



## **Chesnara plc**

Interim Financial Statements

for the six months ended

30 June 2005

and

Explanation of Transition to

International Financial Reporting Standards

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## Financial Highlights

	6 months ended 30 June 2005	6 months ended 30 June 2004	Year ended 31 December 2004
<b>IFRS basis</b>			
Operating profit/(loss)	4.3	(7.2)	2.8
Financing costs	(0.1)	(0.3)	(0.3)
Profit on sale of discontinued operation	–	1.9	1.9
<b>Profit/(loss) before tax</b>	<b>£4.2m</b>	<b>£(5.6)m</b>	<b>£4.4m</b>
Basic earnings/(loss) per share	3.81p	(5.18)p	6.10p
Dividend per share	4.90p	4.75p	11.85p
<b>Shareholders' net equity</b>	<b>£98.1m</b>	<b>£73.9m</b>	<b>£79.4m</b>
<b>Achieved profit basis</b>			
Operating profit/(loss) before tax and exceptional items	2.9	(13.5)	(5.8)
Exceptional items			
Profit on acquisition and sale of subsidiary companies	18.5	1.9	1.9
Operating profit before tax	21.4	(11.6)	(3.9)
Investment variances and economic assumption changes	0.8	(0.1)	0.9
<b>Achieved profit before tax</b>	<b>£22.2m</b>	<b>£(11.7)m</b>	<b>£(3.0)m</b>
Value in-force	123.2	87.9	84.6
Other net assets	57.7	56.8	64.6
<b>Embedded value</b>	<b>£180.9m</b>	<b>£144.7m</b>	<b>£149.2m</b>
Life annual premium income (AP)	£55.8m	£64.7m	£123.3m
Life single premium income (SP)	£33.4m	£22.9m	£78.9m
Life annualised premium income (AP + 1/10 SP)	£59.1m	£67.0m	£131.2m

Under the Achieved Profit basis of reporting, the exceptional profit arising during the six months ended 30 June 2005 relates to the acquisition of CWA Life Holdings plc and represents the excess of the embedded value of that company over the total purchase price. The exceptional profit arising during the six months ended 30 June 2004 and the year ended 31 December 2004 relates to the sale of Key Retirement Solutions Limited, being the excess of the net proceeds received over its carrying value.

I am pleased to present the second interim statements of Chesnara plc ('Chesnara'), the company originally formed to hold the demerged life assurance operations of Countrywide plc. The company was listed on the London Stock Exchange on 25 May 2004.

## Background

Chesnara's original and primary subsidiary, Countrywide Assured plc ('CA'), manages a portfolio of some 190,000 life assurance and personal pension policies whilst its recent acquisition, City of Westminster Assurance Company Limited ('CWA'), a subsidiary of CWA Life Holdings plc ('CWALH'), manages a further 84,000 policies. Whilst CA continues to sell and market Guaranteed Income and Growth Bonds, CWA is closed to new business other than by way of top-ups to existing contracts. As substantially closed books, it is expected that the embedded value of these businesses will decline over time as the number of policies in force reduces and as the surplus emerging in the businesses is distributed by way of dividends. As the portfolio runs off, the regulatory capital supporting them may also be reduced and returned to shareholders.

## Business Review

Since the demerger, Chesnara has pursued a policy of delivering enhanced value to shareholders. I am pleased to report two significant transactions that deliver on that policy during the first half of 2005. Firstly, in February, we entered into a contract with Liberata Financial Services Limited, which outsourced CA's back office operations. This arrangement removes some potential future fixed cost issues associated with a reducing book of business and, as it is based on a per policy charge, it will mean a greater alignment of administration expenses with policy generated income. Later, in June, we delivered on our stated strategy of value-enhancing acquisitions, when we acquired CWALH for £47.8m, including £0.3m transaction costs, from Irish Life and Permanent plc. This acquisition offers the prospect of significant financial synergies once the businesses are merged, and although CWALH's contribution to earnings is minor in the context of these results, we believe that it will, as it is a more mature run-off business, provide a reasonably predictable dividend flow and improve the quality and longevity of shareholder returns.

Chesnara has, for the first time, adopted International Financial Reporting Standards ('IFRS') as the basis for presenting the primary statement of earnings, financial position and cash flows. It will continue to publish supplementary financial information, based on the Achieved Profit method of reporting. In Part 2 of this document we have set out the impact of the transition to IFRS on the results and

financial position of the Group as previously reported under UK GAAP, whilst a short summary is presented on page 8.

On the IFRS basis, Chesnara has posted a pre-tax profit of £4.2m for the half year ended 30 June 2005 (30 June 2004, pre-tax loss of £(5.6)m). This is after increasing the provision for mortgage endowment mis-selling redress by £3.9m (£2.7m net of tax). For the year ended 31 December 2004 we decided, based on experience up to the date of reporting, 21 March 2005, which included early experience of the 'new-style' endowment re-projection letters, that the provision that existed at that time did not require adjustment. However, since then the industry has witnessed the proliferation of complaint handling firms who have engaged in widespread advertising of their services. Although the increasing incidence of time-barring and the welcome recovery in the equity markets has mitigated the effect of the higher than expected number of complaints, we feel it necessary to increase the provision as stated above.

Despite the adverse impact of the increase in this provision on earnings, the strong emergence of surplus has continued and this allows the Board to recommend an interim dividend of 4.9p (2004: 4.75p). This represents an increase of 3.2% and equates to a total interim dividend of £5.1m.

On the alternative Achieved Profit basis of reporting, the operating profit before tax of £22.2m (six months ended 30 June 2004, loss of £(11.7)m), includes an exceptional profit of £18.5m arising on the acquisition of CWALH, which effectively represents the excess of the embedded value acquired over the total purchase consideration. The operating profit before tax and exceptional items for the six months ended 30 June 2005 was £2.9m on this basis (six months ended 30 June 2004, loss of £(13.5)m). This turnaround is largely due to a lower addition to the provision for mortgage endowment mis-selling redress and to the absence of any material adjustment to our persistency assumptions. CA's protection book of business is demonstrating convergence to our longer-term assumptions. The endowment book is demonstrating less convergence, at least in part due to the higher number of complaints and subsequent policy encashments. As endowment mailing volumes, which to some extent drive complaints, will reduce significantly in the second half, we do not propose to make any adjustment to our persistency assumptions at this time.

The Group embedded value has, before the proposed dividend appropriation of £5.1m, increased from £149.2m at 31 December 2004 to £180.9m at 30 June 2005. This net increase is largely due to the acquisition of CWALH's embedded value of some £60m at 30 June 2005, net of debt financing of £21m which was used to part fund the acquisition.

Both CA's and CWA's capital requirement (the ratio of available capital resource to capital resource requirements) remain at a premium to the target level of 150% set by

the Board. CA's ratio of 185% is broadly comparable with the year-end figure of 190% whilst CWA's ratio of 192% also demonstrates a healthy margin over the target level. CA has invested significant effort in updating its Individual Capital Assessment ('ICA'), under which its capital requirements are assessed with guidance from the FSA. Whilst we are yet to receive formal feedback from the FSA we do not expect there to be any additional capital requirement. CWA have also prepared an ICA which demonstrates that further capital support is unlikely to be required.

## Outlook

Whilst there is some inevitable uncertainty regarding endowment mis-selling and persistency, the Board look to the future with optimism. We believe we have a strong grip on these issues. With outsourcing mitigating potential future expense issues, rising investment markets providing a positive underpin and the acquisition of CWALH providing a strong surplus flow and positive financial synergies, we believe that we are well placed to fulfil our stated objective of delivering a reliable and progressive dividend flow.

To further this objective we will continue to research the market for closed life books and look for further consolidation opportunities.

The Board wishes to extend its thanks to all employees for their contribution to the notable achievements in this half-year and also to welcome our new colleagues from CWA.

**Christopher Sporborg**

Chairman

5 October 2005

## Background

Chesnara plc ('Chesnara'), which was listed on the London Stock Exchange on 25 May 2004, was formed to become the new holding company of the life assurance activities formerly owned by Countrywide plc ('Countrywide'). It was considered that as the activities of the life business were fundamentally different in nature from the rest of the members of the Countrywide group, a separate listing would be appropriate for the life business. The listing enabled shareholders to better assess the risk and rewards associated with the life business and its cash flows and allows management to create additional value for shareholders through greater focus as an independent business.

Chesnara's principal subsidiary at the time of the demerger of the life business from Countrywide – Countrywide Assured plc ('CA') – had been established in 1988 as the life assurance division of Countrywide, selling mortgage-related life assurance products through Countrywide's financial services division. Following its substantial closure to new business in August 2003, CA continues to administer an existing portfolio of some 190,000 policies, including those acquired as a result of the purchase of Premium Life in 1995. The portfolio, which primarily consists of endowment and protection policies, reflects CA's history of providing mortgage-related policies to an estate agency-based financial services sales force.

CA continues to sell and market Guaranteed Income and Growth Bonds through Independent Financial Advisers and directly to investors, and in addition it sells a small amount of life protection business to existing customers.

## Business review

Since the demerger, Chesnara has pursued a policy of delivering enhanced value to shareholders through focusing its activities on the efficient run-off of its life businesses which are substantially closed to new business. Significant steps which have been taken to achieve this include: (1) the sale of Key Retirement Solutions Limited, an Independent Financial Adviser, which was a wholly-owned subsidiary of Chesnara and which was engaged in the marketing of property-related equity release products and the sale of associated financial services; (2) the completion by CA of an Insurance Administration Services Agreement with Liberata Financial Services Limited ('Liberata'). This agreement, which is described below, allows us more properly to align the cost base of the CA life business with the size of its policy portfolio as it runs off. In turn this supports and makes more certain the emergence of surplus within the long-term insurance funds which can be transferred for onward distribution to shareholders by way of dividend.

Having established its operating model, Chesnara has been able to focus on corporate governance activities and on the pursuit of its strategy of acquiring other life

businesses in run-off. We believe that this strategy affords opportunities for further operational and administrative efficiencies, together with other financial benefits. These include, significantly, the potential for the effective merging of life and pensions funds, under Part VII of the Financial Services and Markets Act 2000 ('FSMA 2000'), which we believe, besides reducing the reporting and regulatory burden, raises the prospect of financial synergies, including the more efficient use of regulatory capital.

We believe that the acquisition of suitable propositions will enhance both the longevity and certainty of the dividend stream to shareholders and the prospect of a return of capital, provided there is no clearly superior investment alternative.

## *Acquisition of CWA Life Holdings plc*

On 2 June 2005, Chesnara completed the acquisition of CWA Life Holdings plc ('CWALH'), formerly Irish Life (UK) Holdings plc, from Irish Life and Permanent plc for a total purchase consideration of £47.8m of which some £0.3m related to costs associated with the transaction. CWALH's life business subsidiary is City of Westminster Assurance Company Limited ('CWA'). This was Chesnara's first acquisition since its listing in May 2004 and delivers on its stated strategy of the consolidation of value enhancing closed life businesses. The funding for the purchase, which was settled in cash, was made by the raising of further equity of £22m from shareholders by way of a placing and an open offer, and by the provision of a bank loan of £21m, with the balance being sourced from internal retained funds. The Board believes that the bank loan, which is repayable in five equal annual amounts on the anniversary of the draw down date, introduces an element of gearing to the balance sheet which is proportionate to both the size of the acquisition and to the existing capital base of the Company.

CWALH is a suitable and attractive acquisition for shareholders, policyholders and management. Being approximately 40% of the size of the existing Chesnara operations in terms of embedded value it represents both a sizeable and manageable acquisition. It has a strong capital position, no significant regulatory issues and has no with-profits exposure. In common with CA, CWA has outsourced its investment management and the majority of its back office functions. As its business has been in run-off since 1995 and has outsourced its administration since 1999, its future surplus flows can be predicted with a reasonable degree of certainty. This, together with the planned transfer of the CWA business into CA, which will enable financial synergies to be realised, will, the Directors believe, enhance the short, medium and long-term cash flow of the enlarged group. The contribution from CWALH, which is minor in the context of these results as they include only one month of post-acquisition trading activity, will, in future, provide the capacity to support the repayment of the bank loan and to enhance reported earnings and dividend flow to shareholders.

### *Outsourcing arrangements and VAT*

As stated in our Report and Accounts for 2004, we successfully completed an agreement with Liberata to outsource our back office functions with effect from February 2005. The agreement, which runs for 10 years, provides CA with a defined level of cost per policy during the term and mitigates the risks and significant cost inefficiencies that arise from a diminishing policy base. The operational handover has gone well and the transition project, which will migrate the business to Liberata's systems, is progressing under the joint control of CA and Liberata.

CWA's back office is also outsourced on a defined per policy cost, albeit to a different supplier – Computer Sciences Corporation. This agreement is currently due to expire in January 2009.

Following a decision delivered in the European Court of Justice in early 2005 in the case of *Staatssecretaris van Financiën v Arthur Andersen and Co, Accountants*, there was uncertainty whether charges made under the various outsourcing arrangements, which subsist within the Group, would continue to be exempt from VAT. This has significance for the Group's life businesses as their supplies are almost wholly VAT exempt, which means that any VAT levied on supplies of services to the life businesses represents a permanent additional cost burden. In July 2005, HM Revenue and Customs issued a Consultation Document entitled "Changes to the VAT Exemption for Insurance-related Services" and, notwithstanding the strong industry lobbying against the proposed changes, the Directors are of the opinion that it is now prudent to make allowance for future additional VAT costs in valuing insurance contract liabilities.

The terms of CA's agreement with Liberata referred to above are such that the effect of any additional cost burden arising from these changes will be shared, while under the terms of policyholder contracts CA is able to recover additional costs from policyholders in the majority of cases. CWA is unlikely to be able to recover the additional costs arising from these changes under its policy terms. The impact of the changes is that CA's reported IFRS earnings are reduced by £1.5m (£1.1m net of tax) while the value of policies in force included within the overall embedded value reduces by £0.2m (pre and post tax). CA had already anticipated these costs for Prudential Reporting to the Financial Services Authority at 31 December 2004, but had reversed the related provision for UK GAAP reporting at that time. CWA has, during the six months ended 30 June 2005, for both FSA Prudential Reporting and for reported IFRS earnings, established a liability of £0.8m (£0.6m net of tax), together with a concomitant reduction in the value of policies in force within its embedded value of £2.5m (£1.7m net of tax) by way of changes to the underlying expense assumptions. These changes were, however, fully anticipated in connection with the

acquisition of CWA and were recognised in establishing the fair value of assets and liabilities in the acquisition balance sheet as at 2 June 2005.

