Significant accounting policies

Boots Group PLC is a public company incorporated in the United Kingdom. The address of its registered office is disclosed in the shareholder information section of the annual report. The principal activities of the company and its subsidiaries are described in note 2. The principal accounting policies applied in the preparation of these consolidated financial statements and the financial statements of the company are set out below. These policies have been applied consistently to all the years presented, unless otherwise stated, and in preparing an opening IFRS balance sheet at 1st April 2004 for the purposes of transition to IFRSs.

The accounting policies have been applied consistently by group entities.

Basis of accounting

The financial statements prepared in pounds sterling rounded to the nearest £100,000 have been prepared in accordance with International Financial Reporting Standards as adopted by the EU (Adopted IFRSs) for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRSs are given in note 34.

The financial statements have been prepared on the historical cost basis, except for certain financial instruments which are stated at their fair value.

Non-current assets and disposal groups held for sale are stated at the lower of carrying amount and fair value less costs to sell.

The preparation of financial statements in conformity with IFRSs requires management to make judgments, estimates and assumptions that affect the application of policies and reported amounts in the financial statements.

The areas involving a higher degree of judgment or complexity, or areas where assumptions or estimates are significant to the financial statements are disclosed in note 33.

A separate income statement for the company has not been presented as permitted by section 230 (4) of the Companies Act 1985.

Adopted IFRSs not yet applied

The following IFRS was available for early application but has not yet been applied by the group in these financial statements:

> IFRS 7 ‘Financial Instruments: Disclosure’ applicable for years commencing on or after 1st January 2007.

The application of IFRS 7 in the year to 31st March 2006 would not have affected the balance sheet or income statement as the standard is concerned with disclosure only. The group plans to adopt it in the year to 31st March 2008.

Early adoption

The group has applied IFRS 5 ‘Non-current Assets Held for Sale and Discontinued Operations’ from 1st April 2004 and has elected to early adopt the option offered by the amendment to IAS 19 ‘Employee Benefits’, allowing actuarial gains and losses to be taken directly to reserves via the statement of recognised income and expense.

Consolidation

Subsidiaries are all entities over which the group has the power to govern the financial and operating policies so as to obtain benefits from their activities. Subsidiaries are fully consolidated from the date on which control is transferred until the date that control ceases.

The purchase method of accounting is used to account for the acquisition of subsidiaries by the group.

Inter-company transactions, balances and unrealised gains or losses on transactions between group companies are eliminated.

In the company balance sheet, investments in subsidiaries are stated at fair value at the date of acquisition less any dividends paid out of pre-acquisition profits and provisions for subsequent impairment. Where an impairment is charged in the income statement, an equal amount is transferred from the merger reserve.

Foreign currencies

Foreign currency transactions

Transactions in foreign currency are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated at the exchange rate ruling at that date.

Foreign exchange gains and losses are recognised in the income statement.

Non-monetary assets and liabilities that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

Foreign operations

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on consolidation, are translated into sterling at foreign exchange rates ruling at the balance sheet date. The results and cash flows of overseas subsidiaries are translated into sterling on an average exchange rate basis, which approximates to the actual rate for the month.

Exchange differences arising from the translation of the results and net assets of overseas subsidiaries are recognised in the translation reserve.

When a foreign operation is sold, related exchange differences are recognised in the income statement as part of the gain or loss on sale.

The cost of the company investment in shares in overseas subsidiaries is stated at the rate of exchange in force at the date each investment was made.

Intangible assets

Goodwill

Goodwill on acquisitions comprises the excess of the fair value of the consideration plus any associated costs for investments in subsidiary undertakings over the fair value of the net identifiable assets acquired. Adjustments are made to fair values to bring the accounting policies of acquired businesses into alignment with those of the group. The costs of integrating and reorganising acquired businesses are charged to the post-acquisition income statement.

For acquisitions prior to 1st April 2004, goodwill is included on the basis of its deemed cost, which represents the amount recorded under UK GAAP. Goodwill arising on acquisitions prior to 1st April 1998 has been set off against reserves.

Goodwill is carried at cost less accumulated impairment losses.

Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

Product rights and licences

Product rights and licences acquired are shown at historical cost less accumulated amortisation and impairment losses. Similar assets created within the business are only capitalised when commercially feasible and the amounts are material, otherwise, expenditure is charged against profits in the year in which it is incurred.

Software costs

Costs that are directly associated with the production of identifiable and unique software products controlled by the group, are recognised as intangible assets. These intangibles are stated at cost less accumulated amortisation and impairment losses.

