

# Notes to the consolidated financial statements

for the year ended 31 December 2008

## 1 Corporate information

The consolidated financial statements of The Capita Group Plc for the year ended 31 December 2008 were authorised for issue in accordance with a resolution of the Directors on 25 February 2009. The Capita Group Plc is a public limited company incorporated in England and Wales whose shares are publicly traded.

The principal activities of the Group are given in the business review on pages 54-60.

## 2 Summary of significant accounting policies

### (a) Statement of compliance

The consolidated financial statements of The Capita Group Plc and all of its subsidiaries (the Group) have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 1985 and 2006.

The parent company continues to apply UK GAAP in the preparation of its individual financial statements and these are contained on pages 119-130.

### (b) Basis of preparation

The consolidated financial statements have been prepared under IFRS where certain financial instruments and the pension assets and liabilities have been measured at fair value. The carrying value of recognised assets and liabilities that are hedged are adjusted to record changes in the fair values attributable to the risks that are being hedged. The consolidated financial statements are presented in pounds sterling and all values are rounded to the nearest tenth of a million (£m) except when otherwise indicated.

### (c) Basis of consolidation

The consolidated financial statements comprise the financial statements of The Capita Group Plc and its subsidiaries as at 31 December each year. The financial statements of the subsidiaries are prepared for the same reporting year as the parent company, using consistent accounting policies, but in accordance with UK GAAP. Adjustments are made to bring into line any dissimilar accounting policies that may exist between IFRS and UK GAAP.

The preparation of financial statements in conformity with generally accepted accounting principles requires the Directors' to make judgements and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported income and expense during the reported periods. Although these judgements and assumptions are based on the Directors' best knowledge of the amount, events or actions, actual results may differ from these estimates.

The key sources of estimation uncertainty that have a significant risk of causing material adjustment to the carrying amounts of assets and liabilities within the next financial year are the measurement and impairment of goodwill and the measurement of defined benefit obligations and defined benefit assets. The measurement of intangible assets other than goodwill on a business combination involves estimation of future cash flows and the selection of a suitable discount rate. The Group determines whether goodwill is impaired on an annual basis and thus requires an estimation of the value in use of the cash generating units to which the intangible assets are allocated. This involves estimation of future cash flows and choosing a suitable discount rate (see note 14). Measurement of defined benefit obligations requires estimation of future changes in salaries and inflation, as well as mortality rates, the expected return on assets and the selection of a suitable discount rate (see note 31).

All intercompany balances and transactions, including unrealised profits arising from intragroup transactions, have been eliminated in full.

Subsidiaries are consolidated from the date on which control is transferred to the Group until control is transferred out of the Group. Where there is a loss of control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which The Capita Group Plc has control.

### (d) Changes in accounting policies

The accounting policies adopted are consistent with those of the previous financial year except as follows:

The Group has adopted the following new amendments to IFRS and IFRIC interpretations during the year. Adoption of these amendments and interpretations did not have any effect on the financial statements of the Group.

- Reclassification of Financial Assets – Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures
- IFRIC 12 Service Concession Arrangements

The principal effects of these changes are as follows:

#### **Reclassification of Financial Assets – Amendments to IAS 39 Financial Instruments: Recognition and Measurement and IFRS 7 Financial Instruments: Disclosures**

These amendments to the standards, issued in October 2008, permit an entity to reclassify non-derivative financial assets (other than those designated at fair value through profit or loss by the entity upon initial recognition) out of the fair value through profit or loss category in particular circumstances. The amendments also permit an entity to transfer from the available-for-sale category to the loans and receivables category a financial asset that would have met the definition of loans and receivables (if the financial asset had not been designated as available for sale), if the entity has the intention and ability to hold that financial asset for the foreseeable future. These amendments, which are effective from 1 July 2008, have had no impact on the financial statements of the Group.

**IFRIC 12 – Service Concession Arrangements** This interpretation, which is effective for annual periods beginning on or after 1 January 2008, provides guidance on the application of existing International Financial Reporting Standards on the accounting by operators for public-to-private service concession arrangements. Service concession arrangements are arrangements whereby a government or other body grants contracts for the supply of public services, such as roads, energy distribution, prisons or hospitals, to private operators. Adoption of this interpretation has had no impact on the financial statements of the Group.

## 2 Summary of significant accounting policies (continued)

### (e) Revenue

Revenue is earned within the United Kingdom, Europe, India and South-East Asia.

Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Other than in respect of service contracts, described below, and where the Group is acting as lessor (see (v)), revenue represents fee income recognised in respect of services provided during the period (stated net of value added tax).

For time and materials contracts which are those where Capita provide staff to customers at hourly or daily rates, revenue is recognised on the basis of time worked.

Revenue on contracts where there is an ongoing service (e.g. life and pension policy administration, hardware maintenance) is recognised over the period during which the service is provided.

Contracts where there are distinguishable components are separated and revenue is recognised individually on the basis that each component can be reliably estimated. Revenues and costs relating to each element are recognised simultaneously.

### (f) Service contracts

(i) **Brownfield outsourcing contracts** – Brownfield contracts are where there is a transfer of an existing operation to the Group. For brownfield contracts all costs incurred prior to service commencement are expensed as incurred and revenue represents fee income in respect of services provided.

(ii) **Greenfield outsourcing contracts** – A greenfield contract is one in which an entirely new service is being established for a customer. For these contracts no profit is recognised until service delivery commences and is being invoiced. Upon commencement, revenue represents fees invoiced in respect of services provided. Direct incremental costs incurred on the contract prior to service commencement and reimbursable during the contract, excluding any overheads, are included in prepayments and amortised over the life of the contract. On some contracts, non-refundable payments are received, prior to full service commencement, on the achievement of agreed contract delivery milestones. These are recognised as revenue when earned.

(iii) **Property consultancy and transformation contracts** – Revenue represents the sales value of work done in the year, including fees invoiced and estimates in respect of amounts to be invoiced after the year-end. Profits are recognised on long term contracts where the final outcome can be assessed with reasonable certainty. In calculating this the percentage of completion method is used based on the proportion of costs incurred to the total estimated cost. Cost includes direct staff costs and outlays. Full provision is made for all known or anticipated losses on each contract immediately such losses are forecast.

In respect of construction contracts, gross amounts due from customers are stated at the proportion of the anticipated net sales value earned to date less amounts billed on account. To the extent that fees paid on account exceed the value of work performed, they are included in creditors as gross amounts due to customers.

### (g) Foreign currency translation

The functional and presentation currency of The Capita Group Plc and its United Kingdom subsidiaries is the pound sterling (£). Transactions in foreign currencies are initially recorded in the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are taken to the consolidated income statement with the exception of differences on foreign currency borrowings that provide a hedge against a net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the consolidated income statement.

Tax charges and credits attributable to exchange differences on those borrowings are also dealt with in equity. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate as at the date of initial transaction. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

The functional currencies of overseas operations include the euro, Indian rupee, Malaysian ringgit, and the South Korean won. As at the reporting date, the assets and liabilities of the overseas operations are retranslated into the presentation currency of The Capita Group Plc at the rate of exchange ruling at the balance sheet date and their income statements are translated at the weighted average exchange rate for the year. The exchange differences arising on the retranslation are taken directly to a separate component of equity. On disposal of a foreign operation, the deferred cumulative amount recognised in equity relating to that particular foreign operation shall be recognised in the income statement.

The Group has elected not to record cumulative translation differences arising prior to the transition date as permitted by IFRS 1. In utilising this exemption, all cumulative translation differences are deemed to be zero as at 1 January 2004 and all subsequent disposals shall exclude any translation differences arising prior to the date of transition.

## Notes to the consolidated financial statements

### 2 Summary of significant accounting policies (continued)

#### (h) Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and any impairment in value. Depreciation is calculated on a straight-line basis over the estimated useful life of the asset as follows:

Freehold buildings and long leasehold property – over 50 years

Leasehold improvements – period of the lease

Plant and equipment – 3 – 10 years

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. If any such indication exists and where the carrying values exceed the estimated recoverable amount, the assets are written down to their recoverable amount. The recoverable amount of property, plant and equipment is the greater of net selling price and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash inflows, the recoverable amount is determined for the cash-generating unit to which the asset belongs. Impairment losses are recognised in the income statement in the administrative expenses line item.

An item of property, plant and equipment is de-recognised upon disposal or when no future economic benefits are expected to arise from the continued use of the asset. Any gain or loss arising on de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the item) is included in the income statement in the year in which the item is de-recognised.

#### (i) Borrowing costs

Borrowing costs are currently recognised as an expense when incurred in accordance with the benchmark accounting treatment under IAS 23.

#### (j) Goodwill

Goodwill recognised under UK GAAP prior to the date of transition to IFRS is stated at net book value as at this date. This goodwill had been amortised on a straight-line basis over its useful economic life (ranging from 5 to 20 years). This was changed on transition to IFRS. Goodwill recognised subsequent to 1 January 2004 is, on acquisition, initially measured at cost being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses. Goodwill is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. Goodwill arising on acquisitions prior to 31 December 1997 remains set off directly against reserves and does not get recycled through the income statement.

As at the acquisition date, any goodwill acquired is allocated to each of the cash-generating units which are expected to benefit from the combination's synergies. Impairment is determined by assessing the recoverable amount of the cash-generating unit to which the goodwill relates. Where the recoverable amount of the cash-generating unit is less than the carrying amount, an impairment loss is recognised. Where goodwill forms part of a cash-generating unit and part of the operation within that unit is disposed of, the goodwill associated with the operation disposed of is included in the carrying amount of the operation when determining the gain or loss on disposal of the operation. Goodwill disposed of in these circumstances is measured on the basis of the relative values of the operation disposed of and the portion of the cash-generating unit retained.

#### (k) Intangible assets

Intangible assets acquired separately are capitalised at cost and those identified in a business acquisition are capitalised at fair value as at the date of acquisition. Following initial recognition, the carrying amount of an intangible asset is its cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. There were no indefinite-lived assets in 2007 or 2008. Amortisation is charged on assets with finite lives, this expense is taken to the income statement through the administrative expenses line item.

Intangible assets with finite lives are only tested for impairment, either individually or at the cash-generating unit level, where there is an indicator of impairment.

Gains or losses arising from de-recognition of an intangible asset are measured as the difference between the net disposal proceeds and the carrying amount of the asset and are recognised in the income statement when the asset is de-recognised.

Intangible assets identified and recognised since transition to IFRS are profiled as follows:

- brands are amortised evenly over their useful economic lives of 5 and 10 years
- software and licences are amortised over their useful economic lives of 5 years
- contracts and committed sales are amortised over their useful economic lives of between 1.5 and 15 years
- customer lists and relationships are amortised over their useful economic lives of between 4 and 10 years
- other intangibles are amortised over their useful economic lives of 6.5 years.

## 2 Summary of significant accounting policies (continued)

### **(l) Recoverable amount of non-current assets**

At each reporting date, the Group assesses whether there is any indication that an asset may be impaired. Where an indicator of impairment exists, the Group makes a formal estimate of the asset's recoverable amount. Where the carrying amount of an asset exceeds its recoverable amount, the asset is considered impaired and is written down to its recoverable amount. The recoverable amount is the higher of an asset's or cash-generating unit's fair value less costs to sell and its value in use and is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets.

### **(m) Investments and other financial assets**

All investments are initially recorded at their fair value. Subsequently they are reviewed for impairment if events or changes in circumstances indicate the carrying value may not be recoverable.

Investment loans are measured at amortised cost using the effective interest method.

Available for sale financial assets are measured at their fair value with unrealised gains or losses being recognised directly in equity. When the investment is disposed of, the cumulative gain or loss previously recorded in equity is recognised in the income statement.

Financial assets at fair value through the income statement (disclosed in investment income) include financial assets designated upon initial recognition as at fair value through the income statement.

Financial assets may be designated upon initial recognition as at fair value through profit or loss if the assets are part of a group of financial assets which are managed and their performance evaluated on a fair value basis, in accordance with a documented risk management strategy.

### **(n) Trade and other receivables**

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable. Bad debts are written off when identified.

### **(o) Cash and cash equivalents**

Cash and short term deposits in the balance sheet comprise cash at bank and in hand and short term deposits with an original maturity of 3 months or less.

For the purpose of the consolidated cash flow statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts, except where no right of set-off exists.

### **(p) Interest-bearing loans and borrowings**

All loans and borrowings are initially recognised at their fair value.

After initial recognition loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement.

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

### **(q) Provisions**

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event and it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation and a reliable estimate can be made of the amount of the obligation. Where the Group expects some or all of a provision to be reimbursed, for example under an insurance contract, the reimbursement is recognised as a separate asset but only when recovery is virtually certain. The expense relating to any provision is presented in the income statement net of any reimbursement. If the effect of the time value of money 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. Where discounting is used, the increase in the provision due to the passage of time is recognised as a borrowing cost.

### **(r) Surplus properties**

The Group provides, on a discounted basis, for the future rent expense and related cost of leasehold property (net of estimated sub-lease income) where the space is vacant or currently not planned to be used for ongoing operations.

### **(s) Pre-contract costs**

Pre-contract award bidding costs are expensed as incurred.

## Notes to the consolidated financial statements

### 2 Summary of significant accounting policies (continued)

#### (t) Pension schemes

The Group maintains a number of defined contribution pension schemes and for these schemes the Group has no further payment obligations once the contributions have been paid. The contributions are recognised as an employee benefit expense in the income statement for the year when they are due.

In addition, the Group operates a defined benefit pension scheme and participates in a number of other defined benefit pension schemes, all of which require contributions to be made to separate trustee-administered funds. The costs of providing benefits under these schemes are determined separately for each scheme using the projected unit credit method, which attributes entitlement to benefits to the current period (to determine current service cost) and to the current and prior periods (to determine the present value of the defined benefit obligation) and is based on actuarial advice. Past service costs are recognised immediately in the income statement, unless the changes are conditional on employees remaining in service for a specified period of time (the vesting period). In this case, the past service costs are amortised on a straight-line basis over the average vesting period.

When a settlement (eliminating all obligations for benefits already accrued) or a curtailment (reducing future obligations as a result of a material reduction in the scheme membership or a reduction in future entitlement) occurs the obligation and related plan assets are remeasured using current actuarial assumptions and the resultant gain or loss recognised in the income statement during the period in which the settlement or curtailment occurs.