### *Mortgage endowment mis-selling redress provision*

CA and CWA are required to write to endowment policyholders at least every two years to appraise them of the expected maturity value of their policy. These mailings are governed by the rules and guidance issued by the FSA and ABI in May 2004, which include a requirement to give clear notification to policyholders of an individual 'cut-off' date by which they must complain (if they are minded to do so). If the policyholder does not complain by the 'cut-off' date then the company has the right to refuse to consider the complaint. After a short delay, in which the relevant system changes were made, CA began mailing the new style letters in September 2004. Early indications were that the new letters were having little effect on customer complaint rates and therefore no adjustment to the mortgage endowment complaints redress provision was considered necessary at the time that we issued the 2004 Report and Accounts on 21 March 2005, based on experience to that date. However, since then the industry has witnessed increased media coverage and ever-present advertising driven by the proliferation of endowment complaint handling firms. Whilst the value of the service provided by these largely unregulated firms can be debated, it is clear that their activities have given rise to greater than expected levels of complaints. Although complaints emanating from these firms can be identified it is impossible to know how many other complaints are influenced by the advertising or are simply a response to the new style letters.

As a result of the higher than expected levels of complaints received, the Board now consider that an increase of £3.9m (£2.7m net of tax) in the provision is necessary. This takes into account the increased levels of complaints received, the positive contribution from the increase in equity markets during the first half of 2005 and the increasing number of cases that are expected to become time-barred under the existing rules. The provision is calculated on a best estimate basis taking into account recent experience. Therefore, as experience is subject to external factors, there is an element of uncertainty. This will however be alleviated as more of the population becomes time-barred, with the majority of cases being settled in the next two years.

Whereas CA has a rolling programme of mailing, CWA adopted a bulk mailing procedure where mailings are spread over a few months every two years. CWA mailed their endowment policyholder base in the first half of 2005 and, to date, it appears that the provision, which was strengthened to reflect our view of the fair value of assets and liabilities on acquisition, is proving adequate. It is significant that the number of endowment policies in-force in CWA is proportionately much lower than that in CA and that, due to the nature of the mailing profile, the population becomes time-barred, where appropriate, comparatively earlier.



### Persistency

As regards CA persistency, experience over the first six months has differed between our two major product lines. On protection business there has been convergence of actual experience to our underlying persistency assumptions and we do not see the need to make any alteration to these. On endowment business the expected convergence is less clear, at least partly due to the higher than expected number of endowment mis-selling related complaints we have received, and to the subsequent encashment of related policies. As mailing volumes, which at least in part drive complaint activity, will be significantly lower in the second half, we do not propose to make any significant adjustment at this time.

### IFRS reporting

#### TRANSITION TO IFRS

As explained in the Notes to these interim financial statements, the Group has adopted International Financial Reporting Standards ('IFRS') for the first time, as the basis for presenting the primary statements of earnings, financial position and cash flows. It will continue to publish supplementary financial information, based on the Achieved Profit method of reporting. Part 2 of this document sets out more fully the impact of the transition to IFRS on the results and financial position of the Group as previously reported under UK GAAP. The impact of the introduction of IFRS on previously reported periods may be summarised as follows:

	6 months ended or as at 30 June 2004		Year ended or as at 31 December 2004	
	UK GAAP £000	IFRS £000	UK GAAP £000	IFRS £000
Shareholder net equity	71,014	73,920	73,952	79,442
(Loss)/profit before taxation	(4,887)	(5,635)	4,551	4,397
Taxation	1,189	1,252	813	759
(Loss)/profit after taxation	(3,698)	(4,383)	5,364	5,156
Basic (loss)/earnings per share	(4.37)p	(5.18)p	6.34p	6.10p

The main enduring influence of IFRS on reported earnings and on the financial position of the Group, arises from the requirement to classify the Group's long-term contracts into insurance or investment contracts (as defined under IFRS). The primary consequence of this is that insurance contracts continue to be valued using identical methods as under UK GAAP, subject to liability adequacy testing, while acquisition costs and fees received for services provided on investment contracts, previously charged or credited to income under UK GAAP up front, are now deferred over the life of the contract, together with a concomitant release of actuarially based provisions which it is no longer necessary to carry. The net impact of this treatment, compared with UK GAAP, is to reduce shareholder equity while future period reported earnings will be higher than would otherwise be reported under UK GAAP, as the deferred costs and income are released as charges or credits to earnings.

Shareholder net equity has also been impacted by the effect of the addback of the interim dividend of £4,017,000 in respect of the six months ended 30 June 2004 and of the final dividend of £6,124,000 in respect of the year ended 31 December 2004, both of which are not recognised as liabilities at those dates under IFRS. These dividends have also been added back for the purposes of reporting embedded value at those period ends and the statements of Achieved Profit and Embedded Value in respect of prior periods, presented in these interim financial statements, have been restated accordingly.

The impact of these restatements under IFRS are not considered significant in the overall context of the earnings and financial position of the Group. As the main activities of the Group are centred on long-term businesses in run-off, the earnings profile of the Group will continue to be dominated by the underlying emergence of surplus from those businesses. While the application of IFRS compared with UK GAAP leads to a relatively minor reallocation of profit recognition between periods, the prospects for the disposition of the surplus emerging by way of transfer to shareholder funds and onward distribution by way of dividend and the capacity to repay and service borrowings are determined principally by the underlying regulatory solvency position of the life businesses within the Group (see Solvency and Regulatory Capital section below). The adoption of IFRS changes neither the nature nor the measurement of those regulatory constraints, nor does it have a significant influence on the future capacity to return capital to shareholders.

#### CWALH ACQUISITION AND IFRS

The fair values of the assets and liabilities of CWALH, at the acquisition date, 2 June 2005, have been established in accordance with IFRS. In particular, intangible assets related to the acquired in-force value attributed to both insurance and investment contracts have been recognised. As surplus emerges from the underlying businesses in run-off, and is recognised in income, so these intangible assets (whose initial carrying



value has been established by reference to the difference between the total purchase consideration for the acquisition of CWALH, determined as a result of a competitive tendering process, and the fair value of all other assets and liabilities acquired) will be amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus. There is the prospect that future reported IFRS earnings attributable to CWALH will reflect the effective unwinding of the implicit discount rate used to measure the intangible assets and the emergence of surplus at a level which can be established by reference to the value in-force component of CWA's embedded value.

### IFRS RESULT

The Group has posted a pre-tax profit under IFRS of £4.2m for the six months ended 30 June 2005 as against a pre-tax loss of £5.6m at the corresponding interim position in 2004 and a pre-tax profit of £4.4m at the full year end 2004 position. The continuing strong underlying emergence of surplus from long-term business, and significantly reduced charges in respect of adjustments to the mortgage endowment mis-selling redress provision, compared with the prior period, are the principal factors which have given rise to this improvement in earnings. The result also reflects a charge of £2.3m in respect of the amortisation of Deferred Acquisition Costs ('DAC') on insurance business (six months ended 30 June 2004 £6.0m; year ended 31 December 2004 £11.0m). These amounts which had been recognised under UK GAAP continue to be recognised under IFRS. It is expected that the DAC relating to insurance business will be almost fully amortised by 31 December 2005 so that reported earnings after that date will benefit from the lower incidence of amortisation charges from this source.

### Achieved Profit Result

Summary information on the Achieved Profit basis is presented as a supplement to these financial statements to provide alternative information to that presented under IFRS. The Achieved Profit method recognises profits as they are earned over the life of an insurance policy and assists in identifying the value being generated by the life businesses. The result determined under this method represents the movement in the life businesses' embedded value. As the Group's life assurance operations are now substantially closed to new business, the principal underlying components of the achieved result are the expected return from the business in force (being the yield at the risk discount rate on the related policy cash flows as they fall into surplus) together with (1) variances of actual experience from that assumed for each component of the policy in-force cash flows and (2) the impact of resetting assumptions for each component of the prospective cash flows.

The Group has, under this basis, posted a pre-tax profit of £22.2m for the six months ended 30 June 2005 (six months ended 30 June 2004 pre-tax loss of £(11.7)m; year ended 31 December 2004 pre-tax loss of £(3.0)m). The principal factors underlying this result, which is more fully analysed in the supplemental information, are:

- (1) In respect of the core underlying CA result an expected return of £4.4m has been offset by adverse mortgage endowment mis-selling experience of £3.9m pre-tax (£2.7m net of tax).
- (2) The economic assumptions underlying the in-force value of CA business were reset at 30 June 2005, including a reduction in the risk discount rate from 9% to 8.3%. These adjustments gave rise to a net reduction of pre-tax in-force value of £1.6m (£0.8m net of tax). The reduction in the risk discount rate was influenced mostly by a reduction in the underlying longer-term risk-free rate of return rather than by a changed view of the risk factors subsisting within the CA life business.
- (3) An exceptional credit of £18.5m pre-tax (£12.6m net of tax) has been reflected, representing the difference between the total purchase consideration for the acquisition of CWALH and its embedded value at the acquisition date. This effectively reflects the fact that the purchase price for the acquisition of CWALH was broadly at a discount of 21% to its embedded value, and the amount represents the enhancement to shareholder value in Achieved Profit terms as a result of the acquisition. The amount which has been reflected as an exceptional credit has been measured after restating CWALH's embedded value at the acquisition date for:
  - (i) revised economic assumptions, which, except for the risk discount rate established at 7.7%, are now fully aligned with those of CA;
  - (ii) amended expense assumptions to reflect anticipated higher outsourcer costs, due to an increased VAT burden as described above;
  - (iii) an increase in the mortgage endowment mis-selling redress provision as described above.

The CWA risk discount rate of 7.7% is lower than that of CA, reflecting current lower perceived risk in its policy portfolio, arising in part from its greater maturity as a business in run-off.

The post acquisition contribution of CWALH to the Achieved Profit result is otherwise minor, representing only one month's activity.

There are a number of potential synergies which may arise from the acquisition of CWALH and from the proposed transfer of CWA long-term business funds to CA, which have not been reflected in the overall Group embedded value assumptions.

### Embedded Value

The movement on embedded value comprises:

	6 months ended 30 June 2005 £000	6 months ended 30 June 2004 £000 (restated)	Year ended 31 December 2004 £000 (restated)
Embedded value at beginning of period	149,187	152,745	152,745
Net achieved profit/(loss) for the period	16,415	(8,020)	469
Issue of new equity			
Share capital	1,001	—	—
Share premium	20,458	—	—
Dividends paid in period	(6,124)	(10)	(4,027)
<b>Embedded value at end of period</b>	<b>180,937</b>	<b>144,715</b>	<b>149,187</b>

The balance sheet prepared on an achieved profit basis is summarised as follows:

	30 June 2005 £000	30 June 2004 £000 (restated)	31 December 2004 £000 (restated)
Value in-force	123,252	87,901	84,594
Other net assets	57,685	56,814	64,593
	<b>180,937</b>	<b>144,715</b>	<b>149,187</b>
Represented by:			
Share capital	41,501	40,500	40,500
Share premium	20,458	—	—
Capital redemption reserve	50	50	50
Retained earnings	118,928	104,165	108,637
<b>Embedded value</b>	<b>180,937</b>	<b>144,715</b>	<b>149,187</b>

The embedded value represents the value of the Group's net assets attributable to shareholders, together with an estimate of the net present value of profits

attributable to shareholders from the policies in force. The capital structure set out above has been restated from that reported in previous periods to reflect the adoption of the reverse acquisition method of accounting as described more fully in Note 2 to these statements. This gave rise to an amount previously reported as a demerger reserve of £36,272,000 at 30 June 2004 and 31 December 2004 being included in share capital and involved no net change in stated embedded value at those dates.

The amounts presented above in respect of the six months ended 30 June 2004 and the year ended 31 December 2004 have also been restated from amounts previously reported, for the addback, at those respective period ends, of dividends proposed but not yet paid at the period end. These adjustments have been made to align the treatment of dividends proposed but not paid at the balance sheet date, under Achieved Profit reporting with IFRS, and for the purposes of reporting embedded value. Similarly, the interim dividend of £5.1m proposed as at 30 June 2005 has not been reflected as a movement on embedded value for the six months ended 30 June 2005 or as a reduction in embedded value as at that date.

The tables below set out the components of the in-force value by major product line at each period end:

	30 June 2005 000	30 June 2004 000	31 December 2004 000
<b>Number of policies</b>			
<b>CA</b>			
Endowment	72	84	78
Protection	88	113	99
Other	30	31	31
Total	190	228	208
<b>CWA</b>			
Endowment	20	—	—
Protection	24	—	—
Annuities	4	—	—
Pensions	36	—	—
Total	84	—*	—*
<b>CA and CWA combined</b>	<b>274</b>	<b>228</b>	<b>208</b>

\* Not applicable as not part of the Group at these dates.

Value in-force	30 June 2005 £m	30 June 2004 £m	31 December 2004 £m
<b>CA</b>			
Endowment	45.8	50.1	49.3
Protection	40.8	57.3	45.0
Other	3.2	4.7	3.3
Total	89.8	112.1	97.6
<b>CWA</b>			
Endowment	15.1	—	—
Protection	20.7	—	—
Annuities	3.1	—	—
Pensions	27.9	—	—
Total	66.8	—*	—*
<b>CA and CWA combined</b>	<b>156.6</b>	<b>112.1</b>	<b>97.6</b>
Valuation adjustments	2.8	(7.3)	3.0
Cost of capital	(6.0)	(4.0)	(4.4)
Total in-force value (pre-tax)	153.4	100.8	96.2
Taxation	(30.2)	(12.9)	(11.6)
<b>Total in-force value (post-tax)</b>	<b>123.2</b>	<b>87.9</b>	<b>84.6</b>

\* Not applicable as not part of the Group at these dates.