Amortisation

Amortisation is charged to the income statement on a straight-line basis over the useful lives of the intangible assets unless such lives are indefinite. Intangible assets with an indefinite life are systematically tested for impairment at each balance sheet date. Other intangible assets are amortised from the date they are available for use. The useful lives are as follows:

- Product rights – up to 20 years;
- Licences – 20 years;
- Software costs – 3 to 8 years;
- Capitalised development costs – 3 to 5 years.

Amortisation periods and methods are reviewed annually and adjusted if appropriate.

Property, plant and equipment

The group has adopted the transitional provisions of IFRS 1 to use previous revaluations as deemed cost at the transition date. From 1st April 2004, all property, plant and equipment will be accounted for under the cost method.

All property, plant and equipment is stated at cost less accumulated depreciation.

Depreciation of property, plant and equipment is provided to write off the cost, less residual value, by equal instalments over their expected useful economic lives as follows:

- Freehold land and assets in the course of construction – not depreciated;
- Freehold and long leasehold buildings – depreciated to their estimated residual values over their useful economic lives of not more than 50 years;
- Short leasehold properties – remaining period of lease when less than 50 years;
- Computer equipment – 3 to 8 years;
- Motor cars – 4 or 5 years;
- Other motor vehicles – 3 to 10 years;
- Fixtures and plant – 3 to 20 years.

Residual values, remaining useful economic lives and depreciation methods are reviewed annually and adjusted if appropriate.

Gains and losses on disposals are determined by comparing proceeds with carrying amount. These are included in the income statement.

Non-current assets held for sale and discontinued operations

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of fair value less costs to sell and carrying amount.

Impairment losses on initial classification as held for sale are included in the income statement. Gains or losses on subsequent re-measurements are also included in the income statement.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. The asset (disposal group) must be available for immediate sale and the sale must be highly probable within one year.

A discontinued operation is a component of the group's business that represents a separate major line of business or geographical area of operations that has been disposed of, has been abandoned or meets the criteria to be classified as held for sale.

Discontinued operations are presented on the income statement (including the comparative year) as a separate line 'profit from discontinued operations' and are shown net of tax.

Impairment of assets

The carrying amount of the group's assets is reviewed at each balance sheet date to determine whether there is an indication of impairment. If such an indication exists, the asset's recoverable amount is estimated.

For goodwill, intangible assets that have an indefinite life and intangible assets not yet available for use, the recoverable amount is estimated at each balance sheet date and when there is an indication that the asset is impaired.

An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Share based payment transactions

The fair value of the shares/options granted is charged as an employee expense with a corresponding increase in equity. The fair value is measured at the grant date and spread over the period during which the employees become unconditionally entitled to the shares/options. The fair value is based on market value for the All Employee Share Ownership Plan (AESOP) and for the Long Term Bonus Scheme. The fair value of the options in the Executive Share Option Plan are established using an option pricing model. The amount recognised as an expense reflects the estimated number of shares/options that are expected to vest except where forfeiture is only due to market-based conditions not being achieved.

In accordance with the transitional provisions of IFRS 1, no expense is recorded in respect of grants made under the above schemes prior to 7th November 2002.

Cash and cash equivalents

Cash and cash equivalents comprises cash in hand and short term deposits. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet. These are included as a component of cash and cash equivalents for the purpose of the statement of cash flows.

Financial instruments

Financial assets and liabilities are recognised on the balance sheet at fair value when the group/company becomes a party to the contractual provisions of the instrument.

Trade receivables

Trade receivables are stated at their amortised cost as reduced by appropriate allowances for estimated irrecoverable amounts. They are recognised on the trade date of the related transactions.

Trade payables

Trade payables are stated at their amortised cost. They are recognised on the trade date of the related transactions.

Derivative financial instruments

The group uses derivative financial instruments to hedge its exposure to foreign exchange and interest rate risks arising from operational, financing and investment activities.

In accordance with its treasury policy, the group does not hold or issue derivative financial instruments for trading purposes. However, derivatives that do not qualify for hedge accounting are accounted for as trading instruments.

Derivative financial instruments are recognised initially at fair value, with movements on remeasurement recognised immediately in the income statement. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged (see below).

The fair value of interest rate swaps is the estimated amount that the group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest rates and the current creditworthiness of the swap counterparties.

The fair value of forward exchange contracts is their quoted market price at the balance sheet date.

Cash flow hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, or a highly probable forecasted transaction, the highly effective part of any gain or loss on the derivative financial instrument is recognised directly in the hedging reserve.

When the forecasted transaction subsequently results in the recognition of a non-financial asset or non-financial liability the associated cumulative gain or loss is removed from equity and included in the initial cost or other carrying amount of the non-financial asset or liability.

If the hedged forecasted transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains and losses that were recognised directly in equity are reclassified into profit or loss in the same period, or periods, during which the asset acquired or liability assumed affects profit or loss.

