

ACCOUNTING POLICIES

BASIS OF PREPARATION

These consolidated financial statements have been prepared in compliance with International Financial Reporting Standards (“IFRS”) and International Financial Reporting Interpretations Committee (“IFRIC”) interpretations as adopted by the European Union as at 31 December 2007.

The consolidated financial statements have been prepared under the historical cost convention, as modified by the revaluation of available for sale investments and certain financial assets and liabilities (including derivative instruments).

IFRS 7, “Financial instruments: Disclosures”, and the complementary amendment to IAS 1, “Presentation of financial statements – Capital disclosures”, have been implemented in 2007. IFRS 7 introduces new disclosures relating to financial instruments. This standard does not have any impact on the classification and valuation of the group’s financial instruments.

IFRIC 14 – IAS 19, “The limit on a defined benefit asset, minimum funding requirements and their interaction”, has been implemented in 2007. This interpretation provides guidance on assessing the limit in IAS 19 “Employee Benefits” on the amount of the surplus that can be recognised as an asset. It also explains how a pension asset or liability may be affected by a statutory or contractual minimum funding requirement. The IFRIC had no significant impact on the group.

CONSOLIDATION

(a) Subsidiaries

Subsidiaries are all entities (including special purpose entities) over which the group has the power to govern the financial and operating policies generally accompanying a shareholding of more than one half of the voting rights. The existence and effect of potential voting rights that are currently exercisable or convertible are considered when assessing whether the group controls another entity. Subsidiaries are fully consolidated from the date on which control is transferred to the group. They are de-consolidated from the date that control ceases.

The group uses the purchase method of accounting to account for the acquisition of subsidiaries. The cost of an acquisition is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the acquisition. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date, irrespective of the extent of any minority interest. The excess of the cost of acquisition over the fair value of the group’s share of the identifiable net assets acquired is recorded as goodwill. If the cost of the acquisition is less than the fair value of the net assets of the subsidiary acquired, the difference is recognised directly in the income statement.

Inter-company transactions, balances and unrealised gains and losses on transactions between group companies are eliminated.

Any change in the parent’s controlling interest in a subsidiary that does not result in a loss of control (in buying or selling shares to the minority) is treated as a transaction with equity shareholders and is shown as a movement in the consolidated statement of changes in equity.

(b) Associates

Associates are all entities over which the group has significant influence but not control, generally accompanying a shareholding of between 20% and 50% of the voting rights. Investments in associates are accounted for by the equity method of accounting and are initially recognised at cost. The group’s investment in associates includes goodwill (net of any accumulated impairment loss) identified on acquisition.

The group’s share of its associates’ post-acquisition profits or losses is recognised in the income statement and its share of post-acquisition movements in reserves is recognised in reserves. The cumulative post-acquisition movements are adjusted against the carrying amount of the investment.

Unrealised gains and losses on transactions between the group and its associates are eliminated to the extent of the group’s interest in the associates.

SEGMENT REPORTING

A business segment is a group of assets and operations engaged in providing products or services that are subject to risks and returns that are different from those of other business segments. A geographical segment is engaged in providing products or services within a particular economic environment that are different from those of segments operating in other economic environments.

The primary segment for the group is the business segment. Business segments reported are: Textiles and Washroom Services, Pest Control, Facilities Services, Ambius and City Link with central items reported separately as these cannot be reliably allocated across segments. Geographic or secondary segments are United Kingdom, continental Europe, North America, Asia Pacific and Africa.

FOREIGN CURRENCY TRANSLATION

(a) Functional and presentation currency

Items included in the financial statements of each of the group’s entities are measured using the currency of the primary economic environment in which the entity operates (“the functional currency”). The consolidated financial statements are presented in sterling, which is the company’s functional and presentation currency.

(b) Transactions and balances

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at reporting period end exchange rates of monetary assets and

liabilities denominated in foreign currencies are recognised in the income statement except when deferred in equity as qualifying net investment hedges. Foreign exchange differences for financing of investments which are considered “quasi equity” are reported in reserves. Other foreign exchange differences are taken to the income statement.

