Accounting policies

A Basis of preparation These accounts have been prepared under the historical cost convention modified to include certain investments and fixed assets at valuation and in accordance with the Statement of Recommended Practice – Financial Statements of Investment Trust Companies ("SORP") – and applicable accounting standards, except as described below concerning the treatment of capital profits.

As the Company is authorised and regulated by the Financial Services Authority as a deposit taker, the accounts have also been prepared in accordance with the requirements of Part VII of the Companies Act 1985 in respect of banking companies and groups.

The Articles of Association of the Company prohibit the distribution of its capital profits. Accordingly, the Company's capital profits, shown in note 39, are included in the capital reserve. In order to use consistent accounting policies in the Group accounts, the capital profits of subsidiary undertakings have been excluded from consolidated revenue and included in capital reserve. These capital profits of subsidiary undertakings are distributable. The Revenue statement of the Company has been omitted from these accounts in accordance with section 230 of the Companies Act 1985.

Financial Reporting Standard 17 – Retirement Benefits ("FRS 17") The Group has adopted fully the reporting requirements of FRS 17, having previously complied with the transitional disclosure requirements of the standard and SSAP 24. The effect of adopting is explained in note 42.

Urgent Issues Task Force Abstract 38 – Accounting for ESOP Trusts ("UITF 38") The Group has also adopted UITF 38. This requires shares held by the 3i Group Employee Trust to be accounted for as a deduction in arriving at shareholders' funds rather than as an asset.

Fees receivable earned and deal related costs incurred as an intrinsic part of an intention to acquire or dispose of an investment, have been accounted for directly in the capital reserve. To the extent that taxation losses have been transferred between capital and revenue in order to be utilised against excess taxable profits, the transfer is reflected in the Statement of total return, Revenue statement and note 14.

Administrative expenses associated with making and managing investments are allocated between capital and revenue. Finance costs less interest income on surplus funds have been allocated between revenue and capital. This allocation is 70% to capital and 30% to revenue for both administrative expenses and net finance costs.

B Joint ventures and associated undertakings Joint ventures and associated undertakings that are held as part of the investment portfolio of the Group are included in the accounts at the Directors' estimate of Fair Value. Dividends and interest from these investments are included in the revenue account as the Directors' believe that, while not complying with the Companies Act, this gives a true and fair view of the income. This treatment is in accordance with Financial Reporting Standard 9 – Associates and Joint Ventures.

A joint venture is an entity in which the Group holds an interest on a long-term basis and is jointly controlled by the Group and one or more venturers under a contractual agreement. Joint ventures through which the Group carries on its business and not held as part of the investment portfolio are accounted for using the gross equity method of accounting. The treatment adopted is in accordance with Financial Reporting Standard 9 – Associates and Joint Ventures.

C Fixed assets in use by the Group Fixed assets in use by the Group are depreciated by equal annual instalments over their estimated useful lives as follows: office equipment five years; computer equipment three years; computer software three years; motor vehicles four years. Properties in use by the Group are included at external professional valuation, which is carried out at each balance sheet date. Depreciation is not provided against the value of the buildings as the amount is immaterial and impairment is considered annually. Motor vehicles being acquired on hire purchase are capitalised in the balance sheet and depreciated over their estimated useful lives. The interest element of the rental obligations is charged to the revenue account over the period of the agreement and represents a constant proportion of the balance of capital repayments outstanding.

D Financial fixed assets Loan investments, fixed income and equity share investments, together with interests in joint ventures and the shares in Group undertakings, are regarded as financial fixed assets as they are held for long-term investment purposes.

E Valuation of financial fixed assets and investment properties Investment packages comprising mixtures of equity shares, fixed income shares and loan investments, together with financial fixed assets of joint ventures, are included at the Directors' estimate of Fair Value on the following bases:

a Listed investments and quoted shares for which an active market exists are valued at mid-market price. This value is reduced by an appropriate discount dependent on the size of the Group's holding relative to normal trading volumes.

b Unquoted investments are valued by the Directors as follows: new investments are generally valued at cost until the first set of accounts for a full financial period subsequent to investment are received. An enterprise value for the investee company is estimated using various methodologies, and, after adjusting for higher-ranking debt and an appropriate marketability discount, is apportioned over the remaining instruments including the Group's investments in loans, fixed income shares and equity shares. Standard methodologies include applying an average sector earnings multiple to operating profits, valuation by reference to the net asset base, sales basis and the price of recent investments made in the investee company. If failure is expected the equity shares are valued at nil and the fixed income shares and loan investments are valued at the lower of cost or net recoverable amount.

c In all of the above categories of investment where failure has occurred the loss is charged against realised capital profits.

d Deferred consideration is included at the estimated present value of the expected future proceeds. Investment properties are included at external professional valuation.

