Basis of Preparation and Significant Accounting Policies (note 1)

Statutory basis (IFRS) results	Section
Basis of Preparation	1
Basis of presentation of results / supplemental earnings information	2
Policies on first time adoption of IFRS	3
Key Accounting policies that affect IFRS results attributable to shareholders	4
Long-term business	
Product classification	4.1
Investments and derivatives	4.2
Shareholder backed business	4.3
With-profit business	4.4
Fund Management business	4.5
Egg	4.6
Other key accounting policies	4.7
Other significant accounting policies that primarily affect the measurement of the assets and liabilities of with-profit business with no effect on shareholders' equity (note 2)	5
Other changes principally of a presentational nature for IFRS income statement and balance sheet (note 2)	6
Other changes to be included in interim 2005 and future IFRS results announcements (note 2)	7

Achieved Profits (AP) basis results restated for changes adopted on application of IFRS

Basis of preparation and key accounting policies that affect AP basis results attributable to shareholders	8

Notes

1. Status

The policies included in this part of the announcement are intended to provide an explanation of the policies adopted by the Group as they affect results attributable to shareholders, key policies that affect the recognition and measurement of the assets and liabilities of the Group's with-profit funds, and other significant changes of a presentational nature. The policies are comprehensive in this regard but not necessarily fully complete as to all policies being applied in the Group's financial statements. Additional details that relate to the format and other aspects of the Group's financial statements will be included with the Group's interim results announcement to be published on 27 July.

2. Sections 5, 6 and 7

The policies and presentation issues described in sections 5, 6 and 7 do not directly effect the profits and shareholders' equity information contained within the 2 June announcement. These sections are provided primarily for information as to other significant accounting policies that will be included within the interim 2005 results announcement.

Section 1 – Basis of Preparation

Summary	Section
Status of financial results included within this announcement	1.1
Use of estimates	1.2
Consolidation principles	1.3
Entities newly consolidated as a result of IFRS adoption	1.4

Section 1.1 – Status of financial data included within this announcement

With the exception of changes consequent to the adoption of IAS 32, “Financial Instruments: Disclosure and Presentation”, IAS 39, “Financial Instruments: Recognition and Measurement”, and IFRS 4, “Insurance Contracts”), which, as permitted under IAS1,”Presentation of Financial Statements” the Group has chosen to apply at 1 January 2005, the announcement and these schedules include results, on the basis of selected financial information, restated on to IFRS in accordance with the accounting policies that the Group intends to apply for half year 2005 and full year 2005 reporting. The IFRS results for half year 2004 and full year 2004 included in this announcement and prepared on this basis are referred to as ‘Statutory IFRS’. Separately this announcement includes IFRS results on a ‘proforma’ basis that reflects application of IAS32, IAS 39, IFRS 4 (insurance contracts) as if applied to the 2004 results of the Group’s insurance operations. The purpose of the proforma IFRS basis results is to provide users with information that is indicative, as to the prospective basis of presentation for the 2005 results taking account of the Group’s intended approach to application of these standards.

The Statutory IFRS financial information included within this announcement establishes the results attributable to shareholders, on the basis of selected financial information, to be included in the Group’s interim 2005 results and its first full set of IFRS financial statements for the year ending 31 December 2005. Due to the continuing work of the IASB and possible amendments to the interpretative guidance the Group’s accounting policies, and consequently the information presented, may change prior to the publication of the Group’s first IFRS results in July 2005.

For the avoidance of doubt the financial information included in the announcement and published on the Company’s web-site do not represent the Company’s statutory accounts.

The following points should also be noted:

- The preliminary information has been prepared in accordance with the basis of preparation set out in the announcement and this document rather than the basis applicable for a set of full financial statements.

- The disclosure and presentation requirements of formal IFRS financial statements have not been adopted in the preliminary IFRS selected financial information. The format and presentation of the results in the announcement will however be applied as part of future IFRS financial statements.

- The preliminary IFRS selected financial information does not include details on the Group’s consolidated cash flows, consolidated income statement, or consolidated balance sheet presentation.

- In accordance with IFRS1, no adjustments have been made for any changes in estimates made at the time of approval of the previous UK GAAP interim and annual financial statements on which the selected financial information is based.

Section 1.2 – Use of estimates

The preparation of financial information requires the Group to make estimates and assumptions that affect the IFRS figures reported. Although these estimates are based on management’s best knowledge of current facts, circumstances and, to some extent, future events and actions, actual results ultimately may differ from those estimates, possibly significantly.

Section 1.3 – Consolidation principles

The IFRS basis consolidated financial statements of the Group for half year 2005 and future financial reporting will include the assets, liabilities and results of the company and subsidiary undertakings in which Prudential has a controlling interest. The results of subsidiaries are included in the financial statements from the date acquired to the effective date of disposal. All inter-company transactions are eliminated on consolidation. Investment Management fees charged by M&G and the Group's US and Asian fund management operations to long-term business funds will be recorded within inter-segment revenue and expenditure but eliminated on consolidation in the Group Income Statement.

The results included within this announcement reflect these consolidation principles.

Section 1.4 – Entities newly consolidated as a result of IFRS adoption

The consolidated results attributable to shareholders included within this announcement include those of the company and subsidiaries, and other entities falling within the scope of consolidation under IAS 27 and the IFRIC interpretation, SIC 12, of the IASB. Under IFRS certain investment vehicles are newly consolidated due to the requirements differing from those under UK GAAP. The consolidation of the main categories of these entities has the following key effects.

Type of entity	**Changes to Income statement**			**Changes to Balance sheet**		
	Income and expenditure	Minority Interest	Operating profit *	Assets and liabilities	Minority interest	Shareholders equity
Investments of shareholder backed operations						
UK and Asian Unit trusts / Mutual funds and OEICs	Not significant	N/A (reported in short-term fluctuations)	No significant change	Gross up of gross assets attributable to external unit holders and related liability.	N/A	No (except for shares in Prudential Plc held by these funds which are accounted for as Treasury stock)
US investments companies managed by PPM America	Additional income offset by expense to third party debt interests.	No	No significant change	Total assets recorded by underlying investments. Non-recourse borrowings consolidated (see section 6.5)	No	Yes
Investments of PAC with-profit fund						
Venture funds and property partnerships	Altered income offset by altered change to transfer to unallocated surplus for Prudential's share. Additional income attributable to minority reported for presentational purposes within short-term fluctuations (STF) investment returns.	Yes	No significant change	Significant goodwill and external non-recourse borrowings consolidated together with other assets and liabilities (See section 6.6)	Yes	No
Collateralised Debt Obligations (CDO) investment funds	Altered income offset by altered change to transfer to unallocated surplus for Prudential's share.	No	No significant change	Total assets recorded by underlying investments. Non-recourse borrowings consolidated	No	No

* 'Operating profit' referenced in the above table refers to the profit before tax based on longer-term returns, before shareholder tax (but after tax attributable to with-profit funds and unit-linked policyholders). See section 2.1 in respect of the distinction between tax attributable to with-profit fund, unit-linked policyholders, and shareholders.

Section 2 – Basis of presentation / Supplemental Earnings information

Summary	Section
Income statement and presentation of tax of with-profits and unit-linked funds	2.1
Analysis of Profit attributable to shareholders from continuing operations	2.2
Operating profit, based on longer-term investment returns, before shareholder tax	2.3
Short-term fluctuations in investment returns	2.4
Actuarial gains and losses of defined benefit pension schemes	2.5
Discontinued operations	2.6
Earnings per share	2.7

Section 2.1 – Income statement and presentation of tax of with-profit and unit linked funds

Previous basis

Under UK GAAP and the prescribed format under the Companies Act income and expenditure, including tax attributable to policyholders and shareholders of long-term business is recorded within the long-term business technical account section of the profit and loss account. The net of tax result on the technical account is then transferred to the non-technical account section of the consolidated profit and loss account. Within the non-technical account the net of tax result of the long-term business is grossed up by the tax attaching to the result attributable to shareholders. The grossed up result is then added to the pre-tax results from other operations of the company or Group to derive a total pre-tax profit attributable to shareholders. The shareholders' tax charge on the total pre-tax profit attributable to shareholders reflects the aggregate of the tax gross up for life business and the tax charge for other operations.

This basis of presentation reflects a long-standing methodology, codified under the Statement of Recommended Practice issued by the Association of British Insurers and which continues to apply for life insurance companies that continue to prepare their statutory accounts in accordance with UK GAAP.

This basis has been applied for financial reporting so as to address the fact that for UK long-term insurance business there is a single tax charge which integrates tax on both shareholders' profits and policyholders' investment returns. The tax charge included in the long-term business technical account includes tax expense on with-profit funds attributable to both policyholder and shareholders. Different tax rules apply under UK Law depending upon whether the business is life insurance or pension business. Tax on the life insurance business is based on investment returns less expenses attributable to that business. Tax on the pension business is based on the shareholders' profits or losses attributable to that business. The shareholders' portion of the long-term business is taxed at the shareholders' rate with the remaining portion taxed at rates applicable to the policyholders. In determining the surplus for distribution, which in turn conditions the shareholder transfer from the fund (and hence the post-tax Modified Statutory Basis profit) the long-term technical account for the with-profit fund includes transfers to and from the fund for future appropriations, a liability held in the balance sheet for amounts which have yet to be allocated between policyholders and shareholders. These transfers are determined after taking account of the tax borne by the with-profit funds in the income statement.

