

# Accounting policies

## **(a) Basis of preparation**

These consolidated 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 consolidated financial statements, unless otherwise stated.

## **(i) Presentation of the comparative primary statements**

On 10 July 2006, The Standard Life Assurance Company (SLAC) demutualised and the shares of a new holding company for the Standard Life Group, Standard Life plc, were listed on the London Stock Exchange. As a result, the Group operated under two different operating models during the year ended 31 December 2006. For the period from 1 January to 10 July 2006, the parent company of the Group was a mutual insurer and for the period from 10 July to 31 December 2006, the Group was equity holder owned.

Prior to the demutualisation of SLAC, the results of the Group were attributable to participating policyholders and the balance on the consolidated income statement was transferred to the unallocated divisible surplus reflecting that the Group did not report a profit. However, the format of the consolidated income statement for the year ended 31 December 2006 was aligned with that of an equity owned company. The impact of the presentation adopted for the consolidated income statement for the year ended 31 December 2006 is described in Note 1.

The pro forma reconciliation of underlying profit to profit before tax is presented directly after the consolidated income statement to facilitate consideration of this measure in conjunction with the equity holder profit. As explained in accounting policy (ii), certain items are adjusted against equity holder profit, and in doing so the Directors believe they are presenting a more meaningful indication of the underlying business performance of the Group.

The consolidated statement of recognised income and expense was revised in line with the consolidated income statement in 2006. As a result of the revision, for the period from 1 January to 10 July 2006, the 'Total recognised income for the period' represents an amalgamation of the 'Net income/(expense) not recognised in the income statement' and the 'increase in net assets attributable to minority interest'.

The consolidated cash flow statement was revised in line with the consolidated income statement in 2006, showing 'Profit before tax' and adjusting for the transfers to/from unallocated divisible surplus for the period from 1 January to 10 July 2006 through the 'Change in unallocated divisible surplus' in the reconciliation to 'Net cash flows from operating activities'.

## **(ii) New standards, interpretations and amendments to published standards that have been adopted by the Group**

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

The Group has early adopted International Financial Reporting Interpretation 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 Group's financial statements has not been significant.

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

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

### **IFRS 8 *Operating Segments* (effective from 1 January 2009)**

IFRS 8 will replace IAS 14 *Segment reporting* and proposes that the 'management approach' is adopted for reporting the financial performance of operating segments. Management are considering whether the Group will early adopt the requirements for 2008. The standard has no financial impact but is expected to have a significant impact on the Group's segmental disclosures.

**(a) Basis of preparation** *continued*

**(iii) Standards, interpretations and amendments to published standards that are not yet effective and have not been early adopted by the Group** *continued*

**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 Group 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 Group'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 (US FASB). 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 Group will apply the revisions to IAS 23 from 1 January 2009, but it is not expected to have a significant impact on the Group's financial statements.

**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 EU regulators. The Group will apply IFRIC 14 from 1 January 2009, but it is not expected to have a significant impact on the Group'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 Group an obligation to deliver to another party a pro rata share of net assets of the Group only on liquidation, to be classified as equity. Management have assessed that the expected impact of adoption of the amendments on the Group'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 Group or by other parties, should receive the same accounting treatment. Management are considering the expected impact of adoption of the amendments on the Group'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 Group's financial statements.

#### **(iv) Interpretations to existing standards that are not yet effective and not relevant for the Group'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 Group's operations due to the nature of the Group's businesses.

#### **(v) Judgement in applying accounting policies**

The preparation of financial statements, in conformity with Generally Accepted Accounting Principles (GAAP), requires management to exercise judgements in applying the accounting policies that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses arising during the period. The areas where those judgements have the most significant effect on the amounts recognised in the financial statements are as follows:

- group reconstructions – refer to (c);
- classification of insurance and investment contracts – refer to (f);
- insurance contract liabilities – refer to (u), (v), (w), (x) and Note 28; and
- pension and other post retirement provisions – refer to (aa) and Note 33.

#### **(b) Basis of consolidation**

The Group financial statements consolidate the income statements and balance sheets of the Company and its subsidiary undertakings. Associate and joint venture undertakings are accounted for using the equity method from the date that significant influence or joint control, respectively, commences until the date this ceases.

#### **(i) Subsidiaries**

Subsidiaries are all entities, including special purpose entities, over which the Group 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. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the Group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the Group, until the date that control ceases.

The Group 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.

Intra-group transactions, balances and unrealised gains on intra-group transactions are eliminated. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred. Subsidiaries' accounting policies have been changed where necessary to ensure consistency with the policies adopted by the Group.

Where the Group owns more than 50% of an investment vehicle, such as open ended investment companies, unit trusts and limited partnerships, and it is consolidated, the interests of parties other than the Group in such vehicles are classified as liabilities. These are recorded in the consolidated balance sheet line 'Third party interest in consolidated funds' and any movements are recognised in the consolidated income statement. The interests of parties other than the Group in all other types of entities are recorded as minority interest in equity.

**(b) Basis of consolidation** *continued*

**(ii) Associates and joint ventures**

Associates are entities over which the Group 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 Group and other parties undertake an economic activity, which is subject to joint control arising from contractual agreement.

