IFRS accounting

Introduction

The consolidated financial statements included in this Annual Report have been prepared in accordance with United Kingdom generally accepted accounting practice and applicable accounting standards (UK GAAP). From 1 January 2005 the Group will report its consolidated financial results in accordance with International Financial Reporting Standards (IFRS). The following pages present certain unaudited financial information for the year ended 31 December 2004 restated for IFRS expected to be applicable for 2005 reporting and explains the significant differences between UK GAAP and IFRS for the Group.

As noted above, the financial information below has been prepared on the basis of IFRS expected to be applicable for 2005 reporting. These are subject to ongoing review and endorsement by the European Union (EU), possible amendment by interpretative guidance from the International Accounting Standards Board (IASB) or emerging industry practice and therefore subject to change. Moreover, attention is drawn to the fact that, under IFRS, only a complete set of financial statements comprising a balance sheet, income statement, statement of changes in equity, statement of recognised income and expense, cash flow statement, together with comparative financial information and explanatory notes, can provide a fair presentation of the Group's financial position, results of operations and cash flow.

Basis of preparation

The restatement has been prepared on the assumption that all IFRS, including interpretative guidance, issued by the IASB effective for 2005 reporting will be endorsed by the EU. The only standard affecting the IFRS restatement for 2004 for the Group which is assumed will be endorsed by the EU is the amendment to IAS 19 "Employee benefits", allowing actuarial gains or losses to be taken directly to reserves via the statement of recognised income and expense. If the EU does not endorse the amendment to IAS 19 in time for 2005 reporting, this could result in the need to change the basis of accounting or presentation of the financial information set out below.

The EU has endorsed a revised version of IAS 39 "Financial Instruments: Recognition and Measurement", referred to as the carve out version, rather than the full IASB standard. This does not affect the figures presented below as the Group has taken the exemption not to apply IAS 32 and IAS 39 in 2004, being the 2005 comparative year.

IFRS 1 Exemptions

IFRS 1 "First-time adoption of International Accounting Standards" sets out the procedures the Group must follow when it adopts IFRS for the first time as the basis for preparing its consolidated financial statements. The Group is required to determine its IFRS accounting policies and apply these retrospectively to determine its opening balance sheet under IFRS. The standard allows a number of exceptions to this general principle to assist companies as they transition to reporting under IFRS.

The Group will take the following significant exemptions:

- Business combinations: business combinations prior to the transition date (1 January 2004) have not been restated.
- Employee benefits: all actuarial gains and losses have been recognised in equity at the transition date. This is to maintain consistency with the treatment under FRS 17 and the policy going forward of taking actuarial gains or losses directly to reserves via the statement of recognised income and expense.
- Share-based payments: only equity instruments granted after 7 November 2002 and that had not vested prior to 1 January 2005 have been included in the charge to income.
- IAS 32 and IAS 39 "Financial Instruments": comparatives will not be restated for IAS 32 and IAS 39. As a result the information in the figures on page 86 and the comparative information in the 2005 financial statements will be presented on an existing UK GAAP basis.

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Reconciliation of UK GAAP to IFRS

The following is a summary of the adjustments to consolidated profit for the year and consolidated total equity which would have been required if IFRS had been applied instead of UK GAAP.

Profit for the financial year ended 31 December 2004	Before amortisation of intangible assets and exceptional items £million	Amortisation of intangible assets £million	Exceptional items £million	Total £million
Profit for the financial year under UK GAAP	**170.9**	**(15.5)**	**11.7**	**167.1**
Adjustments to conform to IFRS				
Share-based compensation	(2.2)	–	–	(2.2)
Goodwill amortisation	–	15.1	–	15.1
Exceptional items:				
– net assets disposed	–	–	(0.9)	(0.9)
– reversal of recycling of goodwill from reserves	–	–	6.5	6.5
Deferred taxation:				
– unremitted earnings of associated undertakings	(2.6)	–	–	(2.6)
– pharmacy licences acquired prior to 1 January 2004	2.6	–	–	2.6
– rolled over capital gains	1.0	–	–	1.0
– share-based compensation	0.5	–	–	0.5
Other	0.2	–	–	0.2
Profit for the financial year under IFRS	**170.4**	**(0.4)**	**17.3**	**187.3**

Note:

While IAS 1 does not provide definitive guidance on the format of the income statement, it requires additional line items and headings to be presented on the face of the income statement when such presentation is relevant to an understanding of the entity's financial performance. The Group believes that items referred to as exceptional items under UK GAAP should be separately identified under IFRS to assist in understanding the financial performance of the Group.

Earnings per share	Before amortisation of intangible assets and exceptional items pence	Amortisation of intangible assets pence	Exceptional items pence	Total pence
Earnings per share under UK GAAP				
Basic	**48.7**	**(4.4)**	**3.4**	**47.7**
Diluted	**48.2**	**(4.4)**	**3.3**	**47.1**
Earnings per share under IFRS				
Basic	**48.6**	**(0.1)**	**4.9**	**53.4**
Diluted	**48.0**	**(0.1)**	**4.9**	**52.8**

The weighted average number of shares under basic and diluted earnings per share does not differ between UK GAAP and IFRS.

