Morgan

Update on adoption of IFRS

Hanau, 18 April 2005

WHERE WE ARE

- February Prelims Announcement - one-page view of key line areas of impact
- Today - elaboration of those key areas and what they mean for us including directional quantification of impact
- Late June - published IFRS numbers for 2004
- Early August - interim announcement on an IFRS basis

IFRS introduction

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

IFRS vs. UK GAAP – initial high level review

- September 2002. Aimed to focus attention on the areas of greatest impact.

IFRS vs. UK GAAP – detailed comparisons

- Detailed assessment of the differences in accounting and disclosure to establish additional data required under IFRS.

Design of IFRS questionnaire

- Tailored to capture the additional data required under IFRS. For completion by all site financial controllers in the Group.

IFRS data collection

- Date of transition
- Half year comparative period
- Full year comparative period

Revision of Group's accounting policies

- Giving consideration to choices of accounting treatment available under IFRS. Choices similar to UK GAAP where possible.

Training all financial controllers worldwide

- 2-day comprehensive training sessions, by region, for each of Asia, the Americas and Europe, attended by all site financial controllers in the Group.

Implement changes to consolidation system

- Amendments made to management/statutory reporting and consolidation system to capture opening balances and monthly data on IFRS basis.

New IFRS finance policy manual

- Effective 5 January 2005.
- Accessible to all finance staff in the Group via the Morgan intranet.

KPMG review of IFRS restatements

- During April 2005
- Review covers:
  - Opening balances at transition
  - Half year 2004
  - Full year 2004

IFRS – principal areas of impact for Morgan

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

First time adoption – exemptions taken

Employee benefits

- The corridor approach to the recognition of actuarial gains/losses has not been applied prior to the date of transition. Actuarial gains/losses are recognised outside profit or loss in the ‘statement of recognised income and expense’.

Share-based payment

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

Goodwill

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

First time adoption – exemptions taken (continued)

Financial instruments

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

Foreign currency translation

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

Fair value deemed as cost

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

Changes in accounting policy – Employee benefits

UK GAAP

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

IFRS

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

Impact

- Opening balance sheet net assets reduced by c. £82m (2004 deficit) under FRS17 in respect of deficits on defined benefit schemes.
- Actuarial gains/losses recognised outside profit or loss in the ‘statement of recognised income and expense’.

UK GAAP

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

IFRS

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

Impact

- Despite recognising a charge in respect of all 3 types of scheme, the use of option pricing models is expected to result in a charge to the income statement <u>in line with the charge in 2004.</u>

UK GAAP

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

IFRS

- Expenditure on development <u>must</u> be capitalised if it meets <u>all</u> the criteria included in IAS 38.

Impact

- Amount of future development expenditure capitalised is not expected to be significant (most of the 2004 development spend would not have met all the IAS 38 criteria).
- Amortisation of capitalised development expenditure will be over a period not exceeding 3 years.

Changes in accounting policy – Goodwill

UK GAAP

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

IFRS

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

Impact

- Operating profit improvement in the absence of amortisation; (2004: £6.4m).
- Net profit improvement in the absence of recycling goodwill previously written off against reserves relating to disposals; (2004: £16.1m).
- Impairment losses not expected to be significant.

Changes in accounting policy – Other intangibles

UK GAAP

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

IFRS

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

Impact

- Internally developed software - capitalisation is not expected to be significant.
- Purchased software:
  - Balance sheet reclassification from tangible fixed assets to intangible assets.
  - Income statement reclassification from depreciation to amortisation over the period of the useful life, normally 3–10 years.

UK GAAP

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

IFRS

- All derivatives recorded on the balance sheet and marked to market.
- Changes in fair value taken to the income statement or equity (later recycled) depending on the classification.
- Embedded derivatives require separation from the host contract.
- Detailed documentation required to qualify for hedge accounting.

Impact

- Potential volatility of results will be minimised by Morgan's centrally coordinated hedging policy.

UK GAAP

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

IFRS

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

Impact

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

Changes in accounting policy – Deferred taxation

UK GAAP

- DT is recognised in respect of all timing differences between the amounts used for tax purposes and the carrying amounts for accounting purposes.

IFRS

- Wider scope. DT is recognised in respect of all temporary differences between the amounts used for tax purposes and the carrying amounts for accounting purposes.

Impact

- Not expected to be material:
  - Limited fair value adjustments;
  - Increased DT on capital gains expected to be covered by the Group's surplus unrecognised capital losses.