Where the Group has a significant holding in an investment vehicle that meets the definition of an associate or joint venture and that investment in associate backs policyholder liabilities including the unallocated divisible surplus, that investment is accounted for at fair value through profit or loss (FVTPL) in accordance with IAS 39.

All other associates and joint ventures are equity accounted for and in this case, the Group's investment in associates and joint ventures includes goodwill, net of any impairment loss, identified on acquisition.

Investments in associates and joint ventures that are equity accounted for are initially recognised at cost and adjusted thereafter for the post-acquisition change in the Group's share of net assets of the associate. The Group's share of post-acquisition results of its associates is recognised in the income statement. The Group's share of any post-acquisition movements in reserves, where the associate recognised a gain or loss directly in equity, is recognised in unallocated divisible surplus prior to the demutualisation of The Standard Life Assurance Company (SLAC) and reserves post the demutualisation of SLAC. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Where the Group's share of losses in an associate equals or exceeds its interest in an associate, including any other unsecured receivables, the Group's carrying amount is reduced to nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations in connection with or made payments on behalf of an associate.

Unrealised gains on transactions between the Group and its associates and joint ventures are eliminated to the extent of the Group's interest in the associates and joint ventures. Unrealised losses are also eliminated unless the transactions provide evidence of an impairment of the asset transferred. The accounting policies of associates and joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

**(c) Group reconstructions**

The Group uses merger accounting principles to account for group reconstructions which are not business combinations within the scope of IFRS 3 *Business Combinations*. Under the principles of merger accounting, assets and liabilities transferred to a new entity are recorded in the new entity at the carrying value they were measured at by the transferor. No goodwill is recognised as a result of such transactions. These principles were applied in the demutualisation of SLAC in 2006.

Where the group reconstruction involves a change in the operation of with profits funds which changes the measurement of participating contract liabilities and the present value of future profits on non-participating contracts with corresponding changes to the unallocated divisible surplus, these changes are not recognised in the change in participating contract liabilities, the change in the present value of future profits on non-participating contracts and the change in unallocated divisible surplus in the income statement. The liabilities are initially recognised at their revised valuation basis in the balance sheet.

**(d) Foreign currency translation**

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

The balance sheets of Group entities that have a different functional currency than the Group's presentation currency are translated into the presentation currency at the year end exchange rate and their income statements and cash flows are translated at average exchange rates for the year. Prior to the demutualisation of SLAC, all resulting exchange differences were recognised in the unallocated divisible surplus and post the demutualisation of SLAC, all exchange differences arising are recognised in the foreign exchange reserve in equity. Where the unallocated divisible surplus changes as a result of such exchange differences which are attributable to participating policyholders, this change in the unallocated divisible surplus is not recognised in the income statement but is recognised in equity (refer also to (h)(v)).

Foreign currency transactions are translated into the functional currency 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 fair value through profit or loss, 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.

### **(e) Segment reporting**

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. Segments have been separately identified after consideration of the various regulatory reporting regimes, the nature of the products sold, distribution channels, customer segments and management's view of the relative risks and rewards associated with each segment.

A geographical segment is engaged in providing products or services within a particular economic environment that is subject to risks and returns that are different from those of segments operating in other economic environments.

### **(f) Classification of insurance and investment contracts**

The measurement basis of assets and liabilities arising from life and pensions business contracts is dependent upon the classification of those contracts as either insurance or investment contracts. A contract is classified as insurance only if it transfers significant insurance risk. Insurance risk is significant if an insured event could cause an insurer to pay significant additional benefits to those payable if no insured event occurred, in any scenario, excluding scenarios that lack commercial substance. A contract that is classified as an insurance contract remains an insurance contract until all rights and obligations are extinguished or expire. Contracts can be reclassified as insurance contracts after inception if insurance risk becomes significant. Life and pensions business contracts that are not considered to be insurance contracts are classified as investment contracts.

The Group has written insurance and investment contracts which contain discretionary participating features (e.g. with profits business). These contracts provide a contractual right to receive additional benefits as a supplement to guaranteed benefits. These additional benefits are based on the performance of with profits funds and their amount and timing is at the discretion of the Group. These contracts are referred to as participating contracts.

Generally, life and pensions business product classes are sufficiently homogeneous to permit a single classification at the level of the product class. However, in some cases, a product class may contain individual contracts that fall across multiple classifications (hybrid contracts). For certain significant hybrid contracts the product class is separated into the insurance element, a non-participating investment element and a participating investment element so that each element is accounted for separately.

Healthcare and general insurance business contracts are classified as insurance contracts only if they transfer significant insurance risk.

### **(g) Revenue recognition**

#### **(i) Deposit accounting for non-participating investment contracts**

Contributions received on non-participating investment contracts are treated as policyholder deposits and not reported as revenue in the income statement.

Deposit accounting is also applied to reinsurance contracts that do not qualify as insurance contracts under policy (f) above.

The fee income associated with non-participating investment contracts is dealt with under policy (g) (iv) below.

#### **(ii) Premiums**

Premiums received on life and pensions business insurance contracts and participating investment contracts are recognised as revenue when due for payment, except for unit linked premiums which are accounted for when the corresponding liabilities are recognised. For single premium business, this is the date from which the policy is effective. For regular premium contracts, receivables are established at the date when payments are due.

