

IFRS Conversion Project

Half Year 2005

Briefing on Adoption of IFRS
Restatement of Comparatives for 2004
8 July 2005

WHERE WE ARE

- February Prelims Announcement – one page view of key areas of impact
- 18 April (Germany) – elaboration of those key areas and what they mean for Morgan, including directional quantification of impact
- 8 July – IFRS 2004 comparatives and 2005 opening position
- 2 August – interim announcement on an IFRS basis

- Date of transition - 5 January 2004, beginning of earliest comparative period presented.
- Date of adoption - 5 January 2005.
- First IFRS interim report – half year ending 4 July 2005.
- First IFRS annual report – year ending 4 January 2006.
- 1 year of comparative information presented at half year and full year.

IFRS – Principal Areas of Impact for Morgan

- Employee benefits (IAS 19)
- Deferred taxation (IAS 12)
- Share-based payment (IFRS 2)
- Research and development (IAS 38)
- Goodwill (IFRS 3)
- Other intangibles (IAS 38)
- Financial instruments (IAS 32 and IAS 39)
- Leases (IAS 17)
- Foreign currency translation (IAS 21)
- Post-balance sheet events: Dividends (IAS 10)

Employee benefits

- All cumulative actuarial gains/losses at the date of transition have been recognised as an adjustment to the opening balance of retained earnings. From the date of transition actuarial gains/losses are recognised outside profit or loss in the 'statement of recognised income and expense' (as per FRS 17).

Share-based payment

- No charge has been recognised in respect of the fair value of equity instruments granted before 7 November 2002, that vested prior to the date of adoption.

Goodwill

- Acquisitions completed prior to the date of transition have not been restated.

Financial instruments

- IAS 32 and IAS 39 have been applied from the date of adoption. The comparative period has not been restated for IAS 32 and IAS 39.

Foreign currency translation

- Cumulative gains/losses arising on the translation of the results of foreign entities are reset to zero at the date of transition.

Fair value deemed as cost

- A valuation of property, plant and equipment carried out at a previous date can be deemed as cost at the date of transition, and used subsequently as the basis for depreciation and impairment tests.

Changes in Accounting Policy – Employee Benefits

UK GAAP

- Accounting for pensions schemes under SSAP 24. Transitional disclosures presented under FRS 17 for 2002, 2003 and 2004.

IFRS

- Wider scope covering all short-term and long-term employee benefits.
- Similar methodology to FRS 17.

Impact

- Opening 2005 balance sheet net assets reduced by c. £105.4m (IAS 19 £84.7m deficit, reversal of SSAP 24 prepayment of £20.7m).
- Actuarial gains/losses recognised outside income statement in the 'statement of recognised income and expense'.
- P/L – under UK GAAP charge for 2004 was £17.4m, under IAS 19 charge is £19.2m (split EBIT £15.4m, and net interest £3.8m).

Changes in Accounting Policy – Share-based Payment

UK GAAP

- LTIP – Under UITF Abstract 17 (Revised) the fair value of shares at grant date is charged to the profit and loss over the vesting period. 2004 charge: £1.8m.
- Share options – no charge is recognised as the exercise price is based on the market price at grant date.
- Share save schemes - exempt under the UITF.

IFRS

- There is no exemption for share save schemes.
- Option pricing models must be used for all schemes to calculate the fair value at grant date.

Impact

- Recognising a charge in respect of all 3 types of scheme, the use of option pricing models results in a charge to the income statement of £1.7m.

Changes in Accounting Policy – Research and Development

UK GAAP

- Morgan's preference has been to write off all expenditure on research and development in the year in which it is incurred, (2004: £11.7m).

IFRS

- Expenditure on development must be capitalised if it meets all the criteria included in IAS 38.
- Interpretation – Enhancement (do not capitalise) or substantially new or new products (capitalise).

