

14 Statement of accounting policies

Basis of accounting

The financial statements have been prepared on the basis of historical cost and in accordance with applicable United Kingdom accounting standards.

The Group's accounting policies are unchanged from the year ended 31 December 2002, except that, following the Group's acquisition by Coats Holdings plc (formerly Avenue Acquisition plc), pensions and other post-retirement benefits are now accounted for in accordance with SSAP 24 – Accounting for Pension Costs, as this is the parent company's policy, instead of under FRS17 – Retirement Benefits.

Comparative figures have been restated to reflect this change of accounting policy, as a result of which at 31 December 2002 the Group's debtors and provisions for liabilities and charges were increased by £40.1 million and £70.4 million respectively and pension assets and pension liabilities were reduced by £31.1 million and £60.9 million respectively. The pension reserve and profit and loss account have been restated accordingly, and shareholders' funds overall have fallen by £0.5 million.

For the year ended 31 December 2002, the result of the restatement is that operating profit has increased by £5.7 million, the loss on sale or termination of operations has fallen by £3.9 million, other interest payable has increased by £3.6 million, other finance income has fallen by £14.3 million, and the tax charge has fallen by £4.0 million, so that the retained profit has reduced by £4.3 million. Amounts charged to the statement of total recognised gains and losses have reduced by £29.2 million, of which £28.5 million related to actuarial losses and £0.7 million to foreign exchange differences.

For the year ended 31 December 2003, the Group's loss after taxation is £5.8 million lower than it would have been if FRS17 had been applied.

The detailed accounting policy in respect of pensions and other post-retirement benefits is set out below.

Consolidation and results

For all subsidiary undertakings the accounts include the results for those companies controlled throughout the year or to the date of disposal or from the date of acquisition as appropriate.

Where local fiscal and company legislation prevents foreign subsidiaries and associated companies from complying with the Group's accounting policies, adjustments are made on consolidation to present the Group accounts on a consistent basis.

Acquisitions and disposals

In accordance with FRS6 and 7, on the acquisition of a business, including an interest in an associated company, fair values are attributed to the Group's share of the identifiable assets and liabilities of the business existing at the date of acquisition and reflecting the conditions at that date.

Where the cost of acquisition exceeds the values attributable to such net assets, the difference is treated as purchased goodwill and, prior to 1 January 1998, was written off direct to reserves in the year of acquisition.

Following the issue of FRS10 – Goodwill and Intangible Assets, purchased goodwill arising after 1 January 1998 is capitalised and amortised to the profit and loss account over its estimated useful life which will not exceed 20 years.

Negative goodwill is capitalised in accordance with FRS10 and is amortised over the expected useful economic lives of the non-monetary assets acquired. As a matter of accounting policy, goodwill written off directly to reserves prior to 1 January 1998 in respect of businesses still retained remains written off against reserves.

In accordance with FRS11 – Impairment of Fixed Assets and Goodwill, any impairment of capitalised goodwill will be written off to the profit and loss account in the period in which the impairment is recognised.

If a business is subsequently sold or closed, any goodwill arising on acquisition that was written off directly to reserves or that has not been amortised through the profit and loss account is taken into account in determining the profit or loss on sale or closure.

A business is classified as a discontinued operation if it is clearly distinguishable, has a material effect on the nature and focus of the Group's activities, represents a material reduction in the Group's operating facilities and either its sale is completed or, if a termination, its former activities have ceased permanently prior to the approval of these financial statements.

Foreign currencies

Assets and liabilities in foreign currencies are translated into sterling at the rates of exchange ruling at the year end or related forward contract rates. Trading results are translated at the average rates of exchange for the year after eliminating the effects of hyper-inflation in certain countries by using an appropriate stable currency as the functional currency for operations in these countries.

Profits and losses on exchange arising in the normal course of trading and realised exchange differences arising on the conversion or repayment of foreign currency borrowings are dealt with in the profit and loss account. Unrealised exchange differences arising on the translation of overseas net assets and matched long term foreign currency borrowings or forward exchange contracts are taken direct to reserves.

Turnover

All turnover and profit figures relate to external transactions and turnover represents the value of goods and services supplied net of returns.

Exceptional items

Exceptional items are those that need to be disclosed by virtue of their size or incidence. Such items are included within operating profit unless they represent profits or losses on the sale or termination of an operation, costs of a fundamental reorganisation or restructuring having a material effect on the nature and focus of the Group, or profits and losses on the disposal of fixed assets. In these cases, separate disclosure is provided on the face of the profit and loss account after operating profit.

Grants

Revenue based grants are credited against related expenditure.

Operating lease rentals

Rentals on operating leases are charged to the profit and loss account in the year to which they relate.

Research and development expenditure

Expenditure is charged to the profit and loss account in the year it is incurred.

Pensions and other post retirement benefits

It is the policy of the Group to comply with legal requirements and established practice in the various countries in which there are employees or former employees.

The Group operates various defined benefit and contribution pension schemes throughout the world. Contributions to the defined contribution schemes are charged to the profit and loss account as incurred.