Premiums receivable on healthcare and general insurance business insurance contracts are recognised as revenue as they are earned over the period of the policy having regard to the incidence of risk.

#### **(iii) Net investment income**

Realised and unrealised gains and losses resulting from changes in both market value and foreign exchange on investments classified as fair value through profit or loss, 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.

**(g) Revenue recognition** *continued*

**(iii) Net investment income** *continued*

For loans and receivables measured at amortised cost, interest income recognised in the income statement is calculated using the effective interest rate method.

Dividend income is recognised when the right to receive payment is established.

Rental income is recognised in the income statement on a straight-line basis over the term of the lease.

**(iv) Fee and commissions**

All fees related to unit linked non-participating investment contracts are deemed to be associated with the provision of investment management services. Fees related to the provision of investment management services and administration services are recognised as the services are provided. Front-end fees, which are charged on the inception of service contracts, are deferred as a liability and recognised over the expected life of the contract. Ongoing fees that are charged periodically, either directly or by making a deduction from invested funds, are recognised as received, which corresponds to when the services are provided.

Commissions received or receivable are recognised as revenue on the commencement or renewal date of the related policies. However, when it is probable the Group will be required to render further services during the life of the policy, the commission is deferred as a liability and is recognised as the services are provided.

Trail or renewal commission, where the Group does not have an unconditional legal right to avoid payment, is deferred at inception of the contract and an offsetting liability for contingent commission is established.

**(h) Expense recognition**

**(i) Deposit accounting for non-participating investment contracts**

Withdrawals paid out to policyholders on non-participating investment contracts are treated as a reduction to policyholder deposits and not recognised as expenses in the income statement.

Deposit accounting is also applied to reinsurance contracts that do not qualify as insurance contracts under policy (f) above.

**(ii) Claims and benefits paid**

Claims paid on life and pensions business insurance contracts and participating investment contracts and healthcare and general insurance business insurance contracts are recognised as expenses in the income statement.

Maturity claims and annuities are accounted for when due for payment. Surrenders are accounted for when paid or, if earlier, on the date when the policy ceases to be included within the calculation of the insurance liability. Death claims and all other claims are accounted for when notified. Healthcare and general insurance claims are accounted for when there is sufficient evidence of their existence and a reasonable assessment can be made of the monetary amount involved.

Claims payable include the direct costs of settlement. Reinsurance recoveries are accounted for in the same period as the related claim.

**(iii) Change in insurance and participating investment contract liabilities**

The change in insurance and participating investment contract liabilities comprising the full movement in the corresponding liabilities during the period, excluding the impact of foreign exchange adjustments, is recognised in the income statement. The liabilities transferred on the demutualisation of SLAC to Standard Life Assurance Limited (SLAL) were recognised at their revised valuation basis in the balance sheet and any change was not recognised in the income statement.

**(iv) Change in investment contract liabilities**

Investment return and related benefits credited in respect of non-participating investment contracts are recognised in the income statement as changes in investment contract liabilities.

**(v) Change in unallocated divisible surplus (UDS)**

The change in UDS recognised in the income statement comprises the movement in the UDS during the period. However, where movements in assets and liabilities which are attributable to participating policyholders are taken directly to equity, the change in UDS arising from these movements is not recognised in the income statement as it is also recognised in equity.

### **(i) 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.

### **(j) Goodwill and intangible assets**

#### **(i) Goodwill**

Goodwill represents the excess of the cost of a business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the acquisition date.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated, from the acquisition date, to each of the Group's cash generating units that are expected to benefit from the business combination. The carrying amount of goodwill for each cash generating unit is reviewed when changes in circumstances or events indicate that there may be uncertainty over its carrying value, and at least annually.

Goodwill is carried at cost less any accumulated impairment losses and is included in intangible assets.

#### **(ii) Intangible assets**

Intangible assets, including internally developed software and software purchased from third parties, are recognised in the balance sheet if it is probable that the relevant future economic benefits attributable to the asset will flow to the Group and its cost can be measured reliably and are either identified as separable (i.e. capable of being separated from the entity and sold, transferred, rented, or exchanged) or they arise from contractual or other legal rights, regardless of whether those rights are transferable or separable.

Intangible assets are carried at cost less accumulated amortisation and any accumulated impairment losses. Amortisation is charged to the income statement on a straight-line basis over the estimated useful life of the intangible asset. Impairment losses are calculated and recorded on an individual basis in a manner consistent with policy (i).

### **(k) Deferred acquisition costs**

#### **(i) UK, Ireland and Germany – insurance and participating investment contracts**

Acquisition costs incurred in issuing participating insurance or participating investment contracts are not deferred where such costs are borne by a with profits fund that is subject to the Financial Services Authority's (FSA) realistic capital regime. For other participating investment contracts incremental costs directly attributable to the issue of the contracts are deferred. For other participating insurance contracts, acquisition costs which include both incremental acquisition costs and other indirect costs of acquiring and processing new business, are deferred.

Deferred acquisition costs are amortised in proportion to projected margins over the period the relevant contracts are expected to remain in force. After initial recognition deferred acquisition costs are reviewed by category of business and written off to the extent that they are no longer considered to be recoverable.

