Mondi Finance plc

(Registration number: 05916680)

ANNUAL REPORT & FINANCIAL STATEMENTS

for the year ended 31 December 2016

Introduction

The Mondi Finance plc financial statements have been prepared in compliance with Financial Reporting Standard 101, 'Reduced Disclosure Framework' ("FRS 101") and the requirements of the UK Companies Act 2006.

The Company's ultimate parent company and ultimate controlling entity is Mondi plc. The Mondi Group Integrated report and financial statements 2016 are available at: www.mondigroup.com.

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Registered Address

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KT15 2PG

Bankers

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London
United Kingdom
EC2N 2DB

Auditor

Deloitte LLP
Chartered Accountants and
Statutory Auditor
London
United Kingdom

Strategic report

Main business and operations

Mondi Finance plc (the "Company"), is a wholly-owned subsidiary of the Mondi Group (the "Group"), the ultimate parent company being Mondi plc.

The Company is a finance company with its principal activity being to provide financing and associated arrangements to companies within the Group. There have been no significant changes in the Company's principal activities during the year and the directors do not envisage any significant changes in the Company's activities in the foreseeable future.

On 14 April 2016, the Company issued a 1.5% €500m Eurobond with an 8 year term. The Company currently has three €500 million Eurobonds outstanding and is able to issue further Eurobonds under its existing €2.5 billion Euro Medium Term Note programme ("EMTN") subject to market conditions.

The Company utilised its option to extend its €750 million revolving credit facility for an additional year (to 2021) on the second anniversary of the agreement.

The Company's finance costs are discussed in the Group's Integrated report and financial statements. The Company's directors believe that further key performance indicators of the Company are neither necessary nor appropriate for an understanding of the development, performance or position of the business.

The Company earned a profit after tax for the year of €1,089,000 (2015: €28,621,000). The lower profit for the 2016 year is principally driven by a change in related party interest rates charged by the Company and the net reversal of part of the provision for impairment of receivables in 2015 amounting to €8,680,000 compared to an increase in the provision in 2016 of €3,564,000. The change in related party interest rates ensures that a market related interest rate is charged to each related party, based on the Company's cost of funding.

Going concern

The Company will continue to act in line with its principal business activities and continue to act as a financing company for the Group. The directors believe that the Company will continue to be a going concern into the foreseeable future and have adopted the going concern basis of accounting.

Dividends

No dividend was declared and paid in 2016 (2015: none). The directors have not recommended any further dividends.

Risk Management

The most important components of the Company's financial risk are interest rate risk, currency risk, credit risk and liquidity risk. The Company also enters into commodity contracts which are executed on a back-to-back basis with other Group companies and as such it has no net exposure to commodity risk. Due to the Company's business and considering the assets and liabilities on the Company's balance sheet, the principal financial risks the directors consider relevant are currency and interest rate risk. The Company has entered into foreign currency swaps to hedge the foreign currency risk related to intercompany loans and other foreign exchange positions and, when deemed necessary, interest rate swaps to manage the Company's exposure to fluctuations in interest rates.

The Company meets its funding requirements from a variety of sources including three Eurobonds and a syndicated revolving credit facility which expires in July 2021. The availability of some facilities is dependent on the Mondi Group meeting certain financial covenants, all of which have been complied with. The Group's forecasts and projections, taking account of reasonably possible changes in trading performance, show that the Group should be able to operate well within the level of its current facilities and related covenants.

Approved by the board of directors on 27 February 2017 and signed on behalf of the board by:

J C Paterson

Director

Directors' report

The directors submit their annual report together with the audited financial statements for the year ended 31 December 2016.

Company number

05916680

Directors

The directors who held office during the year and to the date of this report were as follows:

C A Hunt	(resigned on 30 December 2016)
J L Hampshire	(appointed on 31 December 2016) (Company secretary)
A C W King	
M A McHugh	
J C Paterson	

The Company's ultimate parent company, Mondi plc, made qualifying third party indemnity provisions for the benefit of the directors which remain in force at the date of this report.

Events occurring after 31 December 2016

There have been no material reportable events since 31 December 2016.

Information set out in the Strategic Report

Disclosures relating to the following items have been included in the strategic report which can be found on page 2:

- dividend payments and recommendations;
- financial risk management objectives, policies and related exposures to interest rate, currency, credit and liquidity risk; and
- likely future developments in the business of the Company.

