



Fortis Insurance Ltd
Directors' Report and
Financial Statements 2005

Directors' Report and Financial Statements

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Directors' Report and Financial Statements

Chief Executive

Barry D Smith

Directors

Shaun D Astley

Lyn Nicholls

Paul Chaplain

Jeffrey O Grosvenor

Robert Smale

Julian R M Harvey

Michael H Cranston

Resigned 30.04.05

Christopher Dobson

Secretary

Rosemary A Smith

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Independent Auditor

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Bankers

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Southampton High Street Branch

PO Box 315

Southampton SO14 2BF

Report of the Directors

The Directors submit their report together with the audited financial statements for the year ended 31st December 2005.

Activities

During the year the Company continued to develop its personal lines business, principally motor, travel and household, and its small commercial lines business.

The Company also administered the run-off of its Marine and City business for which it ceased accepting new business in 1991.

Business review

Full details of the Company's results are contained in the accounts on pages 5 to 44. The Directors intend to continue the development of personal and small commercial lines of business.

Results and dividends

The result of the year's operation is a profit after taxation of £40.3m (2004: £34.1m).

A dividend of £13.1m was paid in 2005 (2004: £12.0m).

Directors

On 30 April 2005 Michael H Cranston resigned as a director. All other Directors served throughout the year and to the date of this report.

Directors' shareholdings

None of the Directors or their families had any disclosable interest in either the shares of the Company, of any other Group Company, or of the ultimate Holding Company at 31 December 2005.

Auditors

Pursuant to a shareholders' resolution, the company is not obliged to reappoint its auditors annually and KPMG Audit Plc will therefore continue in office.

Report of the Directors Continued

Creditor payment policy

The Company agrees terms and conditions under which business transactions with suppliers are conducted. It is the Company's policy that payments to suppliers are made in accordance with these terms, provided that the supplier is also complying with all relevant terms and conditions.

Employees

The average number of persons employed in the United Kingdom by the Company and its subsidiaries during the year was 1,052. The full time equivalent number of employees adjusted for part time staff was 906. Their annual aggregate remuneration was £26.2m. An analysis is shown on Page 42.

Employee involvement

Staff are kept informed of matters affecting the Company by means of regular departmental meetings and bulletins from general management. The views of staff are represented by an elected Staff Council, which holds regular meetings with management.

Disabled persons

The Company's procedures comply with the requirements of the Disability Discrimination Act 1995. If an employee becomes disabled during employment with the Company every effort would be made to retrain that employee to perform a job appropriate to their aptitudes and skills. The Company's policy to encourage career development for its employees includes the disabled for whom further training would be arranged if necessary to allow for special needs.

Charitable donations

Charitable donations in the year amounted to £36,878 (2004: £39,542).

This report was approved by the board of directors on 31 March 2006 and signed on its behalf by:

R A Smith
Secretary

Income statement

For the year ended 31 December 2005

	Notes	2005		2004	
		£m	£m	£m	£m
Gross premiums written	5	596.6		574.0	
Change in the gross provision for unearned premiums		(6.3)		(3.8)	
Gross insurance premium revenue	5		590.3		570.2
Written premiums ceded to reinsurers	5	(23.2)		(25.3)	
Reinsurers' share of change in the provision for unearned premiums		0.1	(23.1)	(0.2)	(25.5)
Net insurance premium revenue			567.2		544.7
Commission income	6		1.0		1.0
Investment income	7		43.2		38.1
Other operating income	8		4.9		3.9
Net income			616.3		587.7
Claims and benefits incurred	9	(428.9)		(423.0)	
Reinsurers' share of claims and benefits incurred		7.0		14.6	
Net policyholder claims and benefits incurred			(421.9)		(408.4)
Acquisition costs	10		(115.8)		(107.0)
Administrative expenses	11		(20.7)		(23.2)
Other operating expenses	12		-		(0.1)
Operating profit			57.9		49.0
Finance costs	13		(0.1)		(0.1)
Profit before income taxes			57.8		48.9
Income taxes	14		(17.5)		(14.8)
Profit for the year			40.3		34.1

Statement of recognised income and expense

For the year ended 31 December 2005

	Note	2005 £m	2004 £m
Gross change in fair value of equity securities available for sale		8.5	4.2
Deferred tax on unrealised gain		(2.6)	(1.2)
Net income recognised directly in equity	27	<u>5.9</u>	<u>3.0</u>
Profit for the year	27	40.3	34.1
Total recognised income and expense for the year		<u>46.2</u>	<u>37.1</u>

Balance Sheet

As at 31 December 2005

	Notes	2005 £m	2004 £m
Assets			
Property, plant and equipment	15	3.9	2.9
Intangible assets			
- Deferred acquisition costs	16	53.4	51.6
Investments in subsidiaries	4	16.3	16.3
Financial assets	17		
- Debt securities – fixed rate		898.8	828.7
- Collective investment schemes		29.0	23.8
Reinsurance assets	22	67.1	75.5
Deferred tax assets	18	5.1	8.1
Insurance and other receivables	20	135.1	117.1
Cash and cash equivalents	21	27.6	23.9
Total assets		1,236.3	1,147.9
Liabilities			
Insurance contract provisions	22	898.8	846.9
Financial liabilities			
- Loans and borrowings	23	21.7	15.9
- Other (Funds held under reinsurance agreements)		0.3	0.9
Reinsurance payables		2.7	6.2
Insurance payables, other payables and deferred income	24	40.1	39.0
Other provisions	25	1.3	1.2
Employee benefits	26	20.0	20.2
Current tax liabilities	19	8.1	7.4
Total liabilities		993.0	937.7
Net assets		243.3	210.2
Shareholders' equity			
	27		
Share capital		71.1	71.1
Share premium		3.9	3.9
Retained earnings		148.3	121.1
Other reserves		20.0	14.1
Total shareholders' equity		243.3	210.2

These financial statements were approved by the board of directors on 31 March 2006 and were signed on its behalf by:

B D Smith
Chief Executive

J R M Harvey
Director

Statement of cash flows

For the year ended 31 December 2005

	2005	2004
	£m	£m
Cash flows from operating activities		
Profit before tax	57.8	48.9
<i>Adjustments for:</i>		
Depreciation of buildings, plant and equipment	1.3	1.1
Amortisation of deferred acquisition costs and other intangible assets	(1.8)	(3.5)
Fair value gains / (losses) on financial assets	8.5	4.2
	<hr/>	<hr/>
	65.8	50.7
(increase)/ decrease in Financial assets	(75.3)	(74.9)
(increase)/ decrease in Reinsurance assets	8.4	0.8
(increase)/ decrease in Insurance and other assets	(18.0)	(1.1)
increase/ (decrease) in Insurance, other payables and deferred income	53.0	64.6
increase/ (decrease) in Reinsurance liabilities	(3.5)	6.2
increase/ (decrease) in Financial liabilities	5.2	(0.7)
increase/ (decrease) in Other liabilities and provisions	(0.2)	0.9
	<hr/>	<hr/>
	35.4	46.5
Income taxes paid	(16.3)	(13.8)
Net cash from operating activities	<hr/>	<hr/>
	19.1	32.7
Cash flows from investing activities		
Acquisition of property, plant and equipment	(2.3)	(1.3)
Net cash from investing activities	<hr/>	<hr/>
	(2.3)	(1.3)
Cash flows from financing activities		
Dividends paid	(13.1)	(12.0)
Net cash from financing activities	<hr/>	<hr/>
	(13.1)	(12.0)
Net increase in cash and cash equivalents		
	3.7	19.4
Cash and cash equivalents at 1 January	23.9	4.5
Cash and cash equivalents at 31 December	<hr/>	<hr/>
	27.6	23.9

Significant accounting policies

Fortis Insurance Limited is a company domiciled in England and Wales.

The financial statements were authorised for issue by the directors on 31 March 2006.

(a) Statement of compliance

The financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) and its interpretations issued by the International Accounting Standards Board (IASB) as adopted by the European Union (EU). These are the Company's first financial statements under IFRS and IFRS 1 has been applied.

An explanation of how the transition to IFRS has affected the reported financial position and financial performance of the Company is provided in note 1.

The Company presents its balance sheet in order of liquidity in accordance with IAS 1. For each asset and liability line item in the balance sheet that combines amounts expected to be recovered or settled within twelve months, or more than twelve months after the balance sheet date, a classification at the balance sheet date is included within the notes. The disclosure in the notes for these classifications are distinguished as follows:

- Amounts expected to be recovered in less than one year are referred to as current.
- Amounts expected to be recovered in more than one year are referred to as non-current.

