Basis of Preparation and Principal Accounting Policies

EU law (IAS Regulation EC 1606/2002) requires that the next annual consolidated financial statements of the Group, for the year ending 31 March 2006, be prepared in accordance with International Financial Reporting Standards ("IFRSs") adopted for use in the EU ("adopted IFRSs").

This interim financial information has 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 March 2006 or are expected to be endorsed and effective (or available for early adoption) at 31 March 2006, the Group's first annual reporting date at which it is required to use adopted IFRSs. Based on these IFRSs, the directors have made assumptions about the accounting policies expected to be applied, which are as set out below, when the first annual IFRS financial statements are prepared for the year ending 31 March 2006.

In particular, the directors have assumed that the following IFRSs 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 March 2006:

- Amendments to IAS 19 'Employee benefits'
- Amendment to IAS 39 'Financial instruments: recognition and measurement – the fair value option'

In addition, the adopted IFRSs that will be effective (or available for early adoption) in the annual financial statements for the year ending 31 March 2006 are still subject to change and 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 March 2006.

The comparative figures for the financial year ended 31 March 2005 are not the company's statutory accounts for that financial year. Those accounts, which were prepared under UK Generally Accepted Accounting Practices ("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 of the Companies Act 1985.

Principal accounting policies

Basis of preparation

The financial statements are presented in £ Sterling and rounded to £0.1m. They are prepared on the historical cost basis except certain financial instruments detailed below.

The preparation of financial statements in conformity with IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates are believed to be reasonable. Actual results may differ from these estimates.

First time adoption of IFRS (IFRS 1)

This Standard has been issued to assist the first time adoption of IFRS. The Standard allows alternative treatments for certain areas of the financial statements during the initial transition period. The treatments have been detailed in the relevant sections.

Goodwill and other intangibles

Goodwill arising on all acquisitions prior to 31 March 1998 has been written off against reserves. Goodwill arising on acquisitions after 1 April 1998 has been capitalised and, under UK GAAP was amortised on a straight-line basis over its estimated useful life, with a maximum of 20 years.

IFRS 3 requires that, when a subsidiary entity is acquired and consolidated into the Group financial statements, intangible assets (such as customer lists or trademarks) are valued and then recognised separately on the balance sheet. These are then amortised over their useful economic lives. Goodwill remains the difference between the purchase price and the value of the tangible and intangible assets but is likely to be smaller under IFRS. Goodwill will not be amortised under IFRS. Instead the carrying value will be reviewed annually for impairment and only written down if impaired.

The Group has made the elective exemption that allows goodwill in respect of acquisitions made prior to 1 April 2004 to remain as stated under UK GAAP.

Other intangible assets are stated at cost less accumulated amortisation. The cost of acquired intangible assets are their purchase cost together with any incidental costs of acquisition. Amortisation is calculated to write off the cost of the asset on a straight-line basis at the following annual rates:

Trademarks	5%
Computer software costs	12.5-50%

Amortisation is disclosed in distribution and marketing expenses in the income statement. The residual value, if not insignificant, is reassessed annually. Expenditure on internally generated goodwill and brands is recognised in the income statement as an expense as incurred.

Investments in subsidiary undertakings
Investments in subsidiary undertakings including long term loans are included in the balance sheet of the Company at the lower of cost and the expected recoverable amount. Any impairment is recognised in the income statement.

Investment in jointly controlled entities
The consolidated financial statements include the Group's share of the total recognised gains and losses in one jointly controlled entity on an equity accounted basis.

Property, plant and equipment
Tangible assets are stated at cost less accumulated depreciation. The cost of self constructed assets includes the cost of materials, direct labour and certain direct overheads.

Leases in which the Group assumes substantially all of the risks and rewards of ownership are classified as finance leases. Each lease is stated at an amount equal to the lower of its fair value and the present value of the minimum lease payments at the inception of the lease less accumulated depreciation.

No depreciation has been charged on freehold land. Other assets have been depreciated to residual value, on a straight-line basis at the following annual rates:

Freehold buildings	2%
Leasehold premises	term of lease, not exceeding 50 years
Warehouse systems	10-20%
Motor vehicles	25%
Mainframe computer equipment	20%
Network computer equipment	33%
Portable computers	50%
Other office equipment	20%

Depreciation is disclosed in distribution and marketing expenses in the income statement. The residual value, if not insignificant, is reassessed annually.