Statement as to disclosure of information to auditor

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the director has taken all the steps he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

This information is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Auditor

Deloitte LLP will cease to hold office as auditor and a resolution to appoint PricewaterhouseCoopers LLP as auditor will be proposed at the forthcoming Annual General meeting.

Approved by the board of directors on 27 February 2017 and signed on behalf of the board.

JL Hampshire

Company secretary

Directors' responsibility statement

The directors are responsible for preparing the annual report and the financial statements in accordance with applicable laws and regulations.

Company law requires the directors to prepare financial statements for each financial year. Under that law, the directors have elected to prepare the financial statements in accordance with Financial Reporting Standard 101, 'Reduced Disclosure Framework' ("FRS 101"). Under company law, the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether Financial Reporting Standard 101 (Reduced Disclosure Framework) has been followed, subject to any material departures disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report to the members of Mondi Finance plc

We have audited the financial statements of Mondi Finance plc (Company) set out on pages 6 to 17, which comprise the balance sheet as at 31 December 2016, the profit and loss account, the statement of comprehensive income and the statement of changes in equity for the year then ended, and the notes to the financial statements.The financial reporting framework that has been applied in their preparation is applicable law and Financial Reporting Standard 101, 'Reduced Disclosure Framework'.

This report is made solely to the Company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the directors' responsibility statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with Financial Reporting Standard 101, 'Reduced Disclosure Framework'; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report and the directors' report.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

William Smith, MA FCA (Senior Statutory Auditor) for and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
London, United Kingdom
27 February 2017

Profit and loss account
for the year ended 31 December 2016

€ thousand	Notes	2016	2015
Administrative expenses		(2,835)	(3,200)
Operating loss	2	**(2,835)**	(3,200)
Interest receivable and similar income	4	93,643	113,284
Foreign exchange loss	5	(11,138)	(8,124)
Interest payable and similar charges	6	(77,574)	(70,072)
Profit on ordinary activities before tax		**2,096**	31,888
Tax charge	7	(1,007)	(3,267)
Profit for the year		**1,089**	28,621

Statement of comprehensive income
for the year ended 31 December 2016

€ thousand	2016 Before tax amount	2015 Before tax amount
Profit for the year	1,089	28,621
Items that may subsequently be reclassified to profit or loss		
Cash flow hedges : amounts recycled to the profit and loss account	395	242
Cash flow hedge : allocation of bond pre-hedge to cash flow hedge reserve	(1,327)	—
Total comprehensive income attributable to the owners of the Company	**157**	28,863

Balance sheet
as at 31 December 2016

€ thousand	Notes	2016	2015
Debtors	8	657,398	717,648
Loans receivable	9	1,707,006	1,721,275
Cash at bank and in hand		367,311	7,500
Derivative financial instruments	10	6,139	7,758
Total current assets		**2,737,854**	2,454,181
Other creditors	11	(599,606)	(589,915)
Short-term borrowings	12	(617,793)	(153,368)
Derivative financial instruments	10	(6,347)	(8,539)
Total current liabilities		**(1,223,746)**	(751,822)
Medium and long-term borrowings	12	(1,102,871)	(1,291,279)
Total non-current liabilities		**(1,102,871)**	(1,291,279)
Total liabilities		**(2,326,617)**	(2,043,101)
Net assets		**411,237**	411,080
Equity			
Share capital	14	50,000	50,000
Cash flow hedge reserve	15	(1,259)	(327)
Profit and loss account		362,496	361,407
Total shareholder's funds		**411,237**	411,080

These financial statements were approved by the board of directors on 27 February 2017

They were signed on behalf of the board by:

J C Paterson

Director

Company Number : 05916680

Statement of changes in equity
for the year ended 31 December 2016

€ thousand	Share Capital	Profit and loss account	Cash flow hedge reserve	Total equity
At 1 January 2015	50,000	332,786	(569)	382,217
Retained profit for the year	—	28,621	—	28,621
Other comprehensive income for the year	—	—	242	242
At 31 December 2015	50,000	361,407	(327)	411,080
Retained profit for the year	—	1,089	—	**1,089**
Other comprehensive income for the year	—	—	(932)	**(932)**
At 31 December 2016	**50,000**	**362,496**	**(1,259)**	**411,237**

1 Basis of preparation

The Company meets the definition of a qualifying entity under Financial Reporting Standard 100 ("FRS 100"). Accordingly, for the year ended 31 December 2016 the financial statements have been prepared in accordance with Financial Reporting Standard 101, 'Reduced Disclosure Framework' ("FRS 101") and the UK Companies Act 2006.