(b) Basis of preparation

The financial statements are presented in Millions of Pounds Sterling, rounded to one decimal place. They are prepared on the historical cost basis except that financial instruments classified as available for sale are stated at their fair value.

The preparation of financial statements in conformity with IFRS requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the year in which the estimate is revised if the revision affects only that year, or in the year of the revision and future years if the revision affects both current and future years.

Judgements made by management in the application of IFRS that have a significant effect on the financial statements, and estimates with a significant risk of material adjustment in the next year, are discussed in note 2.

The accounting policies set out below have been applied consistently to all years presented in these financial statements and in preparing an opening IFRS balance sheet at 1 January 2004 for the purposes of the transition to IFRS.

(c) Classification of contracts

Contracts under which the Company accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder or other beneficiary if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiary are classified as insurance contracts. Insurance risk is risk other than financial risk. Financial risk is the risk of a possible future change in one or more of a specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, a credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. Insurance contracts may also transfer some financial risk.

Significant accounting policies

(d) Recognition and measurement of contracts

Premiums

Gross written premiums comprise the premiums on contracts entered into during the year, irrespective of whether they relate in whole or in part to a later accounting period. Premiums are disclosed gross of commission payable to intermediaries and exclude taxes and levies based on premiums. Premiums written include adjustments to premiums written in prior accounting periods and estimates for “pipeline” premiums. An estimate is made at the balance sheet date to recognise retrospective adjustments to premiums or commissions. The earned portion of premiums received, is recognised as revenue. Pipeline premiums are brought into account, based upon the pattern of booking of renewals and new business. Premiums are earned from the date of attachment of risk, over the indemnity period, based on the pattern of risks underwritten. Outward reinsurance premiums are recognised as a deduction from net insurance revenue in accordance with the contractual arrangements with reinsurers.

Unearned premium provision

The provision for unearned premiums comprises the proportion of gross premiums written which is estimated to be earned in the following or subsequent financial years, computed separately for each insurance contract using the daily pro rata method, adjusted if necessary to reflect any variation in the incidence of risk during the period covered by the contract. For some lines of business this is calculated using the monthly pro rata method.

Claims

Claims incurred consist of claims and claims handling expenses paid during the financial year, together with the movement in the provision for outstanding claims.

Claims outstanding comprise provisions for the Company’s estimate of the ultimate cost of settling all claims incurred but unpaid at the balance sheet date whether reported or not, and related internal and external claims handling expenses. Claims outstanding are assessed by reviewing individual claims and making allowance for claims incurred but not yet reported, adjusted for the effect of both internal and external foreseeable events, such as changes in claims handling procedures, inflation, judicial trends, legislative changes and past experience and trends. Anticipated reinsurance recoveries, and estimates of salvage and subrogation recoveries, are presented separately as assets. Reinsurance and other recoveries are assessed in a manner similar to the assessment of claims outstanding.

Whilst the directors consider that the gross provisions for claims and the related reinsurance recoveries are fairly stated on the basis of the information currently available to them, the ultimate liability will vary as a result of subsequent information and events and may result in significant adjustments to the amounts provided. Adjustments to the amounts of claims provisions established in prior years are reflected in the financial statements for the period in which the adjustments are made, and disclosed separately if material. The methods used, and the estimates made, are reviewed regularly.

Unexpired risk provision

Provision is made for unexpired risks arising from business where the expected value of claims and expenses attributable to the unexpired periods of policies in force at the balance sheet date exceeds the unearned premiums provision in relation to such policies after the deduction of any deferred acquisition costs. The provision for unexpired risks is calculated separately by reference to classes of business which are managed together, after taking into account the relevant investment return.

Significant accounting policies

(d) Recognition and measurement of contracts (continued)

Claims liabilities

The provision represents the estimated ultimate cost of settling all claims including direct and indirect settlement costs, arising from events that occurred up to the balance sheet date. Unpaid losses consist of estimates for reported losses and provisions for losses not reported.

Reinsurance

The Company cedes reinsurance in the normal course of business for the purpose of limiting its net loss potential through the diversification of its risks. Reinsurance arrangements do not relieve the Company from its direct obligations to its policyholders.

Premiums ceded and benefits reimbursed are presented in the income statement and balance sheet on a gross basis.

Only contracts that give rise to a significant transfer of insurance risk are accounted for as insurance. Amounts recoverable under such contracts are recognised in the same year as the related claim. Contracts that do not transfer significant insurance risk (i.e. financial reinsurance), are accounted for as financial instruments.

Reinsurance assets include balances due from reinsurance companies for reinsurance claims. Amounts recoverable from reinsurers' are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy.

Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition, that the Company may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the Company will receive from the reinsurer.

Deferred acquisition costs

The costs of acquiring new and renewal insurance business that is primarily related to the production of that business are deferred (see accounting policy 1).

Such deferred acquisition costs are amortised by reference to the basis on which the related premiums are earned.

(e) Revenue

The accounting policy in relation to revenue from insurance contracts is disclosed in note (d).

Commission income

Commissions received or receivable which do not require the Company to render further service are recognised as revenue by the Company. Reinsurance commissions are deferred and amortised on a pro rata basis over the contract term.

Investment income

Investment income comprises interest income, dividend income and net realised gains from available-for-sale financial assets earned in the period (see note 7).

(f) Expenses

(i) Operating lease payments

Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease.

Significant accounting policies

(f) Expenses (continued)

(ii) Finance lease payments

Minimum lease payments are apportioned between the finance charge and the reduction of the outstanding liability. The finance charge is allocated to each year during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability.

(iii) Net finance costs

Net finance costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, dividend income and foreign exchange gains and losses.

(g) Employee benefits

(i) Defined contribution plans

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

(ii) Defined benefit plans

The Company's net obligation in respect of defined benefit pension plans is calculated by estimating the amount of future benefit that employees have earned in return for their service in the current and prior years; that benefit is discounted to determine its present value, and the fair value of any plan assets is deducted. The discount rate is the yield at the balance sheet date on AAA credit rated bonds that have maturity dates approximating to the terms of the Company's obligations. The calculation is performed by a qualified actuary using the projected unit credit method.

When the benefits of a plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement on a straight-line basis over the average year until the benefits become vested. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

All actuarial gains and losses as at 1 January 2004, the date of transition to IFRS, were recognised in the balance sheet as at that date. In respect of actuarial gains and losses that arise subsequent to 1 January 2004 in calculating the Company's obligation in respect of a plan, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10 per cent of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in the income statement over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

Where the calculation results in a benefit to the Company, the recognised asset is limited to the net total of any unrecognised actuarial losses and past service costs and the present value of any future refunds from the plan or reductions in future contributions to the plan.

(h) Income tax

Income tax on the income statement for the year comprises current 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 the related income tax is also recognised in equity.

Current tax is the expected tax payable on the taxable profit for the year, using tax rates enacted or substantially enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Significant accounting policies

(h) Income tax (continued)

Deferred tax is provided in full, using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes, and the amounts used for taxation purposes. The following temporary differences are not provided for: goodwill not deductible for tax purposes, the initial recognition of assets or liabilities that affects neither accounting nor taxable profit, and differences relating to investments in subsidiaries to the extent that they will probably not 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. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

Deferred tax assets and liabilities are not discounted.

(i) Foreign currency translation

Transactions in foreign currencies 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 to the presentational currency (pounds sterling) at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation 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. Non-monetary assets and liabilities denominated in foreign currencies that are stated at fair value are translated to pounds sterling at foreign exchange rates ruling at the dates the fair value was determined.

(j) Segment reporting

In accordance with IAS 14, Segment Reporting, the Company is not required to present segmental information.

(k) Property, plant and equipment

(i) Owned assets

Items of property, plant and equipment are stated at cost (or deemed cost) less accumulated depreciation (see below) and impairment losses (see accounting policy q).

Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items of property, plant and equipment.

(ii) Leased assets

Leases under the terms of which the Company assumes substantially all the risks and rewards of ownership are classified as finance leases. Assets acquired under finance leases are capitalised at fair value as property plant and equipment and depreciated in accordance with the Company's accounting policy k(iii). Lease payments are accounted for as described in accounting policy f(ii).

(iii) Depreciation

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of each part of an item of property, plant and equipment. Land is not depreciated.

Significant accounting policies

(k) Property, plant and equipment (continued)

(iii) Depreciation (continued)

The estimated useful lives are as follows:

Buildings and leasehold improvements	Fifty years
Equipment and motor vehicles	Two to four years
IT equipment	Three to five years

The gain or loss arising on the disposal of an asset is determined as the difference between the sale proceeds and the carrying value of the asset and is recognised in income. The residual value, if not insignificant, is reassessed annually.