## Solvency and Regulatory Capital

### Regulatory capital resources and requirements

The following summarises the capital resources and requirements of the life businesses for regulatory purposes:

	30 June 2005 £m	30 June 2004 £m	31 December 2004 £m
<b>CA</b>			
Available capital resources (CR)	53.9	52.0	57.9
Capital resources requirement (CRR)	29.1	29.3	30.5
Target capital requirement cover	42.5	43.7	44.4
Excess of CR over target requirement	11.4	8.3	13.5
Ratio of available CR to CRR	185%	177%	190%
<b>CWA</b>			
Available capital resources (CR)	16.5	—*	—*
Capital resources requirement (CRR)	8.6	—*	—*
Target capital requirement cover	13.6	—*	—*
Excess of CR over target requirement	2.9	—*	—*
Ratio of available CR to CRR	192%	—*	—*

\* Not applicable as not part of the Group at these dates.

Available capital resource amounts are stated after appropriating final or interim dividends, as the case may be, which are treated as payable to the parent company, but which had not yet, at each period end, been approved by the respective CA or CWA Board.

CA's Board, as a matter of policy, will continue to target capital resource cover at 150%. The CA solvency position has benefited from the reduction of £3m to £6m in the Reassurer Default Reserve (held for regulatory solvency purposes only) against the possible default of Guardian Assurance plc ('GA'). This followed a review of publicly available information regarding the financial position of GA.

The CWA target capital requirement cover is expressed as a £5m excess over the regulatory CRR, as a consequence of a long-standing agreement with the FSA. If our internal target CR to CRR ratio of 150% had been applied, the excess of capital resources would be £3.6m.

It can be seen from this information that Chesnara plc, which relies on dividend distributions from its life businesses, CA and CWA, is currently in a favourable

position to service its loan commitments and to continue to pursue a progressive dividend policy.

### *Individual Capital Assessments*

CA has invested significant effort in updating its Individual Capital Assessment ('ICA'), which was submitted to the FSA. Further discussion has taken place with the FSA and whilst we are yet to receive formal feedback from them we are not expecting there to be any additional capital requirement as a result of their guidance. CWA have prepared an ICA which demonstrates that, as a well-capitalised predominantly unit-linked company, further capital support should not be required.

### *Investment Funds*

The Board continue to maintain a conservative approach to the investment of shareholder funds, which underpins our strong solvency position. In the past this has resulted in an approach which targeted the investment of 60% of funds in cash, 30% in fixed interest securities with the balance of 10% invested in equities. However, following the acquisition of CWA, whose embedded value is more exposed to equity markets than CA's, a review was undertaken of its incoming surplus and outgoing dividend cash flows. In view of the potential effect on solvency of equity volatility, the Board have reviewed the allocation of shareholder funds and decided that it is inappropriate to maintain the equity content. Therefore a revised benchmark of 70% cash and 30% fixed interest securities has been adopted.

On policyholder investment funds, and in particular the CA Managed Fund, which represents a significant proportion of these funds, the fund managers produced good performance during the half year. The fund benefited from improving equity markets and grew at 6.13% during the half year and was ahead of the ABI Life Balanced Managed Fund average of 5.83%. Apart from the impact on policyholders' policy values, this performance reduces the overall cost of mortgage endowment mis-selling redress payable and has led to an increase in the value in-force as the expected future charges based on fund value have been increased.

### *Developments*

In the second half of the year Chesnara will continue to investigate further consolidation opportunities, work with Liberata to ensure the timely and efficient migration to their systems, initiate the project to enable the transfer of the CWA long-term business into CA and continue with the development of IFRS reporting. We will also commence the processes to enable reporting on the European Embedded Value ('EEV') methodology for the first half of 2006.

### *Consolidation*

Having completed its first acquisition, the Board believe that further value-enhancing opportunities are possible in the small to medium sector of the market and they will continue to investigate suitable targets.

Part of the rationale for the acquisition of CWA was the potential for operating and financial synergies, including efficiency in regulatory reporting and in the use of capital which is required to support regulatory capital requirements. The Board believe that it is important to establish a uniform operating model for its acquired life businesses in run-off and to that end has authorised the effective combination of the businesses by way of a transfer of the CWA long-term business funds into those of CA under FSMA 2000. We will begin this process in the second half of 2005 with a target date of mid-2006, completion being dependent on the approval of the FSA and the High Court.

### *IFRS*

The next phase of the transition to IFRS will be undertaken during the second half of 2005. This will focus on the additional analysis and disclosures which will be included in the annual financial statements for the year ending 31 December 2005.

### *European Embedded Value*

We note the significant industry-wide development, in accordance with principles introduced in May 2004, to account for and present the results and financial position of life businesses on the EEV basis. It is our intention to adopt the EEV basis, in lieu of the Achieved Profit basis, when reporting the interim results for 2006. This will allow the changes to reporting to be made in conjunction with the effects of the expected transfer referred to above.

The change to EEV reporting will impact our method of reporting in a number of areas. Among the more significant are:

- (i) reformulation of the Risk Discount Rate, where the risk margin will be more transparently and objectively established and
- (ii) recognition of the future stream of shareholder expenses.

We do not currently expect these changes, taken together with a number of other lesser adjustments, to have a significant impact on our reported embedded value.

### *Outlook*

The results in the first six months have been adversely affected by the need to make further provision in respect of redress for endowment mis-selling. Whilst the increase is based on recent experience it takes account of the lower mailing volumes over the next year and the increasing effect of time-barring.

Prospects for the equity markets, which have recovered well in the first half-year, look positive but, based on discussion with our Investment Managers, lower returns are expected in the short and medium term.

The underlying emergence of surplus from realisation of the value of the in-force business should continue strongly, albeit at a lower level as the policy numbers decrease. Future surpluses will, however, be enhanced by the reasonably predictable future contribution from CWA.

### Dividend

After slightly exceeding our full year 2004 target dividend payment we have signalled that we would aim to provide a reliable and progressive dividend payment. Despite the negative influence of an additional endowment mis-selling provision, the healthy emergence of surplus from the underlying product base, together with a strong solvency position, enables the Board to recommend an interim dividend of 4.90p which represents an increase of 3.2% over the 2004 interim payment.

**Graham Kettleborough**  
**Chief Executive Officer**

5 October 2005

# Consolidated interim income statement for the six months ended 30 June 2005 (unaudited)

	Note	6 months ended 30 June 2005 £000	6 months ended 30 June 2004			Year ended 31 December 2004		
			Continuing operations £000	Discontinued operation £000	Total £000	Continuing operations £000	Discontinued operation £000	Total £000
Insurance premium revenue		54,900	64,331	–	64,331	122,835	–	122,835
Insurance premium ceded to reinsurers		(12,838)	(15,479)	–	(15,479)	(30,055)	–	(30,055)
Net insurance premium revenue		42,062	48,852	–	48,852	92,780	–	92,780
Fee and commission income								
Insurance contracts		23,959	28,849	–	28,849	54,359	–	54,359
Investment contracts		1,299	633	–	633	1,471	–	1,471
Investment income		61,529	12,214	9	12,223	57,000	9	57,009
<b>Total revenue (net of reinsurance payable)</b>		<b>128,849</b>	<b>90,548</b>	<b>9</b>	<b>90,557</b>	<b>205,610</b>	<b>9</b>	<b>205,619</b>
Other operating income		512	1,083	2,373	3,456	1,659	2,373	4,032
<b>Net income</b>		<b>129,361</b>	<b>91,631</b>	<b>2,382</b>	<b>94,013</b>	<b>207,269</b>	<b>2,382</b>	<b>209,651</b>
Policyholder claims and benefits incurred		(108,662)	(95,836)	–	(95,836)	(195,474)	–	(195,474)
Reinsurers' share of claims and benefits incurred		17,504	14,250	–	14,250	31,152	–	31,152
Net policyholder claims and benefits incurred		(91,158)	(81,586)	–	(81,586)	(164,322)	–	(164,322)
Change in investment contract liabilities		(23,451)	(5,115)	–	(5,115)	(17,200)	–	(17,200)
Reinsurers' share of investment contract liabilities		1,201	639	–	639	1,951	–	1,951
Net change in investment contract liabilities		(22,250)	(4,476)	–	(4,476)	(15,249)	–	(15,249)
Fees, commission and other acquisition costs		(3,124)	(7,023)	–	(7,023)	(12,135)	–	(12,135)
Administrative expenses		(7,741)	(5,542)	(2,268)	(7,810)	(12,180)	(2,268)	(14,448)
Other operating expenses								
Charge for amortisation of intangible assets		(460)	(230)	–	(230)	(383)	–	(383)
Other		(330)	(130)	(5)	(135)	(324)	(5)	(329)
<b>Total expenses</b>		<b>(125,063)</b>	<b>(98,987)</b>	<b>(2,273)</b>	<b>(101,260)</b>	<b>(204,593)</b>	<b>(2,273)</b>	<b>(206,866)</b>
<b>Operating profit</b>		<b>4,298</b>	<b>(7,356)</b>	<b>109</b>	<b>(7,247)</b>	<b>2,676</b>	<b>109</b>	<b>2,785</b>
Financing costs		(115)	(336)	–	(336)	(336)	–	(336)
Profit on sale of discontinued operation		–	–	1,948	1,948	–	1,948	1,948
<b>Profit/(loss) before tax</b>		<b>4,183</b>	<b>(7,692)</b>	<b>2,057</b>	<b>(5,635)</b>	<b>2,341</b>	<b>2,057</b>	<b>4,397</b>
Income tax expense		(871)	1,256	(4)	1,252	763	(4)	759
<b>Profit/(loss) for the period</b>		<b>3,312</b>	<b>(6,436)</b>	<b>2,053</b>	<b>(4,383)</b>	<b>3,103</b>	<b>2,053</b>	<b>5,156</b>
Basic earnings/(loss) per share	4	3.81p	(7.60)p	2.42p	(5.18)p	3.68p	2.42p	6.10p
Diluted earnings per share	4	3.81p	(7.60)p	2.42p	(5.18)p	3.67p	2.42p	6.09p
Dividend per share								
Interim		4.90p			4.75p			4.75p
Final								7.10p
Total								11.85p

The Group considers that it has no product or distribution based segmentation and, as it only has significant business activity within the UK, it has no geographic segmentation. Accordingly, no segmented reporting is presented.



# Consolidated interim balance sheet at 30 June 2005 (unaudited)

	Note	30 June		31 December 2004 £000
		2005 £000	2004 £000	
<b>Assets</b>				
Intangible assets				
Deferred acquisition costs		15,466	13,245	8,137
Acquired value of in-force business				
Insurance contracts		21,081	1,971	1,818
Investment contracts		12,398	—	—
Property and equipment		299	492	403
Investment properties		24,305	3,491	3,092
Financial assets				
Equity securities and holdings in collective investment schemes at fair value through income		866,193	387,791	421,132
Debt securities at fair value through income		520,307	319,438	351,772
Loans and receivables including insurance receivables		23,246	13,985	15,013
Derivative financial instruments		1,991	—	—
Total financial assets		1,411,737	721,214	787,917
Reinsurers' share of insurance contract provisions		175,353	153,993	158,762
Amounts deposited with reinsurers		23,120	21,254	22,888
Income taxes		105	—	103
Cash and cash equivalents		227,200	55,305	39,257
<b>Total assets</b>		<b>1,911,064</b>	<b>970,965</b>	<b>1,022,377</b>
<b>Liabilities</b>				
Insurance contract provisions		983,132	582,425	601,805
Financial liabilities				
Investment contracts at fair value through income		732,280	276,607	306,587
Borrowings	8	21,000	—	—
Derivative financial instruments		1,570	372	199
Total financial liabilities		754,850	276,979	306,786
Provisions		642	728	926
Deferred tax liabilities		8,420	2,771	1,748
Reinsurance payables		2,904	2,331	3,333
Payables related to direct insurance and investment contracts		26,272	16,745	14,351
Deferred income		21,379	8,381	8,038
Income taxes		2,845	499	1,198
Other payables		12,531	6,186	4,750
<b>Total liabilities</b>		<b>1,812,975</b>	<b>897,045</b>	<b>942,935</b>
<b>Net assets</b>		<b>98,089</b>	<b>73,920</b>	<b>79,442</b>
<b>Shareholders' equity</b>				
Share capital	7	41,501	40,500	40,500
Share premium		20,458	—	—
Other reserves		50	50	50
Retained earnings		36,080	33,370	38,892
<b>Total shareholders' equity</b>		<b>98,089</b>	<b>73,920</b>	<b>79,442</b>

# Consolidated interim statement of cash flows for the six months ended 30 June 2005 (unaudited)

	Note	6 months ended 30 June		Year ended 31 December 2004 £000
		2005 £000	2004 £000	
<b>Cash generated from operations</b>	<b>9</b>	29,164	29,551	18,777
Income tax paid		(1,585)	(171)	(1,392)
<b>Net cash from operating activities</b>		<b>27,579</b>	<b>29,380</b>	<b>17,385</b>
<b>Cash flows from investing activities</b>				
Acquisition of subsidiary, net of cash acquired		124,496	–	–
Disposal of subsidiary, net of cash disposed of		–	2,342	2,342
Purchases of property and equipment		(2)	(107)	(143)
<b>Net cash from investing activities</b>		<b>124,494</b>	<b>2,235</b>	<b>2,199</b>
<b>Cash flows from financing activities</b>				
Proceeds from the issue of share capital		23,533	50	50
Redemption of redeemable preference share		–	(50)	(50)
Proceeds from borrowings		21,000	–	–
Payment of transaction costs		(2,539)	–	–
Dividends paid		(6,124)	(10)	(4,027)
<b>Net cash from financing activities</b>		<b>35,870</b>	<b>(10)</b>	<b>(4,027)</b>
<b>Net increase in cash and cash equivalents</b>		<b>187,943</b>	<b>31,605</b>	<b>15,557</b>
<b>Cash and cash equivalents at beginning of period</b>		<b>39,257</b>	<b>23,700</b>	<b>23,700</b>
<b>Cash and cash equivalents at end of period</b>		<b>227,200</b>	<b>55,305</b>	<b>39,257</b>