(c) Group companies

The results and financial position of all the group entities that have a functional currency different from the presentation currency are translated into the presentation currency as follows:

- (i) assets and liabilities for each balance sheet presented are translated at the closing rate at the date of the balance sheet;
- (ii) income and expenses for each income statement are translated at average exchange rates; and
- (iii) all resulting exchange differences are recognised as a separate component of equity.

On consolidation, exchange differences arising from the translation of the net investment in foreign entities, and of borrowings and other currency instruments designated as hedges of such investments, are taken to shareholders’ equity. When a foreign operation is sold, such exchange differences are recognised in the income statement as part of the gain or loss on sale.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at period end exchange rates.

PROPERTY, PLANT AND EQUIPMENT

Land and buildings comprise mainly factories and offices. Provision for depreciation of freehold buildings is made in equal annual instalments of 1% to 2% of cost. Leasehold buildings classified as finance leases are depreciated in equal annual instalments over the shorter of the lease term or estimated useful life of the leased asset. No depreciation is charged on freehold land or fixed assets under construction. When properties are sold, the difference between sale proceeds and net book value is dealt with in the income statement.

All other property, plant and equipment is stated at historical cost less depreciation. Historical cost includes expenditure that is directly attributable to the acquisition of the items. Depreciation on other assets is calculated using the straight-line method to allocate the difference between their cost and their residual values over their estimated useful lives, as follows:

- 4 to 5 years – Vehicles
- 3 to 10 years – Plant, equipment (including equipment for rental), tropical plants and their containers on rental
- 3 to 10 years – Office equipment, furniture and fittings

Assets’ residual values and useful lives are reviewed annually and amended as necessary. Fixed assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the fixed asset may not be recoverable.

An asset’s carrying amount is written down immediately to its recoverable amount if the asset’s carrying amount exceeds the higher of the asset’s fair value less cost to sell or value-in-use.

For the purposes of assessing value-in-use, assets are grouped at the lowest levels for which there are separately identifiable cash flows (cash-generating units) and cash flow forecasts are made using assumptions consistent with the most up-to-date budgets and plans that have been formally approved by management. These cash flows are discounted using a pre-tax discount rate based on the weighted average cost of capital for the group, adjusted for the particular risks of the cash-generating unit being reviewed for impairment.

BUSINESS COMBINATIONS

Under the requirements of IFRS 3, all business combinations are accounted for using the purchase method (“acquisition accounting”). The cost of a business combination is the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, equity instruments issued by the acquirer and any costs directly attributable to the business combination. The cost of a business combination is allocated at the acquisition date by recognising the acquiree’s identifiable assets, liabilities and contingent liabilities that satisfy the recognition criteria, at their fair values at that date. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree. An intangible asset, such as customer relationships, brands, patents and royalties, is recognised if it meets the definition of an intangible asset in IAS 38, “Intangible Assets” and its fair value can be measured reliably. The intangible assets identified in all acquisitions made since 1 January 1998 are goodwill, customer lists and relationships, reacquired franchise rights and contract portfolios. Consideration in excess of net identifiable assets acquired in respect of minority interests in existing subsidiary undertakings is taken directly to reserves.

INTANGIBLE ASSETS

Intangible assets are stated at cost less accumulated amortisation and accumulated impairment losses, where applicable. The main categories of intangible assets are as follows:

INTANGIBLE ASSETS – INDEFINITE USEFUL LIVES

Goodwill

Goodwill represents the excess of the cost of an acquisition over the fair value of the group’s share of the net identifiable assets of the acquired subsidiary/associate at the date of acquisition. Goodwill in respect of business combinations made since 1 January 1998 is included in intangible assets. Goodwill on the acquisition of associates is included in investments in associates. Goodwill in respect of the acquisition of subsidiaries made prior to January 1998 remains eliminated against reserves.

Goodwill is tested annually for impairment and carried at cost less accumulated impairment losses. Impairment losses previously recognised are not reversed. Goodwill is allocated to cash-generating units for the purpose of impairment testing. Gains and losses on the disposal of an entity include the carrying amount of goodwill relating to the entity sold.