(l) Intangible assets

Deferred acquisition costs

Acquisition costs comprise all direct and indirect costs arising from entering into insurance contracts. Deferred acquisition costs represent the proportion of acquisition costs incurred which corresponds to the unearned premiums provision. Acquisition costs are not deferred to the extent that available future margins are not expected to cover such deferred costs.

(m) Investment in subsidiaries

Investments in group undertakings are stated at cost. Details of group undertakings are included in note 30, Related party transactions.

(n) Financial assets

Financial assets, all of which are non-derivative financial assets, are held as available for sale. Purchases of financial assets are recognised on the trade date, which is when the Company commits to purchase the assets. Financial assets are derecognised when contractual rights to receive cash flows from the investments expire, or where the investments, together with substantially all the risks and rewards of ownership, have been transferred.

Financial assets are measured at fair value without any deduction for transaction costs the Company may incur on disposal. The fair value of quoted investments is their quoted bid prices at the balance sheet date.

Realised gains and losses are included in the income statement in the period in which they arise. Unrealised gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, except for foreign exchange gains and losses on monetary items such as debt securities, which are recognised in the income statement. When available-for-sale financial assets are sold or impaired, the cumulative gains or losses previously recognised in equity are recognised in the income statement. Where these investments are interest-bearing, interest calculated using the effective interest method is recognised in the income statement.

(o) Other receivables

Other receivables are stated at their cost less impairment losses (see accounting policy q).

(p) Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits. Bank overdrafts that are repayable on demand and form an integral part of the Company's cash management are included as a component of cash and cash equivalents for the purpose only of the statement of cash flows.

Significant accounting policies

(q) Impairment

The carrying amounts of the Company's assets are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the carrying value is reduced to the estimated recoverable amount by means of a charge to the income statement.

For assets that have an indefinite useful life and intangible assets that are not yet available for use, the recoverable amount is estimated at each balance sheet date.

An impairment loss is recognised whenever the carrying amount of an asset or its cash-generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement.

When a decline in the fair value of an available-for-sale financial asset has been recognised directly in equity and there is objective evidence that the asset is impaired, the cumulative loss that had been recognised directly in equity is recognised in the income statement even though the financial asset has not been derecognised. The amount of the cumulative loss that is recognised in the income statement is the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in the income statement. A decline in fair value below cost of more than 20% or a decline that persists for more than nine months is considered to be evidence of impairment.

Reversals of impairment

If the fair value of a debt instrument classified as available-for-sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed, with the amount of the reversal recognised in profit or loss.

In respect of other assets, an impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount.

An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

(r) Provisions

A provision is recognised in the balance sheet when the Company has 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. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

(s) Loans and borrowings

Interest-bearing loans and borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing loans and borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the year of the borrowings on an effective interest basis.

(t) Dividends

Dividends payable on ordinary shares are recognised when they are paid.

Notes to the financial statements

1 Explanation of transition to IFRS

As stated above, these are the Company's first financial statements prepared in accordance with IFRS.

The accounting policies set out above have been applied in preparing the financial statements for the year ended 31 December 2005, the comparative information presented in these financial statements for the year ended 31 December 2004 and in the preparation of an opening IFRS balance sheet at 1 January 2004.

In preparing its opening IFRS balance sheet, the Company has adjusted amounts reported previously in financial statements prepared in accordance with its old basis of accounting (UK GAAP). An explanation of how the transition from UK GAAP to IFRS has affected the Company's reported financial position and financial performance is set out in the following tables and the notes that accompany the tables.

<i>In millions of pounds</i>	Shareholders' funds		Profit
	At 1 January 2004	At 31 December 2004	attributable to shareholders Year ended 31 December 2004
As originally reported under UK GAAP	194.8	215.5	33.7
Adjustments for:			
Financial assets	2.1	4.4	(1.9)
Pension Scheme	(19.3)	(18.7)	0.6
Other payables	(11.2)	(13.2)	(2.0)
Equalisation provision	1.4	5.2	3.8
Dividend payable	12.0	13.1	-
Deferred tax on adjustments	8.1	6.7	(0.1)
Property plant and equipment	(0.3)	(0.3)	-
Subsidiaries	(2.5)	(2.5)	-
As restated under IFRS	<u>185.1</u>	<u>210.2</u>	<u>34.1</u>

Financial Assets

In accordance with IAS 39, Financial Instruments: Recognition and Measurement, financial assets have been recognised at fair value. The Company's valuation policy for fixed interest securities under UK GAAP was amortised cost. The difference has been transferred to the fair value reserve on transition to IFRS. Movements in the market value of collective investment schemes were, under UK GAAP, included in the income statement. Under IFRS these are transferred to the fair value reserve.

Pension Scheme

Pension scheme liabilities under UK GAAP were valued under SSAP24. Under IAS 19, Employee Benefits, the deficit recognised in the accounts has been charged to reserves. The change reduced the charge to the income statement in 2004.

Other payables

The basis of accrual for certain industry levies was reviewed upon implementation of IFRS and additional provisions made in accordance with the basis of the calculation of the levies.

Notes to the financial statements

1 Explanation of transition to IFRS (continued)

Equalisation provision

Equalisation provisions are not recognised as liabilities under IFRS and these have been removed from the accounts.

Dividend Payable

Dividends under IFRS are accounted for on a paid basis rather than an accrued basis as under UK GAAP. Retained earnings have been increased to eliminate the proposed dividends in the 2004 UK GAAP accounts.

Subsidiaries

Under UK GAAP, subsidiaries were valued at net asset value. Under IFRS they are valued at cost. The UK GAAP revaluation reserve has been eliminated.

Property Plant & Equipment

Property plant and equipment is valued at depreciated cost under IFRS. Under UK GAAP land and buildings were recognised at market value less depreciation.

2 Accounting estimates and judgements

The most critical judgements and estimates made by the Company are those regarding reported and unreported losses, deferred policy acquisition costs and defined benefit obligations.

Outstanding claims and provisions

The Company establishes reserves in respect of the anticipated losses incurred in respect of business it has written. These reserves reflect the expected ultimate cost of settling claims occurring prior to the balance sheet date, but remaining unsettled at that time, and take into account any related reinsurance recoveries. Such reserves are established separately for each line of business written by the Company and fall into two categories – reserves for reported losses and reserves for losses incurred but not reported as of the balance sheet date.

Reserves for reported losses are established on a case-by-case basis and are based largely on past experience of settlements on similar claims. The reserves are set on an undiscounted basis and reflect the anticipated cost of final settlement, taking into account inflation and other factors which might influence the final outcome. Such reserves are reviewed on a regular basis to take account of changing circumstances, such as changes in the law and changes in costs relating to settlement.

Reserves for losses incurred but not reported as of the balance sheet date are also established on an undiscounted basis. They are estimated based on historical data using various actuarial techniques and statistical modelling methodologies. As with case reserves, reserves for losses incurred but not reported are calculated separately for each line of business written and take into account trends in settlement costs in arriving at the final estimates.

For further details on loss reserves see note 22.

Deferred policy acquisition costs

A proportion of the commission expenses and other acquisition costs incurred by the Company in respect of the business written in the year are deferred as at the balance sheet date. Such amounts deferred are then amortised over the estimated remaining period of the policies concerned. The extent to which costs are deferred is dependent on management's judgment as regards the level of costs incurred which relate to the business written.

For further details on deferred policy acquisition costs see note 16.

Notes to the financial statements

2 Accounting estimates and judgements (continued)

Defined benefit obligations

The Company's liability for defined benefit obligations is based on various estimates including discount rates, expected returns on plan assets, future salary increases, future pension increases, mortality rates and future staff turnover. Differences in future actual experience may result in the liability recorded in the Company's balance sheet proving to be either too high or too low.

For further details on defined benefit obligations see note 26.

3 Risk management

Objectives and policies for mitigating business risk

The Company's primary business is the assumption of risk of loss from individuals or businesses directly subject to the risk. As such it is itself exposed to a number of risks, including insurance risk, financial risk, market risk, credit risk and liquidity risk. The Company has various procedures in place to manage these exposures. These include an overall risk management framework, together with a set of clearly defined risk policies which articulate the Company's risk appetite. The Company also maintains a comprehensive risk register which identifies the individual risks faced in each area of the business and the controls in place to mitigate these. The Company's Risk Committee meets regularly to review both the risk policies and the risk register, to ensure they are up-to-date, reflecting the risks currently facing the business, and that corresponding control issues and risk mitigation actions are being addressed in a timely manner. The findings of the Risk Committee are reported to the Company's Board.