From this brief description it is evident that the net of tax shareholder result should properly reflect the post-tax transfer from the fund and that, for reporting that reflects the tax basis of the fund, the pre-tax result attributable to shareholders should be before taxes borne by shareholders but after taxes borne by policyholders i.e. rather than before the full tax borne by the fund.

The taxation basis for UK unit-linked business is complicated by similar factors as described in Section 4.3.4

IFRS basis

Under IFRS the total tax charge is required to be disclosed in the income statement. In addition, segment results under IAS 14 ("Segment Reporting") are required to be disclosed on a pre-tax basis. Since IFRS makes no distinction between taxes borne by policyholders and shareholders, pre-tax results for life business reflect the income and expenditure of with-profit funds after taking account of transfers to or from an unallocated surplus (a net of tax liability in the with-profit fund balance sheet) but before taxes.

As a result of this basis of preparation the total profit before tax on an IFRS basis is not representative of profits before taxes attributable to shareholders.

In order to provide meaningful information, it is the company's intention to provide analysis of the results attributable to shareholders on a basis that is consistent with the previous basis of allocation of tax charges between policyholders and shareholders. Throughout this announcement profit before shareholder tax reflects the conceptual basis of presentation as applied previously by the Group. The Group's IFRS financial statements will be configured to comply with IFRS requirements but at the same time meeting the need to report l pre-tax results that are determined after deduction of taxes attributable to policyholder returns but before taxes attributable to shareholders, as follows:

Profit before taxes attributable to policyholder returns and shareholders	X
Tax attributable to policyholder returns	(X)
Profit before shareholder tax	X
Tax attributable to shareholders	
- Total tax borne by the Group	(X)
- Less: Tax attributable to policyholder returns (as above)	X
- Tax attributable to shareholders	(X)
Profit for the year before minority interests	X

In determining the profit before shareholder tax the company has applied, and will continue to apply, a methodology consistent with that previously applied under UK GAAP. There is no definitive method of calculating the effective shareholder tax rate for with-profit business. A number of methods are consistently used in order to assess the appropriate rate.

Section 2.2 – Analysis of profit attributable to shareholders from continuing operations

The IFRS results within this announcement have been presented on a basis that retains conceptually the approach under UK GAAP of providing additional supplementary earnings per share information (under FRS 3 "Reporting Financial Performance") and information, as advocated by the ABI Statement of Recommended Practice (ABI SORP), which shows operating profits based on longer-term investment returns.

For the purposes of this announcement and results to be published in future, the company's accounting policy is to provide an analysis of profit attributable to continuing operations before shareholder tax on the following classifications:

- Operating profit based on longer-term investment returns.
- Short-term fluctuations in investment returns.
- Actuarial gains and losses of defined benefit pension schemes

The Group has chosen to apply this approach, as the directors believe that such presentation better reflects the Group's underlying performance on a statutory basis of measurement.

Section 2.3 – Operating profit, based on longer-term investment returns before shareholder tax

The Group uses operating profit based on longer-term investment returns as a supplemental measure of its results. For the purposes of measuring results on this basis, investment returns on non-linked shareholder backed business are based on expected long-term rates of return. The expected long-term rates of return are intended to reflect historical real rates of return and, where appropriate, current inflation expectations adjusted for consensus economic and investment forecasts. The most significant operation that requires adjustment for the difference between actual and long-term investment returns is Jackson National Life.

Under UK GAAP reporting, for the purposes of determining the longer-term investment returns of fixed income securities held by Jackson National Life and other operations, realised gains and losses (including losses arising on recognition of permanent diminutions in value) have historically been averaged over five years for inclusion in operating profit.

For equity related securities an appropriate long-term rate of return has been assumed for the portfolios in individual business operations. This rate has been used to determine longer-term returns by either applying it to the monthly average carrying value of such investments after excluding the estimated effects of short-term market movements, or grossing up dividend received by a factor which reflects the ratio of total assumed equity returns over expected long-term dividend yields.

On application of IFRS, the Group has, as a discretionary change of policy, that is not required by IFRS, altered the basis of determining longer-term returns for fixed income securities to more closely reflect longer-term returns.

The new basis of determining longer-term returns for fixed income securities is as follows:

Actual investment income for securities held in the reporting period, less

Allowance for long-term default assumption, plus

Amortisation of interest related realised gains and losses to operating profit, from time of sale to the date of maturity of the sold securities.

The charge for the long-term default assumption reflects an annualised amount based on the credit quality of the securities currently held in the portfolio. The amount of the provision for securities is determined by reference to credit quality and is benchmarked against industry surveys published by the major rating agencies and reflect a blend of analyses that take account of longer-term and recent experience. For the 2004 comparative results, the change of policy is primarily of significance for Jackson National Life.

The change of policy is an improvement on the previous policy. 5 year averaging of realised gains and losses reflects medium term experience but is not as representative of a basis of longer-term returns as the revised method.

The basis of longer-term returns for equity related securities under IFRS will continue to be as applied previously under UK GAAP.

Section 2.4 – Short-term fluctuations in investment returns

Short-term fluctuations in investment returns primarily represent the difference between actual investment returns of non-linked shareholder backed business for the reporting period as reported in the income statement and longer-term investment returns. The actual investment returns reported in the income statements reflect the basis of measurement and classification of investments. The components of actual returns for the Group's non-linked shareholder backed businesses, for all categories of investments (including equities, properties, fixed income securities and derivatives) other than for Jackson National Life are investment income, realised gains and, except in the case of mortgages and loans, unrealised appreciation. Additional details are explained in Sections 4.2 and 4.3.3.

For Jackson National Life these components apply to all categories of investments except for those fixed income securities classified as available for sale (AFS). For these AFS securities unrealised appreciation is credited to the Statement of Recognised Income and Expense (SORIE) i.e. direct to shareholder reserves.

Short-term fluctuations in investment returns also includes the following:

- Value movements on derivatives of shareholder backed operations and, where fair value hedge accounted, the value movement on hedged instruments. The principal component of value movements on derivatives arises in Jackson National Life for which hedge accounting is not generally applied.

- Pre-tax profits attributable to minority interests of consolidated venture fund investment and property subsidiaries of the PAC with-profit fund and other investment funds of the shareholder backed businesses of the Group. After tax, the minority interest in the income statement reflects an equal and opposite charge for the same amount.

Section 2.5 – Actuarial gains and losses of defined benefit pension schemes

Actuarial gains and losses of defined benefit pension schemes are recorded in the income statement rather than the Statement of Recognised Income and Expense (SORIE). Due to IFRS requirements, as they apply to the share of actuarial gains and losses absorbed by with-profit funds, the Group's policy is to record all actuarial gains and losses in the income statement.

Section 2.6 – Discontinued operations

Previously, under UK GAAP, the operating result of discontinued operations was presented as part of the total operating profit before tax. The element attributable to discontinued operations was separately disclosed. Pre-tax profits and losses on the sale or closure of discontinued operations were also included within profit before tax. The tax charge reflected this presentation.

Under IFRS, profit before and after tax is presented only for continuing operations. Profit and losses of discontinued operations are shown after tax, together with post-tax profits or losses on sale or closure, as an item in the income statement to derive total profit for the period.

This change is presentational only although the IFRS results, in respect of the discontinued operations, may of course reflect changes for differences between UK GAAP and IFRS.

Section 2.7 – Earnings per share

Total earnings per share based on profit for the financial period, including the post-tax results of continuing and discontinued operations is published as required by IFRS.

The Group's accounting policy is also for supplemental earnings per share information to be provided on a basis consistent with the basis of presentation of profits before shareholder tax from continuing operations as described in sections 2.1 and 2.3. Earnings per share information provided on this basis is determined after deduction of the appropriate shareholder tax charge and, if relevant, minority interest.
Details of diluted earnings per share will also be provided in the Group's financial statements.

Section 3 – Policies on first time adoption of IFRS

Summary	Section
Date of adoption	3.1
Compliance with IASB standards	3.2
Transition exemptions and other options under IFRS taken by the Group	3.3

Section 3.1 – Date of adoption

The date of adoption of IFRS is 1 January 2004. As at that date the company has applied all IASB standards on a basis prescribed or permitted by those standards in the preparation of its consolidated financial statements. The parent company balance sheet and other financial statements will continue to be prepared in accordance with UK GAAP.