# Consolidated interim statement of changes in equity for the six months ended 30 June 2005 (unaudited)

	Six months ended 30 June 2005				
	Share capital £000	Share premium £000	Capital redemption reserve £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2005</b>	<b>40,500</b>	<b>–</b>	<b>50</b>	<b>38,892</b>	<b>79,442</b>
Profit for the period representing total recognised income and expenses	–	–	–	3,312	3,312
Dividends	–	–	–	(6,124)	(6,124)
Issue of ordinary shares pursuant to exercise of option	84	1,449	–	–	1,533
Issue of ordinary shares pursuant to placing and open offer	917	21,083	–	–	22,000
Expenses incurred in connection with issue of ordinary shares pursuant to placing and open offer	–	(2,074)	–	–	(2,074)
<b>Equity shareholders' funds at 30 June 2005</b>	<b>41,501</b>	<b>20,458</b>	<b>50</b>	<b>36,080</b>	<b>98,089</b>

  

	Six months ended 30 June 2004			
	Share capital £000	Capital redemption reserve £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2004</b>	<b>40,500</b>	<b>–</b>	<b>37,477</b>	<b>77,977</b>
(Loss) for the period representing total recognised income and expenses	–	–	(4,383)	(4,383)
Dividends	–	–	(10)	(10)
Issue of redeemable preference share on reorganisation	50	–	–	50
Redemption of preference share	(50)	–	–	(50)
Transfer from retained earnings to redeem preference share	–	50	(50)	–
Grant of share option	–	–	336	336
<b>Equity shareholders' funds at 30 June 2004</b>	<b>40,500</b>	<b>50</b>	<b>33,370</b>	<b>73,920</b>

  

	Year ended 31 December 2004			
	Share capital £000	Capital redemption reserve £000	Retained earnings £000	Total £000
<b>Equity shareholders' funds at 1 January 2004</b>	<b>40,500</b>	<b>–</b>	<b>37,477</b>	<b>77,977</b>
Profit for the period representing total recognised income and expenses	–	–	5,156	5,156
Dividends	–	–	(4,027)	(4,027)
Issue of redeemable preference share on reorganisation	50	–	–	50
Redemption of preference share	(50)	–	–	(50)
Transfer from retained earnings to redeem preference share	–	50	(50)	–
Grant of share option	–	–	336	336
<b>Equity shareholders' funds at 31 December 2004</b>	<b>40,500</b>	<b>50</b>	<b>38,892</b>	<b>79,442</b>

# Notes to the consolidated interim financial statements (unaudited)

## 1 Basis of preparation

The consolidated interim financial statements of the Company for the six months ended 30 June 2005 comprise the interim financial statements of the Company and its subsidiaries (together referred to as 'the Group').

EU law (IAS Regulation EC 1606 /2002) requires that the next annual consolidated financial statements of the Company, for the year ending 31 December 2005, be prepared in accordance with International Financial Reporting Standards ('IFRSs') adopted for use in the EU ('EU-adopted IFRSs').

The interim financial statements have been prepared on the basis of the recognition and measurement requirements of IFRSs in issue that either are endorsed by the EU and effective (or available for early adoption) at 31 December 2005 or are expected to be endorsed and effective (or available for early adoption) at 31 December 2005, the Group's first annual reporting date at which it is required to use IFRSs. Based on these adopted and unadopted IFRSs the Directors have made assumptions about the accounting policies expected to be applied when the first IFRS annual financial statements are prepared for the year ending 31 December 2005.

In particular the Directors have assumed that the proposed amendments to IAS39 Financial Instruments: Recognition and Measurement (The Fair Value Option) issued by the International Accounting Standards Board will be adopted by the EU in sufficient time that they will be available for use in the annual IFRS financial statements for the year ending 31 December 2005.

In addition the adopted IFRSs that will be effective (or available for early adoption) in the annual financial statements for the year ending 31 December 2005 are still subject to additional interpretations and therefore cannot be determined with certainty. Accordingly the accounting policies for that annual period will be determined finally only when the annual financial statements are prepared for the year ending 31 December 2005.

The significant accounting policies applied in the preparation of these interim consolidated financial statements are set out in Notes 2 and 3 following. The accounting policies have been applied consistently to all periods presented in these consolidated interim financial statements and have also been applied in preparing an opening IFRS balance sheet at 1 January 2004 for the purposes of the transition to IFRS as required by IFRS 1 First-time Adoption of International Financial Reporting Standards.

The comparative figures for the financial year ended 31 December 2004 are not the company's statutory accounts for that financial year. Those accounts, which were prepared under UK GAAP, have been reported on by the company's auditors and delivered to the Registrar of Companies. The report of the auditors was unqualified and did not contain statements under section 237 (2) or (3) of the Companies Act 1985.

## 2 Life business demerger and acquisition by Chesnara plc – reverse acquisition accounting

On 24 May 2004, Chesnara plc acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ('CALH') from Countrywide plc ('Countrywide'), which had, itself, acquired the whole of the issued ordinary share capital of CALH on 22 May 2004 from Countrywide Assured Group plc ('CAG'). These arrangements were effected to secure the demerger from CAG of CALH, which, together with its subsidiary companies, comprised the Life Business of CAG.

On the acquisition of CALH, Chesnara plc issued, as fully paid, 2.5p ordinary shares to the shareholders of Countrywide ('the Countrywide shareholders') as recorded on the shareholders register on 21 May 2004, *pro rata* to their holding in Countrywide, such that they received one ordinary share in Chesnara plc for every two ordinary shares held in Countrywide. On 25 May 2004, the existing ordinary shares of 2.5p in Chesnara plc were consolidated into ordinary shares of 5p each on the basis of one new share for every two old shares, so that, in effect, the Countrywide shareholders received one ordinary 5p share in Chesnara plc for every four ordinary shares held in Countrywide.

In substance the transactions described above represent a continuation of the business of CALH. Chesnara plc, a company with net assets of £2 prior to its acquisition of CALH, was used as a vehicle effectively to secure a listing for the business of CALH on the London Stock Exchange, and, prior to its acquisition of CALH, such net assets did not comprise an integrated set of activities and assets which were capable of generating revenue or of providing a return to investors. Chesnara plc, at the date of its acquisition of CALH, did not, therefore, comprise a business as defined in IFRS 3 Business Combinations. However the consolidated financial statements of Chesnara plc have been prepared based on the reverse acquisition method as set out in IFRS 3, as the Directors consider that this is the fairest way of presenting the financial position, results of operations and cash flows of the combined entities. Accordingly CALH is deemed to be the effective acquirer of Chesnara plc and the consolidated financial statements have been prepared as a continuation of the consolidated financial statements of CALH and its subsidiaries. The consolidated income statement and cash flows for the six months ended 30 June 2004 and

# Notes to the consolidated interim financial statements (unaudited) (continued)

for the year ended 31 December 2004 represent the consolidated financial statements of CALH and the results of Chesnara plc are included in the consolidated financial statements from the demerger date as set out above.

The fair value of the identifiable net assets and of the equity instruments of Chesnara plc before its deemed acquisition by CALH are negligible and the deemed consideration, based on the fair value of the equity instruments deemed to have been issued by CALH to the shareholders of Chesnara plc, is also negligible and is taken as £nil. Accordingly, the application of the purchase method of accounting for the deemed acquisition of Chesnara plc by CALH does not give rise to any goodwill or negative goodwill in the consolidated financial statements.

## 3 Accounting policies

### (a) Basis of consolidation

#### *Subsidiaries*

The consolidated financial statements incorporate the assets, liabilities and the results of the Company and of its subsidiary undertakings. Subsidiary undertakings are those entities in which the Group directly or indirectly has the power to govern the financial and operating policies in order to gain benefits from its activities. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

### (b) Business combinations

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.

### (c) Product classification

The Group's products are classified as either insurance or investment contracts for accounting purposes. Insurance contracts are contracts, which transfer significant insurance risk. Contracts under which the transfer of insurance risk to the company from the policyholder is not significant are classified as investment contracts. Where contracts contain both insurance and investment components and the investment components can be measured reliably, the contracts are unbundled and the components are separately accounted for as insurance contracts and investment contracts respectively.

### (d) Insurance contracts

#### *(i) Premiums*

Premiums are accounted for on a receivable basis, or in the case of unit-linked insurance contracts when the liability is recognised, and exclude any taxes or duties based on premiums. Outward reinsurance premiums are accounted for on a payable basis.

#### *(ii) Claims and benefits*

Claims are accounted for in the accounting period in which they are due or notified. Surrenders are accounted for in the accounting period in which they are paid. Claims include policyholder bonuses allocated in anticipation of a bonus declaration. Reinsurance recoveries are accounted for in the same period as the related claim.

#### *(iii) Acquisition costs*

Acquisition costs comprise all direct and indirect costs arising from the conclusion of insurance contracts. An explicit deferred acquisition cost asset is established in the balance sheet to the extent that acquisition costs exceed initial fees deducted. Deferred acquisition costs are amortised at a rate based on the pattern of anticipated margins in respect of the related policies. Deferral of costs is limited to the extent that there are available future margins.

## Notes to the consolidated interim financial statements (unaudited) (continued)

### *(iv) Measurement of insurance contract provisions*

Under current IFRS requirements, insurance contract provisions are measured using accounting policies having regard to the principles laid down in Council Directive 2002/83/EC

Unit-linked provisions are measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

Insurance contract provisions are determined following an annual actuarial investigation of the long-term fund in accordance with regulatory requirements. The provisions are calculated on the basis of current information and using the appropriate valuation method. The Group's accounting policies for insurance contracts meet the minimum specified requirements for liability adequacy testing under IFRS 4 Insurance Contracts, as they consider current estimates of all contractual cash flows.

Long-term business provisions can never be definitive as to their timing nor the amount of claims and are therefore subject to subsequent reassessment on a regular basis.

Insurance contract provisions are tested for adequacy by discounting current estimates of all contractual cash flows and comparing this amount to the carrying value of the provision and any related assets. Where a shortfall is identified, an additional provision is made and the Group recognises the deficiency in income for the year.

### *(e) Investment contracts*

#### *(i) Amounts collected*

Amounts collected on investment contracts, which primarily involve the transfer of financial risk such as long-term savings contracts, are accounted for using deposit accounting, under which the amounts collected, less any initial fees deducted, are credited directly to the balance sheet as an adjustment to the liability to the investor.

#### *(ii) Amounts deposited with reinsurers*

Amounts deposited with reinsurers under finance reinsurance arrangements relating to investment contracts, which primarily involve the transfer of financial risk, are entered directly to the balance sheet as an amount due from the reinsurer. These assets are measured at fair value through income.

#### *(iii) Benefits*

For investment contracts, benefits paid are not included in the income statement but are instead deducted from investment contract liabilities in the accounting period in which they are paid.

#### *(iv) Acquisition costs*

Acquisition costs relating to investment contracts comprise directly attributable incremental acquisition costs, which vary with and are related to securing new contracts, and are recognised as an asset to the extent that they represent the contractual right to benefit from the provision of investment management services. The asset is presented as a deferred acquisition cost asset and is amortised over the expected term of the contract, as the fees relating to the provision of the services are recognised. All other costs are recognised as expenses when incurred.

#### *(v) Liabilities*

All investment contract liabilities are designated on initial recognition as held at fair value through income. The financial liability in respect of unit-linked contracts is measured by reference to the value of the underlying net asset value of the Group's unitised investment funds, determined on a bid value, at the balance sheet date. Deferred tax on unrealised capital gains is also reflected in the measurement of unit-linked provisions.

The fair value of other investment contracts is measured by discounting current estimates of all contractual cash flows that are expected to arise under contracts.



# Notes to the consolidated interim financial statements (unaudited) (continued)

## *(f) Contracts with discretionary participation features*

A discretionary participation feature is a contractual right held by a policyholder to receive, as a supplement to guaranteed minimum payments, additional payments that are likely to be a significant portion of the total contractual payments. All such contracts are wholly reinsured with Guardian Assurance plc, a subsidiary of Aegon NV and the amount or timing of the additional payments is contractually at the discretion of the reinsurer and are contractually based on:

- (i) the performance of a specified pool of contracts or a specified type of contract,
- (ii) realised and/or unrealised investment returns on a specified pool of assets held by the reinsurer, or
- (iii) the profit or loss of the reinsurer.

All contracts with discretionary participation features, whether classified as investment or insurance contracts, are accounted for as insurance contracts.

## *(g) Reinsurance*

The cost of reinsurance related to long-term insurance contracts is accounted for over the life of the underlying insurance policies using assumptions consistent with those used to account for the underlying policies. Amounts recoverable under reinsurance contracts are assessed for impairment at each balance sheet date.

Reinsurers' share of insurance contracts provisions include balances due from reinsurance companies for ceded insurance liabilities.

Amounts recoverable from reinsurers are estimated in a manner consistent with the outstanding claims provision or settled claims associated with the reinsured policy. Such assets are deemed impaired if there is objective evidence, as a result of an event that occurred after its initial recognition that the Group may not recover all amounts due and that the event has a reliably measurable impact on the amounts that the Group will receive from the reinsurer.

## *(h) Fee and commission income*

Fees charged for services related to the management of investment contracts are recognised as revenue as the services are provided. Initial fees which exceed the level of recurring fees and relate to the future provision of services, are deferred and amortised over the anticipated period in which services will be provided.

On both insurance and investment contracts, annual management charges and contract administration charges are recognised on an accruals basis. Surrender charges are recognised when the surrender benefits are paid.

Commissions received or receivable which do not require the Group to render further services are recognised as revenue by the Group on the effective commencement or renewal dates of the related contract. However, when it is probable that the Group will be required to render further services during the life of the contract, the commission, or part thereof, is deferred and recognised as revenue over the period in which services are rendered.

## *(i) Investment income*

Investment income comprises income from financial assets and investment properties, including dividends, interest and rent and gains and losses on financial assets (realised and unrealised).