Impairment
The carrying amounts of the Group's goodwill are reviewed annually to determine whether there is any indication of impairment. If such an indication exists, the asset's recoverable amount is estimated. The goodwill was tested for impairment at 1 April 2004, the date of transition to IFRS, in accordance with IFRS 1.

An impairment loss is recognised whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. Impairment losses are recognised in the income statement. The recoverable amount is calculated as the present value of estimated future cash flows using a pre tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For an asset that does not generate largely independent cash flows, the recoverable amount is determined for the cash generating unit to which the asset belongs.

Inventories
Inventories are valued at the lower of cost and net realisable value. This value is calculated on a weighted average basis. Work in progress and goods for resale include attributable overheads.

Trade and other receivables
Trade and other receivables are stated at their cost less impairment losses.

Government grants
Government grants related to expenditure on property, plant and equipment are credited to the income statement at the same rate as the depreciation on the asset to which the grants relate. The unamortised balance of capital grants is included within trade and other payables.

Net debt
Net debt comprises cash and cash equivalents less borrowings. Cash and cash equivalents comprises cash in hand and held with qualifying financial institutions in current accounts or overnight deposits net of overdrafts

with qualifying financial institutions. Liquid resources include government securities, investment in money market funds and term deposits with qualifying financial institutions and are classed as investments under current assets. Borrowings represent term loans from qualifying financial institutions together with capital instruments classified as liabilities.

Revenue
Revenue from the sale of goods is recognised in the income statement when the significant risks and rewards of ownership have been transferred. Revenue represents the sale of goods and services and is stated net of sales taxes. Freight recharged to customers is included within revenue.

Operating expense classification
Cost of sales comprises the cost of goods delivered to customers.

Distribution and marketing expenses include all operating company expenses, including freight expenses, together with the Supply Chain, Product Management, Media Publishing, Facilities, Information Systems and e-Commerce process expenses.

Administration expenses comprise Finance, Legal and Human Resources process expenses, together with the expenses of the Group Board.

Net financing costs comprise interest payable on borrowings calculated using the effective interest rate method, interest receivable on funds invested, foreign exchange gains and losses and gains and losses on hedging instruments that are recognised in the income statement.

Interest income is recognised in the income statement as it accrues, using the effective interest method. The interest expense component of finance lease payments is recognised in the income statement using the effective interest rate method.

Catalogue costs
Prior to the issue of a catalogue, all related costs incurred are accrued and carried as a prepayment. On the issue of a catalogue, these costs are written off over the life of the catalogue, which mainly varies between six and twelve months. Major investments in new catalogue production systems are written off over the period during which the benefits of those investments are anticipated, such period not to exceed three years.

Operating leases
Operating lease rentals are charged to the income statement on a straight-line basis over the course of the lease period. The benefits of rent free periods and similar incentives are credited to the income statement on a straight-line basis over the full lease term.

Pension costs
In the United Kingdom the Group operates a pension scheme providing benefits based on final pensionable pay for eligible employees who joined on or before 1 April 2003. The scheme is administered by a corporate trustee and the funds are independent of the Group's finances. In addition there are defined benefit pension schemes in Germany and Ireland (both closed to new entrants).

Contributions to the defined benefit schemes are charged to the income statement so as to spread the cost of pensions over the working lives with the Group of those employees who are in the scheme. The Group has elected to adopt the amendment to IAS 19 (revised), which allows the impact of changes in the value of the deficits to be recorded in the Statement of Recognised Income and Expense rather than the income statement. The Group will also adopt the exemption in IFRS 1 allowing all actuarial gains and losses arising before 1 April 2004 to be shown in the opening balance sheet at 1 April 2004. Annual charges to the income statement comprise a service cost and a finance cost both included within Distribution and Marketing expenses.

For UK employees who joined after 1 April 2003 the Group provides a defined contribution pension scheme. There are also defined contribution schemes in Australia and North America and government schemes in France, Italy, Denmark and North Asia. Obligations for contributions to defined contribution schemes are recognised as an expense in the income statement as incurred.