The interest cost element of the defined benefit pension charge represents a change in the present value of scheme obligations resulting from the passage of time and is determined by applying the discount rate to the opening present value of the benefit obligation taking into account material changes in the obligation during the year. The expected return on plan assets is based on an assessment made at the beginning of the year of long term market returns on scheme assets, adjusted for the effect on fair value of plan assets of contributions received and benefits paid during the year.

In respect of 3 of the defined benefit pension schemes in which the Group participates, the Group accounts for its legal and constructive obligation over the period of its participation which is for a fixed period only.

Actuarial gains and losses are fully recognised in equity through the statement of recognised income and expense such that the balance sheet reflects the scheme's surplus or liability at the balance sheet date. Current and past service cost are charged to operating profit with the interest cost, net of expected return on assets in the plans, included within administrative expenses.

The liability on the balance sheet in respect of the defined benefit pension schemes comprises the total for each scheme, or group of schemes, of the present value of the defined benefit obligation (using a discount rate based on high quality corporate bonds), less any past service cost not yet recognised and less the fair value of plan assets out of which the obligations are to be settled directly. Fair value is based on market price information and in the case of quoted securities is the published bid price. The value of a net pension benefit asset is restricted to the sum of any unrecognised past service costs and the present value of any amount the Group expects to recover by way of refunds from the plan or reductions in the future contributions.

#### (u) Derivative financial instruments

The Group uses derivative financial instruments such as interest rate swaps and foreign currency contracts to hedge risks associated with interest and exchange rate fluctuations. Such derivative financial instruments are stated at fair value. The fair values of interest rate swaps and foreign currency contracts are determined by reference to market rates for similar instruments.

For the purpose 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 cash flows that is attributable to a particular risk associated with either a recognised asset or liability or a forecast transaction.

In relation to fair value hedges (e.g. fixed to floating interest rate swaps held as fair value hedges against fixed interest rate borrowings) which meet the conditions for hedge accounting, any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in the income statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the income statement.

In relation to cash flow hedges the effective portion of the gain or loss on the hedging instrument is recognised directly in equity, while any ineffective portion is recognised immediately in the income statement. Amounts taken to equity are transferred to the income statement when the hedged transaction affects the income statement, such as when the hedged financial income or financial expense is recognised or when a forecast transaction occurs. Where the hedged item is the cost of a non-financial asset or non-financial liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability.

If the forecast transaction or firm commitment is no longer expected to occur, amounts previously recognised in equity are transferred to the income statement. If the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, or if its designation as a hedge is revoked, amounts previously recognised in equity remain in equity until the forecast transaction or firm commitment occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement.

#### (v) Leasing

The determination of whether an arrangement is, or contains, a lease is based on the substance of the arrangement at inception date and is concerned with whether the fulfilment of the arrangement is dependent upon the use of a specific asset or assets and the arrangement conveys a right to use the asset.

**Group as a lessee:** Finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease at the fair value of the leased property or, if lower, at the present value of the minimum lease payments. 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 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.

**Group as a lessor:** Leases where the Group does not transfer substantially all the risks and benefits of ownership of the asset are classified as operating leases. Rental income arising from operating leases is recognised in the income statement on a straight-line basis over the lease term.

## 2 Summary of significant accounting policies (continued)

### (w) Income tax

Deferred income tax is provided, using the liability method, on all temporary differences at the balance sheet date between the tax bases of assets and liabilities and their carrying amounts for financial reporting purposes.

Deferred income tax liabilities are recognised for all taxable temporary differences:

- except where the deferred tax liability arises from the initial recognition of goodwill
- except where the deferred income tax liability arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss
- in respect of taxable temporary differences associated with investments in subsidiaries, associates and interests in joint ventures, except where the timing of the reversal of the temporary differences can be controlled and it is probable that the temporary differences will not reverse in the foreseeable future.

Deferred income 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 and the carry-forward of unused tax assets and unused tax losses can be utilised, except where the deferred income tax asset relating to the deductible temporary difference arises from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit or loss.

The carrying amount of deferred income tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the deferred income tax asset to be utilised.

Deferred income tax assets and liabilities are measured at the tax rates that are expected to apply to the year when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted at the balance sheet date.

Income tax relating to items recognised directly in equity is recognised in equity and not in the income statement.

### (x) Share based payments

The Group operates a number of executive and employee share schemes.

The cost of equity-settled transactions with employees is measured by reference to the fair value at the date at which they are granted and is recognised as an expense over the vesting period, which ends on the date on which the relevant employees become fully entitled to the award. Fair value is determined using an option pricing model. In valuing equity-settled transactions, no account is taken of any vesting conditions, other than conditions linked to the price of the shares of the Company (market conditions).

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.

At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and management's best estimate of the achievement or otherwise of non-market conditions, the number of equity instruments that will ultimately vest or, in the case of an instrument subject to a market condition, be treated as vesting as described above. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity.

Where the terms of an equity-settled award are modified or a new award is designated as replacing a cancelled or settled award, the cost based on the original award terms continues to be recognised over the original vesting period. In addition, an expense is recognised over the remainder of the new vesting period for the incremental fair value of any modification, based on the difference between the fair value of the original award and the fair value of the modified award, both as measured on the date of the modification. No reduction is recognised if this difference is negative.

Where an equity-settled award is cancelled, it is treated as if it had vested on the date of cancellation, and any cost not yet recognised in the income statement for the award is expensed immediately. Any compensation paid up to the fair value of the award at the cancellation or settlement date is deducted from equity, with any excess over the fair value being treated as an expense in the income statement.

The Group has taken advantage of the transitional provisions of IFRS 2 in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested before 1 January 2006.

### (y) Participation in Lloyd's Market Syndicate

Capita provides run-off administrative services to Lloyd's Syndicates. On occasion where there is a commercial driver to do so, the Group will take an equity holding in a Corporate Member (a limited liability company – operating in the Lloyd's market).

The Group has treated this arrangement as an investment in a joint venture, whereby the Group and the other venturers have a contractual arrangement that establishes joint control over the economic activities of the entity. The Group's investment in the joint venture is accounted for using the equity method of accounting. Under the equity method the investment in the joint venture is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of net assets of the entity. The income statement reflects, where material, the share of the results of operations of the joint venture. Profits and losses resulting from transactions between the Group and the joint venture are eliminated to the extent of the interest in the joint venture. The Corporate Member's share of the assets and liabilities of the Syndicate and the quota share arrangement are further disclosed in note 15 to these financial statements.

## Notes to the consolidated financial statements

### 2 Summary of significant accounting policies (continued)

#### (z) New standards and interpretations not applied

The IASB and the IFRIC have issued the following standards and interpretations with an effective date after the date of these financial statements:

		Effective date
<b>International Accounting Standards (IAS/IFRSs)</b>		
IFRS 2	Share-based Payment Vesting Conditions and Cancellations (Amendment)	1 January 2009
IAS 1	Presentation of Financial Statements (Revised)	1 January 2009
–	Improvements to IFRSs	1 January 2009
IFRS 8	Operating Segments	1 January 2009
IAS 23	Borrowing Costs (Revised)	1 January 2009
IAS 27	Consolidated and Separate Financial Statements – Cost of an Investment in a Subsidiary, Jointly Controlled Entity or Associate (Amendment)	1 January 2009
IAS 32	Financial Instruments: Presentation and IAS 1 Presentation of Financial Statements (Amendments)	1 January 2009
IFRS 3	Business Combinations (Revised)	1 July 2009
IAS 39	Financial Instruments: Recognition and Measurement – Eligible Hedged Items (Amendment)	1 July 2009
IAS 27	Consolidated and Separate Financial Statements (Amendment)	1 July 2009
<b>International Financial Reporting Interpretations Committee (IFRIC)</b>		
IFRIC 13	Customer Loyalty Programmes	1 July 2008
IFRIC 15	Agreements for the Construction of Real Estate	1 January 2009
IFRIC 16	Hedges of a Net Investment in a Foreign Operation	1 October 2008
IFRIC 17	Distributions of Non-cash Assets to Owners	1 July 2009
IFRIC 18	Transfer of Assets from Customers	1 July 2009

The Directors do not currently anticipate that the adoption of these standards and interpretations will have a material impact on the Group's financial statements in the period of initial application.

### 3 Revenue

Revenue disclosed in the income statement is analysed as follows:

	Notes	2008 £m	2007 £m
Rendering of services		2,289.0	1,964.0
Construction contracts	20	152.4	107.8
Rental income from operating leases	22	–	1.5
Revenue from operating activities		2,441.4	2,073.3
Finance revenue	8	5.7	1.6
Total revenue		2,447.1	2,074.9

### 4 Investment loss

Investment loss includes:

	2008 £m	2007 £m
(Loss) /profit on financial assets measured at fair value through the income statement	(0.7)	1.2
Investment in joint venture	0.5	–
Net investment (loss)/gain	(0.2)	1.2

Investment income represents income recognised in relation to the Lloyd's Market Syndicates in which the Group has a joint venture arrangement as disclosed in note 15. During the year the Group received a dividend of £0.1m from the Syndicate which is reflected in the net assets recognised in the disclosure in note 15.

The investment loss in the year is in recognition of negative returns on investments in units held in managed funds by the Group's insurance captives, as disclosed in note 15. At the date of the approval of these financial statements the Group no longer has any investment in these managed funds.

## 5 Segmental information

The Group's operations are organised and managed separately according to the nature of the services provided, with each segment representing a strategic business unit offering a different package of related services across the Group's markets. A description of the service provision for each segment can be found in the business review on pages 54-60.

Before eliminating sales between business units on consolidation, the Group accounts for sales between business units as if they were to a third party at market rates.

The tables below present revenue, result and certain asset and liability information for the Group's business segments for the years 2008 and 2007. All operations in 2008 are continuing.

### Year ended 31 December 2008

Segment revenue	HR Solutions £m	Property Consultancy £m	Insurance Services £m	Investor Services £m	Integrated Services £m	ICT & Partnership Services £m	Life & Pensions £m	Professional Services £m	Total £m
Total segment revenue	278.5	284.2	263.6	173.9	393.4	464.8	489.0	378.9	2,726.3
Inter-segment revenue	(20.3)	(22.0)	(17.4)	–	(6.0)	(125.4)	(26.1)	(67.7)	(284.9)
Third party revenue	258.2	262.2	246.2	173.9	387.4	339.4	462.9	311.2	2,441.4
<b>Segment result</b>									
Result after depreciation	25.3	24.0	32.7	40.3	58.4	35.7	56.5	57.2	330.1
Share based payment	(1.1)	(1.2)	(1.6)	(0.7)	(2.3)	(0.7)	(0.8)	(0.8)	(9.2)
Intangible amortisation	(0.2)	(1.4)	(3.7)	(3.7)	(1.2)	(1.6)	(3.5)	(3.3)	(18.6)
	24.0	21.4	27.4	35.9	54.9	33.4	52.2	53.1	302.3
Net finance costs (before callable swaps)									(43.5)
Callable swaps									(32.0)
Investment loss									(0.2)
Profit before tax									226.6
Corporation taxation									(60.8)
Profit after tax									165.8
<b>Other segment information</b>									
<b>Assets by segment</b>									
Assets	50.9	83.5	121.8	74.4	118.7	124.2	219.6	45.0	838.1
Intangible assets	84.3	63.2	244.3	179.6	39.8	45.9	111.3	138.6	907.0
	135.2	146.7	366.1	254.0	158.5	170.1	330.9	183.6	1,745.1
Liabilities	(27.8)	(48.8)	(135.3)	(42.1)	(123.5)	(110.2)	(103.4)	(164.5)	(755.6)
Net allocated assets	107.4	97.9	230.8	211.9	35.0	59.9	227.5	19.1	989.5
Unallocated assets									419.2
Unallocated liabilities									(1,011.8)
Total net assets									396.9
<b>Capital expenditure</b>									
Tangible assets	1.5	2.2	7.6	17.9	10.0	12.2	34.1	5.4	90.9
Depreciation charge	1.3	2.9	4.2	2.8	19.8	6.2	7.7	5.1	50.0
Intangible assets	–	9.5	23.1	9.4	0.1	43.0	26.1	70.2	181.4
Intangible amortisation	0.2	1.4	3.7	3.7	1.2	1.6	3.5	3.3	18.6

Unallocated assets include held for sale financial assets, financial assets held at fair value through the income statement, the cash flow hedge financial asset, cash in bank, currency and interest rate swaps. Unallocated liabilities include lease obligations, loan notes, callable swaps, bonds and the pension liability.

## Notes to the consolidated financial statements

### 5 Segmental information (continued)

The tables below present revenue by the geographical location of customers, carrying amount of assets and expenditure on tangible and intangible assets by location of those assets.