The defined benefits schemes provide benefits based on the final pensionable salary. The assets of most of the defined benefit schemes, particularly those in the UK and North America, are held separately from those of the Group. In certain countries in Europe, pension liabilities are unfunded and are carried on those companies' balance sheets.

In accordance with SSAP 24 – Accounting for Pension Costs, pension costs incurred in the Group's UK and North American defined benefit plans are charged to the profit and loss account over the anticipated working lives of the pension plan members currently in service.

In other overseas countries, pension and other retirement benefits are provided for in a number of ways. The Directors are satisfied that, in relation to legal requirements and established accounting practice, other overseas pension obligations are, in aggregate, adequately provided for and that, in relation to material overseas pension plans, the accounting treatment complies with the requirements of SSAP 24.

Full provision has been made for the current actuarial liability for US post-retirement benefits.

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Tangible fixed assets and depreciation

Tangible fixed assets are stated at cost less accumulated depreciation and, where appropriate, provision for impairment. Depreciation is provided to write off the cost of the assets by equal instalments over their expected useful lives.

The rates used are:

Freehold and long leasehold land	Nil	Motor vehicles	20%
Freehold and long leasehold buildings	2%	Electronic office equipment	25%
Short leasehold property	Over period of lease	All other plant and machinery	5 to 25%

Assets held under finance leases are included in tangible fixed assets at a value equal to the original cost incurred by the lessor less depreciation, and obligations to the lessor are shown as part of creditors. The interest element is charged to profit and loss account under the reducing balance method.

Investments

Fixed asset investments are stated at cost unless, in the opinion of the Directors, there has been an impairment, in which case an appropriate adjustment is made.

Listed current asset investments are stated at the lower of cost or market value, and other current asset investments are stated at the lower of cost and estimated net realisable value.

Associated companies

Investments, excluding those classified as subsidiaries, are regarded as associated companies where the Group has a long term interest in more than 20% of the equity and exercises a significant influence over their affairs on a continuing basis. These are stated in the Consolidated Balance Sheet at the Group's share of net assets after adjustment for goodwill or discount on acquisition.

In accordance with FRS9 – Associates and Joint Ventures, the Group's share of associated companies' operating profits or losses, net interest and exceptional items are shown separately in the financial statements.

Stocks

Stocks are valued on bases consistent with those used in previous years at the lower of cost and net realisable value. Cost is the invoiced value of materials plus, in the case of work in progress and finished goods, labour and factory overheads based on a normal level of production.

Provisions

In accordance with FRS12, provisions are only made for losses arising as a result of restructuring when the Group is constructively obligated to implement the restructuring.

Deferred taxation

Deferred tax is recognised on a full provision basis on timing differences that result in an obligation at the balance sheet date to pay more tax, or a right to pay less tax, at a future date, at rates expected to apply when they crystallise based on current tax rates and law, and is not discounted. Timing differences arise from the inclusion of items of income or expenditure in taxation computations in periods different from those in which they are included in the financial statements.

Deferred tax is not recognised on timing differences arising on property revaluation surpluses where there is no commitment to sell the asset nor on gains on asset sales that are rolled over into replacement assets for tax purposes. In addition, no provision is made for taxation that would arise on the remittance of retained profits by overseas subsidiaries and associated companies subsequent to the balance sheet date as there is no present intention to remit these retained profits.

Deferred tax assets are recognised only to the extent that it is considered more likely than not there will be suitable future taxable profits to permit tax relief of the underlying timing differences. Unrelieved advance corporation tax is carried forward only when it can be set against provisions for taxation or to the extent it is recoverable against tax liabilities in respect of the following period.

Capital instruments

Capital instruments are accounted for in accordance with the principles of FRS4 and are classified as equity share capital, non-equity share capital, minority interest or debt as appropriate. Convertible debt is separately disclosed and is regarded as debt unless conversion actually occurs. Provision is made for any accrued premium payable on redemption of redeemable debt or non-equity interests.

Capital instruments are initially carried at the amount of the net proceeds. The finance costs and issue expenses are allocated to the profit and loss account over the life of the debt at a constant rate on the carrying amount.

Reporting the substance of transactions

In accordance with FRS5, transactions entered into by the Group are recorded in the financial statements taking into account their full commercial substance.

Liquid resources

The Group defines liquid resources as short term deposits and current asset investments maturing or capable of being realised within one year.

Going concern

Following the acquisition of the shares of the Company by Coats Holdings plc (formerly Avenue Acquisition plc) on 7 April 2003, negotiations have taken place with lenders with regard to refinancing the current facilities of Coats Ltd, in conjunction with Coats Holdings plc's acquisition finance.

The Directors believe that these negotiations will be successful and that the bank facilities will be refinanced.

After making enquiries and based on the above, the Directors have formed a judgement that at the time of approving the financial statements, there is a reasonable expectation that the Group has sufficient resources to continue in operational existence for the foreseeable future and therefore consider it appropriate for the financial statements to be prepared on a going concern basis.

The financial statements do not include any adjustments that might result if the refinancing is not completed.