Looking at the main areas of risk faced by the Company, and the strategies in place to manage these:

Insurance Risk

The Company's management of insurance risk is a critical aspect of the business. It manages this through various policies and procedures including underwriting limits, approval procedures for transactions that involve new products or that exceed set limits, pricing guidelines, centralized management of reinsurance and the close monitoring of emerging issues.

The main types of risk insured by the Company are as follows:

- Motor – consisting of both property and liability covers.
- Property – covering claims for damage to buildings or contents, plus losses from business interruption for commercial customers only.
- Travel – providing cover for cancellations of holidays, travel delays, medical cover for illness whilst on holiday, death benefits, and compensation for loss and damage to baggage.
- Liability insurance – offering compensation to employees and members of the public suffering injury and/or property damage.

The Company uses several methods to assess and monitor the risk exposures associated with each of these, both for the individual types of risks insured and the overall risks. These methods include internal risk measurement models, sensitivity analyses, scenario analyses and stress testing.

Notes to the financial statements

3 Risk management (continued)

Insurance Risk (continued)

The theory of probability is applied to the pricing and provisioning for a portfolio of insurance contracts. The principal risks are that the frequency and severity of the claims are greater than expected. Insurance events are, by their nature random and hence the actual number and size of events during any one year may vary from those estimated using established statistical techniques.

The Company reinsures a portion of the risks it underwrites in order to control its exposures to losses and protect capital resources. The Company buys primarily excess of loss (i.e. non-proportional) reinsurance treaties to reduce its net exposure to agreed levels for each line of business in accordance with the Company's risk appetite. In addition, underwriters buy facultative reinsurance in certain specified circumstances.

Concentrations of insurance risk

A key aspect of the insurance risk faced by the Company is the degree of concentration of insurance risk, which may exist where a particular event or series of events could impact significantly upon the Company's liabilities. Such concentrations may arise from a single insurance contract or through a small number of related contracts, and relate to circumstances where significant liabilities could arise.

Concentrations of risk can arise in both high-severity, low frequency events, such as natural disasters and in situations where underwriting is biased towards a particular group, such as a particular geographical concentration or demographic trend.

High-severity, low frequency concentrations

By their nature, the timing and frequency of these events are uncertain. They represent a significant risk to the Company because the occurrence of an event, while unlikely in any given accounting period, would have a significantly adverse effect on the Company's cash flows.

The Company's key methods in managing these risks are two-fold. Firstly, the risk is managed through appropriate underwriting. Underwriters are not permitted to underwrite risks unless the expected profits are commensurate with the risks assumed. Secondly, the risk is managed through the use of reinsurance. The Company purchases excess of loss covers for classes of liability, property, motor and travel business. The Company assesses the costs and benefits associated with the reinsurance programme regularly.

Geographic and demographic concentrations

Liability insurance contracts underwritten by the Company in the past expose the Company to claims in the US from industrial diseases caused by exposure to asbestos. These liabilities comprise 2.6 percent of the Company's general insurance liabilities at 31 December 2005. The assumptions used in determining the liabilities are included in note 22.

Economic downturns

The Company's insurance portfolio exposes it to correlations and interdependencies to different types of risks arising in the event of an economic recession.

The Company's initial strategy in the event of a recession would be to address the above risks in order to reduce any excess losses. This would be performed by increasing premium rates in order to cover the unanticipated losses. Where an increase in the premium rates is not achievable then an alternative option would be to reduce the level of activity in the market.

Notes to the financial statements

3 Risk management (continued)

Insurance Risk (continued)

Total Aggregate Exposure

The Company identifies the total aggregate exposure that it is prepared to accept in relation to concentrations of risk. It monitors these exposures on a regular basis by reviewing reports which show the key aggregations to which the Company is exposed. The Company uses a number of modelling tools to monitor aggregation and to simulate catastrophe losses in order to measure the effectiveness of the reinsurance programmes, and to quantify the net exposure to which the Company is exposed. Additional stress and scenario tests are run using these models during the year.

Financial Risk

The Company is exposed to financial risks through its financial and reinsurance assets. To mitigate these it looks to match its insurance liabilities with assets which redeem at the same time as it is estimated that the liabilities will be settled. This is done on a global basis with some of the Company's assets which represent shareholders funds being allocated as margin over the liability settlement schedule. This policy ensures that the Company is able to meet its obligations under its contractual liabilities as they fall due. Nevertheless, the Company has residual financial risks which arise primarily because:

- It is not possible to perfectly match insurance liabilities with financial assets. This is particularly the case with longer-tail insurance contracts.
- The Company invests a proportion of its capital in financial assets which are not matched with insurance liabilities.

The Company actively manages its assets using an approach that balances quality, diversification, asset/liability matching, liquidity and investment return. The goal of the investment process is to optimise the net of taxes, risk-adjusted investment income and risk-adjusted total return, whilst ensuring that the assets and liabilities are managed on a cash flow and duration basis. The Company's Investment Committee review target portfolios on a periodic basis, establishing investment guidelines and limits, and providing oversight of the asset/liability management process which is regularly reported to the Board.

Market Risk

Market risk can be described as the risk of change in fair value of a financial instrument due to changes in interest rates, equity prices or foreign currency exchange rates.

Interest rate risk

The Company's exposure to market risk for changes in interest rate is primarily concentrated in its investment portfolio. Changes in investment values attributable to interest rate changes are partially mitigated by offsetting changes in the economic value of insurance provisions. The Company monitors this exposure through periodic reviews of its asset and liability positions. Estimates of cash flows, as well as the impact of interest rate fluctuations relating to the investment portfolio and insurance liabilities, are modelled and reviewed quarterly.

The Company is also exposed to the risk of changes in future cash flows from fixed income securities arising from changes in market interest rates.

The effective interest rate at the balance sheet date on sterling assets available for sale is 4.7% (2004: 4.9%) and US dollar assets is 4.5% (2004: 4.4%).

Notes to the financial statements

3 Risk management (continued)

Market Risk (continued)

Equity price risk

The Company's holding of marketable equity securities, through a collective investment scheme, which is carried on the balance sheet at fair value, has exposure to price risk. This risk is defined as the potential loss in market value resulting from an adverse change in prices. The objective is to earn competitive relative returns by investing in a diverse portfolio of high quality, liquid securities.

Portfolio characteristics are analysed regularly and equity price risk is actively managed through a variety of modelling techniques. The scheme diversifies holdings across industries, and concentrations in any one company or industry are limited.

At 31 December 2005, the collective investment scheme holding was recorded at its fair value of £29.0 million. A hypothetical 10% decline in the unit price would have resulted in a £2.9 million impact on fair value.

Foreign exchange risk

All premiums are currently received in Sterling.

The Company's records enable the identification of any claim liabilities in US Dollars. These are compared with US Dollar assets each quarter and US Dollars are bought and sold as necessary to match US Dollar assets to liabilities.

At 31 December, 2005 and 2004, respectively, approximately 1.4% and 1.6% of the Company's invested assets were denominated in US Dollars. It has been determined that a hypothetical 10% reduction in the value of the US Dollar investments would lead to a £1.3 million reduction in the value of the assets, although there would be a similar offsetting change in the value of the related insurance liabilities. There were no other foreign currency investments within the invested assets.

Credit Risk

The Company's portfolios of fixed income securities and, to a lesser extent, short-term and other investments, are subject to credit risk. This risk is defined as the potential loss in market value resulting from adverse changes in a debtor's ability to repay. The Company is exposed to credit risks through its reinsurance arrangements, where amounts due under a reinsurance contract may not be paid. The Company manages this risk through using only A- or better grade reinsurers, based on S&P ratings. The ratings of reinsurers are regularly monitored by the Company's Board.

The Company is also exposed to credit risk from third party companies where it holds fixed income and other securities issued by those companies. The risk is managed based on the Company's investment strategy which clearly articulates its risk appetite in terms of the debt ratings of securities held. This is monitored on a monthly basis by the Company's Investment Committee and regularly reported to the Board.

Notes to the financial statements

3 Risk management (continued) **Objectives and policies for mitigating business risk (continued)**

Liquidity Risk

The Company is exposed to liquidity risks arising from daily calls on its cash resources, notably from claims arising on its general insurance contracts. There is therefore a risk that cash will not be available to settle liabilities when due. The Company manages this risk by setting minimum limits on the proportion of maturing assets that will be available to settle these liabilities and also maintaining a minimum level of borrowing facilities that could be utilised to cover claims maturities at unusually high levels.