Share based payment transactions
The Group operates several share based payment schemes, the largest of which are the Savings Related

Share Option Scheme (SAYE) and the Long Term Incentive Option Plan (LTIOP).

The fair value of options granted is recognised as an employee expense with a corresponding increase in equity and spread over the period during which employees become unconditionally entitled to the options. The fair values are calculated using an appropriate option pricing model. The income statement charge is then adjusted to reflect expected and actual levels of vesting based on non market performance related criteria. The Group's SAYE scheme has been valued using a Black-Scholes model and the income statement charge has been adjusted for forfeitures caused by employees failing to maintain either their employment or the required savings. The Group's LTIOP scheme includes performance criteria based on the Group's total shareholder return performance relative to a group of 13 comparable companies. The fair value of the LTIOP schemes has been calculated using a Monte Carlo model and the income statement charge has been adjusted for options forfeited by employees leaving the Group.

The consolidated income statement includes the administration expenses of the share based payment schemes and the consolidated and Company balance sheets include the assets and liabilities of the schemes. Shares in the Company, held by the trust established to administer the schemes, are shown within reserves.

The Group has chosen to adopt the exemption whereby IFRS 2, Share-Based Payment, is applied only to awards made after 7 November 2002.

Tax

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

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 calculated using tax rates enacted at the balance sheet date.

Financial statements of foreign operations

Overseas companies' profits, losses and cash flows are translated at average exchange rates for the year, and assets and liabilities at rates ruling at the balance sheet date. This leads to exchange gains and losses being generated on consolidation. IFRS requires translation differences on the revaluation of the assets and liabilities of overseas subsidiaries to be taken directly to equity. On the disposal of any overseas entity any exchange differences previously taken to equity will have to be transferred to the income statement and taken to the Group profit/loss on disposal of that entity.

The elective exemption in IFRS 1 means that any translation differences prior to the date of transition (1 April 2004) do not need to be analysed retrospectively and so the deemed cumulative translation differences at this date can be set to nil. Thus, any cumulative translation differences arising prior to the date of transition are excluded from any future profit/loss on disposal of any entities. The Group will adopt this exemption.

Net investment in foreign operations

Exchange differences arising on foreign currency net investments are taken to the foreign exchange reserve.

Foreign currency transactions

Transactions in foreign currencies are recorded using the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated using the rate of exchange ruling at the balance sheet date and the gains and losses on translation are included in the income statement.

Financial instruments

The Group currently has cash, money market deposits, investments in money market funds, overdrafts, money market loans and forward and spot foreign currency contracts used for cash flow hedging. It also has an external interest rate swap and an internal, inter-company currency swap, both of which are used to hedge specific loans.

These financial instruments are recognised initially at cost. Subsequent to initial recognition, they are stated at fair value. The gain or loss on remeasurement to fair value is recognised immediately in the income statement unless the instrument qualifies for hedge accounting as detailed below.

The Group adopted the exemption delaying the implementation of IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement, to the year ending 31 March 2006. The comparative information has not been adjusted.

Cash flow hedging

Where a financial instrument is designated as a hedge of the variability in cash flows of a highly probable forecast transaction, the effective part of any gain or loss on the financial instrument is taken to equity. The hedge is "effectiveness" tested monthly against the designated exposure. All hedges are included on the balance sheet at the fair market value. A hedge is deemed "ineffective" if the forecast transaction is less than 80% or more than 125% of the hedged amount. Hedges are revalued monthly with changes in the fair value of "ineffective" hedges taken to the income statement and changes in the fair value of effective hedges taken to equity.

Fair value hedging

The Group uses derivatives to hedge financial liabilities. The Group designates the hedging, documents it and tests its effectiveness monthly at both Group and company level. Derivatives and liabilities are disclosed at fair value on the balance sheet and revalued monthly with movements to the income statement.

Net investment in foreign entity hedging

The Group currently uses long term US$ debt to hedge its net equity investment in the US Group. The Group designates the hedging, documents it and tests its effectiveness regularly at both Group and Company level. Changes in fair value are taken to equity.

Embedded derivatives

A review is undertaken half yearly of all external, commercial contracts to identify any material embedded derivatives. Any embedded derivatives are disclosed on the balance sheet at fair value and revalued monthly with movements posted to the income statement.