#### **(ii) Canada – insurance and participating investment contracts**

Implicit allowance is made for deferred acquisition costs in the Canadian Asset Liability Valuation Model (CALM). Therefore no explicit deferred acquisition costs have been recognised separately for business written by the Canadian subsidiaries.

#### **(iii) UK, Ireland, Germany and Canada – non-participating investment contracts**

Incremental costs directly attributable to securing rights to receive fees for asset management services sold with unit linked investment contracts are deferred. Where such costs are borne by a with profits fund that is subject to the FSA's realistic capital regime deferral is limited to the level of any related deferred income.

Deferred acquisition costs are amortised over the life of the contracts as the related revenue is recognised. After initial recognition deferred acquisition costs are reviewed by category of business and are written off to the extent that they are no longer considered to be recoverable.

### **(l) Investment property**

Property held for long-term rental yields or investment gain that is not occupied by the Group is classified as investment property.

Investment property is initially recognised at cost including any directly attributable transaction costs. Subsequently investment property is measured at fair value. Fair value is determined without any deduction for transaction costs that may be incurred on sale or other disposal, unless the property is under development with a view to resale and is based on valuations at least annually, by external independent qualified valuers. Gains or losses arising from changes in fair value are recognised in the income statement. Investment property is not depreciated.

Property located on land that is held under an operating lease is classified as investment property as long as it is held for long-term rental yields and is not occupied by the companies in the Group. The initial cost of the property is the lower of the fair value of the property and the present value of the minimum lease payments.

Rental income from investment property is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives granted are recognised as an integral part of the total rental income and are also spread over the term of the lease.

### **(m) Property, plant and equipment**

Land and buildings consists of property occupied by the Group and property that is being constructed or developed for future use as investment property. Land and buildings are recognised initially at cost and subsequently at fair value, based on valuations, at least annually, by external independent qualified valuers less subsequent depreciation on buildings. Property occupied by the Group is valued on a vacant possession basis. Any accumulated depreciation at the date of revaluation is eliminated against the gross carrying amount of the asset and the net amount is restated to the revalued amount of the asset.

Prior to the demutualisation of The Standard Life Assurance Company (SLAC), increases in the fair value of land and buildings were recognised in the unallocated divisible surplus and following the demutualisation of SLAC, all fair value increases are recognised in the revaluation reserve in equity. Where the unallocated divisible surplus changes as a result of fair value increases which are attributable to participating policyholders, this change in the unallocated divisible surplus is not recognised in the income statement but through equity. Decreases in the fair value of land and buildings that offset previous increases in the same asset were recognised in the unallocated divisible surplus prior to the demutualisation of SLAC and are recognised in the revaluation reserve in equity post the demutualisation of SLAC. All other decreases are charged to the income statement for the period.

Owner occupied properties are depreciated on a straight-line basis over their estimated useful lives, generally between 30 and 50 years. The depreciable amount of an asset is determined by the difference between the fair value and the residual value. The residual value is the amount that would be received on disposal if the asset was already at the age and condition expected at the end of its useful life. Properties under development are not depreciated.

Equipment is stated at historical cost less depreciation. Depreciation on equipment is charged to the income statement on a straight-line basis over their estimated useful lives of between two and fifteen years. The residual values and useful lives of the assets are reviewed at each balance sheet date and adjusted if appropriate.

### **(n) 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 consolidated 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 provided on unremitted earnings of subsidiaries to the extent that the temporary difference created is expected to reverse in the foreseeable future.

Deferred tax is recognised in the income statement except when it relates to items recognised directly in the statement of recognised income and expense in which case it is credited or charged directly to equity through the statement of recognised income and expense.

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

The Group's long-term businesses in the UK and Ireland are subject to tax on policyholders' investment returns on certain products and tax on equity holder profits. Policyholder tax is accounted for as an income tax and is included within the total income tax expense. Total income tax expense is analysed between equity holder tax and policyholder tax in the consolidated income statement. Equity holder tax is current and deferred tax on profits attributable to equity holders. Policyholder tax represents current and deferred tax on investment returns attributable to policyholders.

#### **(o) Reinsurance assets**

Reinsurance assets primarily include balances due for ceded insurance liabilities. Amounts recoverable from reinsurers are estimated in a manner consistent with the assumptions used for ascertaining the underlying policy benefits, subject to the terms of the contract. Reinsurance assets that do not qualify as insurance contracts, under the classification requirements described in policy (f), are classified as financial assets and measured at fair value through profit or loss.

Amounts due from reinsurers in respect of claims incurred are separately recognised in 'Other assets' and are accounted for on a basis consistent with loans and receivables (refer to policy (p)).

If a reinsurance asset is considered to be impaired, the carrying amount is reduced to the recoverable amount and the impairment loss is recognised in the income statement. The recoverable amount is determined as the carrying amount less any impairment losses. Impairment losses are determined using the process adopted for assessing the impairment of financial assets held at amortised cost on an individual basis (refer to policy (p)).

#### **(p) 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 Group intends to sell in the short term or that it has designated as fair value through profit or loss (FVTPL). Financial assets classified as loans and receivables include deposits with credit institutions, loans secured by mortgages and loans secured on policies.