	United Kingdom £m	Non-United Kingdom £m	Total £m
<b>Revenue</b>			
Total segment revenue	2,639.5	86.8	2,726.3
Inter-segment revenue	(265.3)	(19.6)	(284.9)
Third party revenue	2,374.2	67.2	2,441.4
<b>Other segment information</b>			
Assets	806.7	31.4	838.1
Intangible assets	859.5	47.5	907.0
Unallocated assets	419.2	–	419.2
Total assets	2,085.4	78.9	2,164.3
<b>Capital expenditure</b>			
Tangible assets	85.1	5.8	90.9
Intangible assets	164.6	16.8	181.4

### Year ended 31 December 2007

Segment revenue	HR Solutions £m	Property Consultancy £m	Insurance Services £m	Investor Services £m	Integrated Services £m	ICT & Partnerships Services £m	Life & Pensions £m	Professional Services £m	Total £m
Total segment revenue	243.2	244.6	260.5	158.2	413.2	352.0	274.1	340.7	2,286.5
Inter-segment revenue	(18.2)	(12.7)	(19.0)	(1.3)	(8.2)	(92.5)	(10.5)	(50.8)	(213.2)
Third party revenue	225.0	231.9	241.5	156.9	405.0	259.5	263.6	289.9	2,073.3
<b>Segment result</b>									
Result after depreciation	22.3	20.4	30.3	37.9	58.3	28.3	33.7	48.7	279.9
Share based payment	(1.0)	(1.1)	(1.2)	(0.6)	(2.5)	(0.6)	(0.8)	(0.8)	(8.6)
Intangible amortisation	(0.1)	(0.7)	(2.6)	(1.3)	(1.6)	–	(1.5)	(1.9)	(9.7)
	21.2	18.6	26.5	36.0	54.2	27.7	31.4	46.0	261.6
Net finance costs									(34.1)
Investment income									1.2
Profit before tax									228.7
Corporation taxation									(62.5)
Profit after tax									166.2
<b>Other segment information</b>									
<b>Assets by segment</b>									
Assets	41.8	72.0	142.8	59.0	141.8	61.4	119.6	53.0	691.4
Intangible assets	84.5	55.0	226.3	173.9	40.9	4.6	88.2	72.3	745.7
	126.3	127.0	369.1	232.9	182.7	66.0	207.8	125.3	1,437.1
Liabilities	(19.7)	(28.4)	(127.3)	(52.9)	(117.0)	(69.6)	(86.2)	(113.6)	(614.7)
Net allocated assets/(liabilities)	106.6	98.6	241.8	180.0	65.7	(3.6)	121.6	11.7	822.4
Unallocated assets									53.5
Unallocated liabilities									(544.1)
Total net assets									331.8
<b>Capital expenditure</b>									
Tangible assets	1.8	2.7	2.9	3.7	19.0	8.8	23.4	5.6	67.9
Depreciation charge	0.9	2.7	3.6	2.0	21.4	4.9	5.8	4.8	46.1
Intangible assets	2.4	0.9	41.6	18.0	23.9	–	27.1	13.0	126.9
Intangible amortisation	0.1	0.7	2.7	1.2	1.6	–	1.9	1.5	9.7

## 5 Segmental information (continued)

The tables below present revenue by the geographical location of clients, carrying amount of assets and expenditure on tangible and intangible assets by location of those assets.

	United Kingdom £m	Non-United Kingdom £m	Total £m
<b>Revenue</b>			
Total segment revenue	2,217.5	69.0	2,286.5
Inter-segment revenue	(203.8)	(9.4)	(213.2)
Third party revenue	2,013.7	59.6	2,073.3
<b>Other segment information</b>			
Assets	665.0	26.4	691.4
Intangible assets	712.1	33.6	745.7
Unallocated assets	53.5	–	53.5
Total assets	1,430.6	60.0	1,490.6
<b>Capital expenditure</b>			
Tangible assets	62.5	5.4	67.9
Intangible assets	109.6	17.3	126.9

## 6 Operating profit

This is stated after charging/(crediting):

	Notes	2008 £m	2007 £m
Employee benefits expense	7	1,051.9	872.7
Amortisation of intangible assets (as shown in amortisation and callable swaps column)	13	18.6	9.7
Depreciation	12	50.0	46.1
Loss/(profit) on sale of property, plant and equipment		1.1	(0.1)
Amortisation of other intangible assets (treated as depreciation)*	13	1.5	1.5
Minimum lease payments recognised as an operating lease expense		70.6	69.5
Foreign exchange differences		(1.6)	0.2

\*Included within operating activities before amortisation.

	2008 £m	2007 £m
<b>UK fees paid to the auditors include fees in relation to:</b>		
Audit of financial statements	0.6	0.5
Other UK fees:		
Local statutory audits for subsidiaries	0.3	0.3
Further assurance services	0.1	0.1
Other non-audit services**	0.1	0.1
	1.1	1.0

\*\*There were no other amounts payable to the auditors requiring disclosure under s390B of the Companies Act 1985.

## 7 Employee benefits expense

	Notes	2008 £m	2007 £m
Wages and salaries		910.1	751.1
Social security costs		86.6	76.0
Pension costs	31	46.0	37.0
Share based payments		9.2	8.6
		1,051.9	872.7

## The average number of employees during the year was made up as follows:

	2008 Number	2007 Number
Sales	731	682
Administration	1,943	1,728
Operations	29,927	24,014
	32,601	26,424

Details of Directors' remuneration are contained within the Directors' remuneration report on pages 71-76.

## Notes to the consolidated financial statements

### 8 Net finance costs

	Notes	2008 £m	2007 £m
Bank interest receivable		(0.9)	(1.2)
Other interest receivable		(0.1)	(0.4)
Loan note interest		0.8	1.1
Bonds		39.9	25.8
Callable swaps – realised		(4.7)	–
Bank loans and overdrafts		8.3	8.5
Other interest payable		0.1	0.2
Unwinding of interest on discounted property provision		0.1	0.1
		<b>43.5</b>	34.1
Callable swaps – mark to market	24	32.0	–
Total finance costs		<b>75.5</b>	34.1

### 9 Income tax

The major components of income tax expense for the years ended 31 December 2008 and 2007 are:

	2008 £m	2007 £m
<b>Consolidated income statement</b>		
<b>Current income tax</b>		
Current income tax charge	73.2	61.8
Adjustment in respect of prior years	(3.1)	(3.0)
<b>Deferred income tax</b>		
Origination and reversal of temporary differences	(8.8)	6.6
Adjustment in respect of prior years	(0.5)	(2.9)
	<b>60.8</b>	62.5

### Consolidated statement of recognised income and expense

	2008 £m	2007 £m
<b>Deferred income tax related to items (credited)/charged directly to equity</b>		
Current income tax deduction on exercise of stock options in excess of share based payments	(17.6)	(10.0)
Deferred income tax on cash flow hedges	5.6	1.6
Deferred income tax movement in relation to share based payments	2.2	5.8
Deferred income tax movement in relation to actuarial (losses)/gains on defined benefit plans	(13.5)	7.6
	<b>(23.3)</b>	5.0

A reconciliation between tax expense and the product of accounting profit multiplied by the UK corporation tax rate for the years ended 31 December 2008 and 2007 is as follows:

	2008 £m	2007 £m
Accounting profit before tax	226.6	228.7
Notional charge at UK corporation tax rate of 28.5% (2007: 30%)	64.6	68.6
Adjustments in respect of current income tax of prior years	(3.1)	(3.0)
Adjustments in respect of deferred tax of prior years	(0.5)	(2.9)
Non-deductible expenses	2.4	1.8
Attributable to lower tax rates in overseas jurisdictions	(2.6)	(1.5)
Attributable to reduction in corporation tax rate	–	(0.5)
At the effective tax rate of 26.8% (2007: 27.3%)	60.8	62.5
Total tax expense reported in the income statement	<b>60.8</b>	62.5

The tax charge for the year ended 31 December 2008 was £60.8m (2007: charge of £62.5m) and is after a prior year net credit of £3.1m resulting from the successful resolution of issues with relevant tax authorities. The tax charge is equivalent to an underlying effective tax rate of 26.8% (2007: 27.3%). The effective tax rate on profit before amortisation and callable swaps valuation is 27.0% (2007: 27.7%). In addition, a net tax credit of £23.3m has been credited directly to equity including a credit of £17.6m in respect of realised stock option gains which resulted in a corresponding reduction in cash tax liabilities for the year ended 31 December 2008.

**9 Income tax (continued)****Deferred income tax**

Deferred income tax at 31 December relates to the following:

	Consolidated balance sheet		Consolidated income statement	
	2008 £m	2007 £m	2008 £m	2007 £m
<b>Deferred tax liabilities</b>				
Accelerated capital allowances	(5.7)	(4.6)	1.3	3.2
Pension scheme's asset	–	(5.7)	0.4	–
Cash flow hedges	(7.2)	(1.6)	–	–
Fair value adjustments on acquisition	(22.7)	(12.6)	(4.8)	(3.3)
	<b>(35.6)</b>	<b>(24.5)</b>		
<b>Deferred tax assets</b>				
Share based payments	16.1	15.7	(2.6)	(0.8)
Pension schemes' liability	6.9	4.5	5.0	5.4
Provisions	6.7	5.0	(1.5)	(1.1)
Losses available for offset against future taxable income	–	0.7	1.8	0.3
Cash flow swaps	8.9	–	(8.9)	–
	<b>38.6</b>	<b>25.9</b>		
<b>Net deferred tax asset</b>	<b>3.0</b>	<b>1.4</b>		
<b>Deferred income tax expense</b>			<b>(9.3)</b>	<b>3.7</b>

The Group has tax losses which arose in the UK of £5.8m (2007: £11.0m) that are available for offset against future taxable profits of the companies in which the losses arose. Deferred tax assets have not been recognised in respect of £5.8m (2007: £8.5m) of these losses, as their recoverability is uncertain.

**10 Earnings per share**

Basic earnings per share amounts are calculated by dividing net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year.

Diluted earnings per share amounts are calculated by dividing the net profit for the year attributable to ordinary equity holders of the parent by the weighted average number of ordinary shares outstanding during the year plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares.

The following reflects the income and share data used in the basic and diluted earnings per share computations:

	2008 £m	2007 £m
Net profit attributable to ordinary equity holders of the parent from operations	<b>165.8</b>	166.2
	2008 Number million	2007 Number million
Weighted average number of ordinary shares (excluding treasury shares) for basic earnings per share	<b>608.3</b>	613.6
Dilutive potential ordinary shares:		
Employee share options	<b>5.5</b>	10.3
Weighted average number of ordinary shares (excluding treasury shares) adjusted for the effect of dilution	<b>613.8</b>	623.9

There have been no other transactions involving ordinary shares or potential ordinary shares between the reporting date and the date of completion of these financial statements.

The following additional earnings per share figures are calculated based on earnings attributable to ordinary equity holders of the parent before amortisation and callable swap valuation of £202.3m (2007: £172.4m) and after amortisation and callable swap valuation of £165.8m (2007: £166.2m). They are included as they provide a better understanding of the underlying trading performance of the Group.

	2008 p	2007 p
Basic earnings per share – underlying	<b>33.26</b>	28.10
– after amortisation and callable swaps	<b>27.26</b>	27.09
Diluted earnings per share – underlying	<b>32.96</b>	27.63
– after amortisation and callable swaps	<b>27.01</b>	26.64

## Notes to the consolidated financial statements

### 11 Dividends paid and proposed

	2008 £m	2007 £m
<b>Declared and paid during the year</b>		
Ordinary shares (equity):		
Final for 2007 paid: 8.0p per share (2006: 6.3p per share)	48.8	39.2
Interim for 2008 paid: 4.8p per share (2007: 4.0p per share)	29.2	24.7
Special dividend for 2007: paid 25.0p per share	–	154.7
	<b>78.0</b>	<b>218.6</b>
<b>Proposed for approval at AGM (not recognised as a liability at 31 December)</b>		
Ordinary shares (equity):		
Final for 2008: 9.6p per share (2007: 8.0p per share)	58.6	48.8

### 12 Property, plant and equipment

	Leasehold improvements, land and buildings £m	Plant and machinery £m	Total £m
<b>Cost</b>			
At 1 January 2007	40.2	228.5	268.7
Subsidiaries acquired	0.3	1.2	1.5
Additions	12.0	55.9	67.9
Disposals	(2.4)	(40.5)	(42.9)
At 31 December 2007	50.1	245.1	295.2
Subsidiaries acquired	2.4	3.0	5.4
Additions	17.1	73.8	90.9
Disposals	(5.3)	(40.1)	(45.4)
At 31 December 2008	<b>64.3</b>	<b>281.8</b>	<b>346.1</b>
<b>Depreciation and impairment</b>			
At 1 January 2007	15.0	82.7	97.7
Provided during the year	6.0	40.1	46.1
Disposals	(2.4)	(39.6)	(42.0)
At 31 December 2007	18.6	83.2	101.8
Provided during the year	8.1	41.9	50.0
Disposals	(4.3)	(39.7)	(44.0)
At 31 December 2008	<b>22.4</b>	<b>85.4</b>	<b>107.8</b>
<b>Net book value</b>			
At 1 January 2007	25.2	145.8	171.0
At 31 December 2007	31.5	161.9	193.4
At 31 December 2008	<b>41.9</b>	<b>196.4</b>	<b>238.3</b>

The net book value of plant and machinery includes an amount of £nil (2007: £nil) in respect of assets held under finance leases. The net book value of assets held by the Group for which it acts as lessor, amounts to £nil (2007: £0.4m).

### 13 Intangible assets

	Brands £m	Software and licences £m	Contracts and committed sales £m	Customer lists and relationships £m	Goodwill £m	Sub-total £m	Other intangibles £m	Total £m
<b>Cost</b>								
At 1 January 2007	5.9	2.0	6.9	34.6	601.4	650.8	13.4	664.2
Recognition of intangibles – prior year acquisitions	0.1	0.3	–	3.0	(2.4)	1.0	–	1.0
Subsidiaries acquired	2.8	3.7	–	8.6	105.8	120.9	–	120.9
Additions	–	–	5.0	–	–	5.0	–	5.0
At 31 December 2007	8.8	6.0	11.9	46.2	704.8	777.7	13.4	791.1
Recognition of intangibles – prior year acquisitions	0.1	–	–	12.5	(9.1)	3.5	–	3.5
Subsidiaries acquired	2.8	8.5	8.3	23.6	134.7	177.9	–	177.9
At 31 December 2008	11.7	14.5	20.2	82.3	830.4	959.1	13.4	972.5
<b>Amortisation and impairment</b>								
At 1 January 2007	2.3	1.0	3.8	6.1	12.0	25.2	9.0	34.2
Amortisation during the year	1.6	1.1	0.9	6.1	–	9.7	1.5	11.2
At 31 December 2007	3.9	2.1	4.7	12.2	12.0	34.9	10.5	45.4
Amortisation during the year	2.1	2.1	1.8	12.6	–	18.6	1.5	20.1
At 31 December 2008	6.0	4.2	6.5	24.8	12.0	53.5	12.0	65.5
<b>Net book value</b>								
At 1 January 2007	3.6	1.0	3.1	28.5	589.4	625.6	4.4	630.0
At 31 December 2007	4.9	3.9	7.2	34.0	692.8	742.8	2.9	745.7
At 31 December 2008	5.7	10.3	13.7	57.5	818.4	905.6	1.4	907.0

During the year a total of £12.6m (2007: £3.4m) of intangible assets was recognised in respect of prior year acquisitions. This amount was previously reflected within goodwill. As required by IAS 12, deferred taxation is recognised in respect of these items, the impact of this was to increase goodwill in 2008 by £3.5m (2007: £1.0m) and to create a deferred tax liability of the same amount.