The principal accounting policies adopted are set out in note 19.

As permitted by FRS 101, the Company has taken advantage of the disclosure exemptions available under that standard in relation to financial instruments, capital management, presentation of comparative information in respect of certain assets, presentation of a cash flow statement, standards not yet effective and related party transactions.

Where required, equivalent disclosures are given in the Group financial statements of Mondi plc. The Group financial statements are available to the public and can be obtained as set out in note 18.

The financial statements are separate financial statements and have been prepared on a going concern basis.

Critical accounting judgements and key estimates

The preparation of the Company's financial statements includes the use of estimates and assumptions which affect certain items reported in the balance sheet and the profit and loss account. The disclosure of contingent assets and liabilities is also affected by the use of estimation techniques. Although the estimates used are based on management's best information about current circumstances and future events and actions, actual results may differ from those estimates. Such estimates relate to management's assumptions about expected future cash flows, market exposures, useful lives and discount rates, among others.

The estimates and assumptions that have a risk of causing a material adjustment to the carrying amounts of certain assets and liabilities within the next financial year are:

- Recoverability of intercompany debtors – the Company assesses the recoverability of intercompany debtors on an annual basis. The financial results and expected future cash flows of intercompany debtors are used as part of this assessment – refer to notes 8 & 9.
- Fair value of derivatives – the Company values its outstanding derivatives at each reporting date with the valuation based on the present value of expected net cash flows arising from the outstanding derivative. Management's judgement is exercised in determining the discount rate and relevant exchange rates used in the valuations – refer to note 10.

2 Operating loss

Operating loss is stated after charging:

€ thousand	2016	2015
Mondi plc management fees	2,416	2,565

None of the directors received any remuneration during the year (2015: €nil) in respect of their services to the Company and the Company had no employees during the current and prior years.

3 Auditor's remuneration

Fees payable to Deloitte LLP for the audit of the Company's annual financial statements of €10,500 (2015: €10,150) have been borne by Mondi plc, the Company's ultimate parent company. Fees of €38,432 (2015: €21,085) have been paid by the Company to the auditor for non-audit services relating to borrowing transactions during the year.

4 Interest receivable and similar income

€ thousand	2016	2015
Interest receivable		
Other loans and receivables owed by Group undertakings	93,241	102,794
Bank deposits	402	382
Receivable impairment reversal	—	10,108
Total	**93,643**	113,284

5 Foreign exchange loss

€ thousand	2016	2015
Foreign exchange loss	(1,593)	(26,008)
Fair value (loss) gain on foreign currency derivatives	(9,545)	17,884
Total	**(11,138)**	(8,124)

6 Interest payable and similar charges

€ thousand	2016	2015
Interest payable		
On loans, overdrafts and bonds	59,981	58,539
To other Group undertakings	14,029	10,105
Receivable impairment	3,564	1,428
Total	**77,574**	70,072

7 Taxation

Analysis of tax charge for the year

€ thousand	2016	2015
Corporation tax		
Foreign withholding tax	1,007	913
Adjustments in respect of prior years		
UK corporation tax group relief	—	2,354
Total tax charge	**1,007**	3,267

Factors affecting tax charge for the year

The Company's total tax charge for the year can be reconciled to the tax on the Company's profit before tax at the average UK corporation tax rate of 20% (2015: 20.25%), as follows:

€ thousand	2016	2015
Profit before tax	**2,096**	31,888
Tax on profit before tax calculated at the average UK corporation tax rate of 20.00% (2015: 20.25%)	**419**	6,457
Tax effect of non taxable income	(1,007)	(2,846)
Previous tax losses utilised	—	(3,611)
Prior year adjustment - group relief	—	2,354
Group relief claimed for which no charge was made	(125)	—
Expenses not deductible	713	—
Withholding tax recognised	1,007	913
Total tax charge for the year	**1,007**	3,267

8 Debtors

€ thousand	2016	2015
Amounts falling due within one year:		
Amounts owed by Group undertakings	657,120	716,359
Prepayments and accrued income	205	205
Other debtors	73	1,084
Total	**657,398**	717,648

There are no debtor balances past due as at the reporting date (2015: €nil). The allowance for doubtful debtors is €nil (2015: €nil).

9 Loans receivable

€ thousand	2016	2015
Loans receivable carried at amortised cost:		
Loans to related parties	1,707,006	1,721,275
Total	**1,707,006**	1,721,275

The allowance for doubtful loans is €11,143,000 (2015: €7,580,000).