Section 3.2 – Compliance with IASB standards

The results referred to throughout the announcement as statutory IFRS basis reflect selected financial information prepared in accordance with IASB standards and IFRIC interpretations, except to the extent of presentation and disclosure requirements to be applied in a formal set of financial statements. 'Proforma IFRS basis' results included within this announcement apply the measurement principles of IAS 39 and IFRS 4 to the assets and liabilities of the Group's insurance operations for 2004 on a memorandum basis.

Section 3.3 – Transition exemptions and other options under IFRS taken by the Group

In general, a Group is required to determine its IFRS accounting polices and apply these retrospectively to determine its opening balance sheet under IFRS. However, in accordance with IFRS 1 ("First-time adoption of International Financial Reporting Standards"), the Group has applied the mandatory exceptions and certain optional exemptions from full retrospective application of IFRS. Exemptions from full retrospective application elected by the Group are as follows:

Business Combinations

The Group has elected not to apply retrospectively the provisions of IFRS 3 ("Business combinations") to business combinations that occurred prior to 1 January 2004. At the date of transition, therefore, no adjustment was made between UK GAAP and IFRS shareholders' funds for any historical business combination. Consistent with this approach goodwill recognised in the opening balance sheet at 1 January 2004 for acquired businesses that have previously been consolidated is the same as previously shown under UK GAAP. Goodwill on newly consolidated entities, for example, on venture fund investments, is determined by reference to net assets at transition date. The Company has chosen to express its goodwill at transition in sterling rather than in functional currency, as permitted by IFRS 1.

Comparatives

The Group has taken advantage of the exemption within IFRS that allows comparative information presented in the first year of adoption of IFRS not to comply with IAS 32 (Financial Instruments: Disclosure and Presentation), IAS 39 (Financial Instruments: Recognition and Measurement) and IFRS 4 (Insurance Contracts). These standards have been formally adopted on 1 January 2005. Notwithstanding this basis of adoption this announcement includes 'proforma IFRS' results on a memorandum basis which shows the impact of adoption of these standards on the 2004 results of the Group's insurance operations.

Cumulative translation differences

The Group has elected that the cumulative translation differences of overseas operations be set to zero at the transition date to IFRS.

Employee benefits

The Group has not adopted the corridor method of valuing pension deficits and therefore all cumulative actuarial gains and losses are recognised in the income statement. The group has taken advantage of the exemption under IAS 19 (“Employee benefits”) not to disclose the present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit of the plans for dates prior to the date of transition.

Equity compensation plans

For options and awards of the equity of Egg plc, the Group has elected not to apply the provisions of IFRS 2 (“Share based payment”) to options and awards granted on or before 7 November 2002 which had not vested by 1 January 2005. For all other options and awards the Group has elected to apply the provisions of IFRS 2 in full.

IFRS1 encourages, but does not require, a first time adopter to apply IFRS 2 (“share based payment”), to equity instruments granted on or before 7 November 2002. However, this election is only permitted if the entity has disclosed publicly the fair value of those equity instruments at measurement date as defined in IFRS2. As part of its US GAAP reporting, the Group has made such disclosures in relation to equity instruments of Prudential plc, but not of Egg plc. The Group has therefore not applied the provisions of IFRS2 to options and awards of the equity of Egg plc granted on or before 7 November 2002. For all other options and awards, the Group has elected to apply the provisions of IFRS2 in full.

Property, plant and equipment

The Group has decided to use historical cost rather than fair value on transition as deemed cost.

Designation of financial assets

As permitted by IAS39 various financial assets have been designated as at fair value through profit or loss or as available for sale at 1 January 2005 on adoption of IAS39 rather than on initial recognition.

Estimates

The Group’s estimates at the date of transition are consistent with those under UK GAAP.

Hedge accounting

Hedge accounting has been applied prospectively by the Group from 1 January 2005 in respect of banking and certain centrally held derivative positions. Hedge accounting is not applied in most circumstances for derivatives held for hedging purposes by Jackson National Life.

Section 4 – Key accounting policies that affect IFRS results attributable to shareholders

Summary	Section
Long-term business	
Product classification	4.1
Investments and derivatives	4.2
Shareholder backed business	4.3
With-profit business	4.4
Fund Management Business – revenue and cost accounting	4.5
Egg: accounting policies for banking assets, liabilities, income and expenditure	4.6
Other key accounting policies that affect IFRS results attributable to shareholders	4.7

Section 4.1 – Long-term business: product classification

For 2004, the statutory IFRS result included in this announcement continues to reflect UK GAAP requirements in relation to long-term business contracts. Under IFRS, from 1 January 2005 when the Group adopts IFRS 4, the measurement basis of assets and liabilities of long-term business contracts is dependent upon the classification of the contracts under IFRS. Under IFRS 4 contracts are initially classified as being either 'insurance' contracts, if the level of insurance risk in the contracts is significant, or 'investment' contracts, if the risk is insignificant.

'Insurance' contracts are permitted to be accounted for under previously applied GAAP. The Group has chosen to adopt this approach. However, as an improvement to accounting policy, permitted by IFRS, the Group will be applying the measurement principles and disclosures of the UK Standard FRS 27 for 2005 reporting. An explanation of the changes under FRS 27 is provided in section 5.1.3. 2004 comparatives are not required to be adjusted.

'Investment' contracts are further delineated under IFRS 4 between those with and without discretionary participating features. For those contracts with discretionary participating features, IFRS 4 also permits the continued application of previously applied GAAP. The Group also intends to adopt this approach, again subject to the FRS 27 improvement.

For 'investment' contracts that do not contain discretionary participating features, AS39 and, where the contract includes an investment management element, IAS18 apply measurement principles to assets and liabilities attaching to the contract that may diverge from those previously applied. Details of the impact for Prudential are described in Section 4.3.2.

Section 4.2 – Long-term business: Investment and derivatives

The valuations principles applied under UK GAAP and IFRS are as follows:

	UK GAAP	IFRS
Land and Buildings	Fair value (including Group occupied)	Fair value (excluding Group occupied properties which are carried at depreciated cost
Financial Investments	Fair value (in some cases applying mid-market values)	
Equity securities		Fair value (bid value)*
Fixed income securities		
- JNL	Amortised cost (subject to provisions for permanent diminution in value)	Fair value (bid value)*
- Other operations	Fair value	Fair value* (except certain securities of some Asia operations reclassified as loans and receivables.)
Loans and receivables		Amortised cost* (subject to provisions for permanent diminution in value, see impairment discussion below)
Loans collateralised by mortgages and other unsecured loans		
- UK insurance operations	Fair value	
- Other operations	Unpaid principal (net of unamortised discounts and premiums and an allowance for loan losses)	
Loans to policyholders		
Deposits with credit institutions	Fair value	Fair value
Derivatives		
- JNL / Egg and minor other	Amortised cost	Fair value*
- UK insurance and Asia	Fair value	Fair value

* These policies are applied for IFRS from 1 January 2005. For 2004 comparatives under statutory IFRS the UK GAAP policy applies. Proforma IFRS results included in this announcement reflect the application of the 2005 policy for insurance operations.

Impairment of financial assets (Policy applicable from 1 January 2005)

The Group assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or group of financial assets is impaired and impairment losses are incurred only if there is objective evidence of impairment as a result of one or more events that have occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Group. The impairment is measured as the difference between the amortised cost of the asset and its fair value and recognised in the income statement.

This policy applies for assets carried at fair value. For loans and other assets carried at amortised cost, the impairment amount is the difference between amortised cost and the present value of the expected cash flows discounted at the original discount rate.

Section 4.3 – Long-term business: Shareholder backed business

	Section
Insurance assets and liabilities	
Insurance contracts	4.3.1
Investment contracts	4.3.2
Investment return and impact on reported results	4.3.3
Taxation of unit linked business – shareholder tax charge	4.3.4

Section 4.3.1 – Long-term business: Shareholder backed business – Insurance Contracts.

Insurance contracts, as defined under IFRS 4 are those contracts that contain significant insurance risk under IFRS. These contracts may continue to be accounted for using previously applied GAAP. The Group has chosen to apply this approach. Under UK GAAP the assets and liabilities of contracts are prepared in accordance with the modified statutory basis of reporting as set out in the revised Statement of Recommended Practice issued by the Association of British Insurers in November 2003.

The insurance contracts of the Group's shareholder backed business fall broadly into the following categories:

UK and Europe insurance operations	-	Bulk and Individual annuity business, written by Prudential Retirement Income Limited, and minor categories of non-participating UK business.
Jackson National Life	-	Fixed and variable Annuity business and life insurance.
Prudential Corporation Asia	-	Non participating term, whole life, and unit-linked policies, together with accident and health policies.

For shareholder backed business of the Group insurance contracts are accounted for as follows:

Deferred acquisition costs (DAC)

Costs of acquiring new business, principally commissions, marketing and advertising costs and certain other costs associated with policy issuance and underwriting that are not reimbursed by policy charges are specifically identified and capitalised as deferred acquisition costs which are included as an asset in the balance sheet. The DAC asset is amortised against margins in future revenues on the related insurance policies, to the extent that the amounts are recoverable out of the margins. Recoverability of the unamortised DAC asset is assessed at the time of the policy issue, and reviewed if profit margins have declined.