Total equity at 31 December 2004	£million
Total equity under UK GAAP	**1,081.5**
Adjustments to conform to IFRS	
Goodwill amortisation in 2004	15.1
2004 exceptional items – net assets disposed in 2004	(0.9)
Deferred taxation:	
– unremitted earnings of associated undertakings	(7.4)
– pharmacy licences acquired prior to 1 January 2004	(64.7)
– rolled over capital gains	(13.4)
– fixed asset revaluations	(4.6)
– share-based compensation	1.2
– other	0.2
Proposed 2004 final dividend	43.5
Other	0.3
Total equity under IFRS	**1,050.8**

Explanation of adjustments to conform to IFRS

Share-based compensation

Principal difference

Under UK GAAP a charge to the profit and loss account is made in respect of share-based compensation schemes based on the intrinsic value of the awards. Under IFRS 2 "Share-based Payment", a charge to income representing the fair value of outstanding equity instruments granted to employees under share-based compensation schemes is recognised over the vesting period of the schemes.

Impact

The Group's principal share-based compensation schemes comprise savings related and discretionary share option schemes. Under UK GAAP, there is no charge for these share-based compensation schemes because they are either Inland Revenue approved (and therefore specifically excluded from the requirement to record a charge) or have an intrinsic value of nil as the option price is set at the market value at the date of grant. As noted on page 85, the Group will take up the option under IFRS 1 permitting companies to apply IFRS 2 only to equity instruments granted after 7 November 2002 and that had not vested prior to 1 January 2005. As a result, the share-based compensation charge for 2004 of £2.2 million shown in the table as an IFRS adjustment takes into account the fair value of only those options granted since 7 November 2002.

There is no significant difference in the accounting for the Group's long-term incentive plan under IFRS compared to UK GAAP.

Goodwill amortisation – business combinations

Principal difference

Under UK GAAP, goodwill is amortised over its expected useful economic life, up to a maximum of 20 years. Under IFRS 3, goodwill is not amortised, but held at its 1 January 2004 carrying value and tested annually for impairment.

IFRS does not allow the recycling of goodwill to the income statement which was previously written off against reserves.

Impact

Goodwill amortisation in 2004 of £15.1 million under UK GAAP is added back to the profit for the year under IFRS.

The exceptional item under UK GAAP in 2004 relating to the profit on disposal of businesses included £11.1 million of capitalised goodwill and £6.5 million of goodwill originally written off directly to reserves and recycled to the profit and loss account as part of the calculation of the profit on disposal.

Under IFRS, the profit on disposal is reduced by the 2004 amortisation charge of £0.9 million deducted from the capitalised goodwill disposed of, and increased by the reversal of the amount of goodwill recycled from reserves.

As noted on page 85, the Group will take up the option under IFRS 1 permitting companies not to restate past business combinations prior to the transition date (1 January 2004).

Deferred taxation

Principal difference

Under UK GAAP, deferred taxation is provided in full on timing differences which result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law, at the balance sheet date. Deferred taxation is provided on unremitted earnings of associated undertakings only where there is a commitment to remit the earnings. Deferred taxation is not provided on timing differences arising from either rolled over gains or the revaluation of fixed assets where there is no commitment to sell the asset.

Under IFRS, specifically IAS 12 "Income taxes", deferred taxation is provided in full on all taxable temporary differences. Consequently for example, deferred taxation is provided on the revaluation of fixed assets and rolled over capital gains regardless of whether there is a commitment to sell the asset. Deferred taxation is also provided on unremitted earnings of associated undertakings where incremental tax would be due, regardless of whether there is a commitment to remit the earnings.

Impact

Unremitted earnings of associated undertakings:
A deferred taxation charge of £2.6 million arising on unremitted earnings of associated undertakings is recognised in the year to 31 December 2004 under IFRS. As at 31 December 2004 the cumulative deferred taxation liability on all such unremitted earnings is £7.4 million.

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Deferred taxation (continued)

Pharmacy licences:
When retail pharmacies are acquired through the purchase of shares (as opposed to asset deals), the Group acquires an asset (the licence) with a tax base cost significantly lower than the book value and so a temporary difference arises. The deferred taxation on this difference is recognised under IFRS. Under UK GAAP deferred taxation is provided on timing differences, and initial recognition of pharmacy licences as a fair value adjustment does not create a timing difference.

As noted on page 85, the Group has chosen not to restate business combinations prior to the IFRS transition date (1 January 2004). A consequence of this, is that under the transitional requirements of IFRS 1, the deferred taxation liability on retail pharmacy licences required to be recognised under IFRS is adjusted through retained earnings rather than capitalised goodwill. For the Group, the effect of this requirement is to reduce total equity under IFRS at 1 January 2004 by £67.3 million, being the deferred taxation liability in relation to retail licences purchased under share deals up to 1 January 2004. The taxation will not be payable as long as the licences are not sold.