INTANGIBLE ASSETS – FINITE USEFUL LIVES

Intangible assets with finite useful lives are initially measured at either cost or fair value and amortised on a straight-line basis over their useful economic lives, which are reviewed on an annual basis. The fair value attributable to intangible assets acquired through a business combination is determined by discounting the expected future cash flows to be generated from that asset at the risk adjusted weighted average cost of capital for the group. The residual values of intangible assets are assumed to be nil.

The estimated useful economic lives of intangible assets are as follows:

Customer lists and relationships:	5 – 16 years
Brands and patents:	2 – 15 years
Reacquired franchise rights:	3 – 5 years
Computer software:	3 – 5 years
Development costs:	5 years

The following are the main categories of intangible assets.

(a) Customer lists and relationships

Customer lists and portfolios acquired as part of a business combination are initially measured at fair value and amortised on a straight-line basis over their useful economic lives. Separate values are not attributed to internally generated customer list or relationships.

(b) Brands and patents

Brands and patents acquired as part of a business combination are initially measured at fair value and amortised on a straight-line basis over their useful economic lives. Expenditure incurred to develop, maintain and renew brands and patents internally is recognised as an expense in the period incurred. Separate values are not attributed to internally generated brands and patents.

(c) Reacquired franchise rights

Reacquired franchise rights acquired as part of a business combination in the Parcel Delivery division represent the benefit to the group from the right to operate in certain geographical regions. These are initially measured at fair value and amortised on a straight-line basis over the remaining contractual period of the franchise agreements which terminate on 25 October 2010.

(d) Computer software

Acquired computer software licences are capitalised on the basis of the costs incurred to acquire and bring in to use the specific software and are amortised over their estimated useful lives.

Costs associated with maintaining computer software programs are recognised as an expense as incurred. Costs that are directly associated with the production of identifiable and unique software products controlled by the group, and that will probably generate economic benefits exceeding costs beyond one year, are recognised as intangible assets. Direct costs include the software development employee costs and an appropriate portion of relevant overheads.

Computer software development costs recognised as assets are amortised over their estimated useful lives.

(e) Research and development

Research expenditure is recognised as an expense as incurred. Costs incurred on development projects (relating to the design and testing of new or improved products) are recognised as intangible assets when it is probable that the project will be a success considering its commercial and technological feasibility and only if the cost can be measured reliably.

Other development expenditure is recognised as an expense as incurred.

Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Development costs that have been capitalised are amortised from the date the product is available for use on a straight-line basis over the period of its expected benefit.

INVENTORIES

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method. The cost of finished goods and work in progress comprises design costs, raw materials, direct labour, other direct costs and related production overheads (based on normal operating capacity). It excludes borrowing costs. Net realisable value is the estimated selling price in the ordinary course of business, less applicable variable selling expenses.

TRADE RECEIVABLES

Trade receivables are recognised initially at fair value and subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the group will not be able to collect all amounts due according to the original terms of receivables. The amount of the provision is recognised in the income statement.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash in hand, deposits held at call with banks and other short-term highly liquid investments with original maturities of three months or less (and subject to insignificant changes in value). In the cash flow statement, cash and cash equivalents are shown net of bank overdrafts. Bank overdrafts are shown within borrowings in current liabilities on the balance sheet.

SHARE CAPITAL

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares or options are shown in equity as a deduction, net of tax, from the proceeds.

Where any group company purchases the company's equity share capital (Treasury shares), the consideration paid, including any directly attributable incremental costs (net of income taxes), is deducted from equity attributable to the company's equity holders until the shares are cancelled, reissued or disposed of. Where such shares are subsequently sold or reissued, any consideration received, net of any directly attributable incremental transaction costs and the related income tax effects, is included in equity attributable to the company's equity holders.

BORROWINGS

Borrowings are recognised initially at fair value, net of transaction costs incurred. Borrowings are subsequently stated at amortised cost (where hedge accounting is not applied); any difference between the proceeds (net of transaction costs) and the redemption value is recognised in the income statement over the period of the borrowings using the effective interest method.