The amount in 'other intangibles' represents the consideration paid to AON to acquire the contract for the administration of the miners' personal injury liability claims on behalf of the Department of Energy and Climate Change.

### 14 Impairment of goodwill

Goodwill acquired through business combinations has been allocated for impairment testing purposes to the groups of cash generating units (CGUs) listed below. These represent the lowest level within the Group at which goodwill is monitored by management for internal reporting purposes.

The significant groups of CGUs identified are Property Consultancy, HR Solutions, Insurance & Specialist Services, Registrar Services, Financial Services, Life & Pensions and IT & Software Services. The remaining groups of CGUs are included in the 'balance of CGUs' column.

The recoverable amount of all the CGUs is based on a value in use calculation using cash flow projections based on the latest 1 year budget forecast extrapolated for 4 future years by a growth rate applicable to each unit; an appropriate terminal value based on a perpetuity calculation using nil real growth is then added. A discount rate of 10.0% (2007: 11.1%) is then applied to these projections.

Compound growth rates (years 2-5)	%
Property Consultancy	9.9
HR Solutions	9.9
Insurance & Specialist Services	4.3
Registrar Services	8.8
Financial Services	7.6
Life & Pensions	7.0
IT & Software Services	9.9
Balance of CGUs (weighted average growth rate)	6.6

The growth rates used do not exceed published industry estimates.

### Carrying amount of goodwill allocated to groups of cash generating units

	Property Consultancy £m	HR Solutions £m	Insurance Services £m	Registrar Services £m	Financial Services £m	Life & Pensions Services £m	IT & Software Services £m	Balance of CGUs £m	Total £m
2008									
Goodwill	49.7	91.3	236.9	116.4	56.9	91.7	83.9	91.6	818.4
2007									
Goodwill	45.1	91.3	219.7	114.9	57.0	78.9	26.9	59.0	692.8

## Notes to the consolidated financial statements

### 14 Impairment of goodwill (continued)

The key assumptions used in the impairment testing were as follows:

- profit before interest and taxation
- discount rates
- rates of growth in CGUs for the years 2 to 5.

#### Profit before interest and taxation

The profit before interest and taxation is based on the assumption that future margins will remain at the levels currently being achieved.

#### Discount rate

The discount rate reflects management's estimate of the gross cost of capital employed for the groups of CGUs listed above. This is the benchmark established to assess operating performance and to evaluate future capital investment proposals. The rate applied to all CGUs is the same across all units, this reflects the Group's funding arrangements where all units have equal access to the Group's treasury functions and borrowing lines to fund their operations. No unit demonstrates abnormal levels of risk or funding profile and therefore the discount rate applied is deemed to be justified.

#### Rates of growth in cash generating units beyond the budget period

Growth rate assumptions are based on, as far as possible, published industry research (Ovum 2008). Where the cash generating unit does not correspond directly with the research undertaken then the growth rate used is that of the nearest possible match in relation to the risks experienced within the associated market. The rates used are further cross-checked with the senior operational management of the units in question.

#### Goodwill impairment

Management believes that no reasonably possible change in the key assumptions above would cause any of the identified CGUs to become impaired.

### 15 Financial assets

<b>Current</b>	<b>2008 £m</b>	2007 £m
Cash flow hedges	4.1	0.9
Currency swaps in relation to US\$ denominated bonds	0.4	–
Interest rate swaps in relation to GBP denominated bonds	0.7	–
	<b>5.2</b>	0.9
	<b>2008 £m</b>	2007 £m
<b>Non Current financial assets</b>		
Available for sale investments <sup>1</sup>	0.3	0.3
Investment loan <sup>2</sup>	35.3	29.1
Financial assets at fair value through the income statement <sup>3</sup>	1.6	25.4
Cash flow hedges <sup>4</sup>	21.6	4.7
Currency swaps in relation to US\$ denominated bonds <sup>4</sup>	269.2	1.0
Interest rate swap in relation to GBP denominated bonds <sup>4</sup>	4.0	0.1
Investment in a joint venture <sup>5</sup>	0.4	–
	<b>332.4</b>	60.6

<sup>1</sup>Available for sale assets includes investments in unlisted ordinary shares. The unlisted ordinary shares, for which there is no immediately identifiable market and which have no fixed maturity date or coupon rate, are carried at cost less provision for any impairment.

<sup>2</sup>The Group has entered into a funding arrangement with Optima Legal Services Limited (OLSL) and during the year has provided it with an additional £6.2m (2007: £16.6m) to fund that company's acquisition of further volume legal services businesses. In addition, the Group entered into an option agreement to acquire the shares of OLSL for £1 in the event that Law Society rules are amended to allow the Group to own the shares in this type of legal services company. The Group believes that the option should be held at the fair value of £1 as the change in law society rules in favour of the Group is uncertain.

<sup>3</sup>Financial assets at fair value through the income statement include investments in units, held in the Group's insurance captives. The units are held in managed funds (comprising units of equities and other assets) which are traded with a quoted market price in an active market. An explanation of the Group's accounting policy with regard to these assets is contained in note 2(m) on page 85. During the year the Group made the decision to withdraw the funds invested in these assets, the remaining units were sold early in 2009, the Group therefore no longer holds units in these funds.

<sup>4</sup>The currency swaps are used to hedge the exposure to currency fluctuations on the Group's US dollar denominated bonds. The asset recognised is equal to the uplift in the fair value of the underlying bonds. The interest rate swap is used to hedge the fair value of the Group's GBP denominated bonds, and the asset recognised above is equal to the uplift in the fair value of the underlying bonds. Details of the interest rate swap, currency swaps and cash flow hedges are contained in note 24.

<sup>5</sup>The investment in a joint venture disclosed represents the Group's interest in a Syndicate (for which the Group provides administrative outsourcing services) operating in the Lloyd's Market, through its joint venture ownership of Cobex Corporate Member No 1 Limited (Cobex) in conjunction with the Group's insurance partners. During the year the Group added further assets and liabilities through the acquisition of further Lloyd's Market Syndicates. The Group's share of the net assets and liabilities of this Syndicate are set out in the following table.

**15 Financial assets (continued)**

	2008 £m	2007 £m
Investments	8.9	5.4
Reinsurance assets	9.6	5.7
Other debtors	2.8	2.6
Cash and cash equivalents	10.0	10.8
<b>Total assets</b>	<b>31.3</b>	<b>24.5</b>
Technical provisions	23.6	22.6
Other creditors	6.9	1.8
Accruals and deferred income	0.4	0.1
<b>Total liabilities</b>	<b>30.9</b>	<b>24.5</b>
<b>Net position</b>	<b>0.4</b>	<b>–</b>

The Group, through Capita Commercial Insurance Services Limited (CCIS), a wholly owned subsidiary, has a 50.1% holding in Cobex Corporate Member No 1 Limited (Cobex). In addition to the assets and liabilities of the underlying Syndicate, Cobex has in place a quota share arrangement with its insurance partners such that only 8.86% of any profit or loss declared by the Syndicate, in respect of Cobex, would be attributable to the Group.

The Group has no rights over the assets or liabilities of the Syndicate other than to the extent that it will receive distributed profits or contribute to relieve losses. The Group has in place a letter of credit amounting to £1.0m (2007: £0.5m) which is the maximum exposure that the Group has to losses generated within the Syndicate. The increase of £0.5m is with regard to the additional assets and liabilities added to the Syndicate during the year.

**16 Business combinations**

The Group made a number of acquisitions in 2008 which are shown in aggregate. The book and fair values of the assets acquired are disclosed in the table below:

	Book values £m	Fair value adjustments £m	Fair value to Group £m
Intangible assets	–	43.2	43.2
Property, plant and equipment	5.9	(0.5)	5.4
Deferred tax	1.5	–	1.5
Debtors	32.4	(2.8)	29.6
Cash and short term deposits	8.9	–	8.9
Creditors	(23.1)	(2.3)	(25.4)
Provisions	(0.5)	(2.2)	(2.7)
<b>Net assets</b>	<b>25.1</b>	<b>35.4</b>	<b>60.5</b>
Goodwill arising on acquisition			123.6
			<b>184.1</b>
Discharged by:			
Cash			180.6
Loan notes issued			3.5
			<b>184.1</b>

Included within the table above are net assets of IBS OPENSsystems Limited of £21.5m, including recognised intangible assets of £13.1m. The cash consideration paid was £74.9m with resulting goodwill of £53.4m. Intangible valuations relating to this acquisition have been performed on a provisional basis and the exercise will be completed in the subsequent year.

During the year deferred consideration of £9.1m was settled in respect of acquisitions made in prior years, £7.8m was paid in cash and the remainder of £1.3m through the issue of loan notes, of which £9.4m had been previously provided; the impact of this was to reduce goodwill by £0.3m.

As required by IAS 12 deferred taxation is calculated on intangible assets recognised as a result of an acquisition, the impact of this was to increase goodwill in 2008 by £11.4m and to create a deferred tax liability of the same amount.

As a result of the above total goodwill of £134.7m was recognised in the year.

Acquisitions in the year included IBS OPENSsystems plc (now known as IBS OPENSsystems Limited), ComputerLand UK PLC (now known as ComputerLand UK Limited), Lancaster Insurance Services Limited, Nieuwenhuis Services BV (now known as Capita Fiduciary BV), and ABS Network Solutions Limited. For all acquisitions in the year the Group acquired 100% of the issued share capital of the acquired company.

Within goodwill are certain intangibles that were not separable from the acquirees and could not be measured reliably. These items include customer loyalty and the assembled workforce.

The Group's acquisition of IBS OPENSsystems Limited is the subject of a referral by the Office of Fair Trading (OFT) to the Competition Commission under section 22(1) of the Enterprise Act 2002. The decision to refer this acquisition was made by the OFT on 19 November 2008, with the decision of the Competition Commission being anticipated in the first half of 2009.

## Notes to the consolidated financial statements

### 16 Business combinations (continued)

#### 2007 acquisitions

The Group made a number of acquisitions in 2007, of which only 2, the acquisition of Harry Weeks and CMGL Group are considered material and thus disclosed separately, the remainder are shown in aggregate. The book and fair values of the assets acquired are disclosed in the tables below:

	Book values £m	Fair value adjustments £m	Fair value to Group £m
<b>Harry Weeks (now known as Evolvi Rail Systems Limited)</b>			
Intangible assets	–	4.5	4.5
Property, plant and equipment	0.2	–	0.2
Deferred tax	0.3	–	0.3
Debtors	2.3	(0.4)	1.9
Cash and short term deposits	0.2	–	0.2
Creditors	(2.5)	(0.2)	(2.7)
Net assets	0.5	3.9	4.4
Goodwill arising on acquisition			18.1
			22.5
Discharged by:			
Cash			22.5

Harry Weeks includes Harry Weeks Travel & Leisure Group Limited, a business travel software provider via its Evolvi and Travelpackonline software products.

The Group acquired 100% of the ordinary share capital of Harry Weeks on 2 February 2007. From the date of acquisition to the comparative year end, Harry Weeks contributed £0.6m to the net profit after tax of the Group. Had the combination taken place at the beginning of 2007, the profit after tax of the Group in the comparative year would have been £166.1m and the revenue from continuing operations would have been £2,079.4m.

Within goodwill are certain intangibles that were not separable from the acquirees and could not be measured reliably. These items include customer loyalty and the assembled workforce.

	Book values £m	Fair value adjustments £m	Fair value to Group £m
<b>CMGL Group of companies</b>			
Intangible assets	–	7.4	7.4
Property, plant and equipment	0.5	–	0.5
Deferred tax	1.7	–	1.7
Debtors	3.7	–	3.7
Cash and short term deposits	(2.0)	–	(2.0)
Creditors	(9.7)	(1.2)	(10.9)
Long term debt	(6.9)	–	(6.9)
Corporation tax	(0.2)	–	(0.2)
Net assets	(12.9)	6.2	(6.7)
Goodwill arising on acquisition			27.0
			20.3
Discharged by:			
Cash			14.4
Loan notes			5.9
			20.3

CMGL Group is a leading provider of outsourced claims and insurance management services to FTSE quoted companies, general insurers, Lloyd's underwriters and London Market companies.

The Group acquired 100% of the ordinary share capital of CMGL on 31 March 2007. From the date of acquisition to the comparative year end, CMGL contributed £1.43m to the net profit after tax of the Group. Had the combination taken place at the beginning of 2007, the profit after tax of the Group in the comparative year would have been £163.7m and the revenue from continuing operations would have been £2,107.6m.

Within goodwill are certain intangibles that were not separable from the acquirees and could not be measured reliably. These items include customer loyalty and the assembled workforce.

**16 Business combinations (continued)**

	Book values £m	Fair value adjustments £m	Fair value to Group £m
<b>Other acquisitions</b>			
Intangible assets	–	3.2	3.2
Property, plant and equipment	0.8	–	0.8
Deferred tax	1.3	–	1.3
Debtors	6.2	0.2	6.4
Cash and short term deposits	6.2	–	6.2
Creditors	(12.8)	(0.4)	(13.2)
Net assets	1.7	3.0	4.7
Goodwill arising on acquisition			47.9
			52.6
Discharged by:			
Cash			52.6

During 2007 deferred consideration of £5.2m was paid in respect of acquisitions made in prior years, of which £4.5m had been previously provided. The impact of this was to increase goodwill by £0.7m.

Deferred consideration which is expected to be paid has been accrued in respect of acquisitions made in 2007 amounting to £7.8m. The impact of this is to increase goodwill by the same amount.

As required by IAS 12 deferred taxation is calculated on intangible assets recognised as a result of an acquisition. The impact of this was to increase goodwill in 2007 by £4.3m and to create a deferred tax liability of the same amount.

As a result of the above, total goodwill of £105.8m was recognised in the year.

Other acquisitions in the year included Aspen (Actuaries & Pension Consultants) Limited (now known as Capita Hartshead (Actuaries & Pension Consultants) Limited), Higham Dunnet Shaw Plc (now known as Capita Hartshead Solutions Limited), Global Fund Administration Limited (now known as Capita Financial Administrators (Gibraltar) Limited, M.V.R.A. Limited, Eagle Management Services Limited and CPFR Solutions Limited.