Claims development

Claims development information is disclosed in order to illustrate the insurance risk inherent in the Company. The tables compare the claims paid on an accident year basis with the provisions established for these claims. The top part of the table provide a review of current estimates of cumulative claims gross of reinsurance and demonstrate how the estimated claims have changed at subsequent reporting or accident year-ends. The estimate is increased or decreased as losses are paid and more information becomes known about the frequency and severity of unpaid claims. Data in the table related to acquired businesses are included from the acquisition date onwards. The lower part of the table provides a reconciliation of the total provision, net of reinsurance included in the balance sheet and the estimate of cumulative claims.

“Provision for prior years” represents the outstanding liabilities in respect of accident year 2000 and prior.

Various factors may distort the re-estimated provisions and cumulative deficiency or redundancy shown in the accompanying table. For example, a substantial portion of the cumulative deficiencies shown in the accompanying table arise from claims on policies written prior to the mid-1970s involving liability exposures such as asbestos and environmental claims. In the post-1984 period, the Company has developed more stringent underwriting standards and policy exclusions and has significantly contracted or terminated the writing of these risks.

While the information in the table provides a historical perspective on the adequacy of unpaid claims estimates established in previous years, readers of these financial statements are cautioned against extrapolating redundancies or deficiencies of the past on current unpaid loss balances. The Company believes that the estimate of total claims outstanding as of the end of 2005 are adequate. However, due to the inherent uncertainties in the provisioning process, it cannot be assured that such balances will ultimately prove to be adequate.

Notes to the financial statements

3 Insurance and financial risk management (continued)

Analysis of claims development – gross of reinsurance & net of recoveries

<i>In millions of pounds</i>	Accident year					Total
	2001	2002	2003	2004	2005	
Estimate of cumulative claims						
At end of accident year	328.9	346.3	370.7	412.8	430.3	1,889.0
- one year later	1.0	(0.8)	(8.7)	(7.0)	-	(15.5)
- two years later	(2.8)	0.1	(3.2)	-	-	(5.9)
- three years later	1.9	(3.2)	-	-	-	(1.3)
- four years later	(1.9)	-	-	-	-	(1.9)
Estimate of cumulative claims	327.1	342.4	358.8	405.8	430.3	1,864.4
Cumulative payments to date	287.4	284.0	264.1	281.3	204.1	1,320.9
Provision for prior years	-	-	-	-	-	62.3
Gross outstanding claims liabilities	39.7	58.4	94.7	124.5	226.2	605.8

Analysis of claims development – net of reinsurance & net of recoveries

<i>In millions of pounds</i>	Accident year					Total
	2001	2002	2003	2004	2005	
Estimate of cumulative claims						
At end of accident year	271.7	335.0	363.3	405.1	424.7	1,799.8
- one year later	(5.8)	(3.5)	(8.2)	(6.6)	-	(24.1)
- two years later	(5.7)	0.8	(3.4)	-	-	(8.3)
- three years later	(2.3)	1.1	-	-	-	(1.2)
- four years later	(4.9)	-	-	-	-	(4.9)
Estimate of cumulative claims	253.0	333.4	351.7	398.5	424.7	1,761.3
Cumulative payments to date	235.0	276.2	262.5	279.8	203.1	1,256.6
Provision for prior years	-	-	-	-	-	35.6
Net outstanding claims liabilities	18.0	57.2	89.2	118.7	221.6	540.3

Notes to the financial statements

4 Investments in subsidiaries

In millions of pounds

2005

2004

Investments in subsidiaries are stated at cost.

At 1 January and 31 December

16.3

16.3

The following companies, which are incorporated in the United Kingdom, were subsidiaries at 31 December 2005 and 31 December 2004.

Company	Activity	% Owned
Northern Star Insurance Company Limited	In Liquidation	100
Fortis Services (UK) Ltd	Administrative services	100
Bishopsgate Head Office Ltd	Property holding	100

Notes to the financial statements

5 Premiums

In millions of pounds

	2005	2004
Written premiums	596.6	574.0
Change in the gross provision for unearned premiums	(6.3)	(3.8)
Gross insurance premium revenue	590.3	570.2
less: written premiums ceded to reinsurers	(23.2)	(25.3)
Reinsurers' share of change in the provision for unearned premiums	0.1	(0.2)
Ceded earned premiums	(23.1)	(25.5)
Net insurance premium revenue	567.2	544.7

6 Commission income

In millions of pounds

	2005	2004
Reinsurance commission	1.0	1.0
Total commission income	1.0	1.0

7 Investment income

In millions of pounds

	2005	2004
Interest Income		
- Available-for-sale interest income	40.7	35.3
- Loans and receivables interest income	1.7	2.1
Dividend income	0.7	0.6
Net realised gains from available-for-sale financial assets	0.1	0.1
Total investment income	43.2	38.1

Investment income includes all gains and losses on financial assets.

8 Other operating income

In millions of pounds

	2005	2004
Release of unused provisions	1.3	-
Other income – miscellaneous	3.6	3.9
Total other operating income	4.9	3.9

Notes to the financial statements

9 Claims and benefits

In millions of pounds

	2005	2004
Current year claims paid	(204.1)	(194.0)
Change in prior years claims	12.8	3.2
Claims handling costs	(13.0)	(12.3)
Additional liabilities arising during the year	(226.2)	(218.9)
Net foreign exchange differences	1.6	(1.0)
Total claims and benefits incurred	(428.9)	(423.0)

10 Acquisition costs

In millions of pounds

	2005	2004
Commission expenses payable	(102.3)	(99.0)
Other acquisition costs payable	(15.3)	(11.5)
Changes in deferred acquisition costs	1.8	3.5
Total acquisition costs	(115.8)	(107.0)

Notes to the financial statements

11 Administrative expenses

In millions of pounds

	2005	2004
Depreciation and amortisation		
-Equipment and motor vehicles	(0.3)	(0.2)
-IT equipment	(1.0)	(1.0)
Personnel expenses		
- Wages and salaries	(21.2)	(18.8)
- Compulsory social security contributions	(1.7)	(1.5)
- Contributions to defined benefit plans	(2.9)	(2.8)
- Contributions to defined contribution plans	(0.7)	(0.5)
- Reduction in liability for defined benefit plans	0.2	0.4
Goods and services	(8.4)	(7.2)
Software costs	(3.6)	(3.4)
Other costs	(9.4)	(12.0)
Total administrative expenses	(49.0)	(47.0)

Administrative expenses are analysed as:

Administration costs	(20.7)	(23.2)
Acquisition costs	(15.3)	(11.5)
Claims costs	(13.0)	(12.3)
	(49.0)	(47.0)

Goods and services includes auditors remuneration of £197,000 (2004: £178,000) for audit fees and £63,000 (2004: £32,000) for other services.

12 Other operating expenses

In millions of pounds

	2005	2004
Increase in other provisions	-	(0.1)
Total other operating expenses	-	(0.1)

13 Finance costs

In millions of pounds

	2005	2004
Interest expense	(0.1)	(0.1)
Total finance costs	(0.1)	(0.1)

Notes to the financial statements

14 Income taxes

Recognised in the income statement

In millions of pounds

	2005	2004
Current tax expense		
Current year – operations	(17.3)	(15.3)
Adjustments for prior years	1.6	1.3
	<u>(15.7)</u>	<u>(14.0)</u>
Deferred tax expense		
Origination and reversal of temporary differences	(1.8)	(0.8)
	<u>(17.5)</u>	<u>(14.8)</u>

Reconciliation of effective tax rate

In millions of pounds

	2005	2004
Profit before tax	57.8	48.9
Income tax using the domestic corporation tax rate	<u>(17.3)</u>	<u>(14.7)</u>
Non deductible expenses and provisions	-	(0.9)
Tax exempt revenues	0.2	0.2
Charge in respect of discounting of reserves	(0.4)	-
Capital allowances for the year in excess of depreciation	-	0.1
Other	0.2	-
	<u>(17.3)</u>	<u>(15.3)</u>
Adjustment in respect of prior years	1.6	1.3
	<u>(15.7)</u>	<u>(14.0)</u>

Deferred tax recognised directly in equity

In millions of pounds

	2005	2004
Relating to equity securities available-for-sale	(1.2)	(0.7)
	<u>(1.2)</u>	<u>(0.7)</u>