Loans and receivables are initially measured at fair value less directly attributable transaction costs. Subsequently, they are measured at amortised cost, using the Effective Interest Rate (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 Group. 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 Group 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.

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

Management determines the classification of investment securities and derivatives at initial recognition. The Group has designated its investment securities as either fair value through the profit and loss or held to maturity. All derivatives are held at fair value and where derivatives are not designated as part of a hedging relationship, changes in fair value are recorded in the income statement. Where derivatives are designated within hedging relationships, the treatment of the fair value changes depends on the nature of the hedging relationship as described below.

#### **(i) Designation as fair value through profit or loss (FVTPL)**

Financial assets and liabilities 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 Group holds portfolios of equities and debt securities that are all managed and monitored, through quarterly investment reports, on a fair value basis so as to maximise returns either for with profits policyholders or equity holders.

The Group 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 Group does not hold or issue derivative financial instruments for speculative trading purposes. The Group designates certain derivatives as part of fair value and cash flow hedge relationships under IAS 39 *Financial Instruments: Recognition and Measurement*. The impact of hedge accounting on the measurement of financial assets and liabilities is detailed in policy (q) (iii).

The Group recognises these assets 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.

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 has 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.

#### **(ii) Designation as held-to-maturity**

The Group classifies certain government bonds, held for regulatory purposes, as held-to-maturity financial assets. Held-to-maturity financial assets are recognised as assets on the trade date and initially measured at fair value plus any directly attributable transaction costs incurred on recognition. At each subsequent reporting date, the Group measures the held-to-maturity investments at amortised cost, using the Effective Interest Rate (EIR) method, less any impairment losses identified, refer to accounting policy (p). Revenue from held-to-maturity assets is recognised in the income statement on an EIR basis.

#### **(iii) Hedge accounting**

A hedge relationship will qualify for hedge accounting by the Group if, and only if, the following conditions are met:

- completion of formal hedging documentation at inception of the hedge which details the hedging instrument, hedged item, risk management objective, strategy, effectiveness testing methodology and hedge relationship;
- hedge relationship is expected to be highly effective at inception in achieving offsetting changes in fair value or cash flow attributable to the hedged risk; and
- effectiveness of the hedge can be reliably measured and the hedge is assessed for effectiveness regularly during the reporting period for which the hedge was designated to demonstrate that it has been highly effective.

The Group discontinues hedge accounting in the following circumstances:

- it is evident from the effectiveness tests that the hedge is not, or ceased to be, highly effective;
- hedging instrument expires, or is sold, terminated or exercised; or
- hedged item matures or is sold or repaid.

### Fair value hedge relationships

A fair value hedge is a hedge of the changes in fair value of a recognised asset or liability or an identified portion of such an asset or liability that is attributable to a particular risk and could impact the income statement. A fair value hedge is therefore used to hedge the exposure to variability in the fair value of financial assets and liabilities such as fixed rate debt instruments. The change in the fair value of the underlying assets or liabilities relating to the hedged risk is recognised in the income statement offsetting the change in the fair value of the hedging derivative. The change in the fair value of the hedged item in relation to the hedged risk is shown as an adjustment against the carrying value of the hedged item in the balance sheet.

If the fair value hedge ceases to meet the relevant hedging criteria, hedge accounting is discontinued and the adjustment to the carrying value of the hedged item is amortised over the remaining period to maturity and recognised in the income statement.

### Cash flow hedge relationships

A cash flow hedge is a hedge of the exposure to variability in cash flows that is attributable to a particular risk associated with a recognised asset or liability or a highly probable forecast transaction and could affect the profit or loss. A cash flow hedge is therefore used to hedge exposure to variability in cash flows such as those on variable rate assets and liabilities. Where a derivative is designated and qualifies as a cash flow hedge, the effective part of any gain or loss resulting from the change in fair value of the derivative is recognised directly in the cash flow reserve in equity. Any ineffectiveness is recognised immediately in the income statement. Amounts that have been recognised directly in the cash flow reserve are recognised in the income statement in the same period or periods during which the hedged item affects the profit or loss.

If a cash flow hedge no longer meets the relevant hedging criteria, hedge accounting is discontinued and no further changes in the fair value of the derivative are recognised in the cash flow reserve. Amounts that have already been recognised directly in the cash flow reserve are recognised in the income statement in the same period or periods during which the hedged item affects the profit or loss.

Where the forecast transaction is no longer expected to occur or the asset or liability is derecognised, the associated accumulated amounts in the cash flow reserve are recognised immediately in the income statement.

### (iv) 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.

### (r) Financial guarantee contracts

The Group recognises and measures financial guarantee contracts in accordance with IAS 39 *Financial Instruments: Recognition and Measurement*. The Group initially recognises and measures a financial guarantee contract at its fair value. At each subsequent reporting date, the Group 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.

### (s) 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.

### (t) 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 or its subsidiaries purchase any equity instruments of the Company, 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 in equity. If the proceeds exceed the purchase price, the excess over the purchase price is transferred to the share premium account.