The performance of these acquisitions post their inclusion in the Group cannot be ascertained as they have been fully integrated within existing offerings.

Within goodwill are certain intangibles that were not separable from the acquirees and could not be measured reliably. These items include customer loyalty and the assembled workforce.

**17 Trade and other receivables**

	2008 £m	2007 £m
<b>Current</b>		
Trade receivables	306.6	245.9
Other receivables	37.2	29.5
Gross amounts due from customers on construction contracts	17.8	11.1
Prepayments and accrued income	222.0	169.9
	583.6	456.4
<b>Non-current</b>		
Other receivables	1.8	1.5
Prepayments and accrued income	6.3	9.6
	8.1	11.1

Trade receivables are non-interest bearing and are generally on 30 days' terms.

At 31 December 2008, trade receivables at a nominal value of £7.1m (2007: £4.2m) were impaired and fully provided for.

## Notes to the consolidated financial statements

### 17 Trade and other receivables (continued)

Movements in the provision for impairment of trade receivables were as follows:

	2008 £m	2007 £m
At 1 January	4.2	4.4
Charge for year	5.7	3.3
Amounts written off	(1.0)	(0.9)
Unused amounts reversed	(1.8)	(2.6)
	<b>7.1</b>	4.2

As at 31 December, the analysis of trade receivables that were past due but not impaired is as follows:

	Total £m	Neither past due nor impaired £m	Past due but not impaired			
			0–3 months £m	4–6 months £m	7–12 months £m	More than 12 months £m
<b>2008</b>	<b>306.6</b>	<b>245.6</b>	<b>52.6</b>	<b>8.4</b>	–	–
2007	245.9	197.4	42.7	5.8	–	–

The Group monitors the level of trade receivables on a monthly basis, continually assessing the risk of default by any counterparty.

### 18 Cash at bank and in hand

	2008 £m	2007 £m
Cash at bank and in hand	<b>86.7</b>	0.8

Cash at bank earns interest at floating rates based on daily bank deposit rates. The fair value of cash is the same as the carrying amount above.

### 19 Trade and other payables

	2008 £m	2007 £m
<b>Current</b>		
Trade payables	<b>111.3</b>	56.5
Other payables	<b>87.3</b>	83.3
Other taxes and social security	<b>60.8</b>	64.2
Gross amounts due to customers on construction contracts	<b>6.2</b>	2.1
Accruals and deferred income	<b>424.8</b>	338.4
Deferred consideration payable	–	12.4
	<b>690.4</b>	556.9
<b>Non-current</b>		
Accruals and deferred income	<b>9.6</b>	9.2
	<b>9.6</b>	9.2

Trade payables are non-interest bearing and are normally settled on terms agreed with suppliers.

### 20 Construction contracts

Presented in the table below are disclosures with regard to the Group's property consultancy business where the provision, as a sub-contractor, is architectural, structural or another service that results in the construction of a new asset.

	2008 £m	2007 £m
Contract revenue recognised in relation to construction contracts in the year	<b>152.4</b>	107.8
Aggregate costs incurred and recognised profits (less losses) to date	<b>180.5</b>	112.9
Gross amount due from customers for construction contracts	<b>17.8</b>	11.1
Gross amount due to customers on construction contracts	<b>6.2</b>	2.1

## 21 Financial liabilities

	Notes	2008 £m	2007 £m
<b>Current</b>			
Bank overdraft		–	46.1
Obligations under finance leases	22	–	0.2
Bonds		<b>101.3</b>	–
Unsecured loan notes		<b>3.7</b>	1.7
Asset-based securitised financing (see below)		<b>10.4</b>	9.7
Callable swaps		<b>1.1</b>	–
		<b>116.5</b>	57.7
<b>Non-current</b>			
Bonds		<b>851.8</b>	461.1
Currency swaps in relation to US\$ denominated bonds		–	19.1
Callable swaps		<b>30.9</b>	–
		<b>882.7</b>	480.2

The aggregate bond value above of £953.1m includes the GBP value of the US\$ denominated bonds at 31 December 2008. To remove the Group's exposure to currency fluctuations it has entered into currency swaps which effectively hedge any movement in the underlying bond fair value. The fair value of the currency swaps is disclosed in note 15 – Financial assets in the current year (2007: Financial liability – above).

The Group has insurance debtors which are subject to a securitisation agreement. The purpose of this arrangement is to securitise customer receivables, derived through the provision of instalment credit facilities to insurance customers of the Group. The Group sells these receivables, with no immediate effect on the income statement, for cash to a third party (Gresham in this case). Gresham takes on the rights and responsibilities of these receivables such that the terms of this agreement dictate that Gresham has no recourse to the Group beyond 14% of the total receivable securitised.

The obligations under finance leases are secured on the assets being financed. The bank overdraft, bonds and loan notes are unsecured. The bonds effectively bear a floating interest charge at a rate based on 6 month LIBOR.

Loan notes issued during the year amounted to £5.3m (2007: £5.9m), further loan notes of £nil (2007: £8.2m) were assumed through business acquisition and £3.3m (2007: £34.6m) were repaid. The interest rates attributable to the loan notes are fixed for each new issue. These rates ranged from 3.45% to 5.25%. The loan notes issued in the year bear interest at a weighted average rate, based on the Bank of England base rate. The outstanding loan notes totalling £3.7m are repayable on demand and have a final weighted average maturity of 1 year.

The Group has issued guaranteed unsecured bonds as follows:

Bond	Interest rate %	Denomination	Value £m	Maturity
<b>Issued 2002***</b>				
Series B	6.44	GBP*	55.0	20 June 2009
<b>Issued 2005***</b>				
Series A	0.525 above 6m LIBOR	GBP	50.0	28 September 2013
Series B	0.525 above 6m LIBOR	GBP	25.0	28 September 2015
<b>Issued 2008*</b>				
Series C	7.19	GBP	32.0	13 September 2015
Total of sterling denominated bonds			162.0	
			US\$m	
<b>Issued 2002***</b>				
Series A	6.10	US\$**	66.0	20 June 2009
Series C	6.47	US\$**	36.0	20 June 2012
<b>Issued 2006***</b>				
Series A	5.74	US\$**	60.0	28 June 2013
Series B	5.88	US\$**	130.0	28 June 2016
Series A	5.66	US\$**	11.0	13 September 2013
Series B	5.81	US\$**	74.0	13 September 2016
Series C	5.77	US\$**	60.0	13 September 2016
<b>Issued 2007***</b>				
Series A	5.57	US\$**	21.0	11 October 2014
Series B	5.88	US\$**	179.0	11 October 2017
<b>Issued 2008**</b>				
Series A	6.04	US\$**	80.0	13 September 2015
Series B	6.51	US\$**	256.0	13 September 2018
Total of US\$ denominated bonds			973.0	

All series are unsecured and rank pari passu in all respects apart from those detailed above.

\* The Group has entered into an interest rate swap to convert the interest cost to floating rate based on 6 month LIBOR.

\*\* The Group has entered into currency swaps for the US\$ issues to achieve a floating rate of interest based on 6 month LIBOR. Further disclosure on the Group's use of hedges is included in note 24 commencing on page 103.

\*\*\*Subsequently, the Group has entered a series of interest rate swaps to convert these issues from paying a floating rate based on 6 month LIBOR to fixed rates. See note 24 for further details of these callable swaps.

The issue costs incurred during the year amounted to £0.7m (2007: £0.3m). Issue costs are spread over the life of the bonds to their maturity. The unamortised balance of issue costs at the year end totalled £1.4m (2007: £0.8m).

## Notes to the consolidated financial statements

### 22 Obligations under leases and hire purchase contracts

#### *Obligations under finance leases and hire purchase contracts*

The Group uses finance leases and hire purchase contracts to acquire plant and machinery. These leases have terms of renewal and purchase options but no escalation clauses. Renewals are at the option of the lessee.

The value of future minimum lease payments and their present value, which are the same, is analysed as follows:

	2008 £m	2007 £m
Not later than 1 year	–	0.2
	–	0.2

#### *Operating lease agreements where the Group is lessee*

The Group has entered into commercial leases on certain properties, motor vehicles and items of plant and machinery. These leases have an average duration of between 3 and 10 years.

Future minimum rentals payable under non-cancellable operating leases are as follows:

	2008 £m	2007 £m
Not later than 1 year	59.2	55.4
Later than 1 year but not later than 5 years	158.0	139.3
Later than 5 years	23.0	80.7
	240.2	275.4

#### *Operating lease agreements where the Group is lessor*

The Group has determined that certain executory contracts contain embedded leases as defined by IFRIC 4 'Determining whether an Arrangement contains a Lease'. Accordingly, these are accounted for as leases in accordance with IAS 17 'Leases'.

Future minimum rentals receivable under these embedded operating leases are as follows:

	2008 £m	2007 £m
Not later than 1 year	–	1.5
Later than 1 year but not later than 5 years	–	–
	–	1.5

### 23 Provisions

	Property provision £m
At 1 January 2008	2.6
Utilisation	(0.7)
Additional provisions in the year	1.3
Unwinding of interest on discounted provisions	0.1
At 31 December 2008	3.3

The property provision is made on a discounted basis for the future rent expense and related cost of leasehold property (net of estimated sub-lease income) where the space is vacant or currently not planned to be used for ongoing operations. The expectation is that this expenditure will be incurred over the remaining periods of the leases which range from 1 to 6 years.

## 24 Financial instruments

### Financial risk management objectives and policies

The Group's principal financial instruments, other than derivatives, comprise bank loans, bond issues, loan notes, finance leases and cash. The main purpose of these financial instruments is to raise finance for the Group's operations. The Group also has various other financial instruments such as trade receivables and trade payables, which arise directly from its operations.

The Group also enters into derivative transactions, primarily interest rate swaps and forward currency contracts. The purpose is to manage the interest rate and currency risks arising from the Group's operations and its sources of finance. It is, and has been throughout the period under review, the Group's policy that no trading in financial instruments shall be undertaken.

The main risks arising from the Group's financial instruments are interest rate risk, foreign currency risk, credit risk and liquidity risk. The Board reviews and agrees policies for managing each of these risks and they are summarised below.

### Classification of financial instruments

The following table analyses by classification and category all of the Group's financial instruments (excluding short term debtors, creditors and cash in hand) that are carried in the financial statements. The values represent both the carrying amounts and the fair value.

	Available for sale £m	At fair value through the income statement £m	Loans and receivables £m	Derivatives used for hedging £m	Liabilities at amortised cost £m	Total £m
<b>At 31 December 2008</b>						
<b>Financial assets</b>						
Investments in units	–	1.6	–	–	–	1.6
Unlisted equity securities	0.3	–	–	–	–	0.3
Investment loan	–	–	35.3	–	–	35.3
Cash flow hedges	–	–	–	25.7	–	25.7
Interest rate swaps in relation to GBP denominated bonds	–	–	–	4.7	–	4.7
Currency swaps in relation to US\$ denominated bonds	–	–	–	269.6	–	269.6
Investment in joint venture	–	–	0.4	–	–	0.4
	0.3	1.6	35.7	300.0	–	337.6
<b>Financial liabilities</b>						
Unsecured loan notes	–	–	–	–	3.7	3.7
Bonds	–	–	953.1	–	–	953.1
Asset-based securitised financing	–	–	10.4	–	–	10.4
Callable swaps	–	32.0	–	–	–	32.0
	–	32.0	963.5	–	3.7	999.2

The aggregate bond value above of £953.1m includes the GBP value of the US\$ denominated bonds at 31 December 2008. To remove the Group's exposure to currency fluctuations it has entered into currency swaps which effectively hedge the movement in the underlying bond fair value. The interest rate swap is being used to hedge the exposure to changes in the fair value of GBP denominated bonds. The fair value of the currency and interest swaps are disclosed in note 15 – Financial assets in the current year.

	Available for sale £m	At fair value through the income statement £m	Loans and receivables £m	Derivatives used for hedging £m	Liabilities at amortised cost £m	Total £m
<b>At 31 December 2007</b>						
<b>Financial assets</b>						
Investments in units	–	25.4	–	–	–	25.4
Unlisted equity securities	0.3	–	–	–	–	0.3
Investment loan	–	–	29.1	–	–	29.1
Cash flow hedges	–	–	–	5.6	–	5.6
Interest rate swaps in relation to GBP denominated bonds	–	–	–	0.1	–	0.1
Currency swaps in relation to US\$ denominated bonds	–	–	–	1.0	–	1.0
	0.3	25.4	29.1	6.7	–	61.5
<b>Financial liabilities</b>						
Bank overdraft	–	–	46.1	–	–	46.1
Obligations under finance leases	–	–	–	–	0.2	0.2
Unsecured loan notes	–	–	–	–	1.7	1.7
Bonds	–	–	461.1	–	–	461.1
Asset-based securitised financing	–	–	9.7	–	–	9.7
Currency swaps in relation to US\$ denominated bonds	–	–	–	19.1	–	19.1
	–	–	516.9	19.1	1.9	537.9

The fair value of financial instruments has been calculated by discounting the expected future cash flows at prevailing interest rates, except for unlisted equity securities and investment loans. Unlisted equity securities and investment loans are held at amortised cost.

## Notes to the consolidated financial statements

### 24 Financial instruments (continued)

#### Interest rate risk

The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long term debt obligations with floating interest rates.

The Group's policy is to manage its interest cost using a mix of fixed and variable rate debts. To manage this, the Group enters into interest rate swaps, in which the Group agrees to exchange, at specified intervals, the difference between fixed and variable rate interest amounts calculated by reference to an agreed upon notional principal amount. These swaps are designated to hedge underlying debt obligations.

In February 2008, Capita executed a series of interest rate callable swaps to convert from paying a rate based on 6 month LIBOR to fixed rate interest on its bonds (private placement debt) of £479m as follows: firstly, in respect of the 2 tranches totaling £100m maturing in 2009, swaps at a fixed rate of 5.22%; secondly, in respect of all other tranches – maturing between 2012 and 2017 – callable swaps (giving the counterparty the option to cancel the trades in September/December 2009 and semi-annually thereafter) at a weighted average fixed rate of 4.64%. At this time, 6 month LIBOR was 5.625% and prevailing market expectations suggested that swap rates would not fall below 4.64%. At the time the transactions were entered into 4.64% was considered to represent good value as a long term cost of funds.