For the business of Jackson National Life, the determination of the expected emergence of margins, against which the amortisation profile of the DAC asset is established, is dependent on certain key assumptions. For single premium deferred annuity business, the key assumption is the expected long-term spread between the earned rate and the rate credited to policyholders. For variable annuity business, the key assumption is the expected long-term level of equity market returns, which, for 2004, was 8.4% per annum implemented using a mean reversion methodology. These returns affect the level of future expected profits through their effects on fee income and the required level of provision for guaranteed minimum death benefits.

Present value of acquired in-force

The present value of future profits on a portfolio of long-term insurance acquired through the purchase of a subsidiary is recognised as an intangible asset and amortised over the useful lifetime of the related contracts in the portfolio on a systematic basis.

Policyholder Liabilities

Policyholder liabilities for UK and Europe shareholder backed business reflect the local regulatory basis of provisioning adjusted, where necessary, to comply with the requirements of the ABI SORP.

For Jackson National Life, the future policyholder benefit provisions for Jackson National Life's conventional protection-type policies are determined using the net level premium method under US GAAP principles and assumptions as of the issue date, as to mortality interest, policy lapsation and expenses plus provisions for adverse deviations. For investment-type products, which despite the description are classified and accounted for under IFRS as insurance contracts, the policyholder benefit provision is generally the policyholder account balance. An exception is variable annuity contracts with guarantee features where US GAAP requires benefits to be accounted for by using estimates of future benefits and fees under best estimate persistency assumptions.

For Prudential Corporation Asia, the future policyholder benefit provisions are determined in accordance with methods prescribed by local GAAP, which normally follows the regulatory basis, adjusted to comply, where necessary, with UK GAAP. For Asian operations in countries where local GAAP is not well established and in which the business written is primarily non-participating and linked business, US GAAP is used as the most appropriate proxy to local GAAP. The future policyholder benefit provisions for non-linked business reported on a US GAAP basis are determined using the net level premium method, with an allowance for surrenders, maintenance and claims expenses. Rates of interest used in establishing the policyholder provisions vary by operation depending on the circumstances attaching to each block of business.

Liability adequacy tests

The Group performs liability adequacy testing on its insurance provisions to ensure that the carrying amount of provisions (less related deferred acquisition costs) is sufficient to cover estimated future cash flows. When performing the liability adequacy test the Group discounts all contractual cash flows and compares this amount to the carrying value of the liability. Any deficiency is immediately charged to the income statement.

Reinsurance

The Group's insurance subsidiaries cede insurance premiums and risk in the normal course of business in order to limit the potential for losses. Outwards reinsurance premiums are accounted for in the same accounting period as the related premiums for the direct or inwards reinsurance business being reinsured.

Contracts entered into by the Group with reinsurers under which the Group is compensated for losses on one or more contracts issued by the Group, and that meet the classification requirements for insurance contracts, are classified as reinsurance contracts held. The benefits to which the Group is entitled under its reinsurance contracts held are recognised as reinsurance assets.

Jackson National Life reinsures portions of the coverage provided by its life insurance products with other insurance companies under agreements of indemnity reinsurance.

Section 4.3.2 – Long-term business: Shareholder backed business – Investment Contracts

The assets and liabilities of contracts with insignificant insurance risk previously were accounted for under UK GAAP under the provisions of the ABI SORP, as described in section 4.3.1. Under IFRS 4 the assets and liabilities of these contracts are required to be accounted for in accordance with IAS 39 (on financial instruments) and, where relevant, the provision of IAS 18 (revenue accounting) in respect of attaching fund management features of the contracts. Contracts of the Prudential Group whose assets and liabilities are required to be re-measured under IFRS from 1 January 2005 can be summarised as:

UK and Europe	-	Certain unit linked savings contracts
Jackson National Life	-	Guaranteed investment contracts (GICs)
	-	Minor amounts of ‘Annuity Certain’ contracts
Prudential Corporation Asia	-	Minor amounts for a number of small categories of business

The impact on UK and Europe unit linked and JNL’s GICs are considered in turn below:

(a) Certain UK and Europe unit linked savings contracts
Change is required for the following assets and liabilities

i) Deferred Acquisition Costs
Under UK GAAP all acquisition expenses are deferred with amortisation on a basis commensurate with the anticipated emergence of margins under the contract. Under IFRS, acquisition costs are deferred to the extent that is appropriate to recognise an asset that represents the entity’s contractual right to benefit from providing investment management services and is amortised as the entity recognises the related revenue. IAS 18 further reduces the costs potentially capable of deferral to incremental costs only. Deferred acquisition costs are amortised to the income statement in line with service provision.

ii) Deferred Income Reserves
These are required to be established under IAS 18 with amortisation over the expected life of the contract. The majority of the relevant UK and Europe contracts are single premium with the initial deferred income reflecting the “front end load” i.e. the difference between the premium paid and the amount credited to the unit fund. Deferred income is amortised to the income statement in line with service provision.

iii) Sterling Reserves
Under UK GAAP, reflecting the regulatory approach in the UK, provisions are established for possible future expense overruns. Under IFRS such provisions are no longer permitted.

(b) Jackson National Life – Guaranteed investment contracts
Previously, under UK GAAP, the assets and liabilities of Jackson National Life’s insurance contracts, including GICs, have been measured by the application of US GAAP principles. Under a traditional GIC the policyholder makes a lump sum deposit. The interest rate paid is fixed and established when the contract is issued. Funding agreements are of a similar nature but the interest rate may be floating, based on a rate linked

to an external index. The US GAAP accounting requirements for such contracts are very similar to those under IFRS on the amortised cost model for liability measurement.

These changes will be reflected in the Group's financial statements from 1 January 2005. 2004 formal IFRS comparative results are unaffected. The proforma IFRS results for 2004 included in this announcement reflect the application of IFRS 4 for insurance operations for memorandum purposes only.

Section 4.3.3 – Long-term business – Shareholder backed business - Investment returns and impact on reported results

With the exception of fixed income securities of Jackson National Life, loans and receivables and some unquoted equities, all investments are classified as 'fair value through profit and loss'. For these securities all investment return, including movements in unrealised appreciation, are included in the income statements. Fixed income securities of Jackson National Life and its subsidiaries are classified as 'Available for sale'. For these securities, the movements in unrealised appreciation are recognised in the statement of recognised income and expenditure.

Movement in the fair values of derivatives and embedded derivatives are recorded in the income statement.

Total profit attributable to shareholders is therefore highly volatile for movements in realised gains and those movements in unrealised appreciation recorded in the income statement. Additional analysis of profit based on longer-term investment returns and short-term fluctuations in investment returns is provided and is explained in section 2.

Section 4.3.4 – Long-term business – Shareholder backed business – Taxation of unit-linked business – shareholder tax charge

Tax charges borne by the Group for unit-linked business in the UK reflect a combination of tax effectively borne by the policyholders on the return of the linked business investments and tax borne by shareholders on the profit attributable to the Company. Deferred tax liabilities in the balance sheet includes provisions for tax on unrealised appreciation of investments held by the company to back unit-linked liabilities. Similarly current tax liabilities include amounts in respect of realisation of gains of such investments previously held for that purpose. Unit liabilities are determined after allowance for the tax borne by the company on behalf of the unit holders.

For the purposes of additional profit measures described in section 2, profit before shareholder tax, but after policyholder tax, is presented as a supplementary measure.

Section 4.4 – Long-term business: with-profit business

	Section
Unallocated surplus	4.4.1
Basis of recognition of profits	4.4.2
Shareholder tax charge	4.4.3

Section 4.4.1 – With-profit business – Unallocated surplus

The Group's with-profit funds consist of the with-profit sub fund of the PAC long-term fund and similarly structured funds in the Group's Singaporean and Malaysian operations. Assets and liabilities of these funds are required by regulation to be held in sub funds held separate from shareholders funds of the companies concerned.

The amounts accumulated in these with-profits funds are available to provide for future policyholder benefit provisions and for bonuses to be distributed to with-profits policyholders. The bonuses, both annual and final, reflect the right of the with-profits policyholders to participate in the financial performance of the with-profits funds. Shareholders have no entitlement to the assets held within the fund other than through surpluses distributed from the funds. Under UK GAAP the excess of the carrying value of the assets is retained within the Fund for Future Appropriations as a liability and reflects amounts that have yet to be allocated between policyholders and shareholders. Under IFRS, the company has chosen to apply the option under IFRS 4 to continue to record unallocated surplus of with-profit funds wholly as a liability.

Section 4.4.2 – With-profits business – basis of recognition of profits

Shareholders' profits with respect to bonuses declared on with-profit business correspond to the shareholders' share of the cost of bonuses declared. The shareholders' share for PAC with-profits policies currently represents one-ninth of the cost of bonuses.