Dividends are accrued on an ex-dividend basis. Interest and rent are accounted for on an accruals basis.

## *(j) Expenses*

### *(i) Operating lease payments*

Leases where a significant proportion of the risks and rewards of ownership is retained by the lessor are classified as operating leases. Payments made under operating leases are recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives received are recognised in the income statement as an integral part of the total lease expense.

## Notes to the consolidated interim financial statements (unaudited) (continued)

### (ii) *Financing costs*

Financing costs comprise interest payable on borrowings calculated using the effective interest rate method.

### (k) *Income taxes*

Income tax on the profit or loss for the year comprises current and deferred tax and is recognised in the income statement.

#### (i) *Current tax*

Current tax is the expected tax payable on the taxable income for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

#### (ii) *Deferred tax*

Deferred tax is provided using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. Deferred tax assets are reduced to the extent that it is no longer probable that the related tax benefit will be realised.

### (l) *Acquired value of in-force business*

Acquired in-force insurance and investment contracts are measured at fair value at the time of acquisition.

The difference between the fair value of insurance contracts and the liability measured in accordance with the accounting policies for the contracts is recorded as acquired present value of in-force business ('Acquired PVIF'). Acquired PVIF is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of surplus. It is tested for impairment annually.

Acquired PVIF in respect of in-force investment contracts is stated at cost less accumulated amortisation and impairment losses. The initial cost is deemed to be the fair value of the contractual customer relationships acquired. The acquired present value of the in-force investment contracts is carried gross of tax and is amortised against income on a time profile which, it is intended, will broadly match the profile of the underlying emergence of profit from the contracts. It is tested for impairment annually.

### (m) *Property and equipment*

Items of property and equipment are stated at cost less accumulated depreciation and impairment losses (see accounting policy (q)).

Depreciation is charged to the income statement on a straight-line basis over the estimated useful lives of the property and equipment as follows:

- Computers: 5 years
- Fixtures and fittings: 5 years
- Office equipment: 5 years
- Motor vehicles: 4 years

### (n) *Investment property*

Investment properties are properties which are held either to earn rental income or for capital appreciation or for both. Investment properties are stated at fair value. An external, independent valuation company, having an appropriate recognised professional qualification and recent experience in the location and category of property being valued, values the portfolio every twelve months.

## Notes to the consolidated interim financial statements (unaudited) (continued)

The fair values are based on market values, being the estimated amount for which a property could be exchanged on the date of valuation between a willing buyer and a willing seller in an arm's length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion.

Any gain or loss arising from a change in fair value is recognised in the income statement. Rental income from investment property is accounted for as described in accounting policy (i).

### (o) *Financial assets*

Debt and equity securities and holdings in collective investment schemes are all classified as fair value through income, with all gains and losses recognised through the income statement. The fair values of quoted financial assets are based on current bid prices.

The Group currently has no unquoted financial assets.

Loans and other receivables are stated at cost less impairment losses.

### (p) *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.

### (q) *Impairment*

The carrying amounts of the Group's assets which are not carried at fair value are reviewed at each balance sheet date to determine whether there is any indication of impairment. If any such indication exists, the assets' recoverable amount is estimated. An impairment loss is recognised whenever the carrying amount of an asset exceeds its recoverable amount. Impairment losses are recognised in the income statement.

Impairment losses are reversed through the income statement if there is a change in the estimates used to determine the recoverable amount. Such losses are reversed only to the extent that the assets' carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation where applicable, if no impairment loss had been recognised.

### (r) *Provisions*

Provisions are recognised when the Group has a present, legal or constructive obligation as a result of past events such that it is probable that an outflow of economic benefits will be required to settle the obligation and a reliable estimate of the amount of the obligation can be made. The Group recognises provisions for onerous contracts when the expected benefits to be derived from a contract are less than the unavoidable costs of meeting the obligations under the contract.

### (s) *Borrowings*

Borrowings are recognised initially at fair value, net of transaction costs, and subsequently stated at amortised cost. The difference between the proceeds and the redemption value is recognised in the income statement over the borrowing period on an effective interest rate basis.

### (t) *Employee benefits*

#### (i) *Pension obligations*

Group companies operate defined contribution pension schemes, which are funded through payments to insurance companies, to which Group companies pay fixed contributions. There are no legal or constructive obligations on Group companies to pay further contributions if the fund does not hold sufficient assets to pay employee benefits relating to service in current and prior periods. Accordingly, Group companies have no further payment obligations once the contributions have been paid.

Contributions to defined contribution pension schemes are recognised as employee benefit expense when they are due.

# Notes to the consolidated interim financial statements (unaudited) (continued)

## (ii) Bonus plans

The Group recognises a liability and an expense for bonuses based on a formula that takes into consideration the profit attributable to the Company's shareholders after certain adjustments. The Group recognises a liability where contractually obliged.

## (u) Share capital

Shares are classified as equity when there is no obligation to transfer cash or other assets. Incremental costs directly attributable to the issue of equity instruments are shown in equity as a deduction from the proceeds, net of tax. Incremental costs directly attributable to the issue of equity instruments, as consideration for the acquisition of a business, are included in the cost of acquisition.

## (v) Dividends

Dividend distributions to the Company's shareholders are recognised as liabilities in the period in which the dividends are paid, and, for the final dividend, when approved by the Company's shareholders at the annual general meeting.

## 4 Earnings/(loss) per share

Earnings/(loss) per share is based on the following:

	6 months ended 30 June		Year ended 31 December 2004
	2005	2004	
Profit/(loss) for the period (£000)	3,312	(4,383)	5,156
Weighted average number of ordinary shares	86,842,651	84,564,168	84,564,168
Basic earnings/(loss) per share	3.81p	(5.18)p	6.10p
Diluted earnings/(loss) per share	3.81p	(5.18)p	6.09p

The basic and diluted loss per share in respect of the six months ended 30 June 2004 and the year ended 31 December 2004 is stated after taking account of profit after tax arising on the sale of a discontinued operation.

The weighted average number of shares in respect of the six months ended 30 June 2004 and the year ended 31 December 2004, is the number of ordinary shares, entitled to dividend, in issue at each of those respective dates. Except for the cancellation of 2 ordinary shares on 22 June 2004, the effect of which is not considered to be material, this corresponds to the number of ordinary shares issued by Chesnara plc on 25 May 2004 in accordance with the scheme of demerger described in Note 2 above. This number of shares has been applied uniformly to the results after tax for both the six months ended 30 June 2004 and the year ended 31 December 2004, as this is considered to be the most meaningful way to present earnings and loss per share for these periods, having regard to the basis on which the results have been presented as set out in Note 2 above.

The weighted average number of shares in respect of the six months ended 30 June 2005 is based on 84,564,168 shares in issue at the beginning of the period and on the issues of shares during the period as described in Note 7.

The diluted weighted average number of shares is 86,914,457, reflecting an adjustment for the equivalent number of shares that would be issued, for no consideration, had the exercise of the share option described in Note 7 been exercised prior to its actual exercise date of 10 February 2005. There were no further share options outstanding during the six months ended 30 June 2005.

# Notes to the consolidated interim financial statements (unaudited) (continued)

## 5 Dividend

A final dividend in respect of the year ended 31 December 2004 of £6.1m paid on 29 April 2005 was based on 86,255,452 shares in issue at a rate of 7.1p per share.

The interim dividend in respect of the six months ended 30 June 2005 of £5.1m is based on 104,588,785 shares in issue at a rate of 4.9p per share and will be paid on 14 November 2005 to shareholders registered at close of business on 14 October 2005, the dividend record date. The ex-dividend date is 12 October 2005.

## 6 Business combinations

On 2 June 2005, Chesnara plc acquired the whole of the issued ordinary share capital of CWA Life Holdings plc ('CWALH'), formerly Irish Life (UK) Holdings plc, from Irish Life and Permanent plc, of which City of Westminster Assurance Company Limited ('CWA') was a wholly-owned subsidiary. CWA is the principal operating subsidiary of CWALH and is a UK based business concentrating on the operation of a life assurance book which is substantially closed to new business. The acquired business contributed revenues of £23,074,000 and net profit of £410,000 to the Chesnara plc Group for the period from 2 June 2005 to 30 June 2005. If the acquisition had occurred on 1 January 2005, Chesnara plc Group's revenue would have been £175,506,000 and net profit would have been £5,085,000 for the six months ended 30 June 2005 (this information is unaudited).

Details of net assets acquired and goodwill are as follows:

	£000
<b>Purchase consideration:</b>	
Cash paid	47,500
Direct costs relating to the acquisition	278
Total purchase consideration	47,778
Fair value of net assets acquired	47,778
Goodwill	—

No goodwill arises on the acquisition of CWALH. This is because the principal operating subsidiary of CWALH, CWA, is closed to new business and because the excess of the total purchase consideration paid over the fair value of the identifiable tangible net assets of the CWALH Group at the acquisition date has been established as the fair value of the intangible assets at the acquisition date, being the purchased value attributed to acquired in-force investment and insurance contracts.

## Notes to the consolidated interim financial statements (unaudited) (continued)

The assets and liabilities arising from the acquisition are as follows:

	Fair value £000	Acquiree's carrying amount £000
Intangible assets		
Deferred acquisition costs	9,858	9,858
Acquired value of in-force business		
Insurance contracts	19,619	—
Investment contracts	12,502	—
Investment properties	20,986	20,986
Financial assets		
Equity securities at fair value through income	419,948	419,948
Debt securities at fair value through income	160,605	160,605
Loans and receivables including insurance receivables	16,101	16,101
Derivative financial instruments	678	678
Deferred tax assets	—	3,024
Reinsurers' share of insurance contract provisions	8,241	8,241
Cash and cash equivalents	172,275	172,275
Insurance contract provisions	(344,138)	(344,138)
Financial liabilities		
Investment contracts at fair value through income	(409,865)	(409,865)
Derivative financial instruments	(1,614)	(1,614)
Deferred tax liabilities	(7,136)	—
Payables related to direct insurance and investment contracts	(10,027)	(10,027)
Deferred income	(13,859)	(13,859)
Income taxes	(1,206)	(1,206)
Other payables	(5,190)	(5,190)
<b>Net assets</b>	<b>47,778</b>	<b>25,817</b>



# Notes to the consolidated interim financial statements (unaudited) (continued)

## 7 Share capital

### Group

	30 June				31 December	
	2005		2004		2004	
	Number of shares	Share capital £000	Number of shares	Share capital £000	Number of shares	Share capital £000
<b>Share capital</b>	<u>104,588,785</u>	<u>41,501</u>	<u>84,564,168</u>	<u>40,500</u>	<u>84,564,168</u>	<u>40,500</u>

Under the reverse acquisition basis of accounting referred to in Note 2, at the date of acquisition of Chesnara plc (the legal parent) the amount of issued share capital in the consolidated balance sheet represents the amount of issued share capital of Countrywide Assured Life Holdings Limited (the legal subsidiary) immediately before the acquisition and the deemed cost of acquisition, which as explained in Note 2 is taken as £nil. The number and value of shares representing the equity structure, reflects the equity structure of Chesnara plc as set out below.

### Company

The share capital of Chesnara plc comprises:

	30 June		31 December 2004 £
	2005 £	2004 £	
<b>Authorised</b> Ordinary shares of 5p each	<u>10,050,000</u>	<u>10,050,000</u>	<u>10,050,000</u>
<b>Issued</b> Ordinary shares of 5p each	<u>5,229,439</u>	<u>4,228,208</u>	<u>4,228,208</u>

# Notes to the consolidated interim financial statements (unaudited) (continued)

The following sets out changes in the authorised and issued share capital of Chesnara plc during the six months ended 30 June 2005.

## Ordinary shares of 5p each

	Authorised		Issued	
	Number	£	Number	£
Balance at 1 January 2005	201,000,000	10,050,000	84,564,168	4,228,208
Issue and allotment on 10 February 2005 pursuant to exercise of share option	—	—	1,691,284	84,564
Issue and allocation on 2 June 2005 pursuant to placing and open offer	—	—	18,333,333	916,666
Balance at 30 June 2005	<u>201,000,000</u>	<u>10,050,000</u>	<u>104,588,785</u>	<u>5,229,439</u>

Pursuant to an agreement dated 18 March 2004 between Chesnara plc and Numis Securities Limited ('Numis'), Numis received, on the admission of Chesnara plc to the Official List of the UK Listing Authority, an option to subscribe for Chesnara plc shares equivalent in number to 2% of the issued share capital of Chesnara plc at the date of admission.

On 10 February 2005, pursuant to a notice of exercise of such option by Numis, the Board approved the issue and allotment of 1,691,284 new ordinary shares of 5p each to rank *pari passu* with the existing ordinary shares of 5p each. The consideration received from Numis in respect of the allotment of shares was £1,533,318, of which £84,564 was credited to the called up share capital account and £1,448,754 was credited to share premium account. On 16 February 2005 the newly issued shares were admitted to trading on the London Stock Exchange.

On 2 June 2005, pursuant to a placing and open offer, the Board approved the issue and allotment of 18,333,333 new ordinary shares of 5p each to rank *pari passu* with the existing ordinary shares of 5p each. The arrangements, which were underwritten by Numis Securities Limited, involved the placing of 9,707,788 ordinary shares at a subscription price of 120p per share and an open offer of 8,625,545 ordinary shares on the basis of 1 new share for every 10 existing ordinary shares, also at a subscription price of 120p per share. The proceeds from the consequential subscription for new ordinary shares were £22,000,000, of which £916,667 was credited to the called up share capital account and of which £21,083,333 was credited to the share premium account. Expenses of £2,074,000 which were incurred in connection with these arrangements were charged to the share premium account. The gross proceeds of £22,000,000 were used to part finance the acquisition of CWA Life Holdings plc, as referred to in Note 6.