Where fair value hedge accounting is applied, the carrying value is adjusted for any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

Borrowings are classified as current liabilities unless the group has a continuing right to defer settlement of the liability for at least 12 months after the balance sheet date under both its committed bank credit facility and Euro Medium Term Note programme.

DEFERRED INCOME TAX

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements. However, if the deferred income tax arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss, it is not accounted for. Deferred income tax is determined using tax rates (and laws) that have been enacted (or substantively enacted) by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred income tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except where the timing of the reversal of the temporary difference is controlled by the group and it is probable that the temporary difference will not reverse in the foreseeable future.

Tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity, in which case it is recognised in equity.

EMPLOYEE BENEFITS

(a) Defined benefit pension obligations

The group operates a number of pension schemes throughout the world. The principal scheme is the UK scheme, which has a number of defined benefit sections, which are now closed to new entrants (other than the Initial No2 section, accounting for 0.5% of the total scheme's liabilities, which remains open) and a defined contribution section. The defined benefit scheme is funded through payments to a trustee-administered fund, determined by periodic actuarial calculations. A number of much smaller defined benefit and defined contribution schemes operate elsewhere which are also funded through payments to trustee-administered funds or insurance companies. A defined benefit plan is a pension plan that defines an amount of pension benefit that an employee will receive on retirement, usually dependent on one or more factors such as age, years of service and compensation. A defined contribution plan is a pension plan under which the group pays fixed contributions into a separate entity.

The asset or liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation at the balance sheet date less the fair value of plan assets. The defined benefit obligation is calculated annually by independent actuaries using the projected unit credit method. The present value of the defined benefit obligation is determined by discounting the estimated future cash outflows using interest rates of high quality corporate bonds that are denominated in the currency in which the benefits will be paid, and that have terms to maturity approximating to the terms of the related pension liability. The group will recognise a pension surplus as an asset where there is an unconditional right to a refund or where the group has sufficient scope to reduce future pension contributions.

Current and past service costs, to the extent they have vested, and curtailments are recognised as charges or credits against operating profit in the income statement. Interest costs on plan liabilities and the expected return on plan assets are recognised in finance costs. Actuarial gains and losses arising from experience adjustments and changes in actuarial assumptions are charged or credited to the consolidated statement of recognised income and expense.

(b) Defined contribution pension plans

The group pays contributions to publicly or privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The group has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

(c) Other post-employment obligations

Some group companies provide post-employment healthcare benefits to their retirees. The entitlement to these benefits is usually conditional on the employee remaining in service up to retirement age and the completion of a minimum service period. The expected costs of these benefits are accrued over the period of employment using an accounting methodology similar to that used for defined benefit pension plans. Actuarial gains and losses arising from experience adjustments, and changes in actuarial assumptions, are charged or credited to the consolidated statement of recognised income and expense.

(d) Share-based compensation

The group operates a number of equity-settled, share-based compensation plans. The economic cost of awarding shares and share options to employees is recognised as an expense in the income statement equivalent to the fair value of the benefit awarded. The fair value is determined by reference to option pricing models, principally Monte Carlo and adjusted Black-Scholes models. The charge is recognised in the income statement over the vesting period of the award. At each balance sheet date, the group revises its estimate of the number of options that are expected to become exercisable. Any revision to the original estimates is reflected in the income statement with a corresponding adjustment to equity immediately to the extent it relates to past service and the remainder over the rest of the vesting period.

The proceeds received net of any directly attributable transaction costs are credited to share capital (nominal value) and share premium when the options are exercised.

(e) Termination benefits

Termination benefits are payable when an employment is terminated before the normal retirement date, or whenever an employee accepts voluntary redundancy in exchange for these benefits. The group recognises termination benefits when it is demonstrably committed to either: terminating the employment of current employees according to a detailed formal plan without possibility of withdrawal; or providing termination benefits as a result of an offer made to encourage voluntary redundancy. Benefits falling due more than 12 months after the balance sheet date are discounted to present value.