Following the dramatic fall in interest rates at the end of 2008 and an increase in the implied volatilities, these callable swaps show a negative mark to market value of £32m at 31 December 2008. This represents a non-cash accounting loss in the year that will reverse as the mark to market valuation will tend towards zero as the swaps approach maturity or cancellation.

In addition to the private placement debt of £479m referred to above, as at 31 December 2008 the Group had a further £200m of private placement debt and a £245m revolving credit facility, both of which pay floating rate interest. This gives the Group as a whole a balanced interest rate risk profile through the use of both fixed and floating rate debt.

The interest rate profile of the financial assets and liabilities of the Group as at 31 December is as follows:

At 31 December 2008	Within 1 year £m	Between 1–2 years £m	Between 2–3 years £m	Between 3–4 years £m	Between 4–5 years £m	More than 5 years £m	Total £m
<b>Fixed rate</b>							
Loan notes	3.7	–	–	–	–	–	3.7
Bonds	101.3	–	–	27.2	105.0	408.9	642.4
Interest rate swap in relation to GBP denominated bonds	(0.7)	–	–	–	–	–	(0.7)
Foreign currency swaps in relation to US\$ denominated bonds	(0.4)	–	–	(2.6)	(16.9)	(142.5)	(162.4)
Callable swaps	1.1	–	–	1.5	5.9	23.5	32.0
<b>Floating rate</b>							
Cash in hand	(86.7)	–	–	–	–	–	(86.7)
Investment loan	–	–	–	–	–	35.3	35.3
Assets available for sale	–	–	–	–	–	(0.3)	(0.3)
At fair value through income statement	(1.6)	–	–	–	–	–	(1.6)
Bonds	–	–	–	–	–	310.7	310.7
Asset-based securitised financing	10.4	–	–	–	–	–	10.4
Cash flow hedges	(4.1)	(1.6)	(3.5)	(2.3)	(2.7)	(11.5)	(25.7)
Interest rate swap in relation to GBP denominated bonds	–	–	–	–	–	(4.0)	(4.0)
Foreign currency swaps in relation to US\$ denominated bonds	–	–	–	–	–	(107.2)	(107.2)

The effect of the interest rate swap and the currency swap on the bond debt is disclosed below. Bonds are classified as floating rate for £200.2m due to the effect of the interest and currency swaps. The remainder of £480.0m is classified as fixed rate due to the additional impact of the callable swaps.

At 31 December 2007	Within 1 year £m	Between 1–2 years £m	Between 2–3 years £m	Between 3–4 years £m	Between 4–5 years £m	More than 5 years £m	Total £m
<b>Fixed rate</b>							
Loan notes	1.7	–	–	–	–	–	1.7
Obligations under finance leases	0.2	–	–	–	–	–	0.2
<b>Floating rate</b>							
Cash in hand	(0.8)	–	–	–	–	–	(0.8)
Overdrafts	46.1	–	–	–	–	–	46.1
Investment loan	–	–	–	–	–	(29.1)	(29.1)
Assets available for sale	–	(0.3)	–	–	–	–	(0.3)
At fair value through income statement	–	(25.4)	–	–	–	–	(25.4)
Bonds	–	88.4	–	–	18.7	354.0	461.1
Asset-based securitised financing	9.7	–	–	–	–	–	9.7
Cash flow hedges	(0.9)	(0.3)	(0.3)	(0.5)	(0.4)	(3.2)	(5.6)
Interest rate swap	–	(0.1)	–	–	–	–	(0.1)
Foreign currency swaps	–	–	–	–	–	(1.0)	(1.0)
Foreign currency swaps	–	11.8	–	–	6.0	1.3	19.1

## 24 Financial instruments (continued)

The following table demonstrates the sensitivity to a reasonably possible change in interest rates, with all other variables held constant, of the Group's profit before tax (through the impact on floating rate borrowings). There is no impact on the Group's equity.

	Increase/ (decrease) in basis points	Effect on profit before tax £m
<b>2008</b>	<b>146/(146)</b>	<b>(2.8)/2.8</b>
2007	125/(125)	(6.0)/6.0

### Foreign currency risk

The Group has exposure to foreign currency risk where it has investments in overseas operations which are affected by foreign exchange movements. The Group is not generally exposed to significant foreign currency risk except in respect of its overseas operations in India which generate exposure to movements in the INR/GBP exchange rates. The Group seeks to mitigate the effect of this exposure by entering forward currency contracts (in the form of Non-deliverable Forward Contracts (NDFs)) to fix the GBP cost of highly probable forecast transactions denominated in INR.

It is the Group's policy to negotiate the terms of the hedge derivatives to match the terms of the hedged items in order to maximise hedge effectiveness.

At 31 December 2008, the Group had cash flow hedges in place to match its forecast monthly INR costs in 2009 and each year up to and including 2019. These forecast INR costs have been determined on the basis of the underlying cash flows, associated with the delivery of services under signed contracts which run to 2019.

The following table demonstrates the sensitivity to a reasonably possible change in the INR/GBP exchange rate, with all other variables held constant, of the Group's profit before tax and the Group's equity due to changes in the fair value of the Group's forward exchange contracts.

	Increase/ (decrease) in INR exchange rate	Effect on profit before tax £m	Effect on equity £m
<b>2008</b>	<b>2.5%</b>	<b>-</b>	<b>6.3</b>
2007	8.2%	-	14.4

### Hedges

#### Fair value hedges

The Group has in issue fixed rate dollar and sterling bonds which it has hedged through a combination of interest rate and currency swaps.

At 31 December 2008 and 31 December 2007, the Group had an interest rate swap in place with a notional amount of £87.0m whereby it receives a fixed rate of interest of 6.44% and pays a variable rate based on 6 month LIBOR. The swap is being used to hedge the exposure to changes in the fair value of £87.0m of the Group's 6.44% bonds.

At December 2008 and December 2007, the Group had in place currency swaps whereby it receives a fixed rate of interest and pays a variable rate based on 6 month LIBOR. The currency swaps are being used to hedge the exposure to changes in the fair value of £518.2m of the Group's bonds, which have coupon rates ranging from 5.57% to 6.47%.

The swaps are being used to hedge the exposure to changes in the value of its US dollar issued bonds. The unsecured bonds, currency and interest rate swaps have the same critical terms including the amount and the date of maturity (see note 21). The Group may, at its option, upon notice of not less than 30 days and not more than 60 days, repay at any time all or part of the notes at no more than the present value of future payments. In addition, the Group has covenanted to maintain a specified consolidated leverage ratio and a consolidated net interest expense coverage ratio.

In February 2008, as noted above in the section on interest rate risk, the Group entered a series of callable interest rate swaps which have effectively fixed the interest rate on £480.0m of the Group's bonds; this includes £75.0m issued at floating rates in 2005 not mentioned as being hedged above. These callable swaps have not been designated as hedging instruments.

#### Cash flow hedges

As noted above, the Group holds a series of forward exchange currency contracts in the form of NDFs designated as hedges of highly probable forecast transactions in INR of the Group's Indian operations.

<b>Forward exchange contracts</b>	<b>Assets £m</b>	<b>2008 Liabilities £m</b>	<b>Assets £m</b>	<b>2007 Liabilities £m</b>
Fair value	<b>25.7</b>	<b>-</b>	5.6	-

The terms of the forward currency contracts have been negotiated to match the terms of the commitments.

The cash flow hedges in respect of the highly probable forecast monthly costs, based on long term contracts that the Group has in place, denominated in INR up to 2019 were assessed to be highly effective and as at 31 December 2008, a net unrealised gain of £25.7m (2007: £5.6m) less deferred tax of £7.2m (2007: £1.6m) was recognised in equity. The net gain recognised on cash flow hedges during the year was £20.9m (2007: £5.6m) whilst net gains of £0.8m (2007: £nil) were reclassified to the income statement and included in administrative expenses. The tax effect of the net movement in cash flow hedges during the year was a charge of £5.6m (2007: £1.6m).

## Notes to the consolidated financial statements

### 24 Financial instruments (continued)

#### Credit risk

The Group trades only with recognised, creditworthy third parties. It is the Group's policy that all customers who wish to trade on credit terms are subject to credit verification procedures. In addition, receivable balances are monitored on an ongoing basis with the result that the Group's exposure to bad debts is not significant.

With respect to credit risk arising from the other financial assets of the Group, which comprise cash and cash equivalents, available for sale financial investments, investment loan, financial assets at fair value through the income statement, investment in a joint venture and certain derivative instruments, the Group's exposure to credit risk arises from default of the counterparty, there is no concentration of counterparty risk and the Group takes all reasonable steps to seek assurance from the associated parties to ensure that it can manage any risk identified appropriately.

The Group has a maximum exposure equal to the carrying amount of the above receivables and instruments.

The Group has a master netting arrangement in respect of its banking facilities resulting in the legal right of set-off for its overdraft and cash balances.

#### Liquidity risk

The Group monitors its risk to a shortage of funds using a daily cash management process. This process considers the maturity of both the Group's financial investments and financial assets (e.g. accounts receivable, other financial assets) and projected cash flows from operations.

The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank overdrafts, bank loans, loan notes, bonds and finance leases.

The table below summarises the maturity profile of the Group's financial liabilities at 31 December 2008 based on contractual payments.

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
<b>At 31 December 2008</b>							
Loan notes	3.7	–	–	–	–	–	3.7
Bonds	101.3	–	–	27.2	105.0	719.6	953.1
Interest on above bonds	3.0	–	–	5.5	20.9	302.7	332.1
Asset-based securitised financing	10.4	–	–	–	–	–	10.4
Callable swaps	1.1	–	–	1.5	5.9	23.5	32.0
	<b>119.5</b>	<b>–</b>	<b>–</b>	<b>34.2</b>	<b>131.8</b>	<b>1,045.8</b>	<b>1,331.3</b>

	Within 1 year £m	Between 1-2 years £m	Between 2-3 years £m	Between 3-4 years £m	Between 4-5 years £m	More than 5 years £m	Total £m
<b>At 31 December 2007</b>							
Loan notes	1.7	–	–	–	–	–	1.7
Obligations under finance leases	0.2	–	–	–	–	–	0.2
Overdrafts	46.1	–	–	–	–	–	46.1
Bonds	–	88.4	–	–	18.7	354.0	461.1
Asset-based securitised financing	9.7	–	–	–	–	–	9.7
Foreign currency swaps	–	11.8	–	–	6.0	1.3	19.1
	<b>57.7</b>	<b>100.2</b>	<b>–</b>	<b>–</b>	<b>24.7</b>	<b>355.3</b>	<b>537.9</b>

#### Capital management

The primary objective of the Group's capital management is to ensure that it maintains a strong credit rating and healthy capital ratios to support its business and maximise shareholder value.

The Group manages its capital structure, and makes adjustments to it, in the light of changes in economic conditions. To maintain or adjust the capital structure, the Group may adjust the dividend payment to shareholders, return capital to shareholders or issue new shares. No changes were made in the objectives, policies or processes during the years ended 31 December 2008 and 31 December 2007.

The Group does not set a target level of gearing but uses capital opportunistically to add value for shareholders. The key discipline adopted by the Group is to widen the margin between the return on capital employed and the cost of that capital as shown in the business review on page 30.

The table below presents quantitative data for the components the Group manages as capital:

	2008 £m	2007 £m
Shareholders' funds	396.9	331.8
Bank overdraft	–	46.1
Cash in hand	(86.7)	(0.8)
Unsecured loan notes	3.7	1.7
Obligations under finance leases	–	0.2
Bonds	953.1	461.1
Currency and interest rate swaps	(274.3)	18.0
At 31 December	<b>992.7</b>	<b>858.1</b>

## 25 Authorised and issued share capital

	2008 Million	2007 Million	2008 £m	2007 £m
<b>Authorised</b>				
Ordinary shares of 2 1/15p	967.7	967.7	20.0	20.0
<b>Allotted, called up and fully paid</b>				
Ordinary shares of 2 1/15p each (pre 14 September 2007: ordinary shares of 2p each)				
At 1 January – ordinary shares of 2 1/15p each (2007: 2p each)	609.0	617.6	12.6	12.3
Shares repurchased – ordinary shares of 2p each	–	(6.6)	–	(0.1)
Issued on exercise of share options – ordinary shares of 2p each	–	7.9	–	0.2
Reduction in issued shares on consolidation – see below	–	(20.0)	–	–
Issued on exercise of share options – ordinary shares of 2 1/15p each	12.2	10.1	0.2	0.2
At 31 December – ordinary shares of 2 1/15p	621.2	609.0	12.8	12.6

In September 2007, The Capita Group Plc, by ordinary resolution, approved a share consolidation whereby shareholders on the register on 14 September 2007 exchanged 31 existing ordinary shares of 2p for 30 new ordinary shares of 2 1/15p each. The effect of the share consolidation was to reduce the authorised share capital of the company to 967,741,920 ordinary shares of 2 1/15p each and to reduce the number of shares in issue by 20m.

During the year the Group repurchased 10.4m ordinary 2 1/15p shares with an aggregate nominal value of £0.2m at a total cost of £68.4m for which it paid cash at an average cost per share of £6.58. There were additional expenses of acquiring the shares of £0.4m in the year. These shares were held in the Capita Employee Benefit Trust at 31 December 2008.

During the year 12.2m ordinary 2 1/15p shares with an aggregate nominal value of £0.2m were issued under share option schemes for a total consideration of £35.7m.

	2008 Million	2007 Million	2008 £m	2007 £m
<b>Treasury shares</b>				
Ordinary shares of 2 1/15p				
At 1 January	–	–	–	–
Shares repurchased – ordinary 2 1/15p shares	10.4	–	0.2	–
Shares transferred to Employee Benefit Trust	(10.4)	–	(0.2)	–
At 31 December – ordinary shares of 2 1/15p	–	–	–	–

	2008 Million	2007 Million	2008 £m	2007 £m
<b>Employee Benefit Trust shares</b>				
Ordinary shares of 2 1/15p				
At 1 January	–	–	–	–
Shares transferred from treasury	10.4	–	0.2	–
At 31 December – ordinary shares of 2 1/15p	10.4	–	0.2	–

The Group will use shares held in the Employee Benefit Trust to satisfy future requirements for shares under the Group's share option and long term investment plans.

The Group has an unexpired authority to repurchase up to 10% of its issued share capital.