Impact

- No development expenditure to be capitalised in 2004.
- Amount of future development expenditure capitalised is not expected to be significant.
- Amortisation of capitalised development expenditure will be over a period not exceeding 3 years.

Changes in Accounting Policy – Goodwill

UK GAAP

- Goodwill in respect of acquisitions since 4 January 1998 is capitalised as an intangible asset and amortised to nil by equal annual instalments over its estimated useful life, normally 20 years.
- On disposal or termination of a business acquired up to 4 January 1998, any goodwill previously written off against reserves is 'recycled' through the profit and loss.

IFRS

- Capitalised goodwill is not amortised but is subject to impairment testing at least annually.
- No recycling of goodwill previously written off against reserves.

Impact

- Operating profit improvement in the absence of amortisation; (2004: £6.4m).
- Net profit improvement in the absence of recycling goodwill previously written off against reserves relating to disposals; (2004: £16.1m).
- No impairment losses.

Changes in Accounting Policy – Other Intangibles

UK GAAP

- Morgan did not recognise any intangible assets other than purchased goodwill arising on acquisitions.

IFRS

- Additional intangible assets will be recognised such as:
 - purchased computer software, that is not integral to plant and equipment, must be classified as intangible assets;
 - computer software developed internally for own use, if it meets all the criteria included in IAS 38.

Impact

- Internally developed software - capitalisation.
- Purchased software:
 - Balance sheet reclassification from tangible fixed assets to intangible assets £6.9m.
 - Income statement reclassification from depreciation to amortisation over the period of the useful life, normally 3 years, £1.4m.

Changes in Accounting Policy – Financial Instruments

UK GAAP

- Cash, borrowings, and financial investments recorded on the balance sheet at cost.
- Derivative contracts not recorded on the balance sheet.
- Hedged foreign currency assets/liabilities translated at the forward contract rate.

IFRS

- Introduced from 5 January 2005 – not date of transition.
- All derivatives recorded on the balance sheet and marked to market.
- Changes in fair value taken to the income statement or equity (later recycled) depending on the classification.
- Embedded derivatives require separation from the host contract.
- Detailed documentation required to qualify for hedge accounting.

Impact

- Potential volatility of results will be minimised by Morgan's centrally coordinated hedging policy – B/S at start of 2005 £0.5m (liability).

Changes in Accounting Policy – Leases

UK GAAP

- Determination of a finance lease – presumed risks/rewards of ownership have transferred to the lessee if, at inception, the present value of the minimum lease payments equates to 90% or more of the fair value of the leased asset.
- Operating lease incentives are spread over the period up to the point at which the rent payable is adjusted to the prevailing market rate.

IFRS

- Determination of a finance lease - based purely on substance over form assessment of whether risks/rewards of ownership have transferred to the lessee.
- Operating lease incentives are spread over the total term of the lease.

Impact

- Pure substance over form approach may lead to more operating leases being categorised as finance leases. Not material.

Changes in Accounting Policy – Deferred Tax

Major disclosure changes under IAS 12:

- Current and deferred tax
 - Assets and liabilities separately disclosed in the balance sheet
 - More detailed analysis of both assets and liabilities
- Reconciliation of effective tax rate based on total tax
[Present system requires reconciliation based on current tax only]
- Deferred tax note will include disclosure of unrecognised DT assets (e.g. losses)

Changes in Accounting Policy – Deferred Tax

Main areas of impact for Morgan:

- Restatement of 4 January 2005 Balance Sheet
 - Substantial deferred tax adjustment on restatement of pension prepayments and provisions under IAS 19
 - Recognition of deferred tax on fair value adjustments on prior year acquisitions
 - Results in elimination of net deferred tax liability under FRS 19 of £10.4m at 4 January 2005, (employee benefits £15.2m decrease in DT; fair value adjustments £4.8m increase in DT)
- Change with effect from 4 January 2006 Balance Sheet
 - Disclosure of unrecognised deferred tax assets
 - To be quantified as part of the year end procedures
- No significant current tax adjustments

Changes in Accounting Policy – Foreign Currency Translation

UK GAAP

- Cumulative translation gains/losses arising on consolidation are recorded in equity.