**(t) Equity** *continued*

**(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'.

**(u) Insurance and investment contract liabilities**

For insurance contracts and participating investment contracts IFRS 4 *Insurance Contracts* permits the continued application of previously applied Generally Accepted Accounting Principles (GAAP), except where a change is deemed to make the financial statements more relevant to the economic decision-making needs of users and no less reliable, or more reliable, and no less relevant to those needs. The Group therefore adopts UK GAAP, including the requirements of FRS 27 *Life Assurance* in relation to its UK-regulated with profits funds, for the measurement of its insurance and participating investment contract liabilities. As permitted under UK GAAP, the Group adopts local regulatory valuation methods, adjusted for consistency with asset measurement policies, for the measurement of liabilities under insurance contracts and participating investment contracts issued by overseas subsidiaries.

Further details on these policies and the policies for the measurement of non-participating investment contracts are given in (v), (w) and (x) below.

**(v) Participating contract liabilities**

Participating contract liabilities are analysed into the following components:

- participating insurance contract liabilities;
- participating investment contract liabilities;
- unallocated divisible surplus; and
- present value of future profits on non-participating contracts, which is treated as a deduction from the gross participating contract liabilities.

The policy for measuring each component is noted below.

**(i) Participating insurance and investment contract liabilities**

Participating contract liabilities arising under contracts held in with profits funds falling within the scope of the Financial Services Authority's (FSA) realistic capital regime are measured on the FSA realistic basis. Under this approach the value of participating insurance and participating investment contract liabilities in each with profits fund is calculated as:

- with profits benefits reserves (WPBR) for the fund as determined under the FSA realistic basis; plus
- future policy related liabilities (FPRL) for the fund as determined under the FSA realistic basis; less
- any amounts due to equity holders included in FPRL; less
- the portion of future profits on non-participating contracts included in FPRL not due to equity holders, where this portion can be separately identified (see policy (v) (iii) below).

The WPBR is primarily based on the retrospective calculation of accumulated assets shares. The FPRL comprises other components such as market consistent stochastic valuation of the cost of options and guarantees.

Prior to the demutualisation of The Standard Life Assurance Company (SLAC), all Group business was held within one with profits fund. On an FSA realistic basis, the element of future profits on non-participating contracts included in the FPRL could not be directly allocated to participating insurance and investment contract liabilities. Hence the present value of future profits on non-participating contracts was presented as a separate item deducted from liabilities comprising participating contract liabilities and the unallocated divisible surplus.

Following the demutualisation of SLAC the Group's principal with profits fund is the Heritage With Profits Fund (HWPF) operated by Standard Life Assurance Limited (SLAL). Under the Scheme of Demutualisation (the Scheme) the residual estate of the HWPF exists to meet amounts which may be charged to the HWPF under the Scheme. However, to the extent that the board of SLAL is satisfied that there is an excess residual estate, it shall be distributed over time as an enhancement to final bonuses payable on the remaining eligible policies invested in the HWPF. This planned enhancement to the benefits under with profits contracts held in the HWPF is included in the FPRL under the FSA realistic basis resulting in a realistic surplus of nil. Applying the policy noted above this planned enhancement is therefore included within the measurement of participating contract liabilities.

The Scheme provides that certain defined cash flows (recourse cash flows) arising in the HWPF on specified blocks of UK and Irish business, both participating and non-participating, may be transferred out of that fund when they emerge, being transferred to the Shareholder Fund or Proprietary Business Fund (PBF) of SLAL, and thus accrue to the ultimate benefit of equity holders of the Company. Under the Scheme such transfers are subject to constraints to protect policyholders.

Under the FSA realistic basis the discounted value of expected future cash flows on participating contracts not reflected in the WPBR is included in the FPRL (as a reduction in FPRL where future cash flows are expected to be positive). The discounted value of expected future cash flows on non-participating contracts not reflected in the measure on non-participating liabilities is recognised as a separate asset (where future cash flows are expected to be positive). The Scheme requirement to transfer future recourse cash flows out of the HWPF is recognised as an addition to FPRL. The discounted value of expected future cash flows on non-participating contracts can be apportioned between those included in the recourse cash flows and those retained in the HWPF for the benefit of policyholders.

Applying the policy noted above:

- the value of participating insurance and participating investment contract liabilities is reduced by future expected (net positive) cash flows arising on participating contracts.
- future expected (net positive) cash flows on non-participating contracts are not recognised as an asset of the HWPF. However, future expected (net positive) cash flows on non-participating contracts that are not recourse cash flows under the Scheme are used to reduce the value of participating insurance and participating investment contract liabilities.

As the recourse cash flows emerge they are recognised as an addition to shareholder funds if positive or as a deduction from shareholder funds if negative.

In accordance with Group policy for overseas subsidiaries, the method used to determine participating contract liabilities for the Canadian business is based on Canadian accounting and regulatory valuation principles. In accordance with Canadian accounting principles, for most participating business the value of participating policy liabilities is set equal to the value of the assets set aside in a separate fund for this business, unless this is insufficient to cover guaranteed benefits, in which case a higher liability is recognised. Prior to 1 January 2007, Canadian Generally Accepted Accounting Principles (GAAP) measured the majority of assets at cost or amortised cost, therefore since the Group's policy is to measure investment securities and investment property at fair value through profit or loss (FVTPL) an adjustment was made to the Canadian GAAP liability to reflect the impact of the measurement change in the backing assets. From 1 January 2007, Canadian GAAP measures assets at FVTPL with the exception of investment property and therefore an adjustment is now only made to the Canadian GAAP liability to reflect the measurement change in investment property.