As a result of a reduction in the tax rate in The Netherlands during 2004 and indexation in the UK, the deferred taxation liability reduced and a deferred taxation credit of £2.6 million is recognised as an adjustment to the profit for the year under IFRS. After this credit, the effect at 31 December 2004 is to reduce total equity under IFRS by £64.7 million.

Going forward, the deferred taxation liability will be recognised on acquisitions with a corresponding increase in capitalised goodwill included within intangible assets. There will be no effect on total equity.

Rolled over capital gains:
A deferred taxation credit of £1.0 million is recognised in the year to 31 December 2004 as a result of a decrease in the French capital gains tax rate from 2005, applied to the rolled over capital gains relating to fixed asset investments held in France. This brings the total deferred taxation liability on rolled over gains at 31 December 2004 to £13.4 million.

Fixed asset revaluations:
The deferred taxation liability required to be recognised under IFRS on fixed asset revaluations at 31 December 2004 is £4.6 million.

Share-based compensation charge:
A deferred taxation asset is recognised under IFRS in respect of share-based compensation. The asset is calculated on the difference between the market price of the Company's shares at the balance sheet date and the option price for options granted to UK employees. An element of this is taken to the income statement under IFRS, and amounted to a £0.5 million deferred taxation credit in 2004, and the remainder is taken directly to reserves. As at 31 December 2004 the cumulative deferred taxation asset on all such options is £1.2 million.

Dividends

Principal difference
Under UK GAAP, dividends proposed are provided for in the year in respect of which they are recommended by the Board for approval by shareholders. Under IFRS, dividends are not provided for until the dividend recommended by the Board is approved by shareholders.

Impact
The accrual for the 2004 proposed final dividend is reversed, increasing total equity under IFRS by £43.5 million.

Securitised receivables

Principal difference
Linked presentation is currently used by the Group to record receivables sold and non-recourse receipts received in respect of securitisation programmes in the UK, France and in Italy. Under IFRS, linked presentation is no longer permitted and going forward the non-recourse receipts are to be reported separately under a new heading "Financial liabilities".

The securitised receivables are purchased by special purpose entities, which currently are not consolidated. However, IFRS states that special purpose entities shall be consolidated when the substance of the relationship with the reporting entity indicates that the special purpose entities are controlled by the reporting entity. The substance of the relationship with the special purpose entities in the UK and in Italy requires those entities to be consolidated. On the basis that the Group does not meet the control indicators set out in SIC 12 (Consolidation – Special Purpose Entities) there is no requirement to consolidate the French special purpose entity.

Impact
"Financial liabilities" will include amounts relating to non-recourse receipts received in respect of securitisation programmes. Based on the position at 31 December 2004 this will amount to £400.8 million.

The consolidation of the UK and Italian special purpose entities has the effect of eliminating from operating expenses fixed charges of approximately £0.8 million. These costs will be treated as finance charges and will be reported together with net interest payable.

There is no impact on reserves resulting from these changes, which are merely reclassifications within the financial statements.

Derivative instruments and hedging activities

Principal difference
Under IFRS, all derivative instruments are recognised in the balance sheet as financial assets or financial liabilities and are recorded at their fair value. The change in the fair value of a derivative instrument is taken immediately to the income statement where, provided fair value hedge accounting can be applied, it will be offset by a change in the fair value of a hedged item. If, however, the derivative is hedging the variability of future cash flows in a cash flow hedge, the change in the fair value of the derivative is taken directly to reserves and is subsequently recycled to the income statement when the hedged cash flow impacts profit and loss. The ineffective portions are taken immediately to the income statement.

The Group uses a mixture of debt and derivative financial instruments to hedge its investment in foreign operations. The effective portion of the change in fair value of the hedging instrument is taken to reserves and is subsequently recycled to the income statement when the Group's investment is disposed of. The ineffective portion is taken immediately to the income statement.

Impact
The effective date of adoption of IAS 32 and IAS 39 for the Group is 1 January 2005. The financial liabilities in the opening balance sheet in 2005 will increase by £22.3 million, offset by related deferred taxation of £6.7 million, giving a net reduction to total equity of £15.6 million.

Available-for-sale financial assets

Principal difference
Under UK GAAP, listed investments are recorded on the balance sheet at the lower of cost and realisable value. Under IAS 32 and IAS 39, the Group's listed investments will be categorised as available-for-sale and are recorded at fair value. Changes in fair value, together with any related deferred taxation, are taken directly to reserves and are recycled to the income statement when the investment is sold.

Impact
The effective date of adoption of IAS 32 and IAS 39 for the Group is 1 January 2005. The financial assets in the opening balance sheet in 2005 will increase by £3.9 million due to the recognition of listed investments at fair value, which together with the related deferred taxation liability of £0.4 million, will give a net increase to total equity of £3.5 million.