## 8 Borrowings

	30 June		31 December
	2005 £000	2004 £000	2004 £000
Bank loan	<u>21,000</u>	<u>—</u>	<u>—</u>

The bank loan which was drawn down on 2 June 2005 under a facility made available on 4 May 2005 is unsecured and is repayable in five equal annual amounts on the anniversary of the draw down date. Accordingly the current portion as at 30 June 2005, being that payable within one year is £4,200,000 and the non-current portion is £16,800,000. The outstanding principal on the loan bears interest at a rate based on the London Inter-bank Offer Rate and is payable in arrears over a period which varies between one and six months at the option of the borrower.

# Notes to the consolidated interim financial statements (unaudited) (continued)

## 9 Cash generated from operations

	6 months ended 30 June		Year ended 31 December
	2005 £000	2004 £000	2004 £000
Profit/(loss) for the year	3,312	(4,383)	5,156
Adjustments for:			
Depreciation	105	179	302
Amortisation of deferred acquisition costs	2,529	6,127	11,235
Amortisation of acquired in-force value	460	230	383
Tax expense/(recovery)	871	(1,252)	(759)
Change in fair value of investment properties	(227)	(488)	(89)
Fair value (gains)/losses on financial assets	(27,309)	1,098	(31,086)
Loss on sale of property and equipment	1	–	4
Profit on sale of subsidiary	–	(1,948)	(1,948)
Interest expense	115	–	–
Equity settled share based payment expense	–	336	336
Changes in operating assets and liabilities (excluding the effect of acquisitions)			
Decrease in financial assets	1,320	40,545	6,326
Increase in reinsurers' share of insurance contract provisions	(8,350)	(331)	(5,100)
Increase in amounts deposited with reinsurers	(232)	(1,104)	(2,738)
Increase in insurance contract provisions	26,176	2,015	21,395
Increase/(decrease) in investment contract liabilities	15,828	(9,369)	20,611
Increase/(decrease) in provisions	2,318	(738)	(540)
Increase/(decrease) in reinsurance payables	(429)	1,246	2,248
Increase/(decrease) in payables related to direct insurance and investment contracts	11,921	1,651	(743)
Increase/(decrease) in other payables	755	(4,263)	(6,216)
Cash generated from operations	<u>29,164</u>	<u>29,551</u>	<u>18,778</u>
In the cash flow statement proceeds from the sale of property and equipment comprise:			
Net book amount	(1)	–	(4)
Loss on sale	<u>(1)</u>	<u>–</u>	<u>(4)</u>
Proceeds from sale	<u>–</u>	<u>–</u>	<u>–</u>

# Notes to the consolidated interim financial statements (unaudited) (continued)

## 10 Statutory accounts

The financial information presented in these consolidated interim financial statements is unaudited and does not constitute statutory accounts. The comparative figures for the financial year ended 31 December 2004 are not the company's statutory accounts for that period. Those accounts, which were prepared under UK GAAP, were reported on by the company's auditors and were delivered to the Registrar of Companies, the report of auditors contained therein being unqualified and not containing a statement under section 237 (2) or (3) of the Companies Act 1985.

## 11 Approval of interim report

This interim report was approved by the Board of Directors on 4 October 2005. A copy of the report is being sent to all shareholders on 12 October 2005 and will be available to the public at the company's registered office, Harbour House, Portway, Preston PR2 2PR, UK and at [www.chesnara.co.uk](http://www.chesnara.co.uk).

## Supplementary information on the Achieved Profit basis

### I Life assurance profit analysis on the Achieved Profit basis

#### (a) Basis of presentation

Supplementary information is presented in these supplementary notes which presents summary data relating to the results and financial position of the Group on the Achieved Profit basis, the objective of which is to provide alternative information to that presented in accordance with International Financial Reporting Standards (IFRSs). The information includes the result of the Group's Life Assurance long-term business on a basis determined in accordance with the ABI Guidance "Supplementary reporting for long-term assurance business" (the 'Achieved Profit method') issued in December 2001.

References to 'Notes' in this supplementary information are to the notes to the interim financial statements prepared in accordance with IFRS.

The unaudited interim supplementary information prepared on the Achieved Profit basis and unaudited comparative figures for the year ended 31 December 2004 are the results and financial position of the Chesnara plc Group as deemed appropriate under the reverse acquisition method of accounting as described in Note 2. In accordance with that method, the consolidated results and financial position of Chesnara plc are based on the consolidated results and financial position of Countrywide Assured Life Holdings Limited.

Dividends declared after the balance sheet date are not recognised at the balance sheet date, because they do not represent a present obligation. This treatment, which accords with IFRS, represents a change from previous accounting treatment on the Achieved Profit basis and amounts previously reported as net assets and embedded value as at 30 June 2004 and 31 December 2004 are, accordingly, restated. Except for these adjustments, there are no other adjustments required, for reporting on the Achieved Profit basis, as a result of the Group's transition to IFRS as the basis of preparation of its primary financial statements.

As described in Note 6 the Group acquired CWA Life Holdings plc on the 2 June 2005, the principal operating subsidiary of which is City of Westminster Assurance Company Limited ('CWA'), which is engaged in long-term assurance business. The achieved profit result set out on page 31 includes the achieved profit arising within CWA from the date of acquisition to 30 June 2005. The excess of the embedded value of CWA (on the Achieved Profit basis) over the total purchase consideration, has been treated as an exceptional credit to the achieved profit result of the Group for the six months ended 30 June 2005 as set out on page 31.

The unaudited comparative figures for the six months ended 30 June 2004 have been presented to provide consistent treatment and disclosure between periods.

**(b) Achieved Profit result**

	6 months ended 30 June		Year ended 31 December
	2005 £000	2004 £000	2004 £000
<b>New business contribution</b>	170	331	664
<b>Existing business contribution</b>			
Expected return	4,423	5,364	10,708
Experience variances			
Persistency	2,576	1,759	2,854
Complaints and pensions review redress	(4,846)	(16,796)	(17,556)
Mortality/morbidity	(781)	(871)	(1,030)
Other	1,036	2,486	3,541
Operating assumption charges			
Persistency	–	(6,005)	(9,105)
Expenses and expense deductions	(209)	(190)	3,110
Other	–	–	(220)
Expected return on unencumbered capital	542	430	1,152
<b>Operating profit before tax and exceptional items</b>	<b>2,911</b>	<b>(13,492)</b>	<b>(5,882)</b>
Exceptional items			
Profit on acquisition and sale of subsidiary companies	18,446	1,948	1,948
<b>Operating profit before tax</b>	<b>21,357</b>	<b>(11,544)</b>	<b>(3,934)</b>
Investment variances	2,294	295	1,774
Economic assumption changes			
Investment return	(4,711)	(445)	(2,146)
Risk discount rate	3,229	–	1,320
<b>Achieved profit before taxation</b>	<b>22,169</b>	<b>(11,694)</b>	<b>(2,986)</b>
Taxation	(5,754)	3,674	3,455
<b>Achieved profit after taxation</b>	<b>16,415</b>	<b>(8,020)</b>	<b>469</b>

The exceptional profit arising during the six months ended 30 June 2005 relates to the acquisition of CWA Life Holdings plc and represents the excess of the embedded value of that company over the total purchase price. The exceptional profit arising during the six months ended 30 June 2004 and the year ended 31 December 2004 relates to the sale of Key Retirement Solutions Limited, being the excess of the net proceeds received over its carrying value.



### (c) Methodology

The Achieved Profit methodology recognises as an element of “Shareholder Funds” the discounted value of the expected future statutory surpluses arising from the insurance and investment contracts in force at the period end. These future surpluses are calculated by projecting future cash flows using realistic assumptions for each component of cash flow. Demographic actuarial assumptions adopted for the determination of discounted value are generally reviewed annually, although more frequent reviews are carried out if there is evidence of material changes. Future economic and investment assumptions are based on period end conditions.

### (d) Key assumptions

The table below shows the key economic and investment assumptions used in the calculation of the value of the in-force business, being that subsisting within Countrywide Assured plc (‘CA’) and City of Westminster Assurance Company Limited (‘CWA’).

	6 months ended 30 June		Year ended 31 December
	2005 %	2004 %	2004 %
Risk discount rate			
CA	8.30	9.25	9.00
CWA	7.70	n/a	n/a
Future expenses inflation			
CA	3.30	3.85	3.10
CWA	2.60	n/a	n/a
Future expense charge inflation rate			
CA	3.30	3.85	3.10
CWA	2.60	n/a	n/a
Future RPI	2.60	2.85	2.50
Unit-linked funds			
Income (pre-tax)	3.23	3.43	3.30
Capital Growth (pre-tax)	3.09	3.79	3.52
Unit-linked funds (total)	6.32	7.22	6.82
<b>Investment returns (pre-tax)</b>			
Government fixed interest	4.20	5.10	4.70
Other fixed interest	4.40	5.50	5.20
Equity	6.80	7.70	7.30
Property	6.80	7.70	7.30

The risk discount rate is used to discount projected future cash flows from the business in-force to present value and is set within the context of assumptions for future investment returns.

The principal economic assumptions have been determined by reference to underlying medium term government fixed interest yields at the respective valuation dates. Other fixed interest yield assumptions reflect the yield curve for different asset outstanding terms and credit and liquidity risk adjustments. The equity return assumes, over the longer term, a risk premium over 5–15 year government fixed interest yields.

Future persistency experience assumptions are determined, in the main, by reference to the life businesses' own emerging experience of individual products, but with some allowance recognised for external industry experience and trends. Explicit allowance for anticipated short-term adverse persistency risk has been reflected by the inclusion, for CA business only, within the core annualised product line lapse assumption rates, of temporary decrement rates, being 8% pa for Endowment business and 3.5% pa for Protection business, with the additional decrement rates assumed operable from 31 December 2004 for temporary periods of twelve months (Endowment business) and six months (Protection business).

Mortality and morbidity decrement assumptions are determined by reference to emerging underlying experience, published industry data and reinsurer rates. Due regard is paid in setting the experience assumptions to policyholder reasonable expectations as mortality and morbidity costs are met by charges against unit accounts.

The renewal expense assumptions reflect the charges under the Insurance Administration Services Agreement with Liberata Financial Services Limited for CA and the charges under the Insurance and Pensions Services Agreement with CSC Services Limited for CWA, together with the residual governance expenses attributable to the life businesses.

During 2003, the CA life business substantially closed to new business and the allowance for future expenses in the calculation of the embedded value at 30 June 2004, 31 December 2004 and 30 June 2005 has been based on management's view of total company expenses chargeable to the long-term business. In addition, the Board has decided, on the grounds of prudence, that, in view of the uncertain outlook for expenses over the longer term, cash flows arising in CA beyond a 13.5-year time horizon should be excluded from the value of policies in-force.

CWA has been substantially closed to new business for a longer period of time than CA and the predictability of its future expenses is accordingly more certain.

Allowance has been made, in both the CA and CWA renewal expense assumptions, for additional VAT costs which may arise on third-party insurance administration arrangements. This follows the issue by HM Revenue and Customs of a consultation document in July 2005 entitled "Changes to the VAT Exemption for Insurance-related Services".

The provisions established to cover redress on endowment complaints, in both the CA and CWA businesses is based on recent experience of complaints cases, assuming the life businesses continue to deal with complaints in accordance with the regulator's procedural requirements, including the application of time-barring.

The portion of a reinsurer default reserve held within CA that relates to unit-linked business is assumed to be released within six months. However, the portion of this reserve that relates to with-profits business is assumed to be released over the expected lifetime of that business.

Expenses inflation and indexation of capital gains assumptions are set within the context of rates of price inflation implicit within the yields of 5–15 year index-linked gilt edged securities.

Future fund management expenses are based on current fees charged to the life businesses.

Tax has been provided at the rates applicable to investment income and expenses relief provided under relevant life company tax legislation, which is assumed to continue unaltered. A projection of future tax charges, based on an assumption of continuation of current tax rules, is made and is discounted at the risk discount rate to produce a deferred tax charge at the period end. The net result is grossed up by the deferred tax charge movement and current tax to derive the gross results.

## 2 Value of policies in force and embedded value

	6 months ended 30 June		Year ended 31 December 2004
	2005 £000	2004 £000 (restated)	2004 £000 (restated)
<b>Value of policies in force</b>			
At beginning of period, net of tax	84,594	98,521	98,521
Purchased in-force value arising on the acquisition of CWA Life Holdings plc, net of tax	44,368	–	–
Gross decrease in the value of policies in force	(7,797)	(14,859)	(19,452)
Taxation	2,087	4,239	5,525
At end of period, net of tax	123,252	87,901	84,594
Other net assets at end of period	57,685	56,814	64,593
<b>Embedded value at end of period</b>	<b>180,937</b>	<b>144,715</b>	<b>149,187</b>

The amounts presented as net assets at end of period and as embedded value at end of period, as at 30 June 2004 and 31 December 2004, have been restated from amounts previously reported for the effect of the addback, at those respective period ends, of dividends proposed but not yet paid at the period end. These adjustments were made to align the treatment of dividends proposed but not paid at the period end under Achieved Profit reporting with IFRS, and for the purposes of reporting Embedded Value.

The following summarises the effect of the adjustments which have been made.

	30 June 2004		31 December 2004	
	As previously reported £000	As restated £000	As previously reported £000	As restated £000
Net assets	52,797	56,814	58,469	64,593
Embedded value	140,698	144,715	143,063	149,187

### 3 Reconciliation of shareholder equity on the IFRS basis to embedded value

	30 June		31 December
	2005 £000	2004 £000	2004 £000
<b>Shareholders' equity on the IFRS basis</b>	<b>98,089</b>	<b>73,920</b>	<b>79,442</b>
Adjustments:			
Deferred acquisition costs			
Insurance contracts	(2,817)	(10,134)	(5,120)
Investment contracts	(11,989)	(2,402)	(2,324)
Deferred income	20,302	7,228	6,910
Adjustment to provisions on investment contracts	(14,474)	(3,524)	(4,038)
Adjustments to provisions on insurance contracts	(1,447)	(348)	62
Revaluation of financial assets/adjustment to contract liabilities	—	200	359
Acquired in-force value	(23,228)	(1,758)	(1,622)
Deferred tax	(751)	2,632	1,638
<b>Sub total</b>	<b>63,685</b>	<b>65,814</b>	<b>75,307</b>
Reinsurer default reserve	(6,000)	(9,000)	(9,000)
Reserve for additional costs	—	—	(1,714)
<b>Sub total</b>	<b>57,685</b>	<b>56,814</b>	<b>64,593</b>
Value of in-force book	123,252	87,901	84,594
<b>Embedded value</b>	<b>180,937</b>	<b>144,715</b>	<b>149,187</b>

The reinsurer default reserve and the reserve for additional costs relate to reserves which are established for FSA prudential reporting. Neither of these reserves are recognised for reporting in accordance with IFRSs or for establishing embedded value, either at 30 June 2004 or 31 December 2004, as the case may be, as the events to which they relate were, in the opinion of the Directors, considered to be remote or uncertain. However, the reserves are charged to the shareholder net assets component of embedded value, but are released within the value-in-force calculations. This method is used so that the cost of capital of maintaining the relevant reserves is recognised within the overall embedded value calculation.