Notes to the financial statements

15 Property, plant and equipment

In millions of pounds

	Land and buildings	Equipment and motor vehicles	IT equipment	Total
Cost				
Balance at 1 January 2004	1.5	0.6	3.0	5.1
Acquisitions	-	-	1.3	1.3
Disposals	-	(0.1)	(0.3)	(0.4)
Balance at 31 December 2004	1.5	0.5	4.0	6.0
Acquisitions	0.4	0.6	1.3	2.3
Balance at 31 December 2005	1.9	1.1	5.3	8.3
Depreciation and impairment losses				
Balance at 1 January 2004	0.4	0.5	1.5	2.4
Depreciation charge for the year	-	0.1	1.0	1.1
Disposals	-	(0.1)	(0.3)	(0.4)
Balance at 31 December 2004	0.4	0.5	2.2	3.1
Depreciation charge for the year	-	0.3	1.0	1.3
Balance at 31 December 2005	0.4	0.8	3.2	4.4
Carrying amounts				
At 31 December 2004	1.1	-	1.8	2.9
At 31 December 2005	1.5	0.3	2.1	3.9

Notes to the financial statements

16 Deferred acquisition costs

As part of the Company's insurance business, certain acquisition costs are deferred. An analysis of these deferred costs is set out below:

<i>In millions of pounds</i>	2005	2004
Balance at 1 January	51.6	48.1
Acquisition costs incurred in year	117.6	110.5
Amortisation charged to income	(115.8)	(107.0)
Balance at 31 December	<u>53.4</u>	<u>51.6</u>

17 Financial assets Available-for-sale

<i>In millions of pounds</i>	2005	2004
Debt securities - fixed rate		
Government bonds	581.8	515.4
Other listed	317.0	313.3
	<u>898.8</u>	<u>828.7</u>
Collective investment schemes		
Listed	29.0	23.8
	<u>29.0</u>	<u>23.8</u>
Total financial assets	<u>927.8</u>	<u>852.5</u>

Available-for-sale

<i>In millions of pounds</i>	2005	2004
The movements in financial assets are as follows:		
At 1 January	852.5	723.9
Translation differences	1.3	(3.8)
Additions	531.1	526.7
Sales and redemptions	(458.7)	(388.0)
Fair value unrealised gains and losses	8.5	4.2
Amortisation of premiums and discounts	(6.9)	(10.5)
At 31 December	<u>927.8</u>	<u>852.5</u>

The current portion of financial assets is £326.0m (2004: £329.3m) and the non-current portion is £601.8m (2004: £523.2m).

Notes to the financial statements

18 Deferred tax assets

Recognised deferred tax assets

Deferred tax assets are attributable to the following:

<i>In millions of pounds</i>	2005	2004
Property, plant and equipment	0.8	0.8
Unrealised appreciation		
- Financial assets	(2.6)	(1.2)
Equalisation provision	-	(1.6)
Employee benefits	6.0	6.0
Provisions	0.9	4.1
Tax (assets) / liabilities	5.1	8.1

There are no unrecognised deferred tax assets or liabilities.

Movement in temporary differences during the year

<i>In millions of pounds</i>	Balance 1 January 2004	Recognised in income	Recognised in equity	Balance 31 December 2004
Property, plant and equipment	0.8	-	-	0.8
Unrealised appreciation				
- Financial assets	(0.6)	-	(0.7)	(1.3)
Equalisation provision	(0.5)	(1.1)	-	(1.6)
Employee benefits	6.2	(0.1)	-	6.1
Provisions	3.7	0.4	-	4.1
Tax (assets) / liabilities	9.6	(0.8)	(0.7)	8.1

<i>In millions of pounds</i>	Balance 1 January 2005	Recognised in income	Recognised in equity	Balance 31 December 2005
Property, plant and equipment	0.8	-	-	0.8
Unrealised appreciation				
- Financial assets	(1.3)	-	(1.2)	(2.5)
Equalisation provision	(1.5)	1.5	-	-
Employee benefits	6.1	(0.1)	-	6.0
Provisions	4.1	(3.3)	-	0.8
Tax (assets) / liabilities	8.2	(1.9)	(1.2)	5.1

The deferred income tax recognised in equity during the year relates to unrealised movements on available for sale financial assets.

Notes to the financial statements

18 Deferred tax assets (continued)

The deferred income tax recognised in equity during the year is as follows:

<i>In millions of pounds</i>	Note	2005	2004
Fair value reserve	27	2.6	1.2
		<u>2.6</u>	<u>1.2</u>

19 Current tax liabilities

The current tax liability of £8.1m (2004: £7.4m) represents the amount of income taxes payable in respect of the current year less adjustment in respect of prior years.

20 Insurance and other receivables

<i>In millions of pounds</i>	2005	2004
Receivables arising from insurance contracts		
- contract holders	34.6	34.0
- agents, brokers and intermediaries	54.7	47.0
- reinsurers	8.8	4.7
Amounts due from group undertakings	22.5	21.8
Other receivables and pre-payments	2.0	2.0
Accrued interest income	12.1	7.5
Deferred other charges	0.4	0.1
	<u>135.1</u>	<u>117.1</u>

21 Cash and cash equivalents

<i>In millions of pounds</i>	2005	2004
Bank and cash balances	27.6	23.9
Cash and cash equivalents in the statement of cash flows	<u>27.6</u>	<u>23.9</u>

The effective interest rate at 31 December 2005 on short term bank deposits was 4.6% (2004: 4.5%), with an average maturity of one day.

Included in cash and cash equivalents held by the Company are balances totalling £0.6m (2004: £0.5m) not available for use by the Company because they are held in trust to guarantee claims liabilities.

Notes to the financial statements

22 Insurance contract provisions and reinsurance assets

In millions of pounds

	2005			2004		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Unearned premiums	273.6	1.5	272.1	267.3	1.5	265.8
Claims reported by policy holders	420.5	63.6	356.9	414.3	62.5	351.8
Claims incurred but not reported	204.7	2.0	202.7	165.3	11.5	153.8
Total insurance contract provisions	898.8	67.1	831.7	846.9	75.5	771.4
Current	251.7	18.8	232.9	194.8	17.4	177.4
Non current	647.1	48.3	598.8	652.1	58.1	594.0
	898.8	67.1	831.7	846.9	75.5	771.4

Recoveries are not included above. For details see subsection (iii).

(i) Analysis of movements in insurance provisions

In millions of pounds

	2005			2004		
	Gross	Reinsurance	Net	Gross	Reinsurance	Net
Balance at 1 January	846.9	(75.5)	771.4	776.5	(76.3)	700.2
Claims paid/recovered from reinsurers	(373.5)	15.5	(358.0)	(346.5)	15.2	(331.3)
Movement in claims incurred but not reported	39.4	9.5	48.9	30.6	3.6	34.2
Claims reported in the period	379.7	(16.6)	363.1	382.5	(18.2)	364.3
Change in gross provision for unearned premiums	6.3	-	6.3	3.8	0.2	4.0
Balance at 31 December	898.8	(67.1)	831.7	846.9	(75.5)	771.4

(ii) Analysis of movements in provision for unearned premium

In millions of pounds

	2005	2004
Balance at 1 January	267.3	263.5
Premiums written during the year	596.6	574.0
Less: premiums earned during the year	(590.3)	(570.2)
Balance at 31 December	273.6	267.3

Notes to the financial statements

22 Insurance contract provisions and reinsurance assets (continued)

(iii) Analysis of movements in outstanding claims

In millions of pounds

	2005	2004
Gross outstanding claims		
Balance at 1 January	579.6	513.0
Current year claims	446.1	427.6
Change in prior year claims	(27.0)	(14.5)
Current year claims paid	(204.1)	(194.0)
Previous year claims paid	(169.4)	(152.5)
Balance at 31 December	<u>625.2</u>	<u>579.6</u>
Gross recoveries		
Balance at 1 January	(17.8)	(14.3)
Current year claims	(15.8)	(14.8)
Change in prior year claims	14.2	11.3
Balance at 31 December	<u>(19.4)</u>	<u>(17.8)</u>
Gross claims outstanding net of recoveries		
Balance at 1 January	561.8	498.7
Current year claims	430.3	412.8
Change in prior year claims	(12.8)	(3.2)
Current year claims paid	(204.1)	(194.0)
Previous year claims paid	(169.4)	(152.5)
Balance at 31 December	<u>605.8</u>	<u>561.8</u>

(iv) Assumptions and sensitivities

Process used to determine the assumptions

The sources of data used as inputs for the assumptions behind insurance provisions are internal, using detailed studies that are carried out annually. The assumptions are checked to ensure that they are consistent with observable market prices or other published information. There is more emphasis on current trends, and where in early years there is insufficient information to make a reliable best estimate of claims development, prudent assumptions are used.