Section 4.4.3 – With-profits business – shareholder tax charge

The total tax charge for with-profit business includes tax expense on with-profit funds attributable to both the policyholders and shareholders. The company has chosen, as a supplementary measure to report profit after policyholder tax, but before shareholder tax. Details are described in section 2.1 as to the rationale and basis of determining shareholder tax.

Section 4.5 – Fund Management business: revenue and cost accounting

Under IAS 18 acquisition costs are recognised over the expected period of the contracts. Acquisition costs that are able to be deferred are restricted to incremental costs. ‘Front end loads’ which reflect the difference between amounts received from the investor and the amounts credited to the unit fund are similarly deferred and amortised over the expected period of the contracts. In practice the impact of IAS 18 for fund management business is, at present, significant only to the results of M&G. No adjustment has been made or is required for the Group’s US and Asian fund management operations.

Section 4.6 – Egg: Accounting policies for banking assets, liabilities, income and expenditure

The following are the more significant accounting policies that apply to Egg’s banking assets and liabilities, as consolidated into the Group’s financial statements.

The Group’s 2004 statutory IFRS comparative results including those of Egg have been prepared without the effects of IAS 39, which will be adopted from 1 January 2005. The policies detailed below apply for the 2004 comparatives unless otherwise stated.

Loans and receivables

Loans and receivables are measured on an amortised cost basis, whereby the principal balance includes the accrued interest recognised on an effective yield basis

Investment securities (policy applicable from 1 January 2005 only – not effective for 2004 IFRS comparatives)

Investment securities intended to be held for continuing use are classified as either available for sale or fair value through profit or loss and are included in the balance sheet at fair value.

Derivatives (policy applicable from 1 January 2005 only – not effect for 2004 IFRS comparatives)

Egg undertakes transactions in derivative financial instruments, which include currency swaps, interest rate swaps, interest rate caps, forward rate agreements, options, credit derivatives and similar instruments for non-trading purposes.

Egg’s derivative activity is all non-trading and entered into for purpose of mitigating or eliminating risk from potential movements in interest rates inherent in its assets, liabilities and positions or for the purpose of reducing credit risk inherent in its balance sheet. All derivative transactions (including foreign exchange and credit) are for economic hedging purpose and so it is therefore decided at the outset which position the derivative will be hedging. Derivatives are reviewed regularly for their effectiveness as hedges and corrective action if appropriate.

Derivatives are classified on the balance sheet as either ‘fair value through profit and loss’ assets or ‘held for trading’ liabilities and measured at fair value.

Where the derivative has been designated as part of a cash flow hedge, the gain or loss on the effective position of the hedge is recognised through equity and the gain or loss on the ineffective position of the hedge is recognised through the profit and loss account.

Derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

Investment securities sold and repurchased (policy applicable from 1 January 2005 only – not effect for 2004 IFRS comparatives)

As a form of funding, certain investment securities of Egg are sold under repurchase agreements. Those securities sold are retained on the balance sheet and a liability recorded at amortised cost. Interest payable over the life of the transaction is accrued on an effective interest rate basis.

Income recognition

Interest income is recognised on an effective yield basis, inclusive of all integral fees and discounts.
Arrangement fees and commissions receivable (in respect of payment protection insurance and other insurance products) are recognised on the basis of work done and an appropriate provision is calculated to reflect potential rebates to customers.

Profit share from creditor insurance policies

Written premiums are earned over the life of the policy. These earnings are matched against claims incurred in each calendar year, recognising any surplus profit above the agreed return on capital for the underwriter.

Mortgage incentives and commissions

Cash backs and discounts, which are recoverable from the customer in the event of an early redemption, are deferred and amortised to the profit and loss account over the early redemption penalty period of the product.

Commission payable in respect of mortgages sold is capitalised and amortised over the early redemption penalty period.

Section 4.7 – Other key accounting policies that affect IFRS results attributable to shareholders

	Section
Tax	4.7.1
Pension costs	4.7.2
Share based payments	4.7.3
Business acquisitions, disposals and goodwill	4.7.4
Shareholders' dividends	4.7.5
Foreign currency translation	4.7.6
Treasury shares	4.7.7

Note
The policies described in sections 4.7.1 to 4.7.7 have been applied for the Group's 2004 Statutory IFRS results. The 'proforma IFRS' basis results, which include the effects of application of IAS 32, IAS 39 and IFRS 4 for insurance operations also include the effects of application of these policies.

Section 4.7.1 – Tax

Deferred taxes are provided under the liability method for all relevant temporary differences, being the difference between the carrying amount of an asset or liability in the balance sheet and its value for tax purposes. IAS12 does not require all temporary differences to be provided for, in particular the Group does not provide for deferred tax on undistributed earnings of subsidiaries where the Group is able to control the timing of the distribution and the temporary difference created is not expected to reverse in the foreseeable future. The tax effects of losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised. Deferred tax related to charges or credits taken directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

The charges for tax attributable to shareholders included within this announcement reflect the accounting policies applied for other assets, liabilities, income and expenditure. Accordingly, the taxation charges recorded within the 'statutory IFRS' 2004 comparative results reflect the application of the Group's IFRS policies excepting those from the application of IAS 39 and IFRS 4 which will be adopted from 1 January 2005. The cumulative transition adjustment to shareholders equity at 1 January 2005 for the adoption of these standards at that date is recorded net of attributable tax.

'Proforma IFRS' 2004 comparative results which illustrate the impact of adoption of IAS 39 and IFRS 4 on the Group's insurance operations are recorded net of attributable tax.

Section 4.7.2 – Pension costs

Previously, under UK GAAP, the Group applied the provisions of SSAP 24 'pension costs'. Additional disclosures were made in the notes to the Group's UK GAAP financial statements concerning the Group's UK defined benefit schemes, applying the methodology prescribed by FRS 17.

Under IAS 19 the surplus or deficit of pension schemes is determined by the difference between the market value of assets held within the schemes (excluding investments in Prudential Group insurance policies) and the net present value of projected future cash flows based on accrued liabilities at the balance sheet date for currently employed members of the scheme, deferred pensioners and retired pensioners. The net present value is determined by applying a discount rate based on the yield at the balance sheet date available in the market on high quality corporate bonds.

Where plan assets are invested in Prudential Group insurance policies, IFRS requires the full amount of the pension obligation to be presented as a liability, and the assets backing the contract to be presented in their respective investment line items. The result is a gross-up on the balance sheet and reclassification in the income statement.

The profit and loss account charge is comprised of two items, namely:

a) The aggregate of the actuarially determined service cost of the currently employed personnel, the unwind of discount on liabilities at the start of the period, less the expected investment return on the scheme assets at the start of the reporting period, which is charged to operating profits and secondly
b) the actuarial gains and losses for changes in assumptions, together with the difference between actual and expected investment return on the scheme assets which are recorded as a separate item in the supplementary analysis of profits.

There are three Group defined benefit schemes operating in the UK, namely the Prudential Staff Pensions Scheme (PSPS) which accounts for 90% of the liabilities, and the much smaller schemes for Scottish Amicable and M&G activities. There is also a small defined benefit pension scheme of the Group's Taiwan Life subsidiary.

The activities of the members of the PSPS and the Scottish Amicable scheme reflect the products and businesses of the contributing group companies and insurance funds of companies over many years. Previously, for UK GAAP FRS 17 disclosure and US GAAP reporting, the company has estimated that the surplus and deficits arising on these two schemes are attributable to the PAC with-profit fund and shareholders backed operations on the basis of the weighted cumulative activity attaching to the contributions paid into the schemes in the past. Currently, it is estimated that 80% of the deficit of PSPS is attributable to the PAC with-profit fund and 20% to shareholder backed operations. For the much smaller Scottish Amicable scheme the deficit has been apportioned as 50% attributable to the PAC with-profit fund and 50% to shareholder backed operations. The profit and loss account charge, inclusive of actuarial gains and losses, and the deficits have been apportioned on this basis for the purposes of Group financial reporting.

The results of the business units contributing to these two schemes reflect the contributions paid by the companies and funds concerned with the difference between the shareholders' share of the IAS 19 basis charge to operating profits and contributions paid being recorded as unallocated central expenditure of other operations. .

Section 4.7.3 – Share based payments

The Group offers share awards and option plans for certain key employees and a Save As You Earn plan (SAYE plan) for all UK and certain overseas employees. The arrangements for distribution to employees of shares held in trust relating to share award plans and for entitlement to dividends depend upon the particular term of each plan. Shares held in trust relating to non-SAYE plans are conditionally gifted to employees.

Previously, under UK GAAP, compensation for non-SAYE plans was recorded over the periods during which share awards or options are earned based on intrinsic value. No costs were required to be recorded for SAYE plans.

Under IFRS, share based payments are accounted for on a fair value basis. The Group measures fair values of the SAYE schemes and other schemes for Prudential Plc shares using the Black Scholes model for awards up until the end of 2004. From 1 January 2005 the Group will continue to apply the Black Scholes model for SAYE plans but adopt the Monte Carlo model for other schemes.