Estimates are also made as to future investment income arising from the assets backing long-term insurance contracts. These estimates are based on current market returns and expectations about future economic and financial developments.

#### **(ii) Unallocated divisible surplus (UDS)**

The UDS represents the difference between assets and all other recognised liabilities in the Group's with profits funds. It is recognised as a liability.

As a result of the policies for measuring the HWPF's assets and all its other recognised liabilities, the UDS of the HWPF comprises the value of future recourse cash flows in participating contracts (but not the value of future recourse cash flows on non-participating contracts) and the effect of any measurement differences between the realistic balance sheet value and IFRS accounting policy value of all assets and all liabilities other than participating contract liabilities recognised in the HWPF.

#### **(iii) Present value of future profits (PVFP) on non-participating contracts held in a with profits fund**

For with profits funds falling within the scope of the FSA's realistic capital regime an amount is recognised for the present value of future profits on non-participating contracts where the determination of the realistic value of liabilities for with profits contracts in that with profits fund takes account directly or indirectly, of this value. The amount is recognised as a deduction from liabilities. Where this amount can be apportioned between an amount recognised in the realistic value of with profits contract liabilities and an amount recognised in the unallocated divisible surplus, the apportioned amounts are deducted in the measurement of participating contract liabilities and unallocated divisible surplus respectively. Otherwise it is recognised as a separate amount deducted from liabilities comprising participating contract liabilities and the unallocated divisible surplus.

### **(w) Non-participating contract liabilities**

#### **(i) Non-participating insurance contracts (life and pension business)**

The insurance contract liabilities for conventional business are calculated using the gross premium method. In general terms, a gross premium valuation basis is one in which the premiums brought into account are the full amounts receivable under the contract. The method includes explicit estimates of premiums, expected claims, costs of maintaining contracts and future renewal expenses. Cash flows are discounted at the valuation rate of interest determined in accordance with Financial Services Authority (FSA) requirements. The relaxations to reserving requirements for non-participating insurance contracts set out in the FSA's Policy Statement PS 06/14 (Prudential changes for insurers) have been adopted during 2007. The Statement covers the introduction of prudent lapse allowances where appropriate; the inclusion (where appropriate) of negative liabilities which would have previously been recognised at a zero value and changes to the attribution of expense allowances when calculating sterling reserves.

The liability for annuity contracts is calculated by discounting the expected future annuity payments together with an appropriate estimate of future expenses at an assumed rate of interest derived from yields on the underlying assets.

In accordance with Group policy for overseas subsidiaries, the method used to determine the insurance contract liabilities for the Canadian business is based on Canadian accounting and regulatory valuation principles. The Canadian regulations set the value of policy liabilities equal to the value of a set of supporting assets just sufficient with reinvestment and disinvestments to meet all policy liabilities when due. Prior to 1 January 2007, Canadian Generally Accepted Accounting Principles (GAAP) measured the majority of assets at cost or amortised cost, therefore since the Group's policy is to measure investment securities and investment property at fair value through profit or loss (FVTPL) an adjustment was made to the Canadian GAAP liability to reflect the impact of the measurement change in the backing assets. From 1 January 2007, Canadian GAAP measures assets at FVTPL with the exception of investment property and therefore an adjustment is now only made to the Canadian GAAP liability to reflect the measurement change in investment property.

#### **(ii) Non-participating insurance contracts (healthcare and general insurance business)**

All healthcare and general insurance business insurance contracts are short-term contracts, generally of a duration no longer than a year. Claims outstanding comprise provisions representing the estimated ultimate cost of selling, including claims notified but not settled by the balance sheet date and claims incurred as a result of events up to the balance sheet date not reported as at that date.

A provision is made at the balance sheet date for the total expected cost of settlement of all claims incurred in respect of events up to that date, together with related claims handling expenses, less any amounts already paid. Unearned premiums represent that proportion of premiums received on in force contracts that relate to unexpired risks at the reporting date and are recognised as a liability.

#### **(iii) Non-participating investment contracts (life and pensions business)**

Unit linked non-participating investment contract liabilities are designated as FVTPL as they are implicitly managed on a fair value basis as their value is directly linked to the market value of the underlying portfolio of assets. The fair value of a unit linked liability is equal to the value of the (funded) units allocated to the contracts. The unit value is based on the bid value of the fund assets at the reporting date before expenses of selling or buying the underlying assets.

Liabilities for non-linked investment contracts are measured at amortised cost. Amortised cost is calculated as the fair value of contributions received at the date of initial recognition, less the effect of payments such as transaction costs, plus or minus the cumulative amortisation, using the effective interest rate (EIR) method, of any difference between that initial amount and the maturity value, and less any write-down for surrender payments. At each reporting date, the amortised cost liability is determined as the value of future best estimate cash flows discounted at the EIR.