Interest is charged at a rate based on the Company's average cost of debt and adjusted for local country interest rates.

10 Derivative financial instruments

The Company enters into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange risk, including foreign exchange forward contracts and when deemed necessary, interest rate swaps. Derivatives are classified as current or non-current depending on their maturity. They are not used for speculative purposes.

Foreign exchange risk

The Company uses currency spot, forward and swap transactions to limit the effects of movements in exchange rates on foreign currency denominated assets and liabilities.

Interest rate risk

When deemed necessary, the Company uses interest rate swap contracts to manage its exposure to interest rate fluctuations on a portion of its existing debt.

Non-hedge transactions

Where the Company has chosen not to designate derivatives as hedges, fair value changes are recognised through the profit and loss account and are classified within foreign exchange loss.

All derivatives are held at fair value. The fair value of derivative financial instruments is as follows:

€ thousand	2016		2015	
	Asset	Liability	Asset	Liability
Derivatives carried at fair value through profit or loss (FVTPL)				
Held for trading derivatives that are not designated in hedge accounting relationships:				
Foreign exchange contracts	6,139	(6,347)	7,758	(8,539)
Total	**6,139**	**(6,347)**	7,758	(8,539)

Further details of derivative financials instruments are provided in note 16.

11 Other creditors

€ thousand	2016	2015
Amounts owed to Group undertakings	567,516	561,790
Interest payable	31,681	26,398
Other accruals	409	1,727
Total	**599,606**	589,915

12 Borrowings

2016/€ thousand	Within 1 year or on demand	Between 1 and 2 years	Between 2 and 5 years	After 5 years	Total
Borrowings from Group undertakings	85,986	—	—	—	85,986
Bonds	499,562	—	498,740	495,685	1,493,987
Syndicated credit facility	—	—	—	—	—
Other external borrowings	32,245	32,245	42,868	33,333	140,691
Bank overdrafts	—	—	—	—	—
Total borrowings	**617,793**	**32,245**	**541,608**	**529,018**	**1,720,664**

2015/€ thousand	Within 1 year or on demand	Between 1 and 2 years	Between 2 and 5 years	After 5 years	Total
Borrowings from Group undertakings	2,206	—	—	—	2,206
Bonds	—	497,961	498,426	—	996,387
Syndicated credit facility	—	—	156,686	—	156,686
Other external borrowings	131,524	31,524	63,825	42,857	269,730
Bank overdrafts	19,638	—	—	—	19,638
Total borrowings	153,368	529,485	718,937	42,857	1,444,647

All borrowings are unsecured and recorded at amortised cost. The outstanding unamortised discount amount related to the Company's three bond issues is €2,372,000 (2015: €1,250,000). The outstanding unamortised debt issuance cost is €5,900,000 (2015: €5,377,000). The principal loan arrangements in place include the following:

€ thousand	Maturity	Interest rate	Facility Amount	
		%	2016	2015
Financing facilities				
Syndicated Revolving Credit Facility	July 2021	EURIBOR/LIBOR + margin	750,000	750,000
€500 million Eurobond	April 2017	5.75%	500,000	500,000
€500 million Eurobond	September 2020	3.375%	500,000	500,000
€500 million Eurobond	April 2024	1.50%	500,000	—
European Investment Bank Facility	June 2025	EURIBOR + margin	80,952	90,476

The €500 million 2017 Eurobond and the €500m 2020 Eurobond contain a step-up clause whereby the coupon will be increased by 1.25% per annum if Mondi Group fails to maintain at least one investment grade credit rating from either Moody's Investors Service or Standard & Poor's. Mondi Group currently has investment grade credit ratings from both Moody's Investors Service (Baa2, outlook Stable) and Standard & Poor's (BBB, outlook Stable).

13 Deferred tax

The Company has the following gross amounts in respect of which no deferred tax asset has been recognised:

€ thousand	2016	2015
At 1 January	3,888	8,449
Loss true-up for prior year tax return	17,505	13,513
Tax losses utilised	—	(17,832)
Other unrecognised timing differences	932	(242)
At 31 December	**22,325**	3,888

The tax losses may be carried forward indefinitely.