The reassurer default reserve relates to the reserve which is maintained against the effect of possible default by a major reinsurer, Guardian Assurance plc, which is a subsidiary of Aegon NV.

The adjustment for the reserve for additional costs related to VAT which may become assessable on charges made under an Insurance Administration Services Agreement with Liberata Financial Services Limited. Following a decision delivered in the European Court of Justice in early 2005 in the case of *Staatssecretaris van Financiën v Arthur Andersen and Co, Accountants*, there was uncertainty whether charges made under such arrangements would be exempt from VAT. However following the issue of a Consultation Document entitled “Changes to the VAT Exemption for Insurance-related Services” by HM Revenue and Customs in July 2005, subsequent to that decision, the Directors are of the opinion that it is appropriate to establish reserves for additional VAT costs as at 30 June 2005 for reporting in accordance with IFRS and for establishing embedded value as at that date. Accordingly, the IFRS treatment accords with the treatment in measuring embedded value and the adjustment in the reconciliation set out above is no longer required as at 30 June 2005.

# Independent review report by KPMG Audit Plc to Chesnara plc

## Introduction

We have been engaged by the Company to review the financial information set out on pages 13 to 29 and we have read the other information contained in the interim report and considered whether it contains any apparent misstatements or material inconsistencies with the financial information.

This report is made solely to the Company in accordance with the terms of our engagement to assist the Company in meeting the requirements of the Listing Rules of the Financial Services Authority. Our review has been undertaken so that we might state to the Company those matters we are required to state to it in this report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company for our review work, for this report, or for the conclusions we have reached.

## Directors' responsibilities

The interim report, including the financial information contained therein, is the responsibility of and has been approved by the Directors. The Directors are responsible for preparing the interim report in accordance with the Listing Rules which require that the accounting policies and presentation applied to the interim figures should be consistent with those applied in preparing the preceding annual financial statements except where any changes, and the reasons for them, are disclosed.

As disclosed in Note I to the financial information, the next annual financial statement of the group will be prepared in accordance with IFRSs adopted for use in the European Union.

The accounting policies that have been adopted in preparing the financial information are consistent with those that the Directors currently intend to use in the next financial statements. There is, however, a possibility that the Directors may determine that some changes to these policies are necessary when preparing the full annual financial statement for the first time in accordance with those IFRSs adopted for use by the European Union. This is because, as disclosed in Note I, the Directors have anticipated that certain standards, which have yet to be formally adopted for use in the EU, will be so adopted in time to be applicable to the next annual financial statements.

## Review work performed

We conducted our review in accordance with guidance contained in Bulletin 1999/4 "Review of interim financial information" issued by the Auditing Practices Board for use in the United Kingdom. A review consists principally of making enquiries of Group management and applying analytical procedures to the financial information and underlying financial data and, based thereon, assessing whether the accounting policies and presentations have been consistently applied unless otherwise disclosed. A review is substantially less in scope than an audit performed in accordance with Auditing Standards and therefore provides a lower level of assurance than an audit. Accordingly, we do not express an audit opinion on the financial information.

## Review conclusion

On the basis of our review we are not aware of any material modifications that should be made to the financial information as presented for the six months ended 30 June 2005.

## KPMG Audit Plc

Chartered Accountants

Manchester

5 October 2005

## Part 2 – Explanation of transition to International Financial Reporting Standards

### A. Introduction

As stated in Note 1 of Part 1 of this document these are the Group's first consolidated interim financial statements for part of the period which will be covered by the first annual consolidated financial statements to be prepared in accordance with International Financial Reporting Standards ('IFRSs'). The Group's transition date for IFRS reporting purposes is 1 January 2004.

The accounting policies set out in Notes 2 and 3 of Part 1 of this document have been consistently applied in preparing the consolidated interim financial statements for the six months ended and as at 30 June 2005 and the comparative information for the six months ended and as at 30 June 2004 and for the year ended and as at 31 December 2004. They have also been applied in the preparation of an opening balance sheet prepared in accordance with IFRS at 1 January 2004, the transition date. In preparing this comparative information in accordance with IFRSs the Group has adjusted amounts previously reported in financial statements prepared in accordance with UK GAAP. An explanation of how the transition from UK GAAP to IFRSs has affected the Group's financial position and financial performance is set out in the following tables and in the notes that accompany the tables.

This information is prepared on the basis of the recognition and measurement requirements of IFRSs in issue that either are endorsed by the EU and effective (or available for early adoption) at 31 December 2005 or are expected to be endorsed and effective (or available for early adoption) at 31 December 2005, the Group's first annual reporting date at which it is required to use IFRSs. Based on these adopted and unadopted IFRSs the Directors have made assumptions about the accounting policies expected to be applied when the first IFRS annual financial statements are prepared for the year ending 31 December 2005.

In particular the Directors have assumed that the proposed amendments to IAS39 Financial Instruments: Recognition and Measurement (The Fair Value Option) issued by the International Accounting Standards Board will be adopted by the EU in sufficient time that they will be available for use in the annual IFRS financial statements for the year ending 31 December 2005.

### B. Transitional arrangements on first time adoption of IFRS

Companies are required to apply their IFRS accounting policies retrospectively to determine IFRS opening balance sheets and comparative figures. However, IFRS 1 First-Time Adoption of International Financial Reporting Standards provides a number of exemptions to this general principle. The Group has not taken advantage of the exemptions to retrospective application set out in IFRS 1 and has applied all relevant standards retrospectively, with the following exception:

The Group has elected to apply IFRS 1, Paragraph 25A, which permits financial assets and liabilities to be designated as fair value through income at the date of transition to IFRS, whereas IAS39 Financial Instruments: Recognition and Measurement would require this designation only to be made on initial recognition.

The Group has also elected not to apply the exemptions from presenting comparative information in accordance with IFRS 4 Insurance Contracts, IFRS 5 Non-current Assets Held For Sale And Discontinued Operations, IAS32 Financial Instruments: Disclosure and Presentation and IAS39 Financial Instruments: Recognition and Measurement.

# Transition of the balance sheet as at 1 January 2004

Note	UK GAAP (a) £000	Investment contracts		Deferred acquisition costs (d) £000	Deferred income (e) £000	Revaluation of financial assets/ adjustment to contract liabilities (f) £000	Application of reverse acquisition accounting (i) £000	IFRS £000
		Reclassification and deposit accounting (b) £000	Release of reserves (c) £000					
<b>Assets</b>								
Intangible assets								
Deferred acquisition costs	16,135			3,237				19,372
Acquired value of in-force business								
Insurance contracts	2,201							2,201
Investment contracts	–							–
Property and equipment	904							904
Investment properties	3,003							3,003
Financial assets								
Equity securities and holdings in collective investment schemes at fair value through income	414,036					(3,993)		410,043
Debt securities at fair value through income	328,911					(171)		328,740
Loans and receivables including insurance receivables	24,559							24,559
Derivative financial instruments	–							–
Deferred tax assets	–							–
Reinsurers share of insurance contract provisions	174,187	(19,469)				(1,056)		153,662
Amounts deposited with reinsurer	–	19,469	404	(732)	1,200	(191)		20,150
Income taxes	–							–
Cash and cash equivalents	23,700							23,700
<b>Total assets</b>	<b>987,636</b>	<b>–</b>	<b>404</b>	<b>2,505</b>	<b>1,200</b>	<b>(5,411)</b>	<b>–</b>	<b>986,334</b>
<b>Liabilities</b>								
Insurance contract provisions	875,374	(290,359)				(4,605)		580,410
Financial liabilities								
Investment contracts at fair value through income	–	290,359	(3,830)			(553)		285,976
Derivative financial instruments	167							167
Provisions	1,466							1,466
Deferred tax liabilities	4,926		1,270	752	(2,272)	(76)		4,600
Reinsurance payables	1,085							1,085
Payables related to direct insurance and investment contracts	15,094							15,094
Deferred income	–				8,774			8,774
Income taxes	117							117
Other payables	10,668							10,668
<b>Total liabilities</b>	<b>908,897</b>	<b>–</b>	<b>(2,560)</b>	<b>752</b>	<b>6,502</b>	<b>(5,234)</b>	<b>–</b>	<b>908,357</b>
<b>Net assets</b>	<b>78,739</b>	<b>–</b>	<b>2,964</b>	<b>1,753</b>	<b>(5,302)</b>	<b>(177)</b>	<b>–</b>	<b>77,977</b>
<b>Shareholders' equity</b>								
Share capital	4,228						36,272	40,500
Share premium	–							–
Other reserves	36,272						(36,272)	–
Retained earnings	38,239	–	2,964	1,753	(5,302)	(177)		37,477
<b>Total shareholders' equity</b>	<b>78,739</b>	<b>–</b>	<b>2,964</b>	<b>1,753</b>	<b>(5,302)</b>	<b>(177)</b>	<b>–</b>	<b>77,977</b>

## Transition of the balance sheet as at 30 June 2004

Note	UK GAAP (a) £000	Investment contracts		Deferred acquisition costs (d) £000	Deferred income (e) £000	Revaluation of financial assets/ adjustment to contract liabilities (f) £000	Post- balance sheet event- dividends (h) £000	Application of reverse acquisition accounting (i) £000	IFRS £000
		Reclassification and deposit accounting (b) £000	Release of reserves (c) £000						
<b>Assets</b>									
Intangible assets									
Deferred acquisition costs	10,139			3,106					13,245
Acquired value of in-force business									
Insurance contracts	1,971								1,971
Investment contracts	–								–
Property and equipment	492								492
Investment properties	3,491								3,491
Financial assets									
Equity securities and holdings in collective investment schemes at fair value through income	391,698					(3,907)			387,791
Debt securities at fair value through income	319,638					(200)			319,438
Loans and receivables including insurance receivables	13,985								13,985
Derivative financial instruments	–								–
Deferred tax assets	–								–
Reinsurers share of insurance contract provisions	175,571	(20,549)				(1,029)			153,993
Amounts deposited with reinsurer	–	20,549	444	(704)	1,153	(188)			21,254
Income taxes	–								–
Cash and cash equivalents	55,305								55,305
<b>Total assets</b>	<b>972,290</b>	<b>–</b>	<b>444</b>	<b>2,402</b>	<b>1,153</b>	<b>(5,324)</b>	<b>–</b>	<b>–</b>	<b>970,965</b>
<b>Liabilities</b>									
Insurance contract provisions	867,238	(280,237)				(4,576)			582,425
Financial liabilities									
Investment contracts at fair value through income	–	280,237	(3,082)			(548)			276,607
Derivative financial instruments	372								372
Provisions	728								728
Deferred tax liabilities	3,160		1,118	721	(2,168)	(60)			2,771
Reinsurance payables	2,331								2,331
Payables related to direct insurance and investment contracts	16,745								16,745
Deferred income	–				8,381				8,381
Income taxes	499								499
Other payables	10,203						(4,017)		6,186
<b>Total liabilities</b>	<b>901,276</b>	<b>–</b>	<b>(1,964)</b>	<b>721</b>	<b>6,213</b>	<b>(5,184)</b>	<b>(4,017)</b>	<b>–</b>	<b>897,045</b>
<b>Net assets</b>	<b>71,014</b>	<b>–</b>	<b>2,408</b>	<b>1,681</b>	<b>(5,060)</b>	<b>(140)</b>	<b>4,017</b>	<b>–</b>	<b>73,920</b>
<b>Shareholders' equity</b>									
Share capital	4,228							36,272	40,500
Other reserves	36,322							(36,272)	50
Retained earnings	30,464		2,408	1,681	(5,060)	(140)	4,017		33,370
<b>Total shareholders' equity</b>	<b>71,014</b>	<b>–</b>	<b>2,408</b>	<b>1,681</b>	<b>(5,060)</b>	<b>(140)</b>	<b>4,017</b>	<b>–</b>	<b>73,920</b>



