

3 Critical accounting estimates and judgements (continued)

Future cash flows are discounted using a discount rate based on the Group's weighted average cost of capital, adjusted if appropriate for circumstances specific to the asset being tested. The weighted average cost of capital is impacted by estimates of interest rates, equity returns and market and country-related risks. The Group's weighted average cost of capital is reviewed on an annual basis.

Further details are set out in Notes 15 and 16.

Retirement benefits

Among the range of retirement benefits provided in businesses around the Group are a number of defined benefit pension plans and an unfunded healthcare benefit scheme in the USA. The amounts recorded in the financial statements for both of these types of arrangement are based on a number of assumptions, changes to which could have a material impact on the reported amounts.

Any net deficit or surplus arising on defined benefit plans and the liability under the healthcare plan is shown in the balance sheet. The amount recorded is the difference between plan assets and liabilities at the balance sheet date. Plan assets are based on market value at that date. Plan liabilities, including healthcare liabilities, are based on actuarial estimates of the present value of future pension or other benefits that will be payable to members. The most sensitive assumptions involved in calculating the expected liabilities are mortality rates and the discount rate used to calculate the present value. If the mortality rates assumption changed, a one year increase to longevity at age 60 would increase the liability by £30 million. The main financial assumption is the real discount rate, being the excess of the discount rate over the rate of inflation. If this assumption increased by 0.1%, the gross plan liabilities would decrease by approximately £13 million.

The income statement generally comprises a regular charge to operating profit and a finance charge, which represents the net of expected income from plan assets and an interest charge on plan liabilities. These calculations are based on expected outcomes at the start of the financial year. The income statement is most sensitive to changes in expected returns from plan assets and the discount rate used to calculate the interest charge on plan liabilities. A 0.1% increase in the assumption of the real discount rate would increase the finance expense by approximately £0.2 million.

Full details of these assumptions, which are based on advice from the Group's actuaries, are set out in Note 31.

Provisions

The Group recognises a provision where a legal or constructive obligation exists at the balance sheet date and a reliable estimate can be made of the likely outcome. Where appropriate, future cash outflows that are expected to arise over a number of years are discounted to a present value using a relevant discount rate.

At the balance sheet date, provisions included amounts for insurance claims payable by the Group's reinsurance company, legal matters, employee termination and other restructuring costs.

Although provisions are reviewed on a regular basis and adjusted for management's best current estimates, the judgemental nature of these items means that future amounts settled may be different from those provided.

Further details are set out in Note 32.

Taxation

The Group operates in a large number of tax jurisdictions around the world. Tax regulations generally are complex and in some jurisdictions agreeing tax liabilities with local tax authorities can take several years. Consequently, at the balance sheet date, tax liabilities and assets are based on management's best estimate of the future amounts that will be settled. While the Group aims to ensure that the estimates recorded are accurate, the actual amounts could be different from those expected. Deferred tax assets mainly represent retirement benefit obligations that the Group expects to recover at some time in the future and by their nature the amounts recorded are therefore dependent on management's judgement about future events.

Further details are set out in Notes 11 and 30.