

Accounting Policies

Statement of Compliance

The consolidated and Company financial statements of Grafton Group plc have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU), which comprise standards and interpretations approved by the International Accounting Standards Board (IASB) and International Accounting Standards and Standing Interpretations Committee and subsequently adopted by the EU.

The Company financial statements have been prepared in accordance with IFRSs as adopted by the European Union (EU) and as applied in accordance with the Companies Acts, 1963 to 2006. The Company has taken advantage of the exemption in Section 148(8) of the Companies Act 1963 from presenting to its members the Company Income Statement and related notes which forms part of the approved financial statements of the Company as the Company publishes Company and Group financial statements together.

The standards and interpretations applied in these financial statements were those effective for accounting periods beginning on or after 1 January 2007.

The Group has not applied the following standard and interpretation that have been issued by the IASB and adopted by the EU but are not yet effective:

- IFRS 8 *Operating Segments*; and
- IFRIC 11 *IFRS 2: Group and Treasury Share Transactions*.

The Group is still in the process of considering the impact of IFRS 8 on its segmental information. The adoption of IFRIC 11 will not have any impact on the Group financial statements and is not expected to have a material impact on the Company financial statements as the accounting policy currently applied is consistent with the requirements of the interpretation.

Basis of Preparation

The consolidated and Company financial statements, which are presented in euro rounded to the nearest thousand, have been prepared under the historical cost convention, as modified by the previous revaluation of land and buildings and the measurement at fair value of share based payments at initial date of award and derivative financial instruments. The carrying values of recognised assets and liabilities that are hedged are adjusted to record changes in the fair values attributable to the risks that are being hedged.

The accounting policies set out below have been applied consistently by all the Group's companies in all periods presented in these consolidated financial statements.

The preparation of financial statements in conformity with IFRS as adopted by the EU requires management to exercise judgement in the process of applying the Company's accounting policies. The areas involving a high degree of judgement or complexity, or areas where assumptions and estimates are significant in relation to the consolidated financial statements, relate primarily to accounting for defined benefit pension schemes, financial instruments, share based payments, impairment provisions, leases, intangible assets, goodwill impairment and taxation.

The financial year-ends of the Group's subsidiaries are coterminous.

Basis of consolidation

The consolidated financial statements include the financial statements of the Company, all subsidiaries and the proportionally consolidated joint venture drawn up to 31 December each year.

Subsidiaries

The financial statements of subsidiaries are included in the consolidated financial statements from the date on which control over the operating and financial decisions is obtained and cease to be consolidated from the date on which control is transferred out of the Group. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain economic benefits from its activities.

Accounting Policies

Joint ventures

In line with the benchmark accounting methodology in IAS 31 Interests in Joint Ventures, the Group's share of results and net assets of joint ventures, which are entities in which the Group holds an interest on a long-term basis and which are jointly controlled by the Group and one or more other venturers, are accounted for on the basis of proportionate consolidation from the date on which joint control is finalised and are derecognised when joint control ceases. The Group combines its share of the joint ventures individual income and expenses, assets and liabilities and cash flows on a line by line basis with similar items in the Group's financial statements.

Loans to joint ventures are classified as loans and receivables within financial assets.

Transactions eliminated on consolidation

Intra-group balances and transactions, and any unrealised gains and losses arising from such transactions, are eliminated in preparing the consolidated financial statements. Transactions with joint ventures are similarly eliminated to the extent of the Group's proportionate share of the joint venture.

Revenue Recognition

Revenue is the value of goods and services supplied to external customers and excludes inter-company sales and value added tax.

In general, revenue is recognised to the extent that it is subject to reliable measurement, that it is probable that economic benefits will flow to the Group and that the significant risks and rewards of ownership have passed to the buyer. Revenue on long-term contracts is recognised in accordance with the percentage-of-completion method with the completion percentage being computed on an input cost basis.

Segment Reporting

A segment is a distinguishable component of the Group that is engaged either in providing products or services (business segment), or in providing products or services within a particular economic environment (geographical segment), which is subject to risks and returns different to those of other segments. Geographical segmentation is the Group's primary reporting segment.

Foreign Currency Translation

Functional and presentation currency

The consolidated financial statements are presented in euro which is the Company's functional currency. Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates which is primarily euro and sterling.