UK GAAP

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

IFRS

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

Impact

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

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

UK GAAP

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

IFRS

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

Impact

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

Area	Impact on Financial Position / Results at Transition (range)	Comment
Employee Benefits	FRS 17 – 2004 • Deficit £82m • P&L charge £15.8m	Reduction in net assets due to the recognition of deficits on defined benefit schemes.
Share-based Payments	≈ 2004 P/L charge c. £1.8m	Fair value charge in the income statement in respect of the LTIP, share option schemes and share save schemes
Research and Development	<£2m p.a.	Capitalisation of development expenditure meeting all IAS38 criteria.
Goodwill	£6.4m (2004) £16.1m (2004)	Cessation of goodwill amortisation results in an increase in net income. No recycling of goodwill previously written off against reserves relating to disposals. Impairment losses not expected.

Area	Impact on financial position/results at transition (range)	Comment
Other intangibles	Reclassification only	Reclassification of certain software from tangible fixed assets to intangible assets.
Financial instruments	Not expected to be material.	Recognition of all derivatives and embedded derivatives. Formalised hedge accounting.
Leases	Not expected to be material.	Additional capitalisation of finance leases.
Deferred taxation	Not expected to be material.	DT recognised on all temporary differences.
Foreign currency translation	Not material	Recycling' of translation gains/losses on disposal of foreign subsidiaries.
Post-balance sheet events: Dividends	Not expected to be material.	No reduction in net assets when dividends are proposed after the balance sheet date.

IFRS – next steps

- Full IFRS restatements announcement to be made at the end of June, including:
  - ❖ Accounting policies applied under IFRS;
  - ❖ Reconciliations of equity at 5 January 2004, 4 July 2004 and 4 January 2005;
  - ❖ Reconcilations of net income for the half year to 4 July 2004 and full year to 4 January 2005.
- A trading update will be given at the end of June.
- Half year results to 4 July 2005 under IFRS to be announced on 3 August.

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Update on bank refinancing

Hanau, 18 April 2005

Bank refinancing

- New US$ 350m facility
- Replaces existing 3-year syndication
- Removes other legacy financing e.g. bi-laterals
- Extends maturity from 3 years to 5 years
- Covenants now in line with Morgan’s improved credit
- Reduced costs of financing going forward

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Employee benefits

Exemption: The corridor approach to the recognition of actuarial gains/losses has not been applied prior to the date of transition.

Benefit: Precludes the need to calculate the cumulative actuarial gain/loss position at the date of transition in respect of each and every defined benefit scheme in the Group since inception.

Goodwill

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

Benefit: Precludes the need to recalculate goodwill arising on each and every acquisition prior to the date of transition, applying IFRS recognition and measurement criteria to all aspects of the transaction.

Foreign currency translation

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

Benefit: Precludes the requirement to calculate the cumulative translation gains/losses position at the date of transition in respect of each and every foreign subsidiary in the Group since its acquisition or start-up.

Fair value deemed as cost

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

Benefit: Precludes the requirement to construct a calculation of depreciated cost at the date of transition.

UK GAAP: Accounting for defined contribution and defined benefit pension obligations under SSAP 24

- Contributions are charged to the profit and loss account so as to spread the pension cost over the anticipated period of service of the pension scheme members. Actuarial gains/losses are spread over the expected remaining service lives of current employees.

IFRS: Accounting for long-term employee benefits under IAS 19

- Defined contribution schemes: The accounting treatment is broadly the same as under UK GAAP described above.
- Defined benefit schemes: Obligations are included in the balance sheet at present value (i.e. present value of expected future payments) and are presented net of scheme assets stated at fair value (i.e. market value). Actuarial gains/losses are recognised immediately in the 'statement of recognised income and expense'.

Development expenditure and other internally generated intangibles – IAS 38 criteria for capitalisation

Under IAS 38 the criteria for the recognition of an intangible asset are that the business can demonstrate:-

- the technical feasibility of completing the intangible asset so that it will be available for use or sale;
- its intention to complete the intangible assets and use it or sell it;
- its ability to use or sell the intangible asset;
- how the intangible asset will generate probable future economic benefits, i.e. demonstrate the existence of a market for the output of the intangible or, if to be used internally, that it is useful;
- the availability of adequate technical, financial and other resources to complete the development and to use or sell the asset;
- its ability to measure reliably the expenditure attributable to the asset during its development.

All criteria must be met.

IFRS – background to deferred taxation

IFRS has wider scope for recognition of deferred taxation.

Temporary differences = all timing differences plus further temporary differences

E.g. DT is also recognised on:

- Fair value adjustments
- Non-depreciatory assets e.g. land, even if there is no intention to sell (although can use capital losses to recover)
- Capital gains at the point of rollover (recognition delayed under FRS 19)
- Un-remitted earnings i.e. changes in the value of JV's such as earnings/impairment losses
- Consolidation adjustments e.g. temporary differences due to the inter-co profit element in stock