## 26 Share based payment plans

The Group operates several share based payment plans as follows:

### Deferred Annual Bonus Plan

This scheme is applicable to Executive Directors and Divisional Executive Directors. Under this scheme awards are made annually consisting of Deferred Shares, which are linked to the payout under the Annual Bonus Scheme (details of which are contained in the Directors' remuneration report) and Matching Shares. The value of Deferred Shares is determined by the payout under the Annual Bonus Scheme: half of the annual bonus is paid in cash and the remainder is compulsorily deferred on a gross basis into Deferred Shares. The Deferred Shares are held for a period of 3 years from the date of award during which they are not forfeitable, except in the case of dismissal for gross misconduct.

A conditional award of Matching Shares is made at the same time as the award of Deferred Shares. Participants will be eligible to receive up to 1.5 Matching Shares for every Deferred Share. Matching Shares will vest after the 3 year holding period to the extent to which performance conditions have been met. 33.3% of the Matching Shares will vest if growth in the Company's earnings per share (EPS) is equal to growth in the UK Retail Price Index (RPI) plus 6% per annum, rising on a straight-line basis to 100% vesting if growth in the Company's EPS is equal to or greater than growth in the RPI plus 16% per annum. The performance condition attached to the awards may be amended by the Group Remuneration Committee, a sub-committee of the Group Board, from time to time, subject to the new condition being no less demanding than the original condition.

### Long Term Incentive Plan (2008 LTIP)

The 2008 LTIP was approved and adopted at the AGM on 6 May 2008. The vesting of awards made during 2008 will depend on share price growth and EPS growth targets measured over a 3 year period. An award will not vest if the Capita's average share price at the date of vesting is below the average share price at the date of grant. This scheme is open to all senior employees and shares will vest according to performance criteria. The number of shares which will vest is dependent upon the Company's EPS growth exceeding RPI growth by 4% and on banding within the scheme.

## Notes to the consolidated financial statements

### 26 Share based payment plans (continued)

#### Long Term Indexed Share Appreciation Scheme (LTISAS)

The LTISAS was only open to the Executive Directors and the Divisional Executive Directors. Under the scheme, participants were provided with 2 equal tranches of 600,000 options. The criteria were the same for each of these grants and therefore both tranches had performance periods that ended on 31 December 2006. The exercise price of the option was restated in line with the FTSE All Share Index from the date of grant to 25 November 2007. The restated exercise prices were £3.48 for the 2002 award and £4.74 for the 2004 award. This feature ensured that participants only gained if the share price out-performed the index. Options became exercisable, over the performance period, subject to the growth in the Company's EPS exceeding certain targets as follows:

As growth in the Company's EPS over the 3 year period to 31 December 2006 exceeded RPI growth by 17.6%, 100% of the options vested (representing 1,200,000 shares per participant) and became exercisable on 25 November 2007.

The last award under the LTISAS was made in November 2004 and vested in full on 31 December 2006 and no further awards will be made under this plan.

#### Long Term Investment Plan (LTIP)

Awards under the LTIP were structured either as Restricted Share Awards or Indexed Performance Share Appreciation Rights (IPSARs). The last Restricted Share Awards and awards of IPSARs vested in full in May 2001 and 2003 respectively. The performance requirements were met in full on those dates and the IPSARs are exercisable at £1.69. No further awards were made under the LTIP and only 1 award of IPSARs was made.

#### 1997 Executive Share Option Scheme

This scheme is open to senior employees other than Executive Directors and Divisional Executive Directors. The exercise price of the options is equal to the market price of the shares on the date of grant. Options granted under this scheme become exercisable if the growth in the Company's EPS exceeds the growth in RPI by 8% over the 3 year vesting period from the date of grant. The contractual life of each option granted is 7 years. There are no cash settlement alternatives.

#### Capita Sharesave Scheme

This is an employee Save As You Earn scheme open to all Capita employees. Under this scheme, employees are granted share options at a discount to the market price at the date of grant. The discount is currently nil (2007: nil; 2006: nil; 2005: 10% and 20% prior to 2005). The options become exercisable for a 6 month period following completion of a 3 or 5 year savings period. There are no performance conditions attached to these options.

The expense recognised for share based payments in respect of employee services received during the year to 31 December 2008 was £9.2m (2007: £8.6m), all of which arises from equity-settled share based payment transactions.

The following table illustrates the number and weighted average exercise prices (WAEP) of, and movements in, share options during the year (excluding Deferred Annual Bonus Plan, LTISAS and IPSARs), which are shown separately.

#### Share options (1997 Executive Share Option Scheme and Capita Sharesave Scheme)

	2008 Million	2008 WAEP	2007 Million	2007 WAEP
Outstanding as at 1 January	20.6	£4.54	28.9	£3.65
Granted during the year	1.6	£7.04	5.5	£6.89
Exercised	(6.7)	£3.88	(10.8)	£3.54
Forfeited	(1.3)	£5.65	(2.8)	£3.91
Expired during the year	(0.1)	£4.57	(0.2)	£4.07
Outstanding as at 31 December <sup>1</sup>	14.1	£5.05	20.6	£4.54
Exercisable at 31 December	3.3	£3.29	4.8	£3.45

<sup>1</sup>Included within this balance are options over 0.8m (2007: 6.4m) shares that have not been recognised in accordance with IFRS 2 as the options were granted on or before 7 November 2002. These options have not been subsequently modified and therefore do not need to be accounted for in accordance with IFRS 2.

The options have been exercised on a regular basis throughout the year and the weighted average share price during the year was £6.76 (2007: £7.03).

#### 2008 LTIP

	2008 Million	2008 WAEP	2007 Million	2007 WAEP
Awarded during the year	1.9	–	–	–
Forfeited	(0.1)	–	–	–
Outstanding as at 31 December	1.8	–	–	–
Exercisable at 31 December	–	–	–	–

**26 Share based payment plans (continued)****LTISAS**

	2008 Million	2008 WAEP	2007 Million	2007 WAEP
Outstanding as at 1 January	3.5	£4.32	10.7	£4.11
Exercised	(2.4)	£4.12	(7.2)	£4.01
Outstanding as at 31 December	1.1	£4.74	3.5	£4.32
Exercisable at 31 December	1.1	£4.74	3.5	£4.32

The options were exercised at a weighted average price of £7.16 (2007: £7.10).

Under the LTISAS scheme two tranches of 600,000 share options have been issued to each participant in the scheme. Both were deemed to have been granted in November 2002. The first tranche, totalling 5,400,000 share options, was awarded and issued in November 2002 when the share price was £2.16. The second tranche, also totalling 5,400,000 share options, was awarded in November 2002 and issued in November 2004 when the share price was £3.51. Both tranches of share options became exercisable on 25 November 2007, with a weighted average exercise price of £4.11.

**IPSARS**

	2008 Million	2008 WAEP	2007 Million	2007 WAEP
Outstanding as at 1 January	2.4	£1.69	2.4	£1.69
Exercised	(2.4)	£1.69	–	–
Outstanding as at 31 December	–	–	2.4	£1.69
Exercisable at 31 December	–	–	2.4	£1.69

The options were exercised at a weighted average price of £6.81 (2007: n/a).

The total cash value of the Deferred Shares awarded during the year under the Deferred Annual Bonus plan, discussed above, was £1.7m (2007: £1.5m). The Matching Shares allocation in respect of the 2007 awards under this plan charged in 2008 was £0.6m (2007: £0.6m).

The weighted average fair value of options granted during the year was £2.69 (2007: £1.11). The range of exercise prices for all options outstanding at the end of the year was £1.88 to £7.33 (2007: £1.88 to £7.33).

The fair value of equity-settled share options granted is estimated as at the date of grant using a multiple simulation option pricing valuation model, taking into account the terms and conditions upon which the options were granted. The following table lists the inputs to the model used for the years ended 31 December 2008 and 31 December 2007.

	2008	2007
Dividend yield (%)	1.5	1.5
Expected share price volatility (%)	22.41	19.00
Risk free interest rate (%)	4.64	4.97
Expected life of option (years)	3.10	3.62
Weighted average share price of options granted during the year	£7.04	£6.89

The expected life of the options is based on historical data and is not necessarily indicative of exercise patterns that may occur. The expected volatility reflects the assumption that the historical volatility is indicative of future trends, which may also not necessarily be the actual outcome. No other features of options grant were incorporated into the measurement of fair value.

## Notes to the consolidated financial statements

### 27 Reconciliation of movements in equity

	Share capital £m	Share premium £m	Employee Benefit Trust shares £m	Capital redemption reserve £m	Retained earnings £m	Foreign currency translation reserve £m	Net unrealised gains reserve £m	Total equity £m	Minority interests £m	Total £m
At 1 January 2007	12.3	308.1	–	1.7	4.0	(0.4)	–	325.7	0.1	325.8
Total recognised income and expense for the year	–	–	–	–	188.2	1.1	4.0	193.3	–	193.3
Share based payment	–	–	–	–	8.6	–	–	8.6	–	8.6
Purchase of own shares – cancelled	(0.1)	–	–	0.1	(43.6)	–	–	(43.6)	–	(43.6)
Transferred to goodwill on purchase of minority interest	–	–	–	–	–	–	–	–	(0.1)	(0.1)
Share transaction costs	–	–	–	–	(0.5)	–	–	(0.5)	–	(0.5)
Shares issued	0.4	66.8	–	–	–	–	–	67.2	–	67.2
Treasury shares purchased	–	–	–	–	(0.3)	–	–	(0.3)	–	(0.3)
Equity dividends paid	–	–	–	–	(218.6)	–	–	(218.6)	–	(218.6)
At 1 January 2008	12.6	374.9	–	1.8	(62.2)	0.7	4.0	331.8	–	331.8
Total recognised income and expense for the year	–	–	–	–	146.6	5.9	14.5	167.0	–	167.0
Share based payment	–	–	–	–	9.2	–	–	9.2	–	9.2
Share transaction costs	–	–	–	–	(0.4)	–	–	(0.4)	–	(0.4)
Shares issued	0.2	35.5	–	–	–	–	–	35.7	–	35.7
Employee benefit trust shares purchased	–	–	(0.2)	–	(68.2)	–	–	(68.4)	–	(68.4)
Equity dividends paid	–	–	–	–	(78.0)	–	–	(78.0)	–	(78.0)
At 31 December 2008	12.8	410.4	(0.2)	1.8	(53.0)	6.6	18.5	396.9	–	396.9

**Share capital** – The balance classified as share capital is the nominal proceeds on issue of the Company's equity share capital, comprising 2<sup>1</sup>/<sub>15</sub>p ordinary shares.

**Share premium** – The amount paid to the Company by shareholders, in cash or other consideration, over and above the nominal value of shares issued to them.

**Employee Benefit Trust shares** – Shares that have been bought back by the Company, which are available for retirement or resale; shares held in the Employee Benefit Trust have no voting rights and do not have entitlement to a dividend.

**Capital redemption reserve** – The Company can redeem shares by repaying the nominal value to the shareholder, whereupon the shares are cancelled. Redemption must be from distributable profits.

**Foreign currency translation reserve** – Gains or losses resulting from the process of expressing amounts denominated or measured in 1 currency in terms of another currency by use of the exchange rate between the 2 currencies. This process is required to consolidate the financial statements of foreign affiliates into the total Group financial statements and to recognise the conversion of foreign currency or the settlement of a receivable or payable denominated in foreign currency at a rate different from that at which the item is recorded.

**Net unrealised gains reserve** – This reserve records the portion of the gain or loss on a hedging instrument in a cash flow hedge that is determined to be an effective hedge. Also recorded here are fair value changes on available for sale investments.

**Retained earnings** – Net profits kept to accumulate in the Group after dividends are paid and retained in the business as working capital.

**28 Additional cash flow information****Reconciliation of net cash flow to movement in net funds/(debt)**

	Net debt at 1 January 2008 £m	Acquisitions in 2008 (exc. cash) £m	Cash flow movements £m	Non-cash flow movements £m	Net debt at 31 December 2008 £m
Cash and cash equivalents	0.8	–	85.9	–	86.7
Overdrafts	(46.1)	–	46.1	–	–
Cash	(45.3)	–	132.0	–	86.7
Loan notes	(1.7)	–	3.3	(5.3)	(3.7)
Bonds <sup>†</sup>	(461.1)	–	(199.5)	(292.5)	(953.1)
Currency swaps in relation to US\$ denominated bonds <sup>†</sup>	(18.1)	–	–	287.7	269.6
Interest rate swaps in relation to GBP denominated bonds <sup>†</sup>	0.1	–	–	4.6	4.7
Finance leases	(0.2)	–	0.2	–	–
Sub-total net debt	(526.3)	–	(64.0)	(5.5)	(595.8)
Asset based securitised finance*	(9.7)	–	(0.7)	–	(10.4)
Callable swaps	–	–	–	(32.0)	(32.0)
	(536.0)	–	(64.7)	(37.5)	(638.2)

The aggregate bond fair value above of £953.1m (disclosed in note 21 – Financial liabilities) includes the GBP value of the US\$ denominated bonds at 31 December 2008. To remove the Group's exposure to currency fluctuations it has entered into currency swaps which effectively hedge the movement in the underlying bond fair value. The interest rate swap is being used to hedge the exposure to changes in the fair value of GBP denominated bonds. The combined fair value of the swaps, of £274.3m, is disclosed in note 15 – Financial assets.

<sup>†</sup>The sum of these items held at fair value equates to the underlying value of the Group's bond debt of £678.8m.

\*The asset based securitised finance movement represents the net movement on the underlying balances with customers.

	Notes	Net debt at 1 January 2007 £m	Acquisitions in 2007 (exc. cash) £m	Cash flow movements £m	Non-cash flow movements £m	Net debt at 31 December 2007 £m
Cash and cash equivalents		9.7	–	(8.9)	–	0.8
Overdrafts		(0.5)	–	(45.6)	–	(46.1)
Cash		9.2	–	(54.5)	–	(45.3)
Loan notes		(22.2)	–	26.4	(5.9)	(1.7)
Long term debt		–	(8.2)	8.2	–	–
Bonds		(372.0)	–	(100.6)	11.5	(461.1)
Currency swaps in relation to US\$ denominated bonds		(6.4)	–	–	(11.7)	(18.1)
Interest rate swaps in relation to GBP denominated bonds		–	–	–	0.1	0.1
Finance leases		(0.5)	(0.1)	0.4	–	(0.2)
Sub-total net debt		(391.9)	(8.3)	(120.1)	(6.0)	(526.3)
Asset based securitised finance	21	(27.5)	–	17.8	–	(9.7)
		(419.4)	(8.3)	(102.3)	(6.0)	(536.0)

**29 Capital commitments**

At 31 December 2008, amounts contracted for but not provided in the financial statements for the acquisition of property, plant and equipment amounted to £0.7m (2007: £0.9m).