Transactions and balances

Transactions in foreign currencies are recorded at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated to the relevant functional currency at the rate of exchange ruling at the balance sheet date. All currency translation differences on monetary assets and liabilities are taken to the income statement except for differences on foreign currency borrowings designated as a hedge of a net investment which are taken directly to equity together with the exchange difference on the carrying amount of the related investment.

Group companies

Results and cash flows of subsidiaries which do not have the euro as their functional currency are translated into euro at average exchange rates for the year and the related balance sheets are translated at the rates of exchange ruling at the balance sheet date. Adjustments arising on translation of the results of such subsidiaries at average rates and on the restatement of the opening net assets at closing rates are dealt with in a separate translation reserve within equity, net of differences on related currency borrowings designated as a hedge of the net investment.

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Goodwill and fair value adjustments arising on acquisition of operations trading in currencies other than the euro are regarded as assets and liabilities of the foreign currency denominated operation, are expressed in its functional currency and are recorded at the exchange rate at the date of the transaction and subsequently retranslated at the applicable closing rates.

Exceptional Items

The Group has adopted a policy in relation to its income statement which seeks to highlight any significant items within the Group results. Such items may include significant restructuring, profit and loss on disposal or termination of operations, litigation costs and settlements, profit or loss on disposal of property and impairment of assets. Judgement is used by the Group in assessing the particular items, which by virtue of their scale and nature, should be disclosed in the income statement or related notes.

Finance Expense

Finance expense comprises interest payable on borrowings calculated using the effective interest rate method, foreign exchange gains and losses on borrowings and gains and losses on hedging instruments that are recognised in the income statement. The interest expense component of finance lease payments is recognised in the income statement using the effective interest rate method. Where appropriate the fair value adjustment to hedged items that are the subject of a fair value hedge is also included as finance expense or finance income.

The finance cost on pension scheme liabilities is recognised as finance expense in the income statement as permitted by IAS 19.

Finance Income

Interest income is recognised in the income statement as it accrues using the effective interest method.

The expected return on plan assets is recognised as finance income in the income statement as permitted by IAS 19.

Business Combinations

The purchase method of accounting is employed in accounting for the acquisition of subsidiaries by the Group. The Group availed of the exemption under IFRS 1, "First-time Adoption of International Financial Reporting Standards", whereby business combinations prior to the transition date of 1 January 2004 are not restated. IFRS 3, "Business Combinations", has been applied with effect from the transition date of 1 January 2004 and goodwill amortisation ceased from that date.

The cost of a business combination is measured as the aggregate of the fair value at the date of exchange of assets given, liabilities incurred or assumed and equity instruments issued in exchange for control together with any directly attributable expenses. Deferred expenditure arising on business combinations is determined through discounting the amounts payable to their present value at the date of exchange. The discount element is reflected as an interest charge in the income statement over the life of the deferred payment. In the case of a business combination the identifiable assets and liabilities acquired are measured at their provisional fair values at the date of acquisition. Adjustments to provisional values allocated to assets and liabilities are made within twelve months of the acquisition date and reflected as a restatement of the acquisition balance sheet.

Goodwill

Goodwill is the excess of the consideration paid over the fair value of the identifiable assets, liabilities and contingent liabilities in a business combination and relates to assets which are not capable of being individually identified and separately recognised.

Goodwill is subject to impairment testing on an annual basis and throughout the year if an indicator of impairment exists.

Accounting Policies

Goodwill arising on acquisitions between 1 January 1998 and 1 January 2004 was capitalised and the related amortisation, which was based on a presumed maximum useful life of 20 years, was charged against operating income in the income statement on a straight-line basis from the date of initial recognition. Goodwill was stated at cost less accumulated amortisation and any impairment in value. Goodwill arising on acquisitions made prior to 1 January 1998 was written-off immediately against reserves and was not reinstated on implementation of IFRS as adopted by the EU. In accordance with IFRS 1, this goodwill was not recognised as goodwill in the IFRS transition Balance Sheet and remains eliminated against reserves.

Goodwill arising in respect of acquisitions completed prior to 1 January 2004 (being the transition date to IFRS as adopted by the EU) is included at its net book value recorded under previous GAAP. In line with IFRS 3, goodwill amortisation ceased with effect from the transition date being 1 January 2004.