## Transition of the balance sheet as at 31 December 2004

Note	UK GAAP (a) £000	Investment contracts		Deferred acquisition costs (d) £000	Deferred income (e) £000	Revaluation of financial assets/ adjustment to contract liabilities (f) £000	Post- balance sheet event- dividends (h) £000	Application of reverse acquisition accounting (i) £000	IFRS £000
		Reclassification and deposit accounting (b) £000	Release of reserves (c) £000						
<b>Assets</b>									
Intangible assets									
Deferred acquisition costs	5,122			3,015					8,137
Acquired value of in-force business									
Insurance contracts	1,818								1,818
Investment contracts	–								–
Property and equipment	403								403
Investment properties	3,092								3,092
Financial assets									
Equity securities and holdings in collective investment schemes at fair value through income	425,295					(4,163)			421,132
Debt securities at fair value through income	352,131					(359)			351,772
Loans and receivables including insurance receivables	15,013								15,013
Derivative financial instruments	–								–
Deferred tax assets	–								–
Reinsurers share of insurance contract provisions	182,037	(22,194)				(1,081)			158,762
Amounts deposited with reinsurer	–	22,194	456	(692)	1,128	(198)			22,888
Income taxes	103								103
Cash and cash equivalents	39,257								39,257
<b>Total assets</b>	<b>1,024,271</b>	<b>–</b>	<b>456</b>	<b>2,323</b>	<b>1,128</b>	<b>(5,801)</b>	<b>–</b>	<b>–</b>	<b>1,022,377</b>
<b>Liabilities</b>									
Insurance contract provisions	917,416	(310,752)				(4,859)			601,805
Financial liabilities									
Investment contracts at fair value through income	–	310,752	(3,582)			(583)			306,587
Derivative financial instruments	199								199
Provisions	926								926
Deferred tax liabilities	2,022		1,211	696	(2,073)	(108)			1,748
Reinsurance payables	3,333								3,333
Payables related to direct insurance and investment contracts	14,351								14,351
Deferred income	–				8,038				8,038
Income taxes	1,198								1,198
Other payables	10,874						(6,124)		4,750
<b>Total liabilities</b>	<b>950,319</b>	<b>–</b>	<b>(2,371)</b>	<b>696</b>	<b>5,965</b>	<b>(5,550)</b>	<b>(6,124)</b>	<b>–</b>	<b>942,935</b>
<b>Net assets</b>	<b>73,952</b>	<b>–</b>	<b>2,827</b>	<b>1,627</b>	<b>(4,837)</b>	<b>(251)</b>	<b>6,124</b>	<b>–</b>	<b>79,442</b>
<b>Shareholders' equity</b>									
Share capital	4,228							36,272	40,500
Other reserves	36,322							(36,272)	50
Retained earnings	33,402		2,827	1,627	(4,837)	(251)	6,124		38,892
<b>Total shareholders' equity</b>	<b>73,952</b>	<b>–</b>	<b>2,827</b>	<b>1,627</b>	<b>(4,837)</b>	<b>(251)</b>	<b>6,124</b>	<b>–</b>	<b>79,442</b>

# Reconciliation of the income statement for the six months ended 30 June 2004

Note	UK GAAP (a) £000	Investment contracts		Deferred acquisition costs (d) £000	Deferred income (e) £000	Revaluation of financial assets/ adjustment to contract liabilities (f) £000	Share-based payment (g) £000	IFRS £000
		Reclassification and deposit accounting (b) £000	Release of reserves (c) £000					
Insurance premium revenue	87,631	(23,300)						64,331
Insurance premium ceded to reinsurers	(15,761)	282						(15,479)
Net insurance premium revenue	71,870							48,852
Fee and commission income								
Insurance contracts	29,136	(287)						28,849
Investment contracts	–	287			346			633
Investment income	12,166					57		12,223
<b>Total revenue (net of reinsurance payable)</b>	<b>113,172</b>							<b>90,557</b>
Other operating income	3,456							3,456
<b>Net income</b>	<b>116,628</b>							<b>94,013</b>
Policyholder claims and benefits incurred	(123,469)	27,662				(29)		(95,836)
Reinsurers share of claims and benefits incurred	15,101	(878)				27		14,250
Net policyholder claims and benefits incurred	(108,368)							(81,586)
Change in investment contract liabilities	–	(4,362)	(748)			(5)		(5,115)
Reinsurers share of investment contract liabilities	–	596	40			3		639
Net change in investment contract liabilities	–							(4,476)
Fees, commission and other acquisition costs	(6,920)			(103)				(7,023)
Administrative expenses	(7,810)							(7,810)
Other operating expenses								
Charge for amortisation of intangible assets	(230)							(230)
Other	(135)							(135)
<b>Total expenses</b>	<b>(123,463)</b>							<b>(101,260)</b>
<b>Operating loss</b>	<b>(6,835)</b>							<b>(7,247)</b>
Financing costs	–						(336)	(336)
Profit on sale of discontinued operation	1,948							1,948
<b>Loss before tax</b>	<b>(4,887)</b>							<b>(5,635)</b>
Income tax expense	1,189		152	31	(104)	(16)		1,252
<b>Loss for the period</b>	<b>(3,698)</b>	<b>–</b>	<b>(556)</b>	<b>(72)</b>	<b>242</b>	<b>37</b>	<b>(336)</b>	<b>(4,383)</b>

# Reconciliation of the income statement for the year ended 31 December 2004

Note	UK GAAP (a) £000	Investment contracts		Deferred acquisition costs (d) £000	Deferred income (e) £000	Revaluation of financial assets/ adjustment to contract liabilities (f) £000	Share-based payment (g) £000	IFRS £000
		Reclassification and deposit accounting (b) £000	Release of reserves (c) £000					
Insurance premium revenue	202,230	(79,395)						122,835
Insurance premium ceded to reinsurers	(31,193)	1,138						(30,055)
Net insurance premium revenue	171,037							92,780
Fee and commission income:								
Insurance contracts	55,167	(808)						54,359
Investment contracts	—	808			662			1,471
Investment income	57,368					(359)		57,009
<b>Total revenue (net of reinsurance payable)</b>	<b>283,572</b>							<b>205,619</b>
Other operating income	4,032							4,032
<b>Net income</b>	<b>287,604</b>							<b>209,651</b>
Policyholder claims and benefits incurred	(292,105)	96,377				254		(195,474)
Reinsurers share of claims and benefits incurred	34,220	(3,043)				(25)		31,152
Net policyholder claims and benefits incurred	(257,885)							(164,322)
Change in investment contract liabilities	—	(16,982)	(248)			30		(17,200)
Reinsurers share of investment contract liabilities	—	1,905	53			(7)		1,951
Net change in investment contract liabilities	—							(15,249)
Fees, commission and other acquisition costs	(11,956)			(179)				(12,135)
Administrative expenses	(14,448)							(14,448)
Other operating expenses								
Charge for amortisation of intangible assets	(383)							(383)
Other	(329)							(329)
<b>Total expenses</b>	<b>(285,001)</b>							<b>(206,866)</b>
<b>Operating profit</b>	<b>2,603</b>							<b>2,785</b>
Financing costs	—						(336)	(336)
Profit on sale of discontinued operation	1,948							1,948
<b>Profit before tax</b>	<b>4,551</b>							<b>4,397</b>
Income tax expense	813		59	54	(199)	32		759
<b>Profit for the period</b>	<b>5,364</b>	<b>—</b>	<b>(136)</b>	<b>(125)</b>	<b>464</b>	<b>(75)</b>	<b>(336)</b>	<b>5,156</b>

### **(a) Reclassification of UK GAAP reported amounts to IFRS format**

The UK GAAP balance sheet and income statement which were previously reported and presented in accordance with the modified statutory solvency basis, have been presented in a format which is consistent with IFRS. Other than changes highlighted in the transition matrices, no changes have been made to the amounts previously reported under UK GAAP.

### **(b) Accounting for investment contracts: reclassification and deposit accounting**

Under UK GAAP all of the long-term contracts of the Group were accounted for and disclosed as insurance contracts. IFRS 4 Insurance Contracts requires all such contracts to be classified for accounting purposes as either insurance contracts or as investment contracts, depending on whether significant insurance risk is transferred to the Group under the contract. Assets and liabilities relating to investment and insurance contracts are disclosed separately in the balance sheet.

Investment contract liabilities fall to be accounted for in accordance with IAS39 Financial Instruments: Measurement and Recognition. In accordance with IFRS amounts receivable from policyholders under investment contracts are no longer credited to premium revenue in the income statement but are treated as amounts received on deposit and are credited directly to investment contract liabilities. Likewise amounts payable to policyholders under investment contracts are no longer charged to claims expense in the income statement but are deducted from investment contract liabilities. Group companies are party to various reinsurance contracts which provide for certain of these amounts receivable and payable under investment contracts to be borne by the reinsurer. Amounts previously treated under UK GAAP as charges to the income statement, being outward reinsurance premiums ceded to reinsurers, or as credits to the income statement, being reinsurers' share of claims payable, are similarly no longer accounted for as charges or credits to the income statement, but are treated as direct movements in amounts deposited with reinsurers in the balance sheet. None of these adjustments has any net impact on profit before tax, profit after tax or on shareholders' equity.

IFRS 4 requires the existing UK GAAP method of accounting for insurance contracts to continue subject to liability adequacy tests and to the fair valuation of derivatives embedded in insurance contracts under IAS39.

### **(c) Accounting for investment contracts: release of reserves**

As stated in Note (b) investment contract liabilities fall to be accounted for in accordance with IAS39. A consequence of this is that certain reserves held in respect of investment contracts under UK GAAP are released under IFRS. This has the effect of increasing shareholder equity. As also stated in Note I to these consolidated interim financial statements the Directors have assumed that the proposed amendment to IAS39 Financial Instruments: Measurement and Recognition (The Fair Value Option) issued by the International Accounting Standards Board will be adopted by the EU in sufficient time that it will be available for use in the annual IFRS financial statements for the year ending 31 December 2005. In accordance with the anticipated amended version of IAS39 the Directors have decided that investment contract liabilities should be measured at fair value.

### **(d) Deferred acquisition costs**

Under IAS18 Revenue the deferral of acquisition costs attributable to investment contracts varies from the treatment under UK GAAP both as to the amount of costs deferred and as to the amortisation period. Under UK GAAP all acquisition costs, which are directly attributable to investment contracts are deferred and are then subsequently amortised against income over the period in which they are deemed to be recovered from further receipts from policyholders (classified as regular annual premium revenue under UK GAAP). This method leads to a relatively short amortisation period, being some four years on average. Under IAS18 Revenue only directly attributable incremental costs are deferred. Further, they are subsequently amortised over the lives of the contracts, which are typically considerably longer than four years. As all of the relevant costs had, under UK GAAP, been fully amortised at 1 January 2004, the date of transition from UK GAAP, this adjustment has led to an increase in shareholder equity at that date, with subsequent increased charges to the income statement compared with UK GAAP, in connection with the amortisation of such costs.

### **(e) Deferred income**

Under UK GAAP front end fees received from policyholders in respect of services to be provided on investment contracts in future periods are recognised as income in the period in which they are received, while under IAS18 Revenue such revenue is recognised in the accounting periods in which services are rendered which has been determined as the life of the contracts. Accordingly an explicit deferred income liability is recognised in respect of front end fees which relate to services to be provided in future periods.

This deferral of income has led to a reduction in shareholders' equity at 1 January 2004, the date of transition to IFRS, with subsequent additional amounts credited to the income statement in subsequent periods compared with UK GAAP.

**(f) Revaluation of financial assets/adjustment to contract liabilities**

Under UK GAAP at the IFRS transition date, 1 January 2004, listed investments were valued on the basis of the market convention applicable to where the investments were primarily traded, which was either last traded or mid-market price. Under IFRS listed investments, which are included in financial assets, are classified as fair value through income and IAS39 requires that the fair value for listed investments be determined at bid value. Insofar as this revaluation from last traded or middle market price to bid value relates to investments held within the unit-linked funds, which are thereby reduced in value, there is an offset by way of a corresponding reduction in insurance contract provisions and in investment contract liabilities carried at fair value through income. There is, however, a small reduction in net equity at 1 January 2004 as a result of these adjustments, relating to surplus asset units held within unit-linked funds, which are not matched by liability units, and to the revaluation of investments held outside the unit-linked funds.

**(g) Share based payment**

As stated in Note 7 to these consolidated interim financial statements Numis Securities Limited ('Numis') received, on the admission of Chesnara plc to the official list of the UK Listing Authority on 25 May 2004, an option to subscribe for ordinary shares in Chesnara plc. IFRS 2 Share Based Payment requires the difference between the total value of such shares at their option price and the fair value of the option at the date of grant to be charged as an expense to the income statement. Accordingly, an amount representing the difference was charged to financing costs in the income statement for the six months ended 30 June 2004 and the year ended 31 December 2004, with a corresponding amount credited directly to retained earnings. This cost, which is not cash-based, was not recognised in the corresponding income statements prepared in accordance with UK GAAP and the adjustment in accordance with IFRS has no net effect on shareholder equity.

**(h) Post balance sheet events – dividends**

Under IAS10 Events after the Balance Sheet Date dividends declared after the balance sheet date are not recognised as a liability at the balance sheet date, because the proposed dividend does not represent a present obligation under IAS37 Provisions, Contingent Liabilities and Contingent Assets. Under UK GAAP proposed dividends had been recognised in the balance sheet as at 30 June 2004 and 31 December 2004, and these amounts are reversed under IFRS.

**(i) Reverse acquisition accounting**

On 24 May 2004, Chesnara plc ('Chesnara'), by way of the issue of its ordinary shares to the shareholders of Countrywide plc, acquired the whole of the issued ordinary share capital of Countrywide Assured Life Holdings Limited ('CALH') as part of the process of the demerger of CALH from Countrywide plc.

Chesnara, a company with net assets of £2 prior to its acquisition of CALH, was effectively used as a vehicle to secure a listing for the business of CALH on the London Stock Exchange. As such the net assets of Chesnara prior to the acquisition of CALH did not comprise an integrated set of activities and assets which were capable of generating revenue or of providing a return to investors. Chesnara, at the date of its acquisition of CALH therefore did not comprise a business as defined in IFRS 3 Business Combinations.

However, the Directors consider that the fairest way of presenting the financial position and results of operations from the viewpoint of the continuing interest of the shareholders of Countrywide plc is to prepare the accounts on the basis of the reverse acquisition method of accounting set out in IFRS 3, as the demerger and listing arrangements described above effectively represent a continuation of the business of CALH. This replicates the treatment that would have been accorded under IFRS, had Chesnara constituted a business at the date of its acquisition of CALH.

Under the reverse acquisition method of accounting CALH (the legal subsidiary) is treated as the parent company of Chesnara (the legal parent), so that the consolidated financial statements are treated as a continuation of the financial statements of CALH. In particular the issued share capital in the consolidated financial statements at the date of acquisition is taken as the issued share capital of CALH, the accounting parent.

The adoption of the reverse acquisition method of accounting for the purposes of presenting IFRS financial statements comprises a difference from UK GAAP. The adjustment in the statements of transition of the balance sheets involves the elimination of the reserve arising on demerger, recognised under UK GAAP, together with the credit of a corresponding amount to issued share capital. This adjustment gives rise to no net change in shareholders' equity and gives rise to the issued share capital of the Chesnara plc Group corresponding with the share capital of CALH at the acquisition date.