IFRS

- Cumulative translation gains/losses arising on consolidation are recorded in equity, and must be ‘recycled’ through the income statement on disposal of a foreign operation.

Impact

- Cumulative translation gains/losses must be captured separately to other reserve movements.
- Will affect profit/loss result on disposal of a foreign operation.

Changes in accounting policy – Post-balance sheet events: Dividends

UK GAAP

- Financial statements incorporate transactions that are determined to be ‘adjusting’ post-balance sheet events e.g. the proposal of a dividend relating to the period recently ended.

IFRS

- Dividends proposed after the period end are not recognised in the financial statements.

Impact

- Only dividends declared and approved during the period will be recognised in the financial statements. Hence there will be no appropriation of profit or reduction in net assets in respect of dividends proposed after the balance sheet date.

Balance Sheet at 5 January 2004 / 4 July 2004 / 4 January 2005 / 5 January 2005

	Opening 2004 <u>£m</u>	HY 2004 <u>£m</u>	Closing 2004 <u>£m</u>	Opening 2005 <u>£m</u>
UK GAAP net assets	259.8	268.0	240.4	240.4
IFRS adjustments:				
–IAS 19 – Pensions & SSAP 24	(65.8)	(98.6)	(105.4)	(105.4)
–IAS 12 – Deferred tax (1)	15.6	15.6	15.2	15.2
–IAS 12 – Deferred tax (2)	(5.6)	(5.6)	(4.8)	(4.8)
–IFRS 2 – Share based payments	-	0.8	1.8	1.8
–IAS 17 – Leases	-	-	-	-
–IAS 38 – R & D	-	-	-	-
–IFRS 3 – Goodwill	-	3.3	6.4	6.4
–IAS 19 – Other employee benefits	(0.1)	(0.4)	(0.1)	(0.1)
–IAS 37 – Provisions	(0.3)	(0.3)	(0.4)	(0.4)
–IAS 39 – Financial instruments	-	-	-	(0.5)
Net assets restated for IFRS	203.6	182.8	153.1	152.6

Income Statement at 4 July 2004 – Half Year

	UK GAAP	Adjustment	IFRS
	£m	£m	£m
Revenue	406.2	-	406.2
EBIT	24.9	0.3	25.2
Operating profit (IFRS)	0.1	3.6	3.7
Net Finance Costs	(6.9)	(1.9)	(8.8)
Loss before tax	(7.3)	1.7	(5.6)
Loss for the period	(48.0)	14.2	(33.8)
EPS Basic	(16.7p)	4.0p	(12.7p)
EPS Underlying	4.7p	(0.6p)	4.1p

Income Statement at 4 January 2005 – Full Year

	UK GAAP	Adjustment	IFRS
	£m	£m	£m
Revenue	795.9	-	795.9
EBIT	53.7	2.1	55.8
Operating loss (IFRS)	(15.2)	8.5	(6.7)
Net Finance Costs	(12.2)	(3.9)	(16.1)
Loss before tax	(35.6)	4.6	(31.0)
Loss for the period	(81.3)	21.1	(60.2)
EPS Basic	(27.3p)	5.3p	(22.0p)
EPS Underlying	10.4p	(0.5p)	9.9p

Key Changes in 2004 Full Year Results

- EBIT
 - IAS 19 – Pensions adjustment £(2.0)m
 - IFRS 2 – Share based payments adjustment £(0.1)m
- Operating profit (after restructuring costs) – IFRS
 - The above, plus:
 - Goodwill amortisation no longer required £(6.4)m
- Finance charge
 - IAS 19 finance cost £3.9m

- Half Year results 2 August
- Accounting policies and transition notes – Morgan website