**30 Contingent liabilities**

(a) The Group has provided, through the normal course of its business, performance bonds and bank guarantees of £51.4m (2007: £37.9m).

(b) Further consideration may be due, dependent on certain performance criteria, on acquisitions completed by the Group in 2005 up to a maximum of £0.3m.

(c) Further consideration may be due, dependent on certain performance criteria, on acquisitions completed by the Group in 2007 up to a maximum of £21.9m.

(d) Further consideration may be due, dependent on certain performance criteria, on acquisitions completed by the Group in 2008 up to a maximum of £17.0m.

## Notes to the consolidated financial statements

### 31 Pensions

The Group operates both defined benefit and defined contribution pension schemes. These pension schemes are funded and contributions are made to separate trustee-administered funds. The assets of the pension schemes are held separately from the Group.

The pension charge for the defined contribution pension schemes for the year is £26.7m (2007: £21.8m).

In 2008 there was one main defined benefit pension scheme where the Group was the sole employing sponsor: The Capita Pension and Life Assurance Scheme (Capita scheme). Grouped together under 'Other schemes' are smaller arrangements: 1 scheme where the Group is the sole employing sponsor; allocated sections of 2 multi-employer schemes in which the Group is a participating employer; an allocated section in an industry wide scheme; and several schemes to which the Group makes contributions under Admitted Body status to our customers' defined benefit pension schemes in respect of certain TUPE employees.

For the Admitted Body schemes, which are all part of the Local Government Pension Scheme, the Group will only participate in the schemes for a finite period up to the end of the contracts. The Group is required to pay regular contributions as decided by the respective Scheme Actuary and as detailed in each schemes' Schedule of Contributions. In addition, for some schemes, the Group will be required to pay any deficit (as determined by the respective Scheme Actuary) that is remaining for the notional section of the scheme at the end of the contract.

The assets and liabilities of the defined benefit pension schemes (excluding additional voluntary contributions) as at 31 December are:

	Capita scheme £m	Other schemes £m	Group total £m
<b>At 31 December 2008</b>			
<b>Scheme assets at fair value:</b>			
Equities/hedge funds/absolute returns	206.6	68.3	274.9
Bonds	66.7	29.9	96.6
Property	15.9	6.5	22.4
Insurance contracts	3.2	0.2	3.4
Cash/other	25.4	4.7	30.1
Total	317.8	109.6	427.4
<b>Present value of scheme liabilities</b>	<b>(320.2)</b>	<b>(131.7)</b>	<b>(451.9)</b>
<b>Net asset/(liability)</b>	<b>(2.4)</b>	<b>(22.1)</b>	<b>(24.5)</b>
<b>At 31 December 2007</b>			
<b>Scheme assets at fair value:</b>			
Equities/hedge funds/absolute returns	248.9	85.1	334.0
Bonds	56.1	33.6	89.7
Property	17.5	8.8	26.3
Insurance contracts	3.5	0.5	4.0
Cash/other	24.5	9.6	34.1
Total	350.5	137.6	488.1
<b>Present value of scheme liabilities</b>	<b>(330.2)</b>	<b>(153.5)</b>	<b>(483.7)</b>
<b>Net asset/(liability)</b>	<b>20.3</b>	<b>(15.9)</b>	<b>4.4</b>

The pension schemes have not invested in any of the Group's own financial instruments nor in properties or other assets used by the Group.

**31 Pensions (continued)**

The amounts recognised in the consolidated income statement and in the consolidated statement of recognised income and expense for the year are analysed as follows:

	Capita scheme £m	Other schemes £m	Group total £m
<b>Year ended 31 December 2008</b>			
<b>Recognised in the income statement:</b>			
Current service cost	21.6	3.2	24.8
Past service cost	0.7	–	0.7
Recognised in arriving at operating profit	22.3	3.2	25.5
Expected return on scheme assets	(25.6)	(9.5)	(35.1)
Interest cost on scheme liabilities	19.8	9.1	28.9
Net finance cost included in administrative expenses	(5.8)	(0.4)	(6.2)
Total defined benefit charge	16.5	2.8	19.3
<b>Taken to the statement of recognised income and expense:</b>			
Actual return on scheme assets	(67.1)	(30.6)	(97.7)
Less: expected return on scheme assets	(25.6)	(9.5)	(35.1)
	(92.7)	(40.1)	(132.8)
Other actuarial gains	52.1	32.6	84.7
Actuarial losses recognised in the statement of recognised income and expense	(40.6)	(7.5)	(48.1)

Of the total service cost charge of £25.5m, £19.8m was included in cost of sales and £5.7m was included in administrative expenses.

	Capita scheme £m	Other schemes £m	Group total £m
<b>Year ended 31 December 2007</b>			
<b>Recognised in the income statement:</b>			
Current service cost	17.9	2.1	20.0
Past service cost	1.3	0.2	1.5
Recognised in arriving at operating profit	19.2	2.3	21.5
Expected return on scheme assets	(22.8)	(8.3)	(31.1)
Interest cost on scheme liabilities	17.4	7.4	24.8
Net finance cost included in administrative expenses	(5.4)	(0.9)	(6.3)
Total defined benefit charge	13.8	1.4	15.2
<b>Taken to the statement of recognised income and expense:</b>			
Actual return on scheme assets	18.5	8.0	26.5
Less: expected return on scheme assets	(22.8)	(8.3)	(31.1)
	(4.3)	(0.3)	(4.6)
Other actuarial gains	28.4	1.6	30.0
Actuarial gains recognised in the statement of recognised income and expense	24.1	1.3	25.4

Of the total service cost charge of £21.5m, £16.7m was included in cost of sales and £4.8m was included in administrative expenses.

Pension contributions are determined based on the advice of qualified independent actuaries. The Group made special additional cash contributions to the Capita scheme of £10m in December 2008 and £40m in January 2009 as a result of the outcome of the full formal valuation.

Formal valuations of the Capita scheme and the FPS scheme were carried out as at 6 April 2005 and 31 March 2005 respectively. For the other schemes, the latest formal valuations were carried out as at either 1 April 2004, 31 December 2006 or 31 March 2007. The latest triennial formal valuation for the Capita scheme as at 6 April 2008 has been prepared and approval by the scheme's trustees is expected shortly (the indicative valuation on the statutory funding objective basis is a deficit of £26.0m). These valuations are updated by qualified independent actuaries at each balance sheet date. Scheme assets are stated at their market valuations at each respective balance sheet date.

The assumption for the expected long term rate of return on assets has been derived by considering the current level of expected returns on risk-free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the portfolio is invested and the expectations for future returns of each asset class. The expected return for each asset was then weighted based on the target asset allocation to develop the assumption for the expected long term rate of return on assets for the portfolio.

## Notes to the consolidated financial statements

## 31 Pensions (continued)

	Capita scheme		Other schemes	
	2008 %	2007 %	2008 %	2007 %
<b>Main assumptions:</b>				
Rate of price inflation	2.7	3.2	2.7	3.2
Rate of salary increase	3.7	4.2	3.7	4.2
Rate of increase of pensions in payment <sup>1</sup> :				
– inflation capped at 5%	2.6	3.2	2.6	3.2
– inflation capped at 2.5%	2.0	2.3	2.0	2.3
Discount rate	6.2	5.9	6.2	5.9
Expected rates of return on scheme assets (net of scheme expenses):				
Equities/hedge funds/absolute returns	5.6 to 7.7	7.6	5.6 to 7.7	7.6
Bonds	5.7	5.2	4.6 to 6.2	5.0 to 5.5
Property	4.6	7.6	4.6	7.6
Insurance contracts	6.2	5.9	6.2	5.9
Cash/other	2.0	5.5	2.0	5.5
Expected take up of extended limits of tax free cash due to A day legislation	50.0	50.0	50.0 <sup>2</sup>	50.0 <sup>2</sup>

Post retirement mortality	Capita scheme		Other schemes <sup>3</sup>	
	2008	2007	2008	2007
– Current pensioners	PA92 MC (YOB) rated up 1 year, 0.5% p.a. minimum improvement	PA92 MC (YOB) rated up 2 years	PA92 MC (YOB) rated up 1 year, 0.5% p.a. minimum improvement	PA92 MC (YOB) rated up 2 years
– Future pensioners	PA92 MC (YOB) rated up 1 year, 0.5% p.a. minimum improvement	PA92 MC (YOB) rated up 2 years	PA92 MC (YOB) rated up 1 year, 0.5% p.a. minimum improvement	PA92 MC (YOB) rated up 2 years

Mortality tables above are independently prepared and published.

<sup>1</sup>There are other levels of pension increase which apply to particular periods of membership.

<sup>2</sup>This does not apply to the Admitted Body Schemes where no allowance for the extended limits is taken.

<sup>3</sup>This does not apply to the Admitted Body schemes.

Changes in the present value of the defined benefit pension obligations are analysed as follows:

	Capita scheme £m	Other schemes £m	Group total £m
As at 1 January 2007	328.8	141.8	470.6
Current service cost	17.9	2.1	20.0
Past service cost	1.3	0.2	1.5
Interest cost	17.4	7.4	24.8
Benefits paid	(8.1)	(3.3)	(11.4)
Actuarial gains and losses	(28.4)	(1.6)	(30.0)
Contributions by employees	0.3	1.1	1.4
Contract bulk transfers/change in classification of plans	1.0	5.8	6.8
As at 31 December 2007	330.2	153.5	483.7
Current service cost	21.6	3.2	24.8
Past service cost	0.7	–	0.7
Interest cost	19.8	9.1	28.9
Benefits paid	(9.5)	(2.8)	(12.3)
Actuarial gains and losses	(52.1)	(32.6)	(84.7)
Contributions by employees	0.3	1.3	1.6
Contract bulk transfers/change in classification of plans	9.2	–	9.2
As at 31 December 2008	320.2	131.7	451.9

The defined benefit obligation comprises £451.9m (2007: £483.7m) arising from schemes that are wholly or partly funded.

**31 Pensions (continued)**

Changes in the fair value of scheme assets are analysed as follows:

	Capita scheme £m	Other schemes £m	Group total £m
As at 1 January 2007	321.4	122.4	443.8
Expected return on scheme assets	22.8	8.3	31.1
Contract bulk transfers/business combinations	1.0	5.8	6.8
Employer contributions	17.4	3.6	21.0
Contributions by employees	0.3	1.1	1.4
Benefits paid	(8.1)	(3.3)	(11.4)
Actuarial gains and losses	(4.3)	(0.3)	(4.6)
As at 31 December 2007	350.5	137.6	488.1
Expected return on scheme assets	<b>25.6</b>	<b>9.5</b>	<b>35.1</b>
Contract bulk transfers/business combinations	<b>9.2</b>	<b>-</b>	<b>9.2</b>
Employer contributions	<b>34.4</b>	<b>4.1</b>	<b>38.5</b>
Contributions by employees	<b>0.3</b>	<b>1.3</b>	<b>1.6</b>
Benefits paid	<b>(9.5)</b>	<b>(2.8)</b>	<b>(12.3)</b>
Actuarial gains and losses	<b>(92.7)</b>	<b>(40.1)</b>	<b>(132.8)</b>
As at 31 December 2008	<b>317.8</b>	<b>109.6</b>	<b>427.4</b>

The total employer contributions to the defined benefit pension schemes in 2009 are estimated to be £66.9m in respect of the Capita scheme and £5.1m in respect of the 'Other' schemes.

History of experience gains and losses:

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
<b>Capita scheme</b>					
Fair value of scheme assets	<b>317.8</b>	350.5	321.4	286.1	234.4
Present value of defined benefit obligation	<b>(320.2)</b>	(330.2)	(328.8)	(308.1)	(257.8)
Scheme surplus/(deficit)	<b>(2.4)</b>	20.3	(7.4)	(22.0)	(23.4)
Experience adjustments arising on scheme liabilities	<b>3.5</b>	-	3.6	(29.3)	(20.6)
Experience adjustments arising on scheme assets	<b>(92.7)</b>	(4.3)	9.8	26.4	2.6
<b>Other schemes</b>					
Fair value of scheme assets	<b>109.6</b>	137.6	122.4	109.3	84.6
Present value of defined benefit obligation	<b>(131.7)</b>	(153.5)	(141.8)	(130.3)	(105.3)
Scheme deficit	<b>(22.1)</b>	(15.9)	(19.4)	(21.0)	(20.7)
Experience adjustments arising on scheme liabilities	<b>28.7</b>	0.1	(3.9)	(13.1)	(4.7)
Experience adjustments arising on scheme assets	<b>(40.1)</b>	(0.3)	3.5	12.5	3.0

The cumulative amount of actuarial losses recognised since 1 January 2004 in the consolidated statement of recognised income and expense is £33.1m (2007: cumulative actuarial gains of £15.0m). The Directors are unable to determine how much of the pension scheme deficit recognised on transition to IFRS of £77.8m (of which an IFRS transitional adjustment of £67.7m was taken directly to equity) is attributable to actuarial gains and losses since inception of those pension schemes. Consequently, the Directors are unable to determine the amount of actuarial gains and losses that would have been recognised in the consolidated statement of recognised income and expense before 1 January 2004.

**32 Related party transactions**

Other than the information disclosed in the Directors' report and the Directors' remuneration report, the only other related party transactions requiring disclosure are details of key management personnel compensation. These details are set out in the table below.

**Compensation of key management personnel (excluding Directors of parent company)**

	2008 £m	2007 £m
Short term employment benefits	<b>2.1</b>	3.0
Post employment benefits	<b>-</b>	0.1
Share based payments	<b>1.2</b>	1.8
	<b>3.3</b>	4.9

Gains on share options exercised in the year by key management personnel totalled £2.5m (2007: £11.3m).