The fair value is recognised in the profit and loss account over the relevant vesting period and adjusted for lapses and forfeitures, with the number of shares expected to lapse or be forfeited estimated at each balance sheet date prior to the vesting date. The only exception is where the share based payment depends upon vesting outcomes attached to market based performance conditions such as in the case of the Restricted Share Plan. Under these circumstances additional modelling is required to take into account these market based performance conditions which effectively estimate the number of shares expected to vest. No subsequent adjustment is then made to the fair value charge for shares that do not vest on account of these performance conditions not being met.

Section 4.7.4 – Business acquisitions, disposals and goodwill

Business acquisitions are accounted for by applying the purchase method of accounting, which adjusts the net assets of the acquired company to fair value at the date of purchase. The difference between the fair value of the net assets of the acquired company and the fair value of the consideration given represents goodwill. Revenues and expenses of acquired entities are included in the consolidated profit and loss account from the date of acquisition in the year acquired. Revenues and expenses of entities sold during the period are included in the consolidated profit and loss account up to the date of disposal. The profit or loss on disposal is calculated as the difference between sale proceeds net of expenses less net assets of the entity at the date of disposal. Gross premiums of acquired or discontinued insurance entities are separately presented in the consolidated profit and loss account.

Under UK GAAP, with effect from 1 January 1998, goodwill arising from acquisitions is reflected as an asset on the consolidated balance sheet and is amortised through consolidated profit and loss account on a straight-line basis over its estimated useful life, not exceeding 20 years. Prior to 1 January 1998, goodwill relating to acquisitions was charged directly to shareholders' funds. As permitted under the transitional arrangements of FRS 10, 'Goodwill and intangible assets', amounts previously charged to shareholders' funds have not been reinstated as assets in the UK GAAP balance sheet.

For life insurance company acquisitions, the adjusted net assets include an identifiable intangible asset recorded for the present value of in-force business, which represents the profits that are expected to emerge from the acquired insurance business. The present value of in-force business is calculated using best estimate actuarial assumptions for interest, mortality, persistency and expense and is amortised over the anticipated lives of the related contracts in the portfolio.

Under IFRS, the goodwill balance at 1 January 2004 reflects the carrying value of UK GAAP goodwill for previously consolidated entities at that date on the basis described above, as well as goodwill on certain newly consolidated entities discussed in Section 1.4. Under IFRS, goodwill is no longer amortised. However, impairment testing is required annually and on adoption. In addition, as prescribed by IFRS 1, goodwill previously charged to shareholders' funds on transition is not transferred to the income statement upon disposal of an entity.

Under UK GAAP, the Group's interests in associates are carried at the Group's share of underlying net assets at the date of acquisition, adjusted each year for the Group's share of increases or decreases in shareholders' funds of the associate. Goodwill is included in the carrying value and amortised in the consolidated profit and loss account on a straight-line basis over its estimated useful life. Under IFRS, interests in associates are recorded using the equity method of accounting. Equity method investments are recorded at the purchase price in the year of acquisition including related goodwill. Goodwill is no longer amortised under IFRS.

<u>Section 4.7.5 – Shareholders' dividends</u>

Previously under UK GAAP, shareholders' dividends were accrued in the period to which they related regardless of when they were declared. Under IFRS, dividends declared after the balance sheet date but before authorisation are treated as a non-adjusting event. The charge for dividends for a full year under IFRS therefore comprise the final dividend in respect of the prior year and the interim dividend in respect of the current year.

<u>Section 4.7.6 – Foreign currency translation</u>

The profit and loss accounts of foreign subsidiaries are translated at average exchange rates for the year. Assets and liabilities of foreign subsidies are translated at year-end exchange rates.

Under UK GAAP the impact of these currency translations has been recorded in the profit and loss account reserve within the statement of total recognised gains and loses. Under IFRS, this treatment is replicated with such amounts recorded in the statement of Recognised Income and Expense, and is a separate component of shareholders' equity.

Foreign currency borrowings that have been used to finance or provide a hedge against group equity investments in overseas subsidiaries are translated at year-end exchange rates.

Under UK GAAP exchange gains and loses attaching to these borrowings are also recorded within the statement of recognised gains and loses. Under IFRS exchange differences on such borrowings and derivatives entered into as a documented and effective hedge against such group equity investments are recorded directly within cumulative translation adjustment component of shareholders' equity.

On sale or termination of a foreign entity IFRS requires that cumulative exchange differences are recycled from equity into the income statement. This is not required under UK GAAP.

Under IFRS, goodwill existing at 1 January 2004 has been expressed in sterling as permitted by IFRS 1. Goodwill on the acquisition of a foreign entity after 1 January 2004 and any fair value adjustment to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate. Under UK GAAP, goodwill is translated to sterling when first recognised.

Under IFRS the company has chosen to reset all currency translation adjustments to zero on first time adoption.

Section 4.7.7 - Treasury shares

The Group holds Treasury shares in two respects. First, the Group offers share award and option plans for certain key employees and a Save As You Earn Plan (SAYE plan) for all UK and certain overseas employees. The arrangements for distribution to employees include shares being held in trust relating to share plan awards and shares issued to a qualifying share ownership trust.

Secondly, the Group is required under IFRS to consolidate certain UK unit trust and OEIC funds. In some cases these funds hold investments in equity shares of Prudential plc.

Under both UK GAAP and IFRS the cost of acquiring shares held in Prudential plc must be presented as a deduction in determining shareholders' equity.

Section 5 – Other significant accounting policies that primarily affect the measurement of the assets and liabilities of with-profit business with no effect on shareholders' equity

Summary	Section
Insurance assets and liabilities	5.1
Product classification and implications for re-measurement	
IFRS 4 for product classification	5.1.1
Prudential Annuities Limited	5.1.2
Implementation of FRS 27 for UK regulated with-profit funds	5.1.3
Other significant items (see note)	5.2
Pension costs	5.2.1
Investment properties	5.2.2
Owner occupied properties	5.2.3
Property leases	5.2.4

Note

The consolidation of venture fund investment subsidiaries also results in significantly altered measurement of assets and liabilities of the PAC with-profit fund. The details are explained in section 6.6.

Section 5.1.1 – IFRS 4 for product classification

The Company will be adopting IFRS 4 'Insurance contracts' as at 1 January 2005. The carrying value of insurance assets and liabilities of the Group's insurance contracts, including with-profit business, do not require re-measurement. From 1 January 2005 the requirements of IFRS 4 may potentially require re-measurement depending upon the classification of the contracts concerned.

The PAC with-profits sub-fund writes business that is predominantly conventional with-profit or accumulating with-profit business. Both of these categories contain discretionary participating features.

Under IFRS 4, regardless of whether or not the contracts are classified as 'insurance' or 'investment' in nature, i.e. with or without significant insurance risk, such contracts may continue to be accounted for under UK GAAP, subject to the policy improvement discussed in section 5.1.3.

The PAC with-profits funds also writes a small amount of non-participating business which falls to be classified as insurance contracts under IFRS 4. These continue to be accounted for under UK GAAP, again subject to the policy improvement discussed in section 5.1.3.

Similar principles apply to the Group's with-profit business in Singapore and Malaysia, which continue to be accounted for under UK GAAP.

Section 5.1.2 – Prudential Annuities Limited (PAL)

PAL is owned by the PAC with-profits sub-fund, with all profits and losses of the company contributing to the unallocated surplus of the with-profit fund.

PAL writes conventional annuity business, which falls to be classified as insurance contracts under IFRS 4. Accordingly UK GAAP continues to apply to the assets and liabilities of the contracts following the adoption of IFRS 4 on 1 January 2005.

See also section 5.1.3 for discussion of valuation of non-participating business following the implementation of FRS 27.

Section 5.1.3 – Implementation of FRS 27 for UK regulated with-profit funds

The company has chosen to adopt IFRS4 from 1 January 2005. Accordingly, the amounts shown in the IFRS comparative consolidated balance sheet at 31 December 2004 for technical provisions and unallocated surplus for with-profits business of the PAC with-profits fund, i.e. the with-profits sub-fund (WPSF) and the Scottish Amicable Insurance Fund (SAIF) will be determined in accordance with UK GAAP, i.e. the Modified Statutory Basis of accounting. With the exception of minor accounting adjustments technical provisions determined on this basis reflect the UK regulatory basis of reporting that has applied for many years and which effectively constitutes the 'Peak 1' basis under the new regime of the UK Financial Services Authority.

The FSA's Peak 2 calculation under the new realistic regime, which came into effect for the first time for 2004 regulatory reporting requires the value of liabilities to be calculated as:

- A with-profits benefits reserve (WPBR), plus
- Future policy related liabilities (FPRL), plus
- The realistic current liabilities of the fund.

The WPBR is primarily based on the retrospective calculation of accumulated asset shares but is adjusted to reflect future expected policyholder benefits and other outgoings. By contrast, the Peak 1 basis addresses, at least explicitly, only declared bonuses.