(f) Profit-sharing and bonus plans

The group recognises a liability and an expense for bonuses and profit-sharing, based on a formula that takes into consideration the probability of certain performance criteria being achieved. A provision is recognised where a contractual obligation exists or where past practice indicates that there is a constructive obligation to make such payments in the future.

(g) Holiday pay

Paid holidays are regarded as an employee benefit and as such are charged to the income statement as the benefits are earned. An accrual is made at the balance sheet date to reflect the fair value of holidays earned but not yet taken.

PROVISIONS

Vacant property, environmental, self-insurance and other provisions are recognised when the group has a present legal or constructive obligation as a result of past events and it is probable that an outflow of resources will be required to settle the obligation; and if this amount is capable of being reliably estimated. If such an obligation is not capable of being reliably estimated it is classified as a contingent liability.

Vacant property provision is made in respect of vacant and partly sub-let leasehold properties to the extent that future rental payments are expected to exceed future rental income. Environmental provision is made for all known liabilities to remediate contaminated land on the basis of management's best estimate of the costs of these liabilities. Self-insurance provision is made for all claims incurred as at the balance sheet (whether notified or not) date based on actuarial assessments of the likely amounts of these liabilities. Other provisions are made for all other known liabilities that exist at the year end based on management's best estimate as to the cost of settling these liabilities. Provisions are not recognised for future operating losses.

Where there are a number of similar obligations, the likelihood that an outflow will be required in settlement is determined by considering the class of obligations as a whole.

When the effect of the time value of money is material, provision amounts are calculated on the present value of the expenditures expected to be required to settle the obligation. The present value is calculated using forward market interest rates, as measured at the balance sheet reporting date, which have been adjusted for risks already reflected in future cash flow estimates.

REVENUE RECOGNITION

Revenue comprises the fair value for the rendering of services, net of value-added tax and other similar sales-based taxes, rebates and discounts and after eliminating sales within the group. Revenue is recognised as follows:

(a) Service revenue

Revenue excludes VAT and other similar sales based taxes, rebates and discounts and represents the amounts receivable for services rendered and goods sold outside the group.

For non-contract based business, revenue represents the value of goods delivered or services performed. For contract based business, revenue represents the sales value of work carried out for customers during the period. Contract income is recognised in accounting periods on a straight-line basis over the life of the contract. For long-term contracts involving the installation of equipment, revenue is recognised using the percentage completion method and represents the sales value of work executed during the period.

(b) Rental income

Rental assets such as tropical plants, washroom equipment, garments, linen, security equipment etc which are owned by group entities or where at least substantially all the risks and rewards of ownership of such equipment are retained by group entities are capitalised as fixed assets and depreciated over their estimated useful lives.

All rental income received or receivable in respect of rental assets is accounted for on an operating lease basis. Income from the rental of these assets is credited to revenue on a strict time-apportioned basis.

(c) Franchise income

Franchise income is recognised as services are provided or continuing rights granted by the agreement are used.

(d) Interest income

Interest income is recognised on a time-apportioned basis using the effective interest method. When a receivable is impaired, the group reduces the carrying amount to its recoverable amount, being the estimated future cash flow discounted at the original effective interest rate of the instrument, and continues unwinding the discount as interest income. Interest income on impaired loans is recognised either as cash is collected or on a cost-recovery basis as conditions warrant.

LEASES

Leases of property, plant and equipment where the group has substantially all the risks and rewards of ownership are classified as finance leases. Finance leases are capitalised at the lease's inception at the lower of the fair value of the leased property and the present value of the minimum lease payments. Each lease payment is allocated between the liability and finance charges so as to achieve a constant rate on the finance balance outstanding.

The corresponding rental obligations, net of finance charges, are included in other payables. The interest element of the finance cost is charged to the income statement over the lease period so as to produce a constant periodic rate of interest on the remaining balance of the liability for each period. The property, plant and equipment acquired under finance leases are depreciated over the shorter of the useful life of the asset or the lease term.