For cash flow hedges, other than those covered by the preceding two policy statements, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss. The ineffective part of any gain or loss is recognised immediately in the income statement.

When a hedging instrument expires or is sold, terminated or exercised, or the entity revokes designation of the hedge relationship but the hedged forecast transaction is still expected to occur, the cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If the hedged transaction is no longer expected to take place, the cumulative unrealised gain or loss recognised in equity is recognised immediately in the income statement.

Fair value hedges
Where a derivative financial instrument hedges the changes in the fair value of a recognised asset or liability or an unrecognised firm commitment (or an identified portion of such asset, liability or firm commitment), any gain or loss on the hedging instrument is recognised in the income statement. The hedged item is also stated at fair value in respect of the risk(s) being hedged, with any gain or loss recognised in the income statement.

Hedge of monetary assets and liabilities
Where a derivative financial instrument is used to hedge economically the foreign exchange exposure of a recognised monetary asset or liability, no hedge accounting is applied and any gain or loss on the hedging instrument is recognised in the income statement.

Hedge of net investment in foreign operation
On consolidation, the highly effective portion of the gain or loss on an instrument designated as a hedge of net investment in a foreign operation that is determined to be an effective hedge is recognised directly in the hedging reserve.

The ineffective portion is recognised immediately in the income statement.

Interest-bearing borrowings
Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs.

Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

Net finance costs
Net finance costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, foreign exchange gains and losses, interest on pension scheme liabilities net of expected return on assets, and gains and losses on hedging instruments that are recognised in the income statement.

Interest income is recognised in the income statement as it accrues, using the effective interest rate method.

The interest expense component of finance lease payments is recognised in the income statement to produce, or approximate to, a constant periodic rate of charge on the remaining balance of the outstanding obligation.

Revenue
Revenue comprises sales and services to external customers (excluding VAT and other sales taxes). Consideration received from customers is only recorded as revenue when the group has completed full performance in respect of that consideration.

In respect of the Boots loyalty scheme, the Advantage Card, when points are issued to customers the retail value of those points expected to be redeemed is deferred. When the points are used by the customer they are recorded as revenue.

Sales of gift vouchers are only included in revenue when the vouchers are redeemed.

Inventories
Inventories are valued at the lower of cost and net realisable value and are based on the first-in-first-out principle. Cost comprises purchase cost of goods, direct labour and those overheads related to manufacture and distribution based on normal activity levels.

Pensions
The group operates a number of pension schemes under which contributions by employees and by the sponsoring companies are held in trust funds separated from the group's finances.

Obligations for contributions to defined contribution pension schemes are recognised as an expense in the income statement as incurred.

The group's net obligation in respect of defined benefit pension schemes is calculated separately for each scheme by estimating the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any scheme assets is deducted. The discount rate is the yield at the balance sheet date on AA rated bonds that have maturity dates approximating to the terms of the group's obligations. The calculation is performed by a qualified actuary using the projected unit credit method. Scheme assets are valued at bid price.

Current and past service costs are recognised in operating profit and net financing costs include interest on pension scheme liabilities and expected return on assets.

All actuarial gains and losses that arise in calculating the group's obligation in respect of a scheme are recognised immediately in reserves and reported in the statement of recognised income and expense (SORIE).

Leases
Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Benefits received as an incentive to sign a lease, whatever form they may take, are credited to the income statement on a straight-line basis over the lease term.

Leases, for which the group assumes substantially all the risks and rewards of ownership, are classified as finance leases, including outsourced assets that are held exclusively for the use of the group. The cost of assets held under finance leases is included under property, plant and equipment and depreciation is provided in accordance with the policy for the class of asset concerned up to the length of the lease. The corresponding obligations under these leases are shown as liabilities. The finance charge element of rentals is charged to the income statement to produce, or approximate to, a constant periodic rate of charge on the remaining balance of the outstanding obligations. Lease premiums paid are treated as prepayments and are amortised over the period of the lease.

Income tax

Income tax on the profit or loss for the year represents the sum of the tax currently payable and deferred tax. Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

Current tax is the expected tax payable on the taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The group's liability for current tax is calculated using tax rates enacted or substantively enacted at the balance sheet date, and any adjustments to tax payable in respect of previous years.

Deferred taxation

Deferred tax is provided in full using the balance sheet liability method. It is the tax expected to be payable or recoverable on the temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets and liabilities that affect neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that it is not probable that they will reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The carrying amount of deferred tax assets are reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered.

Additional income taxes that arise from the distribution of dividends are recognised at the same time as the liability to pay the related dividend.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same taxation authority and the group intends to settle its current tax assets and liabilities on a net basis.

Provisions

Provisions are recognised in the balance sheet when there is a present legal or constructive obligation as a result of a past event, and it is probable that an outflow of economic benefits will be required to settle the obligation.