€ thousand	2016	2015
The gross deferred tax asset not recognised is presented as follows:		
Tax losses not recognised	21,066	3,561
Other unrecognised timing differences	1,259	327
At 31 December	**22,325**	3,888

14 Share capital

€ thousand	2016	2015
Issued, called up and fully paid		
50,000,000 ordinary shares of €1 each (2015: 50,000,000 ordinary shares of €1 each)	50,000	50,000

15 Cash flow hedge reserve

€ thousand	2016	2015
Balance at 1 January	(327)	(569)
Losses recycled to income	395	242
Allocation of bond pre-hedge to cash flow hedge reserve	(1,327)	—
At 31 December	**(1,259)**	(327)

The cash flow hedge reserve represents the cumulative gains and losses on hedging instruments deemed effective in cash flow hedges. The cumulative deferred gain or loss on the hedging instrument is recognised in profit or loss only when the hedged transaction impacts the profit or loss.

Gains and losses transferred from the hedging reserve into profit or loss during the year are included in the following line items in the profit and loss account:

€ thousand	2016	2015
Interest payable on loans, overdrafts and bonds	(395)	(242)

16 Financial instruments

Valuation techniques and assumptions applied for the purposes of measuring fair value

The fair values of financial assets and financial liabilities are determined as follows:

- The fair values of financial assets and financial liabilities with standard terms and conditions and traded on active liquid markets are determined with reference to quoted market prices (includes listed redeemable notes, bills of exchange, debentures and perpetual notes).
- The fair value of other financial assets and financial liabilities (excluding derivative instruments) is determined in accordance with generally accepted pricing models based on discounted cash flow analyses using prices from observable current market transactions and dealer quotes for similar instruments.

16 Financial instruments (continued)

- The fair values of derivative instruments are calculated using quoted prices. Where such prices are not available, a discounted cash flow analysis is performed using the applicable yield curve for the duration of the instruments for non-optional derivatives, and option pricing models for optional derivatives.
    - Foreign currency forward contracts are measured using quoted forward exchange rates and yield curves derived from quoted interest rates matching maturities of the contracts.
    - Interest rate swaps are measured at the present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates.

17 Related party transactions

The Group and its subsidiaries, in the ordinary course of business, enter into various sale, purchase and service transactions with joint ventures, associates and others in which the Group has a material interest. These transactions are under terms that are no less favourable than those arranged with third parties.

The following shows transactions and balances with companies which are not wholly-owned by Mondi plc or Mondi Limited:

€ thousand	2016	2015
Loans to related parties	40,551	7,753
Payables due to related parties	(101,530)	(76,489)
Interest received from related parties	2,337	147
Interest paid to related parties	(2)	(22)

18 Ultimate parent undertaking

The immediate parent company and controlling party is Mondi Investments Limited, a Company incorporated in Great Britain and registered in England and Wales. Copies of the financial statements of Mondi Investments Limited may be obtained from the directors, Building 1, 1st Floor, Aviator Park, Station Road, Addlestone, Surrey KT15 2PG.

The ultimate parent company and ultimate controlling entity is Mondi plc, a Company incorporated in Great Britain and registered in England and Wales. Mondi plc is the parent undertaking of the largest and smallest group which includes the Company and for which Group financial statements are prepared. Financial statements for Mondi plc may be obtained from the Company secretary, Building 1, 1st Floor, Aviator Park, Station Road, Addlestone, Surrey KT15 2PG.

19 Accounting policies

Basis of preparation

Going concern
After making enquiries, the directors have formed a judgement that, at the time of approving the financial statements and having considered the Company's forecasts, projections and support from the parent company, there is a reasonable expectation that the Company has adequate resources to continue in operation for the foreseeable future. For this reason, the directors continue to adopt the going concern basis in preparing the financial statements.

Foreign currency transactions

The financial statements are presented in Euros, which is the currency of the primary economic environment in which the Company operates (its functional currency).

Foreign currency transactions are recorded in their functional currencies at the exchange rates ruling on the dates of the transactions. At each reporting date, monetary assets and liabilities that are denominated in foreign currencies are translated at the rates prevailing on the reporting date. Gains and losses arising on translation are included in the profit and loss account and are classified as either operating or financing depending on the nature of the monetary item giving rise to them.

Revenue recognition

Interest income (note 4)
Interest income is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time proportion basis, by reference to the principal outstanding and at the applicable effective interest rate.

19 Accounting policies (continued)

Tax (note 7)

The tax expense represents the sum of the current tax charge and the movement in deferred tax.

Current tax

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the reporting date. The tax currently payable is based on taxable profit for the year. Taxable profit differs from net profit as reported in the profit and loss account because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible.