Where a subsidiary is sold, any goodwill arising on acquisition, net of any impairments, which has not been amortised through the income statement is included in determining the profit or loss arising on disposal.

Intangible Assets (Other than Goodwill)

An intangible asset, which is a non-monetary asset without a physical substance, is recognised to the extent that it is probable that the expected future economic benefits attributable to the asset will flow to the Group and that its fair value can be measured. The asset is deemed to be identifiable when it is separable (i.e. capable of being divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability) or when it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the Group or from other rights and obligations.

Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the intangible asset meets the definition of an asset and the fair value can be reliably measured on initial recognition.

Intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The carrying values of intangible assets are reviewed for indicators of impairment at each reporting date and are subject to impairment testing when events or changes in circumstances indicate that the carrying values may not be recoverable.

The amortisation of intangible assets is calculated to write-off the book value of intangible assets over their useful lives which is currently eight years on a straight-line basis on the assumption of zero residual value.

Property, Plant and Equipment

Property, plant and equipment are stated at cost or deemed cost less accumulated depreciation and impairment losses. The Group's Irish properties were revalued to fair value in 1998 and are measured on the basis of deemed cost being the revalued amount at the date of that revaluation less accumulated depreciation.

Property, plant and equipment are depreciated over their useful economic life on a straight line basis at the following rates:

Freehold buildings	50-100 years
Freehold land	Not depreciated
Leasehold buildings	Lease term or up to 100 years
Plant and machinery	5-20 years
Motor vehicles	5 years
Plant hire equipment	4-8 years

The residual value and useful lives of property, plant and equipment are reviewed and adjusted if appropriate at each balance sheet date.

On disposal of property, plant and equipment the cost and related accumulated depreciation and impairments are removed from the balance sheet and the net amount, less any proceeds, is taken to the income statement.

Accounting Policies

The carrying amounts of the Group's property, plant and equipment are reviewed at each balance sheet date to determine whether there is any indication of impairment. An impairment loss is recognised whenever the carrying amount of an asset or its cash generation unit exceeds its recoverable amount. Impairment losses are recognised in the income statement unless the asset is recorded at a revalued amount in which case it is firstly dealt with through the revaluation reserve relating to that asset with any residual amount being transferred to the income statement.

Subsequent costs are included in an asset's carrying amount or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the replaced item can be measured reliably. All other repair and maintenance costs are charged to the income statement during the financial period in which they are incurred.

Investments

All investments are initially recognised at the fair value of the consideration paid including any related acquisition charges.

Where investments are actively traded in organised financial markets, fair value is determined by reference to Stock Exchange quoted market bid prices at the close of business on the balance sheet date. Where it is impracticable to determine fair value in accordance with IAS 39, unquoted equity investments are recorded at historical cost and are included within financial assets on this basis in the Group Balance Sheet. They are assessed for impairment annually.

Leases

Assets held under finance leases, which are leases where substantially all the risks and rewards of ownership of the asset have transferred to the Group and hire purchase contracts are capitalised in the balance sheet and are depreciated over their useful lives with any impairment being recognised in accumulated depreciation. The asset is recorded 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 finance lease. The capital elements of future obligations under leases and hire purchase contracts are included in liabilities in the balance sheet and analysed between current and non-current amounts. The interest elements of the rental obligations are charged to the income statement over the periods of the leases and hire purchase contracts so as to produce a constant periodic rate of interest on the remaining balance of the liability.

Leases where the lessor retains substantially all the risks and rewards of ownership are classified as operating leases. Operating lease rentals are charged to the income statement on a straight-line basis over the lease term. Lease incentives are recognised over the lease term on a straight line basis.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is based on the first-in, first-out principle and includes all expenditure incurred in acquiring the inventories and bringing them to their present location and condition. Raw materials are valued on the basis of purchase cost on a first-in, first-out basis. In the case of finished goods and work-in-progress, cost includes direct materials, direct labour and attributable overheads based on normal operating capacity and excludes borrowing costs. Net realisable value is the estimated proceeds of sale less all further costs to completion and less all costs to be incurred in marketing, selling and distribution.

Trade and Other Receivables and Payables

Trade and other receivables and payables are stated at cost, which approximates to fair value given the short-term nature of these assets and liabilities.