The nature of the business makes it very difficult to predict with certainty the likely outcome of any particular claim and the ultimate cost of notified claims. Each notified claim is assessed on a separate, case by case basis with due regard to the claim circumstances and historical evidence of the size of similar claims. Case estimates are reviewed regularly and are updated as and when new information arises. The provisions are based on information currently available. However, the ultimate liabilities may vary as a result of subsequent developments. The impact of many of the items affecting the ultimate costs of the loss is difficult to estimate. The degree of complexity involved will also differ by book of business due to differences in the underlying insurance contract, claim complexity, the volume of claims and the individual severity of claims, determining the occurrence date of a claim, and reporting lags.

For the Company's exposure to asbestos, environmental pollution and latent injury damage, claims arise from policies written under which the Company has assumed liabilities, on an indemnity or assumption basis. The Company's estimate of its ultimate liability for such exposures includes case estimate provisions and a provision for

Notes to the financial statements

22 Insurance contract provisions and reinsurance assets (continued)

liabilities incurred but not reported. The provision for liabilities incurred but not reported is established based on various methods such as loss development patterns and frequency and severity trends.

Estimation of ultimate liabilities for asbestos and environmental exposures is inherently difficult due to several significant issues surrounding such exposures. Among the issues are: (a) the long period between exposure and manifestation of an injury; (b) difficulty in identifying the sources of asbestos or environmental contamination; (c) difficulty in allocating responsibility or liability for asbestos or environmental damage; (d) changes in underlying laws and judicial interpretation of those laws; and (e) uncertainty regarding the identity and number of parties insured with potential asbestos or environmental exposure.

For all other risks, the cost of outstanding claims and the IBNR provisions are estimated using various statistical methods. Such methods extrapolate the development of paid and incurred claims, average cost per claims and ultimate claim numbers for each accident year based upon observed development of earlier years and expected loss ratios.

The key methods, which remain unchanged from prior years, are:

- chain ladder methods, which use historical data to estimate the paid and incurred to date proportions of the ultimate claim cost;
- expected loss ratio methods, which use the Company's expectation of the loss ratio for a class of business;
- benchmarking methods, which use the experience of comparable, more mature, classes to estimate the cost of claims.

The actual method or blend of methods used varies by accident year being considered, the class of business and observed historical claims development.

To the extent that these methods use historical claims development information they assume that the historical claims development pattern will occur again in the future. There are reasons why this may not be the case, which, insofar as they can be identified, have been allowed for by modifying the methods. Such reasons include:

- changes in processes that affect the development / recording of claims paid and incurred (such as changes in claim reserving procedures);
- economic, legal, political and social trends (resulting in, for example, a difference in expected levels of inflation);
- changes in mix of business;
- random fluctuations, including the impact of large losses.

IBNR provisions are initially estimated at a gross level and a separate calculation is carried out to estimate the size of reinsurance recoveries. The Company is covered by a variety of excess of loss reinsurance programmes with sufficiently high retentions for only relatively few, large claims to be recoverable. The method used by the Company takes historical data, gross IBNR estimates and details of the reinsurance programme, to assess the expected size of reinsurance recoveries.

Notes to the financial statements

22 Insurance contract provisions and reinsurance assets (continued)

Assumptions

The assumptions that have the greatest effect on the measurement of insurance contract provisions are the expected loss ratios for the most recent accident years for both the Property and Motor classes of business. The expected loss ratio assumed for the accident years 2004 and 2005 is 76% and 78% respectively for Motor and 54% and 58% respectively for Household Property.

The Company's reserves for asbestos and environmental related losses arise from business written for accident years 1985 and prior. The Company has minimal exposure in the more recent accident years. The key assumptions affecting the measurement of the provisions are (a) continued growth in the number of claims filed due to a more aggressive plaintiff's bar; (b) increase in claims involving defendants formerly regarded as peripheral.

Changes in assumptions and sensitivities to changes in key variables

The Company believes that the liability for claims reported in the balance sheet is adequate. However, it recognises that the process of estimation is based upon certain variables and assumptions, which could differ when claims arise.

The impact of a 1% change in the loss ratio across the entire book would equate to a £5.7million pre-tax change in the reported income.

Notes to the financial statements

23 Loans and borrowings

This note provides information about the contractual terms of the Company's loans and borrowings.

<i>In millions of pounds</i>	2005	2004
Non-current liabilities		
Due to group undertakings	15.9	15.9
	<hr/>	<hr/>
	15.9	15.9
Current liabilities		
Unsecured bank facility	5.8	-
	<hr/>	<hr/>
	5.8	-
Total loans and borrowings	<hr/>	<hr/>
	21.7	15.9

The unsecured bank facility in 2005 represents unpresented cheques as at the balance sheet date.

24 Insurance payables, other payables and deferred income

<i>In millions of pounds</i>	2005	2004
Amounts due to group undertakings	4.6	5.2
Direct insurance contract payables	2.7	2.2
Other payables and accrued expenses	20.7	21.7
VAT and other taxes payable	11.4	9.1
Deferred income	0.7	0.8
Total insurance payables, other payables and deferred income	<hr/>	<hr/>
	40.1	39.0

Deferred income represents amounts deferred under investment management service contracts that are recognised as revenue as the investment management services are provided.

25 Other provisions

<i>In millions of pounds</i>	
Balance at 1 January 2005	1.2
Provisions made during the year	0.1
Provisions reversed during the year	-
Balance at 31 December 2005	<hr/>
	1.3
Non-current – payable after one year	0.9
Current – payable within one year	0.4
	<hr/>
	1.3

Other provisions include a liability for the cost of Company staff on long term sickness, together with a liability in relation to the unused Company staff annual leave entitlements.

Notes to the financial statements

26 Pension schemes

The Company operates a funded defined benefit pension scheme, the Fortis Insurance Staff Pension Scheme, in respect of staff who were members of the scheme on 31st December 1997 and staff of group companies who had contractual rights to join the scheme after this date. In 2001 active members of the Northern Star Insurance Company Limited Superannuation Fund whose employment transferred to Fortis Insurance Limited joined the scheme for future service on a benefit structure mirroring that in their previous scheme and were granted past service benefits in respect of a bulk transfer payment received from that scheme. The assets of the scheme are held in a separate trust fund. Assets are invested in unit trusts and bank deposits under trustee guidelines. Contributions to the scheme are charged to the Income Statement so as to spread the cost of pensions over employees' working lives with the Company. The contributions are determined by a qualified actuary on the basis of triennial valuations using the projected unit method. The most recent formal triennial valuation was at 1st April 2003. At that date, the market value of the assets of the scheme amounted to £28,705,000 and was sufficient to cover 70% of the benefits that had accrued to members, after allowing for the expected future increases in earnings.

The Company also operates a defined contribution scheme called Fortis Insurance Limited Group Pension Scheme in respect of other staff. The assets of the scheme are held separately from those of the Company in an independently administered fund. The pension cost in respect of members of this fund represents contribution payable by the Company to the fund and amounted to £664,000 (2004: £519,000).

The Company accounts for pension costs in accordance with IAS 19, Employment Benefits.

A full actuarial valuation was carried out at 1st April 2003 and updated by a qualified independent actuary on an IAS 19 basis at 31st December 2005. The major assumptions used by the actuary were:

Valuation Method	2005 Projected unit	2004 Projected unit	2003 Projected unit
Rate of increase in salaries	2.0%	5.0%	4.8%
Rate of increase in pensions in payment:			
– Pre 1988 GMP	Nil	Nil	Nil
– Post 1988 GMP	1.8%	3.0%	2.8%
– Post 1988 Non GMP (ex Bishopsgate members)	5.0%	5.0%	5.0%
– Post 1988 Non GMP (ex Northern Star members)	1.8%	3.0%	2.8%
Discount Rate	4.5%	5.3%	5.4%
Inflation assumption	1.8%	3.0%	2.8%

The assumptions used by the actuary are the best estimates chosen from a range of possible actuarial assumptions, which, due to the timescale covered, may not necessarily be borne out in practice.

The scheme is closed to new members. Under the projected unit method of valuing the liabilities of the scheme, the current service cost will increase as the members of the scheme approach retirement.

Notes to the financial statements

26 Pension schemes (continued)

In millions of pounds

	2005	2004
Present value of funded obligations	76.3	68.5
Fair value of plan assets	50.9	41.1
Present value of net obligations	25.4	27.4
Unrecognised actuarial gains and losses	(5.4)	(7.2)
Recognised liability for defined benefit obligations (see below)	20.0	20.2

Liability for defined benefit obligations

The Company makes contributions to a defined benefit plan that provides pension benefits for employees upon retirement. The plan does not invest in shares issued by the Company.