#### **(x) Liability adequacy test**

The Group applies a liability adequacy test at each reporting date to ensure that the insurance liabilities are adequate in the light of the estimated future cash flows. This test is performed by comparing the carrying value of the liability and the discounted projections of future cash flows (including premiums, claims, expenses, investment return and other items), using best estimate assumptions.

If a deficiency is found in the liability (i.e. the carrying value amount of its insurance liabilities is less than the future expected cash flows) that deficiency is provided for in full. The deficiency is recognised in the income statement.

### **(y) Borrowings**

Borrowings include bank overdrafts and certificates of deposit, commercial paper, medium term notes and mortgage backed securities issued by Standard Life Bank Limited. Borrowings are recognised initially at fair value, less attributable transaction costs. Subsequent to initial recognition, borrowings are carried at amortised cost with any difference between the carrying value and redemption value being recognised in the income statement over the period of the borrowings on an effective interest rate basis.

### **(z) 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 effective interest rate. 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.

### **(aa) 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 relevant Group companies, determined by periodic actuarial calculations.

For defined benefit plans, the liability recognised in the balance sheet is the present value of the defined benefit obligation less the fair value of plan assets, together with adjustments for past service costs. Plan assets exclude any insurance contracts or non-transferable financial instruments issued by the Group. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method whereby estimated future cash outflows are discounted using interest rates of high quality corporate bonds denominated in the currency in which the benefits will be paid of similar term as the pension liability.

Actuarial gains and losses are recognised in the statement of recognised income and expense in the period in which they occur.

For defined contribution plans, the Group pays contributions to publicly or privately administered pension insurance plans. The Group has no further payment obligations once the contributions have been paid. The contributions are recognised in staff expenses when they are due.

### **(bb) Deferred income**

Front-end fees on service contracts, including investment management service contracts are deferred as a liability and amortised on a straight-line basis to the income statement over the period services are provided.

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

Provisions for restructuring costs and legal claims are recognised when the Group 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.

### **(dd) 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.

### **(ee) Leases**

Leases, where a significant portion of the risks and rewards of ownership are retained by the lessor, are classified as operating leases. Where the Group is the lessee, payments made under operating leases, net of any incentives received from the lessor, are charged to the income statement on a straight-line basis over the period of the lease.

Where the Group is the lessor, lease income from operating leases is recognised in the income statement on a straight-line basis over the lease term. Initial direct costs incurred in arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income.

The Group has not entered into any material finance lease arrangements as either the lessor or lessee.

#### **(ff) 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 annual performance shares to all eligible employees when the Group's profit exceeds certain targets. Further details of the schemes are set out in Note 41. 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.

If the equity instruments granted vest immediately, the employees become unconditionally entitled to those equity instruments. Therefore, the Group immediately recognises the charge in respect of the services received in full in the income statement with a corresponding credit to the equity compensation reserve in equity.

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 Group recognises the charge in respect of those services as they are rendered during the vesting period with a corresponding credit to the equity compensation reserve in equity.

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.

#### **(gg) 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 Group 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 Group 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.

#### **(hh) Securities lending and repurchase agreements**

The Group undertakes securities lending agreements under which securities are loaned to third parties. Where they do not meet the criteria for derecognition under IAS 39: *Financial Instruments: Recognition and Measurement*, the loaned securities are not derecognised and continue to be classified in accordance with the Group's policy. The collateral received from securities borrowers typically consists of cash or debt securities. Non-cash collateral arising from securities lending arrangements is only recognised on the consolidated balance sheet where the relevant criteria are met. Cash collateral is reinvested and the resulting financial asset and corresponding obligation to return such collateral is recognised on the consolidated balance sheet.

Securities sold subject to repurchase agreements are not derecognised and continue to be classified in accordance with the Group's policy. These securities are only reclassified as assets pledged when the transferee has the right by contract or custom to sell or repledge the security. The counterparty liability is recognised on the consolidated balance sheet. Any difference between the sale and repurchase price is accrued over the life of the agreement as interest expense using the effective interest rate method.

#### **(ii) Underlying profit**

Underlying profit is calculated by adjusting the profit for the period for volatility that arises from different IFRS measurement bases for liabilities and backing assets, volatility arising from derivatives that are part of economic hedges but do not qualify as hedge relationships under IFRS, restructuring costs, significant corporate transaction expenses, impairment of intangibles and profit or loss arising on the disposal of a subsidiary, joint venture or associate. The Directors believe that, by eliminating this volatility from equity holder profit, they are presenting a more meaningful indication of the underlying business performance of the Group.

### **(jj) Earnings per share**

Basic earnings per share is calculated by dividing profit attributable to ordinary equity holders by the weighted average number of ordinary shares in issue during the year less the weighted average number of shares owned by the Company and employee trusts that have not vested unconditionally in employees.

Diluted earnings per share is calculated by adjusting the weighted average number of ordinary shares in issue during the year to assume the conversion of all dilutive potential ordinary shares, such as share options granted to employees.

Diluted earnings per share can also be calculated by adjusting the profit or loss for the effects of changes in income, expenses, tax and dividends that would have occurred had the dilutive potential ordinary shares been converted into ordinary shares.

Alternative earnings per share is calculated on underlying profit before non-operating items and tax. Refer to policy (ii) above for details of the adjusted items.