

PUNCH TAVERNS PLC

ACCOUNTING POLICIES

The principal Group accounting policies under International Financial Reporting Standards ('IFRS') are set out below.

Basis of consolidation

Consolidated financial statements comprise the financial statements of the parent company (Punch Taverns plc) and all of its subsidiaries.

The Group's interests in its joint ventures are incorporated in the financial statements using the equity method of accounting.

Subsidiaries are consolidated from the date on which control is transferred to the Group and cease to be consolidated from the date on which control is transferred out of the Group. Investments in subsidiaries are carried at cost less any impairment in value in the financial statements of the Company. Investments in joint ventures are carried at cost plus post-acquisition changes in the Group's share of accumulated profits less distributions received and less any impairment in value.

All intra-group balances and transactions, including unrealised profits arising from intra-group transactions, are eliminated in full. Unrealised losses are eliminated unless the transaction provides evidence of an impairment of the asset transferred.

Goodwill

Goodwill on acquisition is initially measured at cost, being the excess of the cost of the business combination over the fair value of the Group's share of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Where assets are transferred between segments, the goodwill attributable to these assets is also transferred.

Goodwill carried in the balance sheet is not amortised. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired.

If the cost of acquisition is less than the fair value of the net identifiable assets, liabilities and contingent liabilities of the subsidiary acquired, the gain is recognised immediately in the income statement.

Operating leases and other intangible assets

Operating leases and other intangible assets are capitalised at cost. Amortisation is charged to the income statement on a straight-line basis over the estimated useful lives of intangible assets. The estimated useful lives are as follows:

Operating leases

Over the term of the lease

Software

3 to 10 years

Payments made on entering into or acquiring operating leases are accounted for as intangible assets and amortised over the lease term on a straight-line basis.

Property, plant and equipment

Properties held at 22 August 2004, the date of transition to IFRS, were revalued at that date and this revaluation is the deemed cost under IFRS.

Landlord's fixtures and fittings include removable items, which are generally regarded as within landlord ownership. These are depreciated in accordance with the policy detailed below.

Property, plant and equipment assets are carried at cost or deemed cost less accumulated depreciation and any recognised impairment in value. Depreciation is provided to write off the cost of property, plant and equipment, less estimated residual values, by equal annual instalments as follows:

Licensed properties, unlicensed properties and owner-occupied properties

50 years or the life of the lease if shorter

Landlord's fixtures and fittings, office furniture and fittings and motor vehicles

5 to 15 years

Information technology equipment

3 years

Freehold land is not depreciated.

An annual assessment of residual values is performed and there is no depreciable amount if residual values are the same as, or more than, book value. Residual values are based on the estimated amount which would be currently obtainable from disposal of the asset net of disposal costs if the asset were already of the age and condition expected at the end of its useful life.

Impairment

Assets that have an indefinite useful life are not subject to amortisation and are tested annually for impairment and if events or changes in circumstances indicate that the carrying amount may not be recoverable. Assets that are subject to depreciation or amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. A review for indicators of impairment is performed annually. An impairment loss is recognised for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of an asset's fair value less costs to sell and value in use. Any impairment charge is recognised in the income statement in the year in which it occurs. When an impairment loss, other than an impairment loss on goodwill, subsequently reverses due to a change in the original estimate, the carrying amount of the asset is increased to the revised estimate of its recoverable amount, up to the carrying amount that would have resulted, net of depreciation, had no impairment loss been recognised for the asset in prior years.

Provisions

Provisions are recognised when the Group has a present legal or constructive obligation to transfer economic resources as a result of past events.

Provisions are measured at management's best estimate of the expenditure required to settle the present obligation at the balance sheet date. Provisions are discounted if the effect of the time value of money is material. The discount rate used to determine the present value reflects current market assessments of the time value of money and the risks specific to the liability.

Borrowings

All loans and borrowings are initially recognised at the fair value of the consideration received net of issue costs associated with the borrowings.

After initial recognition, interest bearing loans and borrowings are subsequently measured at amortised cost using the effective interest rate method. Amortised cost is calculated taking account of any issue costs, and any discounts or premiums on settlement.

Gains and losses are recognised in the income statement when the liabilities are derecognised, as well as through the amortisation process.

Equity instruments

Equity instruments issued by the Company are recorded at the fair value of the proceeds, net of direct issue costs.

Convertible bonds

On issue the debt and equity components of convertible bonds are separated and recorded at fair value net of issue costs. The fair value of the debt component is estimated using the prevailing market interest rate for similar non-convertible debt. This amount is classified as a liability and measured on an amortised cost basis until extinguished on conversion or maturity of the bonds. The remainder of the proceeds is allocated to the conversion option and is recognised in equity, net of income tax effects. The carrying amount of the equity component is not re-measured in subsequent years.

Taxation

Income tax expense comprises both the income tax payable, based on taxable profits for the year, and deferred tax.

Deferred tax is provided on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts except where the deferred tax liability arises from the initial recognition of goodwill or where the deferred tax asset or liability arises on an asset or liability in a transaction which is not a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred tax assets are recognised for all deductible temporary differences, carry-forward of unused tax assets and unused tax losses, to the extent that it is probable that taxable profit will be available against which the deductible temporary differences, carry-forward of unused tax assets and unused tax losses can be utilised.

Deferred tax is calculated using tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date. Movements in deferred tax are charged or credited in the income statement, except where they relate to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

For properties acquired as part of a business combination, movements in the deferred tax liability resulting from indexation allowance are taken to the income statement until the tax base cost plus indexation allowance reaches the fair value on acquisition, and directly to equity thereafter for historic revaluation surpluses.

