similar financial assets) is derecognised where:

- the rights to receive cash flows from the asset have expired;
- the Company retains the right to receive cash flows from the asset, but has assumed an obligation to pay them in full without material delay to a third party under a 'pass through' arrangement; or
- the Company has transferred its rights to receive cash flows from the asset and has either transferred substantially all the risks and rewards of the asset, or has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

A financial liability is derecognised when the obligation under the liability is discharged or cancelled or expires.

Financial assets and liabilities are offset and the net amount reported in the balance sheet only when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or to realise the asset and settle the liability simultaneously.