Trade receivables are carried at original invoice amount less an allowance for potentially uncollectable debts. Provision is made when there is objective evidence that the Group will not be in a position to collect all of its receivables when they fall due. Bad debts are written-off against the provision or in the income statement.

Accounting Policies

Cash and Cash Equivalents

Cash and cash equivalents comprise cash balances held for the purposes of meeting short-term cash commitments and money market instruments which are readily convertible to a known amount of cash. Where money market instruments are categorised as cash equivalents, the related balances have a maturity of three months or less. In addition, for the purposes of the Group Cash Flow Statement, bank overdrafts are netted against cash and cash equivalents where the overdrafts are repayable on demand and form an integral part of cash management. Overdrafts are included within current interest-bearing loans and borrowings in the Group Balance Sheet.

Derivative Financial Instruments

The Group uses derivative financial instruments (principally interest rate and currency swaps) to hedge its exposure to foreign exchange and interest rate risks arising from its financing activities.

Derivative financial instruments are recognised initially at cost and thereafter are stated at fair value. Fair value is the amount which an asset could be exchanged, or a liability settled, between knowledgeable willing parties in an arms length transaction. Where derivatives do not fulfil the criteria for hedge accounting, changes in fair values are reported in the income statement. Where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged as outlined in the accounting policy below on hedging.

The fair value of interest rate and currency swaps is the estimated amount that the Group would receive or pay to terminate the swap at the balance sheet date, taking into account current interest and currency exchange rates and the current creditworthiness of the swap counterparties.

Hedging

For the purposes of hedge accounting, hedges are classified either as fair value hedges (which entail hedging the exposure to movements in the fair value of a recognised asset or liability) or cash flow hedges (which hedge exposure to fluctuations in future cash flows derived from a particular risk associated with a recognised asset or liability, a firm commitment or a highly probable forecast transaction) or hedges of net investment.

(i) Fair Value Hedge

In the case of fair value hedges which satisfy the conditions for special hedge accounting, any gain or loss stemming from the re-measurement of the hedging instrument to fair value is reported in the income statement. In addition, any gain or loss on the hedged item which is attributable to the fair value movement in the hedged risk is adjusted against the carrying amount of the hedged item and reflected in the income statement.

Where a derivative financial instrument is used to economically hedge the foreign exchange exposure of a recognised monetary asset or liability, hedge accounting is not applied and any gain or loss accruing on the hedging instrument is recognised as finance income or expense in the income statement.

(ii) Cash Flow Hedges

Where a derivative financial instrument is designated as a hedge of the variability in cash flows of a recognised asset or liability, a firm commitment or a highly probable forecasted transaction, the effective part of any gain or loss on the derivative financial instrument is recognised as a separate component of equity with the ineffective portion being reported as finance expense or income in the income statement. If a hedge of a forecasted transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains and losses that were recognised directly in equity are reclassified into profit or loss in the same period or periods during which the asset acquired or liability assumed affects profit or loss. For cash flow hedges, other than those covered by the preceding statements, the associated cumulative gain or loss is removed from equity and recognised in the income statement in the same period or periods during which the hedged forecast transaction affects profit or loss. The ineffective part of any gain or loss is recognised immediately in the income statement.

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Hedge accounting is discontinued when a hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. The cumulative gain or loss at that point remains in equity and is recognised in accordance with the above policy when the transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement in the period.

(iii) Hedge of Net Investment in Foreign Operation

Where foreign currency borrowings provide a hedge against a net investment in a foreign operation, foreign exchange differences are taken directly to a foreign currency translation reserve (being a separate component of equity). Cumulative gains and losses remain in equity until disposal of the net investment in the foreign operation or repayment of the borrowing at which point the related differences are transferred to the income statement as part of the overall gain or loss on sale or repayment.

Interest Bearing Loans and Borrowings

All loans and borrowings are initially recorded at cost being the fair value of the consideration received net of related transaction costs. After initial recognition, current and non-current interest-bearing loans and borrowings are measured at amortised cost using the effective interest rate method. Amortised cost includes any issue costs and any discount or premium on settlement. Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least twelve months after the balance sheet date.