The FPRL must include a market consistent valuation of costs of guarantees, options and smoothing of bonuses, less any related charges, and this amount must be determined using either a stochastic approach, hedging costs, or a series of deterministic projections with attributed probabilities. Under the Peak 1 basis there is an allowance on a determination for the intrinsic value of these costs.

The Peak 2 approach underpins the changed requirements of FRS 27, which the UK companies not choosing to adopt IFRS are required to apply under UK GAAP in 2005.

Under FRS 27 ("Life Assurance"), the main changes that are required for UK with-profits funds are:

- De-recognition of deferred acquisition costs and related deferred tax
- Inclusion on the FSA Peak 2 basis of the value of in force non-participating business written by the WPSF and SAIF, and
- Replacement of Modified Statutory Basis liabilities for with-profit business with adjusted realistic basis liabilities. Adjusted realistic liabilities represent the Peak 2 realistic liabilities for with-profits business, included in Form 19 of the FAS regulatory returns, but after excluding the element for shareholders' share of future bonuses.

Under IFRS 4, improvements to an accounting policy are permitted to be implemented prospectively providing certain conditions are met. It is the Company's intention to apply the provisions of FRS 27 as such an improvement. This improvement will apply only to the UK regulated funds. Notwithstanding the superficial similarities between the PAC structure and the with-profits funds of the Group's Singapore and Malaysia operations it is not appropriate to extend the application of the new improvement to overseas with-profit business.

Section 5.2.1 – Pension Costs

Section 4.7.2 describes the IAS 19 basis of accounting for the costs of the Group's UK defined benefit schemes, and the basis of allocation of the deficit between the PAC with-profit sub-fund and the Group's shareholder backed operations. The net of tax deficit attributable to the PAC with-profit sub-fund are a liability of its balance sheets with consequent reduction in the unallocated surplus of the fund, which is also shown as a liability.

See also Section 8.2 (ii) for discussion of the accounting treatment under the Achieved Profits basis.

Section 5.2.2 – Investment properties

Property held for long-term rental yields and capital appreciation within the long-term assurance funds is classified as investment property. Investment property comprises freehold and long leasehold land and buildings and is carried in the balance sheet at fair value, exclusive of depreciation. Properties are valued annually either by the Group's qualified surveyors or professional external valuers using The Royal Institution of Chartered Surveyors (RICS) guidelines. The RICS guidelines apply separate assumptions to the value of the land, buildings and tenancy associated with each property. Each property is externally valued at least once every three years. The cost of additions and renovations is capitalised and considered when estimating fair value.

Property purchased with the intent to develop is treated as investment property and carried at fair value under UK GAAP. Under IFRS, property purchased with the intent to develop is treated as development property and carried at cost.

Section 5.2.3 – Owner occupied properties

The Company has chosen to apply the IFRS option to account for such properties at depreciated cost.

Section 5.2.4 – Property leases

Under UK GAAP, leasehold investment properties where the Group is the lessee are recorded within investments as an asset net of the present value of future minimum lease payments. Under IFRS, the property is presented gross, and the future minimum lease payments are reclassified to other liabilities on the balance sheet.

Under UK GAAP, lease incentives granted on leases to tenants in investment property (i.e. rent free periods) are amortized over the period up to the first rent review. Under IFRS, these lease incentives are amortized over the length of the lease term.

Section 6 – Other changes principally of a presentational nature for IFRS income statement and balance sheet to be published in July with Interim 2005 results

Summary	Section
Long-term business	6.1
Unit-linked assets	6.1.1
Deposit accounting for investment contracts	6.1.2
Banking business assets and liabilities	6.2
Grossing up of derivative assets and liabilities	6.3
Grossing up of current and deferred tax assets and liabilities	6.4
Non-recourse borrowings of consolidated US investment funds	6.5
Goodwill and non-recourse borrowings of consolidated venture fund investments and property partnerships of the PAC with-profit fund	6.6
Securitisation of assets	6.7
Securities lending	6.8
Assets and disposal groups held for sale	6.9

Section 6.1.1 – Long-term business unit linked assets

Previously, under UK GAAP, assets held to cover linked liabilities have been recorded in aggregate as a single line entry in the consolidated balance sheet. Under IFRS these assets are analysed in the consolidated balance sheet by the appropriate type of investment e.g. equities, properties, bonds etc. For some unit linked funds of UK and Europe Insurance Operations the assets covering linked liabilities include holdings in unit trusts. In some instances the unit trusts are required to be consolidated under IAS 27 and SIC 12 guidance issued by IFRIC. Where consolidation is required the underlying holdings of the unit trusts are included in the Group balance sheet with the value attributable to external unit holders recorded as a liability.

Section 6.1.2 – Long-term business deposit accounting for investment contracts

Previously, under UK GAAP, the long-term technical account section of the profit and loss accounts included, as required by regulation, all of the income and expenditure attaching to long-term business. The income and expenditure included premiums earned and claims incurred on long-term business regardless of the nature of the contacts.

Under IFRS, on adoption of IAS 39 and IFRS 4 at 1 January 2005, long-term business contracts are classified between those with and without significant risk features. For those contracts with significant risk features, or discretionary participating features, the IFRS income statement presentation may include the previous UK GAAP basis of recording premiums and claims. However, for contracts with insignificant insurance risk the underlying nature is closer to a deposit style arrangement between the policyholder and the company. Accordingly, under IFRS, premiums and claims for these contracts are recorded within the balance sheet directly as a movement on the policyholder liability. After making these, and other consequential changes, the IFRS income statement reflects fee income on the contracts, expenses and taxation rather than the traditional revenue account presentation. For the Prudential Group deposit accounting is restricted to certain UKIO unit linked contracts, annuity certain business, JNL’s guaranteed investment contracts, and minor categories within Prudential Corporation Asia. The changes for deposit accounting are presentational only.

Section 6.2 – Banking business assets and liabilities

Previously, under UK GAAP, banking business assets and liabilities were recorded in the consolidated balance sheet as single line entries. This presentation was reflective of the fact that the Companies Act format for the Group was specific to insurers and, therefore, it was inappropriate to show amounts for individual categories of banking asset and liability on separate lines of the consolidated balance sheet.

Under IFRS, these concerns over format do not apply. Also there is a general requirement under IFRS that like items should be recorded within the consolidated balance sheet regardless of the business to which they relate. The IFRS balance sheet to be presented in July will include banking business assets and liability represented by appropriate line items. Continued disclosure will be made as necessary of the banking business components to assist users of the financial statements.

Section 6.3 – Grossing up of derivative assets and liabilities (policy applicable from 1 January 2005 only – not effective for 2004 statutory IFRS comparatives)

Previously, under US GAAP, the Group's carrying value of derivatives has been recorded on a basis that nets asset and liability amounts of individual derivatives. Under IFRS there is a general expectation that asset and liability balances should not be netted in the balance sheet unless counter party offset applies. Accordingly, upon adoption of IAS 32 on 1 January 2005, derivative assets and liabilities will be shown gross in the balance sheet. This changes (which has no effect of shareholders' profit or equity) is in addition to the altered basis of measurement for JNL's derivatives.

Section 6.4 – Grossing up of current and deferred tax assets and liabilities

Previously, under UK GAAP, the Group's current and deferred taxes had been recorded on a basis that nets asset and liability amounts. Under IFRS there is a general expectation that current and deferred tax asset and liability balances should not be netted in the balance sheet unless counter party offset applies. Accordingly under IFRS current and deferred tax assets and liabilities will be shown gross in the balance sheet.

Section 6.5 – Non recourse borrowing of consolidated US investment funds

Previously, under UK GAAP, the Group has consolidated certain investment subsidiaries managed by PPM America. Non recourse borrowings of these subsidiaries, which at 31 December 2004 were £183m, together with the assets and other liabilities of these subsidiaries have been included in the consolidated balance sheet.

Previously, the Group's 2004 financial statements have also explained in disclosure notes that in addition to the debt of these subsidiaries, PPM America manages investment companies with liabilities, at 31st December 2004 of £753m pertaining to debt instruments issued to external parties. In all instances the holders of the debt instruments issued by these companies do not have recourse beyond the assets of those companies. Under IFRS, where deemed to be controlled, these companies are required to be consolidated.

In addition, the Group has consolidated certain investment funds that were previously accounted for as debt securities at fair value. Under IFRS, interests in such investment funds which are deemed to be controlled under IAS27 and SIC12 are required to be consolidated as subsidiaries. Consolidation of these funds gives rise to the assets and liabilities of the underlying entity being included in the group balance sheet, with any deficit/surplus on consolidation allocated to the residual tranche holders. .

See Section 1.4 for additional discussion on the treatment of these funds.