Deferred tax

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount of assets and liabilities in the Company's financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each reporting date. The carrying amount is reduced to the extent that it is no longer probable that sufficient taxable profit will be available to allow all or part of the asset to be recovered within a reasonable period of time. Similarly, it is increased to the extent that it is probable that sufficient taxable profit will be available in the future for all or part of the deferred tax asset to be recovered within a reasonable period of time.

Deferred tax is calculated at the tax rates that are expected to apply in the year when the liability is settled or the asset is realised. Deferred tax is charged or credited to the profit and loss account, except when it relates to items charged or credited directly to other comprehensive income and accumulated in equity, in which case the deferred tax is also taken directly to other comprehensive income and accumulated in equity.

Deferred tax assets and liabilities are offset when they relate to income taxes levied by the same tax authority and the Company intends to settle its current tax assets and liabilities on a net basis.

Financial instruments (note 16)

Financial assets and financial liabilities are recognised in the Company's balance sheet when the Company becomes party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognised immediately in profit or loss.

Financial asset investments (note 9)

Investments, other than investments in subsidiaries and associates, are either classified as available-for-sale or loans and receivables.

Available-for-sale investments are initially recorded at fair value. They are subsequently remeasured at each reporting date to fair value. Any unrealised gains and losses are recognised in other comprehensive income and deferred in equity until an investment is disposed of or impaired, at which time the cumulative gain or loss deferred in equity is included in the profit and loss account.

Loans and receivables are measured on initial recognition at fair value, and are subsequently measured at amortised cost using the effective interest rate method.

19 Accounting policies (continued)

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments of a maturity of three months or less from the date of acquisition that are readily convertible to a known amount of cash and that are subject to an insignificant risk of changes in value. Bank overdrafts are shown within short-term borrowings in current liabilities in the balance sheet.

Trade debtors and creditors (notes 8 and 11)
Trade debtors and creditors are initially recognised at fair value and are subsequently carried at amortised cost using the effective interest rate method.

Borrowings (note 12)
Interest bearing loans and overdrafts are initially recognised at fair value, net of direct transaction costs. Borrowings are subsequently measured at amortised cost. Any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the profit and loss account over the term of the borrowings using the effective interest rate method.

Borrowing costs (note 6)
Where financial liabilities are measured at amortised cost using the effective interest method, interest expense is recognised on an effective yield basis in profit or loss within finance costs.

All other borrowing costs are recognised in the profit and loss account in the period in which they are incurred.

Impairment of financial assets
Financial assets are assessed for indicators of impairment at each reporting date. Financial assets are impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected. Impairments recognised through the profit and loss account are classified as either operating or financing depending on the nature of the monetary item giving rise to them.

Derivative financial instruments and hedge accounting (note 10)

The Company enters into forward, option and swap contracts in order to hedge its exposure to foreign exchange, interest rate and commodity price risks. The Company does not use derivative financial instruments for speculative purposes.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and subsequently held at fair value in the balance sheet within derivative financial instruments, and are classified as current or non-current depending on the maturity of the derivative.

Changes in the fair value of derivative instruments that are not formally designated in hedge relationships are recognised immediately in the profit and loss account and are classified within operating profit or net finance costs, depending on the type of risk to which the derivative relates.

Cash flow hedges
The effective portion of changes in the fair value of derivative financial instruments that are designated as hedges of future cash flows are recognised directly in other comprehensive income and accumulated in equity. The gain or loss relating to the ineffective portion is recognised immediately in the profit and loss account. If the cash flow hedge of a forecast transaction results in the recognition of a non-financial asset or a non-financial liability then, at the time the asset or liability is recognised, the associated gains or losses on the derivative that had previously been recognised in the Company's cash flow hedge reserve in equity are included in the initial measurement of the asset or liability. For hedges that do not result in the recognition of a non-financial asset or a non-financial liability, amounts deferred in the Company's cash flow hedge reserve in equity are recognised in the profit and loss account in the same period in which the hedged item affects profit and loss on a proportionate basis.

Fair value hedges
For an effective hedge of an exposure to changes in fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in the profit and loss account. Gains or losses from remeasuring the associated derivative are also recognised in the profit and loss account.

Ineffective, expired, sold, terminated or exercised hedging instruments
Hedge accounting is discontinued when the hedge relationship is revoked or the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, any cumulative gain or loss deferred in equity remains in equity and is recognised in the profit and loss account when the forecast transaction is ultimately recognised. If a hedge transaction is no longer expected to occur, the net cumulative gain or loss deferred in equity is included immediately in the profit and loss account.