Deferred tax balances are not discounted.

Leasing

Leases of property, plant and equipment, where the Group has substantially all the risks and rewards of ownership, are classified as finance leases. Finance leases are capitalised at the inception of the lease at the fair value of the leased asset or, if lower, the present value of the minimum lease payments. A corresponding liability is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between the finance charges and reduction of the lease liability so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset or the lease term.

Leases where the lessor retains substantially all the risks and benefits of ownership of the asset are classified as operating leases. Operating lease payments are recognised as an expense in the income statement on a straight-line basis over the lease term.

Payments made on entering into or acquiring operating leases are accounted for as intangible assets and amortised over the lease term on a straight-line basis.

Pensions

The Group operates a number of defined benefit schemes which require contributions to be made to separately administered funds. The asset or liability recognised in the balance sheet in respect of the Group's defined benefit arrangements is the difference between the fair value of scheme assets and the present value of scheme liabilities. Defined benefit scheme assets are only recognised to the extent that they are recoverable by the Group. The cost of providing benefits under the plans is determined separately for each plan using the projected unit credit actuarial method. The current service cost is charged to operating profit. The interest cost and the expected return on assets are shown as a net amount within finance income or finance expense. The cumulative net deficits on these defined benefit pension schemes have been recognised in full in equity at the date of transition to IFRS and subsequent actuarial gains and losses are recognised in full as they occur in the statement of recognised income and expense.

The Group also contributes to money purchase pension plans for employees. Contributions are charged to the income statement as they become payable.

Accounting for derivative financial instruments and hedging activities

The Group uses derivative financial instruments such as interest rate swaps to hedge its risk associated with interest rate fluctuations. Such derivative financial instruments are initially accounted for and subsequently re-measured to fair value. The fair value of the interest rate swap contracts is determined by reference to market values for similar instruments.

The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. For the purposes of hedge accounting, hedges are classified as either fair value hedges when they hedge the exposure to changes in the fair value of a recognised asset or liability, or cash flow hedges where they hedge exposure to variability in forecast transactions.

The Group documents at the inception of the transaction the relationship between the hedging instruments and the hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions. The Group also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Cash flow hedges

The effective portion of changes in the fair value of derivatives that are designated as and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement.

Amounts accumulated in equity are recycled within finance costs in the income statement in the periods when the hedged item will affect profit or loss.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised or no longer qualifies for hedge accounting. At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement immediately. The replacement or rollover of a hedging instrument into another hedging instrument is not an expiry, sale or termination where such replacement or rollover is part of the documented hedging strategy.

Derivatives that do not qualify for hedge accounting

Changes in fair value of any derivative financial instruments that do not qualify for hedge accounting are recognised immediately in the income statement.

Financial guarantee contracts

Financial guarantee contracts are initially recognised at fair value. Subsequent movements in fair values are recognised in the income statement.

Share-based payment transactions

A number of employees of the Group (including Directors) receive an element of remuneration in the form of share-based payment transactions, whereby employees render services in exchange for shares or rights over shares ('equity-settled transactions').

Equity settled transactions are measured at fair value at the date of grant. The fair value of transactions involving the granting of shares is determined by the share price at the date of grant. The fair value of transactions involving the granting of share options is calculated by an external valuer based on a binomial model, a beta model or the Black-Scholes model dependent upon the most appropriate valuation model for the individual scheme. In valuing equity-settled transactions, no account is taken of any performance conditions, other than conditions linked to the price of the shares of Punch Taverns plc ('market conditions').

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, on a straight-line basis over the vesting period based on the Group's estimate of how many of the awards will eventually vest. No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market condition, which are treated as vesting irrespective of whether or not the market condition is satisfied, provided that all other performance conditions are satisfied.

Where the terms of an equity-settled award are modified, as a minimum, an expense is recognised as if the terms had not been modified. In addition, an expense is recognised for any increase in the value of the transaction as a result of the modification, as measured at the date of the modification.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation and any expense not yet recognised for the award is recognised immediately. However, if a new award is substituted for the cancelled award, and designated as a replacement award on the date that it is granted, the cancelled and new awards are treated as if they were a modification to the original award, as described in the previous paragraph. The dilutive effect of outstanding options is reflected as additional share dilution in the computation of earnings per share.

Revenue

Revenue is measured at the fair value of the consideration received or receivable and represents amounts receivable for goods and services provided in the normal course of business, net of discounts and VAT. All operations take place solely in the United Kingdom.

Drink and food sales

Revenue in respect of drink and food sales is recognised at the point at which the goods are provided, net of any discounts or volume rebates allowed.

Rents receivable

Rents receivable are recognised on a straight-line basis over the lease term.

Machine income

The Group's share of net machine income is recognised in the period to which it relates.

Trade and other receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amount. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Receivables are written off against the doubtful debt provision when management deems the debt to be no longer recoverable.

Cash and cash equivalents

Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of three months or less.

Cash deposits held as security for the benefit of note holders are not classified as cash and cash equivalents.

Inventories

Inventories are valued at the lower of cost (calculated on a first in – first out basis) and net realisable value.

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell and are not depreciated

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale and completion should be expected within one year from the date of classification.

Dividend distribution

Final dividends are recognised as a liability in the Group's and the Company's financial statements in the period in which the dividends are approved by the Company's shareholders. Interim dividends are recognised when they are paid.

Exceptional items

In order to provide a trend measure of underlying performance, profit is presented excluding items which management consider will distort comparability, either due to their significant non-recurring nature or as a result of specific accounting treatments.