Movements in the net liability for defined benefit obligations recognised in the balance sheet

In millions of pounds

	2005	2004
Net liability for defined benefit obligations at 1 January	20.2	20.5
Contributions received	(2.9)	(2.8)
Expense recognised in the income statement (see below)	2.7	2.5
Net liability for defined benefit obligations at 31 December	20.0	20.2

Expense recognised in the income statement

In millions of pounds

	2005	2004
Past service cost	0.1	0.3
Current service costs	2.4	2.0
Interest on obligation	3.2	2.9
Expected return on plan assets	(3.1)	(2.7)
Net actuarial loss recognised during year	0.1	0.0
	2.7	2.5

The expense is recognised in the following line items in the income statement:

In millions of pounds

	2005	2004
Claims	1.1	1.2
Acquisition	0.8	0.6
Administration	0.8	0.7
	2.7	2.5
Actual return on plan assets	8.6	3.7

Notes to the financial statements

27 Capital and reserves

Reconciliation of movement in capital and reserves

Attributable to equity holders

<i>In millions of pounds</i>	Share capital	Share premium	Retained earnings	Other reserves		Total
				Fair value reserve	Statutory reserve	
Balance at 1 January 2005	71.1	3.9	121.1	0.1	14.0	210.2
Profit for the year	-	-	40.3	-	-	40.3
Fair value gains/(losses)	-	-	-	5.9	-	5.9
Dividends to shareholders	-	-	(13.1)	-	-	(13.1)
Balance at 31 December 2005	71.1	3.9	148.3	6.0	14.0	243.3

<i>In millions of pounds</i>	Share capital	Share premium	Retained earnings	Other reserves		Total
				Fair value reserve	Statutory reserve	
Balance at 1 January 2004	71.1	3.9	99.0	(2.9)	14.0	185.1
Profit for the year	-	-	34.1	-	-	34.1
Fair value gains/(losses)	-	-	-	3.0	-	3.0
Dividends to shareholders	-	-	(12.0)	-	-	(12.0)
Balance at 31 December 2004	71.1	3.9	121.1	0.1	14.0	210.2

Notes to the financial statements

27 Capital and reserves (continued) Share capital and share premium

<i>In thousands of shares</i>	Ordinary shares		Deferred shares	
	2005	2004	2005	2004
On issue at 1 January	68,109	68,109	3,000	3,000
On issue at 31 December – fully paid	68,109	68,109	3,000	3,000

At 31 December 2005, the authorised share capital comprised 68,108,985 ordinary shares (2004: 68,108,985) and 3,000,000 (2004: 3,000,000) deferred shares. The ordinary and deferred shares have a par value of £1.

The holders of ordinary shares are entitled to receive dividends as declared from time to time and are entitled to one vote per share at meetings of the Company. Deferred shares do not carry the right to vote and are not entitled to participate in profits of the Company. All shares rank equally with regard to the Company's residual assets, except that deferred shareholders participate only to the extent of the face value of the shares. On winding up, the deferred shares would rank second, repaying the holders the amount of capital paid up.

Fair value reserve

The fair value reserve includes the cumulative net change in the fair value of available-for-sale investments, net of tax, until the investment is derecognised.

Notes to the financial statements

28 Operating leases

Leases as lessee

Non-cancellable operating lease rentals are payable as follows:

In millions of pounds

	2005	2004
Less than one year	-	0.1
Between one and five years	0.2	0.3
More than five years	0.9	0.9
	<u>1.1</u>	<u>1.3</u>

The Company leases office premises under operating leases. The leases typically run for a period of 25 years, with an option to renew the lease after that date. Lease payments are increased every five years to reflect market rentals. None of the leases includes contingent rentals.

During the year ended 31 December 2005, £1.2m was recognised as an expense in the income statement in respect of operating leases (2004: £1.2m).

29 Staff numbers and costs

The total number of persons employed by the company (including executive directors) at the year-end, analysed by category, was as follows:

	2005	2004
Business acquisition	327	251
Claims handling	540	548
Administration	240	220
	<u>1107</u>	<u>1019</u>

The full time equivalent number of employees was as follows:

	2005	2004
Business acquisition	289	223
Claims handling	450	456
Administration	214	197
	<u>953</u>	<u>876</u>

The aggregate payroll costs in respect of these persons were as follows:

In millions of pounds

	2005	2004
Wages and salaries	21.2	18.8
Social security costs	1.7	1.5
Other pension costs	3.3	3.0
	<u>26.2</u>	<u>23.3</u>

Notes to the financial statements

30 Related party transactions

The Company has a related party relationship with its key management personnel who are all Directors of the Company.

Transactions with Directors

In addition to their salaries, the Company also provides non-cash benefits to Directors and contributes to a post-employment defined benefit plan on their behalf.

The Directors' compensations are as follows:

<i>In millions of pounds</i>	2005	2004
Short-term employee benefits	1.6	1.4
Post-employment benefits	0.2	0.2
Equity compensation benefits	0.1	0.1
	<hr/>	<hr/>
	1.9	1.7
	<hr/>	<hr/>
In respect of the highest paid Director	0.4	0.4

Under the defined benefit scheme, the highest paid Director's accrued pension at the year-end was £8,000 (2004: £6,000)

The Directors are able to obtain discounted personal insurance at the same rates as all other staff.

In the ordinary course of business the Company carries out transactions with related parties as defined in IAS 24. Material transactions are set out below.

<i>In millions of pounds</i>	2005 Income Statement	2005 Balance Sheet	2004 Income Statement	2004 Balance Sheet	2003 Balance Sheet
Immediate parent & ultimate holding company transactions and assets held in the balance sheet	0.8	0.6	0.1	-	0.1
Fellow subsidiary company transactions and assets held in the balance sheet	53.6	16.6	52.6	15.9	13.8
Subsidiary company transactions and assets held in the balance sheet	0.2	0.2	0.3	0.1	1.3
Pension scheme transactions and liability	(2.9)	(20.0)	(2.8)	(20.2)	(20.6)
Other related party transactions and assets/liabilities held in the balance sheet	(6.8)	48.1	(9.3)	36.7	53.0
Grand total	<hr/>	<hr/>	<hr/>	<hr/>	<hr/>
	44.9	45.5	40.9	32.5	47.6

The Company's immediate parent undertaking is Fortis (UK) Ltd to which the Company provides administration and management services. The balance for these transactions is outstanding at the balance sheet date. The transactions with the ultimate holding company relate to share option costs.

Notes to the financial statements

30 Related party transactions (continued)

Fellow subsidiary company transactions and assets relate to insurance policies sold by RIAS plc and Outright Ltd, insurance brokers which are both wholly owned by Fortis (UK) Ltd. The Company also provides administration and management services to these companies.

The Company provides administration and claims settlement services to its subsidiary, Fortis Services (UK) Ltd, in addition to loan facilities for which interest is charged. The Company also bears the cost of rent charged by its subsidiary, Bishopsgate Head Office Ltd.

Other related party transactions consist of investment management charges with Fortis Investments, interest on deposits held by Fortis Bank SA/NV & NV and also an asset in relation to reinsured claim recoverables with Fortis Re. All of these companies are within the Fortis Group.

31 Parent company

The Company's results are consolidated into the accounts of Fortis Insurance International N.V.; a Company incorporated in the Netherlands.

The Company's ultimate holding company is Fortis Utrecht NV which is incorporated in the Netherlands and is jointly owned by Fortis N.V., incorporated in the Netherlands and Fortis SA/NV, incorporated in Belgium.

Copies of the above accounts can be obtained from the Company Secretary, Fortis Insurance Limited, Fortis House, Tollgate, Eastleigh, Hants SO53 3YA.

32 Events after the balance sheet date

There were no material adjusting or non-adjusting events after the balance sheet date.

STATEMENT OF DIRECTORS' RESPONSIBILITIES IN RESPECT OF THE DIRECTORS' REPORT AND THE FINANCIAL STATEMENTS

The directors are responsible for preparing the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with IFRS as adopted by the EU.

The financial statements are required by law to present fairly the financial position and the performance of the company; the Companies Act 1985 provides in relation to such financial statements that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state whether they have been prepared in accordance with IFRS as adopted by the EU; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF FORTIS INSURANCE LIMITED

We have audited the financial statements of Fortis Insurance Limited for the year ended 31 December 2005 which comprise the income statement, the balance sheet, the cash flow statement, the statement of recognised income and expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As described in the Statement of Directors' Responsibilities set out on page 45 the company's directors are responsible for the preparation of the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the Directors' Report and consider the implications for our report if we become aware of any apparent misstatements within it.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRS as adopted by the EU, of the state of the company's affairs as at 31 December 2005 and of its profit for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.