Section 6.6 – Goodwill and non-recourse borrowings of consolidated venture fund investments and property partnerships of the PAC with-profit fund

As part of its portfolio of investments held to cover policyholder liabilities and unallocated surplus the PAC with-profit fund has investments in companies that are managed by Prudential Venture Managers Limited (PVML) and also operates property partnerships with third parties. Previously, under UK GAAP, these holdings have been carried in the consolidated balance sheets at fair value. Movements in the fair value of these holdings were recorded in the long-term technical account section of the profit and loss account under UK GAAP. This investment appreciation (together with investment appreciation of the fund's other investments) to the extent not contributing to the surplus for distribution was credited to the Fund For Future Appropriations. Shareholders' equity was not affected by the values of the holdings.

Under IFRS holdings which are deemed to be controlled are required to be consolidated as subsidiaries. Typically due to the leveraged nature of venture fund investments, and net assets of the businesses concerned, consolidation gives rise to considerable goodwill and borrowings to be brought onto the group balance sheet. Under IFRS, the goodwill is tested annually for impairment. In all cases the holders of the debt instruments do not have recourse beyond the assets of the issuing companies or their subsidiaries. Changes in the carrying value of these subsidiaries are reflected in the unallocated surplus of the PAC with-profit fund with no effect on shareholders' equity.

See Section 1.4 for additional discussion on the treatment of these funds.

Section 6.7 – Securitisation of assets (policy applicable from 1 January 2005 only – not effective for 2004 Statutory IFRS comparatives)

Egg has issued investment securities in order to finance certain portfolios of loan and investment assets. These obligations are secured on the assets of Egg. The securitised assets and the related liabilities are presented gross within the relevant headings in the consolidated balance sheet, unless there is a legally enforceable right to offset and there is an intention to settle net in which case the assets and liabilities are presented net

Section 6.8 – Securities Lending

The Group's policy is to de-recognise financial assets when the contractual right to the cash flows from the financial asset expire. The Group also derecognises financial assets that it transfers to another party provided the transfer of the asset also transfers the right to receive the cash flows of the financial asset. Where the transfer does not result in the Group transferring the right to receive the cash flows of the financial assets, but it does result in the Group assuming a corresponding obligation to pay the cash flows to another recipient, the financial assets are also accordingly derecognised.

The Group is party to various securities lending agreements under which securities are loaned to third parties on a short-term basis. The loaned securities are not removed from the Group's consolidated balance sheet, rather they are retained within the appropriate investment classification. The Group's policy is that collateral in excess of 100% of the fair value of securities loaned is required from all securities borrowers and typically consists of cash, debt securities, equity securities or letters of credit.

In cases where the Group takes possession of the collateral under its securities lending programme (including cash collateral), the collateral is included in other financial investments or cash in the consolidated balance sheet, with a corresponding liability being recorded to recognise the obligation to return such collateral.

Section 6.9 – Assets and disposal groups held for sale

IFRS introduces the concept of assets and disposal groups held for sale. If certain criteria are met, these assets and disposal groups are presented separately in the balances sheet.

Section 7 – Other changes to be included in interim 2005 and future IFRS results announcements

Summary	Section
Segmental reporting	7.1
Cash flow statements	7.2
Cash and cash equivalents	7.3

Section 7.1 - Segmental Reporting

Under IAS14 the Group is obliged to report results and certain other financial data by business and geographic segments. The Group has chosen these segments to be:

Business (primary)	Geographical (secondary)
Long-term business	UK and Europe
Banking	US
Fund Management	Asia
Unallocated Corporate	

The Group will also continue to report results by business unit.

Section 7.2 – Cash flow statements

Previously, under UK GAAP, the Group applied the provisions of FRS 1 ‘Cash flow statements’. Under this standard the statement of cash flows reflects only the cash flows of the Group’s non-insurance businesses included in the non-technical account section of the profit and loss account, and amounts transferred to shareholders’ funds from the Group’s long-term businesses.

Under IFRS cash flow statements reflect the cash flows of the entirety of the group’s businesses without recognition of the regulatory framework attaching to long-term business funds of UK and certain overseas companies whereby the assets and liabilities of those funds are ring fenced from shareholder funds.

The Group will continue to provide supplementary information, as part of the financial review section of results announcements, on Group holding company cash flow.

Section 7.3 – Cash and cash equivalents

Under UK GAAP, cash represented cash at bank and in hand. Under IFRS, cash and cash equivalents consist of cash at bank and in hand, deposits held at call with banks, treasury bills and other short-term highly liquid investments with less than 90 days maturity from the date of acquisition.

Section 8 – Achieved Profits basis results – restated for changes adopted on application of IFRS

Summary	Section
Basis of preparation	8.1
Policy changes on adoption of IFRS	8.2
Transition adjustment at 1 January 2005 on adoption of IAS32, IAS 39 and IFRS4	8.3

Section 8.1 – Basis of preparation

The achieved profits basis results include the results of the Group's long-term business operations on the achieved profits basis. These results are combined with the statutory basis results of the Group's other operations including banking and fund management business. The restated achieved profits basis results for long term business have been prepared in accordance with the guidance issued by the Association of British Insurers in December 2001 'supplementary reporting for Long-Term, Insurance Business (the Achieved Profits Method)'. The information is supplementary to the statutory (IFRS) basis results. With the exception of the changes described in section 8.2 below, the results have been prepared on the same basis as previously published.

Section 8.2 – Policy changes on adoption of IFRS

Long-term business

The achieved profits basis is a value based method. The shareholders' funds on an achieved profits basis, at a given point in time, is the value of future cash flows expected to arise from the current book of long-term insurance business plus the net worth of the company. Accordingly changes of policy arising from the adoption of IFRS will not generally affect the Achieved Profits basis shareholders' funds.

There are though two changes, which affect the results of long-term business operations. These are:

(i) Altered basis of determining longer-term returns credited to operating results

The Group's policy is to present its Achieved Profits basis results so that operating profits based on longer-term investment returns are distinguished from short-term fluctuations in investment returns. These items, together with any exceptional gains or losses comprised the total profit for the year.

Previously, the longer-term returns have been determined after including 5 year averaged realised gains and losses on fixed income securities.

As a discretionary change of policy, i.e. not required by IFRS, the Group has altered its policy so as to determine longer-term returns for fixed income securities, of non participating shareholder backed business by applying a charge for default assumptions and to amortise interest related realised gains and losses to operating profits over the period to when the sold bonds would have otherwise matured. For 2004, the change of policy is principally of significance for the results of Jackson National Life.

Total profit is unaffected by the change of policy.

(ii) Accounting for defined benefit pension schemes

Under statutory (IFRS) basis results, the excess of liabilities determined on an IAS 19 basis over the market value of the schemes assets is provided for as a liability. After deduction of appropriate deferred tax, the proportion of the deficit that relates to with-profit long-term business is deducted from unallocated surplus. The proportions of the deficit that relates to shareholder backed long-term business and the Group's other non-insurance operations are deducted from statutory (IFRS) basis shareholders' funds. On adoption of IFRS the impact of IAS 19 is reported as a change of policy with shareholder's funds at the date of adoption being restated.

For Achieved Profits basis results, the profits from new business written in the reporting period and the value of in-force business at the balance sheet date have been determined after incorporating projections of expenses. These expenses included projections of attributable pension costs based on the current contribution formulae in particular that contributions to the main UK pension scheme, the Prudential Staff Pension Scheme continue at 12.5% of payroll costs. The payments reflect the assessed level of appropriate contributions based on the last triennial valuation in 2002 when, on the actuarial basis of calculation (as opposed to FRS 17 and IAS 19) the scheme was 110% funded.

The next triennial valuation will be as at 5 April 2005 and is expected to be completed in the third or fourth quarter of 2005. Following this valuation the contribution basis will be reassessed.

To be consistent with the IFRS basis the restated 2004 Achieved Profits basis shareholders' funds include provision for the deficit attributable to shareholders. This provision comprises the amount allocated to shareholder backed long-term business and the Group's other non-insurance operations (as for the statutory (IFRS) basis) and the company's economic exposure through the 10% participation in the surpluses distributed from the PAC with-profit fund. The same methodology has also been applied for the company's 2004 results on the European Embedded Value basis.

b) Non-insurance operations
The principal changes that affect shareholders' results and funds for 2004 are for:

> Pensions costs (as described above)
> Timing basis of recognition of external dividend
> Stock based compensation and
> Altered measurement of acquisition costs and front end fees of fund management business, where appropriate.

These changes reflect the adoption of all IFRS standards other than IAS 32, IAS 39 and IFRS 4

<u>Section 8.3 – Transition adjustment at 1 January 2005 on adoption of IAS32, IAS39 and IFRS4</u>

On adoption of IAS32, IAS 39 and IFRS 4 at 1 January 2005, the measurement of the carrying values of the Group's financial instrument and related other items as permitted or prescribed under IFRS standards is reassessed. The amount of the change is accounted for as an adjustment to shareholders’ funds at that date. On the Achieved Profits basis, for assets and liabilities of long-term businesses, the amount of the change is offset by an equal and opposite change to the additional shareholders' interest. In other words, the total value expected to arise from future cash flows in unaltered but the analysis between the statutory basis shareholders' funds and the additional interest on the Achieved Profits basis alters.