F Income recognition Dividends receivable on listed shares are brought into account on the ex-dividend date. Dividends receivable on shares where no ex-dividend date is quoted are brought into account when the right to receive payment is established. The fixed return on a loan investment is recognised on a time apportionment basis so as to reflect the effective yield on the loan. Other income, including interest receivable from derivatives, is recognised on the accruals basis except for income from finance leases and hire purchase contracts, which is credited to revenue so as to result in a constant periodic rate of return on the net cash investment.

G Administrative expenses Administrative expenses which comprise the costs of making and managing investments and the management of the Group are accounted for on an accruals basis. Costs associated with making and managing investments are allocated to revenue and capital profits. Costs of management of the Group are charged to revenue profit. Costs incurred as an intrinsic part of an intention to acquire or dispose of an investment have been accounted for in full as part of capital return as opposed to being allocated between revenue and capital.

H Finance costs Finance costs, including those of derivatives, are accounted for on an accruals basis. Discounts, premiums and expenses arising on the issue of bonds and notes are amortised over the period of the related borrowing.

I Trading assets Loans and advances to customers and other non-investment assets are carried at the lower of book amount and recoverable amount.

J Deferred tax Provision is made for deferred tax, using the liability method, on all material timing differences between the treatment of certain items for taxation and accounting purposes. Deferred tax is provided at a rate at which it is anticipated the timing difference will reverse. Provision is also made for deferred tax on the unrealised appreciation of investment held by certain subsidiaries, as reduced by losses, where these are expected to crystallise in the future. Deferred tax assets are recognised only when there is evidence that there will be taxable profits in the future to offset the deferred tax asset.

K Foreign currency translation Foreign currency revenue items, assets and liabilities, including those of non-UK subsidiary undertakings, are translated into sterling at the exchange rates ruling at the balance sheet date, with the exception of borrowings covered by forward exchange contracts which are translated at the contracted rates of exchange. Exchange adjustments arising on the translation of investments, borrowings and net assets including those of overseas subsidiary undertakings are dealt with through the appropriate reserves. Exchange adjustments arising on realised transactions are dealt with in the revenue or capital profit for the period as appropriate.

L Pensions Defined benefit pension scheme assets are measured at fair value, scheme liabilities are measured using the projected unit method and discounted at the current rate of return on high quality corporate bonds of equivalent currency and terms to the scheme liabilities. The current service cost and vested past service cost are charged to administrative expenses. The interest cost and the expected return on assets are included as other finance income or costs in the revenue reserve. Actuarial gains or losses are recognised in the capital reserve.

Contributions to defined contribution schemes are charged to administrative expenses.

International Financial Reporting Standards

In June 2002, the European Union adopted a regulation that requires, from 1 January 2005, European listed groups to prepare their consolidated financial statements in accordance with International Financial Reporting Standards (“IFRS”) as adopted by the EU.

During 2003 the Group formed a project team and initiated a programme to change its accounting policies and systems to be IFRS compliant by 2005. These changes are nearing completion and it is our intention to restate the balance sheet at the transition date of 1 April 2004 and the results for the year to 31 March 2005 on an IFRS basis at the end of June, to allow the impact to be interpreted and understood.

IFRS differ in certain respects from the Group’s accounting policies under UK GAAP. The summary below outlines the important differences for the Group in respect of recognition and measurement on the basis of extant IFRS that will be effective for the year to 31 March 2006, including revised IAS 32 and 39.

Dividends IFRS require dividends payable to be recorded in the period in which they are approved whereas under UK GAAP dividends are recorded in the period to which they relate.

Share-based payment Under UK GAAP, no compensation expense is recognised for Inland Revenue approved Save-as-you-earn share option schemes or for other share option schemes where the option has no intrinsic value (ie where at date of grant the exercise price equals the market value). IFRS require the fair value of share options at the date of grant to be recognised as an expense over the vesting period.

Financial instruments: financial liabilities IFRS require all financial liabilities to be measured at amortised cost except those held for trading and those that were designated as fair value through profit and loss on initial recognition. Under UK GAAP financial liabilities are recorded at amortised cost. In IFRS as adopted by the EU, the option to designate at fair value through profit and loss is not available.

Liabilities and equity Under UK GAAP, all issued shares are classified as shareholders’ funds, and analysed between equity and non-equity interests. There is no concept of non-equity shares in IFRS. Instruments are classified between equity and liabilities in accordance with the substance of the contractual arrangements. Instruments such as convertible loans are analysed into their constituent liability and equity parts.

Transition IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’ (IFRS 1) will apply to the Group’s financial statements. The standard requires an opening IFRS balance sheet to be prepared as at the date of transition to IFRS, being the beginning of the earliest comparative period presented under IFRS in its first IFRS financial statements (1 April 2004). Accounting policies must comply with each IFRS effective at the reporting date of the first IFRS financial statements, and applied throughout all periods presented.