Leases in which a significant portion of the risks and rewards of ownership are retained by the lessor are classified as operating leases. Payments made under operating leases (net of any incentives received from the lessor) are charged to the income statement on a straight-line basis over the period of the lease.

DIVIDEND DISTRIBUTION

Dividend distribution to the company's shareholders is recognised as a liability in the group's financial statements in the period in which the dividends are approved by the company's shareholders. Interim dividends are recognised when paid.

FINANCIAL INSTRUMENTS

Financial assets and financial liabilities are recognised when the group becomes a party to the contractual provisions of the relevant instrument and derecognised when it ceases to be a party to such provisions.

FINANCIAL ASSETS

The group classifies its investments in the following categories: financial assets at fair value through the profit or loss, loans and receivables, held-to-maturity investments and available-for-sale financial assets. The classification depends on the purpose for which the investments were acquired. Management determines the classification of its investments at initial recognition and re-evaluates this designation at every reporting date. The group assesses at each balance sheet date whether there is objective evidence that financial assets are impaired.

All financial assets are held at amortised cost except for derivatives, which are classified as held for trading and certain assets classified as available-for-sale, which are held at fair value.

(a) Financial assets at fair value through profit and loss

Derivatives are categorised as held for trading unless they are designated as hedges. Assets are classified as current if they are either held for trading or are expected to be realised within 12 months of the balance sheet date.

(b) Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. They arise when the group provides money, goods or services directly to a debtor with no intention of trading the receivable. They are included in current assets, except for maturities greater than 12 months from the balance sheet date. These are classified as non-current assets. Loans and receivables are included in trade and other receivables in the balance sheet.

(c) Held-to-maturity investments

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the group's management has the positive intention and ability to hold to maturity.

(d) Available-for-sale financial assets

Available-for-sale financial assets are non-derivatives that are either designated in this category or not classified in any of the other categories. They are included in non-current assets unless management intends to dispose of the investment within 12 months of the balance sheet date.

Available-for-sale investments are fair valued and changes to market values are recognised in equity. On subsequent disposal or impairment, the accumulated gains and losses, previously recognised in equity, are recognised in the income statement as "gains and losses from investment securities". Loans and receivables and held-to-maturity investments are measured at amortised cost using the effective interest method, subject to impairment.

The group assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets is impaired. In the case of equity securities classified as available for sale, a significant or prolonged decline in the fair value of the security below its cost is considered as an indicator that the securities are impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in profit or loss – is removed from equity and recognised in the income statement. Impairment losses recognised in the income statement on equity instruments are not reversed through the income statement. Impairment testing of trade receivables is described on page 97.

FINANCIAL LIABILITIES

All financial liabilities are stated at amortised cost using the effective interest rate method except for derivatives, which are classified as held for trading (except where they qualify for hedge accounting) and are held at fair value.

ACCOUNTING FOR DERIVATIVE FINANCIAL INSTRUMENTS AND HEDGING ACTIVITIES

Derivatives are initially recognised at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value at the balance sheet date. The method of recognising the resulting gain or loss depends on whether the derivative is designated as a hedging instrument and, if so, the nature of the item being hedged. The group designates certain derivatives as either (1) hedges of the fair value of recognised assets or liabilities or (2) hedges of net investments in foreign operations. The group does not operate any cash flow hedging activities.

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

(a) Fair value hedge

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

(b) Net investment hedge

Any gain or loss on the hedging instrument relating to the effective portion of the hedge is recognised in equity; the gain or loss relating to the ineffective portion is recognised immediately in the income statement. Gains and losses accumulated in equity are included in the income statement when the foreign operation is disposed of.

(c) Derivatives that do not qualify for hedge accounting

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

DISCONTINUED OPERATIONS

A discontinued operation is a component of an entity that has either been disposed of, or that is classified as held for sale, which represents a separate major line of business or geographical area of operations and is part of a single coordinated plan to dispose of a separate line of business or geographical area of operations.

FAIR VALUE ESTIMATION

The fair value of any financial instruments traded in active markets is based on quoted market prices at the balance sheet date. The quoted market price used for financial assets held by the group is the current bid price; the appropriate quoted market price for financial liabilities is the current ask price.