Provisions

A provision is recognised on a discounted basis when the Group has a present (either legal or constructive) obligation as a result of a past event; it is probable that a transfer of economic benefits will be required to settle the obligations and a reliable estimate can be made of the amount required to settle the obligation. Provisions are not recognised in respect of future operating losses.

Retirement Benefit Obligations

Obligations to the defined contribution pension plans are recognised as an expense in the income statement as service is received from the relevant employees. The Group has no obligations to make further contributions to these schemes.

The Group operates a number of defined benefit pension schemes which require contributions to be made to separately administered funds. The Group's net obligation in respect of defined benefit pension schemes is calculated separately for each plan by estimating the amount of future benefits that employees have earned in return for their service in the current and prior periods. That benefit is discounted to determine its present value, and the fair value of any plan asset is deducted. The discount rate employed in determining the present value of the schemes' liabilities is determined by reference to market yields at the balance sheet date on high quality corporate bonds for a term consistent with the currency and term of the associated post-employment benefit obligations.

The net surplus or deficit arising in the Group's defined benefit pension schemes are shown within either non-current assets or liabilities on the face of the Group Balance Sheet. The deferred tax impact of pension scheme surpluses and deficits is disclosed separately within deferred tax assets or liabilities as appropriate. The Group recognises post transition date actuarial gains and losses immediately in the statement of recognised income and expense.

Any increase in the present value of plans' liabilities expected to arise from employee service during the period is charged to operating profit. The expected return on the plans' assets and the expected increase during the period in the present value of the plans' liabilities arising are included in finance income and expense respectively.

When the benefits of a defined benefit plan are improved, the portion of the increased benefit relating to past service by employees is recognised as an expense in the income statement over the remaining average period until the benefits vest. To the extent that the benefits vest immediately, the expense is recognised immediately in the income statement.

Accounting Policies

Share Based Payment Transactions

Group share schemes allow employees to acquire shares in the Company. They are all equity settled. The fair value of share entitlements granted is recognised as an employee expense in the income statement with a corresponding increase in equity. The fair value is determined by an external valuer using a binomial model. Share entitlements granted by the Company are subject to certain non-market based vesting conditions. Non-market vesting conditions are not taken into account when estimating the fair value of entitlements as at the grant date. The expense for share entitlements shown in the income statement is based on the fair value of the total number of entitlements expected to vest and is allocated to accounting periods on a straight line basis over the vesting period. The cumulative charge to the income statement is reversed where entitlements do not vest because all non-market performance conditions have not been met or where an employee in receipt of share entitlements leaves the Group before the end of the vesting period.

The proceeds received by the Company on the vesting of share entitlements are credited to share capital and share premium when the share entitlements are converted. In line with the transitional arrangements set out in IFRS 2, "Share Based Payment", the recognition and measurement principles of this standard have been applied in respect of share entitlements granted after 7 November 2002.

Income Tax

The income tax expense in the income statement represents the sum of current tax and deferred tax.

Income tax is recognised in the income statement except to the extent that it relates to items recognised directly in equity or items for which there is no corresponding income statement charge, in which case it is recognised in equity.

Current tax is based on taxable profit. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are not taxable or deductible. The Group's liability for current tax is calculated using rates that have been enacted or substantially enacted at the balance sheet date.

Deferred tax is provided, using the liability method, on all temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax assets and liabilities are measured at the tax rates that are expected to apply in the year when the asset is realised or the liability is settled based on rates that have been enacted or substantially enacted at the balance sheet date.

Deferred tax assets and liabilities are not recognised for the following temporary differences;

- Goodwill not deductible for tax purposes
- Temporary difference arising from the initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit or taxable profit or loss; and
- Temporary differences associated with investments in subsidiaries in which case deferred tax is only recognised to the extent that it is probable the temporary differences will reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profit would be available to allow all or part of the deferred tax asset to be utilised.

Share Capital

Repurchase of share capital

When share capital recognised as equity is purchased, the amount of the consideration paid, including directly attributable costs, is recognised as a change in equity.

Dividends

Dividends on ordinary shares are recognised as a liability in the Group's financial statements in the period in which they are declared by the Company. In the case of interim dividends, these are considered to be declared when they are paid and in the case of final dividends these are declared when authorised by the shareholders in General Meeting.