Quoted market prices or dealer quotes for similar instruments are used for long-term debt. Other techniques, such as estimated discounted cash flows, are used to determine fair value for the remaining financial instruments. The fair value of interest rate and currency swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the balance sheet date. The fair value of financial instruments that are not traded in an active market is determined by using valuation techniques. The group uses a variety of methods and makes assumptions that are based on market conditions existing at each balance sheet date.

The nominal value less estimated credit adjustments of trade receivables and payables are assumed to approximate to their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate that is available to the group for similar financial instruments.

CRITICAL ACCOUNTING ESTIMATES AND ASSUMPTIONS

Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances.

The group makes estimates and assumptions concerning the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

(a) Estimated impairment of goodwill

The group tests annually whether goodwill has suffered any impairment in accordance with the accounting policy stated on page 72. The recoverable amounts of cash-generating units have been determined based on value-in-use calculations. These calculations require the use of estimates and assumptions consistent with the most up-to-date budgets and plans that have been formally approved by management. Refer to note 11 for the key assumptions used for the value-in-use calculations.

(b) Valuation of acquired intangible assets

Acquisitions may result in customer relationships, brands and reacquired franchise rights being recognised. These are valued using the excess earnings and relief from royalty methods. In applying these methodologies certain key judgements and estimates are required to be made in respect of future cashflows.

(c) Income taxes

The group is subject to income taxes in numerous jurisdictions. Significant judgement is required in determining the worldwide provision for income taxes. There are many transactions and calculations for which the ultimate tax determination is uncertain during the ordinary course of business. The group recognises liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

(d) Provision for vacant property and environmental restoration

Significant judgement is required in determining the worldwide provision for vacant property and environmental restoration. Vacant property and environmental restoration tend to be long-term in nature and the required use of an appropriate market discount rate and forecast future utilisation based

upon management's best estimate determines the level of provision required at the balance sheet date. The phasing and actual cash spend may be different from the original forecast utilisation spend.

(e) Retirement benefits

Defined benefit schemes are reappraised annually by independent actuaries based upon actuarial assumptions. Significant judgement is required in determining these actuarial assumptions. Refer to note 24 for the principal assumptions used for the Rentokil Initial Pension Scheme in the United Kingdom.

(f) Self insurance

The group operates captive insurance companies in the UK and US. These companies provide reinsurance exclusively to certain companies within the group. Provision is made based on actuarial assessment of the liabilities arising from the insurance coverage provided. The actuarial assessment of the reserve for future claims necessarily includes estimates as to the likely trend of future claims costs and as to the emergence of further claims subsequent to the year end. An actuarial review of claims is performed annually. To the extent that actual claims differ from those projected, the provisions could vary significantly.

STANDARDS, AMENDMENTS AND INTERPRETATIONS TO PUBLISHED STANDARDS THAT ARE NOT YET EFFECTIVE

The following accounting standards and amendments to existing standards are not yet effective and have not been early adopted by the group.

- (i) IFRS 8 "Operating Segments". This new standard requires identification and reporting of operating segments on the basis of internal reports that are regularly reviewed by the board in order to allocate resources to the segment and assess its performance. The group is currently in the process of assessing the impact of IFRS 8 and intends to adopt it no later than accounting periods beginning on 1 January 2009.
- (ii) IAS 23 (Revised) "Borrowing Costs". This revision of an existing standard requires the capitalisation of borrowing costs directly attributable to an acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The revised standard is not expected to have any impact on the group. The group intends to adopt IAS 23 no later than accounting periods beginning on 1 January 2009.
- (iii) IFRS 3 (Revised) "Business Combinations". This revision of an existing standard continues to apply the acquisition method to business combinations with certain changes which could impact the group. For example, all payments to purchase a business must be recorded at fair value at the acquisition date with some contingent payments subsequently remeasured at fair value through the consolidated income statement. In addition, all transaction costs must be expensed. The group intends to adopt IFRS 3 (Revised) no later than accounting periods beginning on 1 January 2009.