Answers

Section 1

Good morning ladies and gentlemen, and welcome to the latest in Ethical Investors' series of presentations which is designed to give you an overview of how we might go about assessing a potential investment, paying particular attention to issues of the environment and ethics.

We will be looking at this under a number of headings. These are:

How an assessment of the group's performance will be affected by the environmental and ethical policies identified in the annual report;

Measures which could be used to assess performance in respect of environmental and ethical policies;

An assessment of performance of a specific company, based on the stated policies and objectives; (We'll be focusing our attention on the BOC Group for this part of the presentation, and I have provided each of you with a copy of the Group's Annual Report for the year ended 30 September 2002.)

Additional information we might require to carry out a more detailed analysis of performance, including why this is needed;

The extent to which the current UK framework of accounting and the organisation's accounting policies assist (or impede) an assessment of performance.

So let's look at the first of these:

How an assessment of the group's performance will be affected by the environmental and ethical policies identified in the annual report.

Assessment of any company's performance requires measures of performance to be considered in the context of the general business environment and the stated organisational objectives. In recent years, there has been an increased awareness that the operations of the organisation impact on the environment. This has led to an increased requirement to measure and control such impacts. Measuring such impacts has not been part of traditional performance measurement, which has tended to focus on financial measures of performance.

In the case of a company such as the BOC Group which has acknowledged the importance of environmental and ethical issues by establishing policies in these areas, the most obvious outcome is that the 'traditional' measures of performance such as Return on Capital Employed (ROCE) will be augmented by newer measures which will be based on the stated environmental and ethical policies. These newer measures are more difficult to define as they will tend to vary from company to company. There is a level of agreement as to the relevance of measures of performance such as ROCE and Earnings per Share (eps). Indeed these measures could be considered to be 'standard' measures as they will feature in any textbook on the subject. There are no such 'standard' measures of performance for environmental and ethical policies.

This means that the stated environmental and ethical policies form part of the objectives of the group. They will therefore be part of the overall context in which the assessment of performance will be set. In that sense the assessment is not affected by the group identifying environmental and ethical policies.

To the extent that there are no set measures which should be applied, the assessment of performance will be changed. To make the assessment meaningful, greater consideration must be given to the group's objectives. If this is not done, there is a risk that the assessment will lack depth and relevance. Although such an assessment will require the use of more not for profit indicators (NFPIs) than has traditionally been the case in assessing performance, the broad approach is the same. That is to say, the starting point is the stated objectives, from which critical success factors (CSFs) will be identified. Once the CSFs are identified, appropriate measures will be selected.

Moving on from this, we need to consider the effect of including environmental and ethical issues in our assessment.

Measures which could be used to assess performance in respect of environmental and ethical policies.

To establish the stated objectives, we need to review the annual report.

On page 4, the Chairman's statement notes:
'The board has reviewed all aspects of governance in its widest sense, adopting best practice whenever opportunities have been identified and has updated its approach to social responsibility.'

This does not provide any specific objectives, but it does provide a context. It is clear that the group seeks to meet the highest standards of social responsibility and corporate governance.

The theme is developed a little further in the Chief Executive's Review. On page 6, having noted:
'Our commitment to safety and the environment has been constant'

the Chief Executive goes on to refer to the need to control costs and the acquisitive nature of the group's strategy. He then concludes:

'These are components of our consistent drive for profitable growth and for improvements in margins, return on capital and cash flow.'

The significant point about these comments is that they clearly show that in the view of the management team, safety and the environment are as important as the 'traditional' goals of growth, improved profitability, improved ROCE and cash flow. Safety and concern for the environment are part of the foundation for the group's success.

This gives a clue to what the Chairman meant when he noted:

'Our strategy to deliver superior returns . . . is to focus on sustained and sustainable growth in earnings and improvements in capital efficiency.'

It would seem that by focusing on sustained and sustainable growth, the management team take a long term view. This view is that growth cannot be acceptable if it is at the cost of the environment, as such growth would not be sustainable.

Further references to the context are found in both the Chief Executive's Review and the Group Profile.

Page 7 – Chief Executive's Review:
'Attending to growth and the financial health of the group are key priorities. We also have programmes to ensure that we fulfil our wider responsibilities in the communities where we live and to the environment in general. . . . . . I want everyone within BOC, and all those whom our business touches, to be safe and to avoid being hurt by our activities.'

Page 25 – Group profile:
'The BOC Group takes its safety, health and environmental responsibilities seriously, and strives in all its business dealings to operate safe working practices, eliminate incidents and to ensure it causes no harm to the environment. The group's commitment on this front is best illustrated by the breadth of measures taken to equip employees with training and the appropriate tools.'

With regard to safety, the profile states:
'It is as important for the group to transmit safe working methodologies to customers and suppliers as it is to have clear, entrenched and measurable performance standards practised by all BOC plants, depots and distributors'.

These statements are helpful and leave no doubt that the group is serious about both the environment and safety. However they still tend to set the context, and provide little in the way of measurable objectives. It is on page 54 in the statement on corporate governance that specific objectives are stated:

'In 2002, the BOC Group's corporate social investment programme had three key objectives.'

These objectives are:
- to continue to focus on projects designed to improve environmental stewardship
- to continue to develop the choices of social investment donations to our employees
- to broaden the organisation's involvement in social programmes around the world

These objectives however, highlight the main problems of including environmental and ethical policies when assessing the group's performance. These problems are:

- as noted above, there are no agreed measures for assessing environmental and ethical policies
- although the framework provided by the law and accounting standards ensures that there is a degree of comparability with regard to the financial data which companies present, no such framework is available for environmental and ethical reporting. Indeed any such reporting is voluntary.

In other words, although a stated objective of the BOC Group is to cause no harm to the environment, there is no data available to assess if the objective has been met. In order to assess this objective we must rely on voluntary disclosures by the company or seek a proxy measure.

Based on the approach of identifying objectives, CSFs and measures, a possible framework for assessing performance in respect of environmental and ethical policies is to consider the following:

Number of external standards achieved
(e.g. ISO 14001 environmental certification)
Number of external standards still to be achieved
Number of operations covered by external standards
Incidence of non-compliance with legal requirements
Incidence of avoidable accidents
Level of voluntary expenditure on environmental protection

Let's consider the basis for each of these measures.

Number of external standards achieved
The fact that the group seeks to achieve such standards (which are externally set) is verifiable evidence of a serious commitment to achieving the highest possible standard of performance. As assessment is also carried out externally, achieving such standards provides verifiable evidence of a good level of performance.

Number of external standards still to be achieved
As compliance with external standards is voluntary, the group is free to choose which standards it will seek to achieve, and which standards it will not seek to achieve. Thus it is possible that the group will be certified as performing at a level which is less than could reasonably be expected.

Number of operations covered by external standards
The extent to which the group's operating sites are covered or not covered by certification will give an indication of the extent to which the aspirations are converted into actions.

Incidence of non compliance with legal requirements
It could be argued that the legal requirements are the minimum acceptable level of performance. In this sense, any non-compliance would indicate that the group's performance is not as impressive as the aspirations suggest.

Incidence of avoidable accidents
The Chief Executive has stated: 'I want everyone within BOC, and all those whom our business touches, to be safe and to avoid being hurt by our activities'. If the company operates in such a way that the incidence of avoidable accidents is increasing, it would be difficult to argue that the group is achieving the Chief Executive's objective.

Level of voluntary expenditure on environmental protection
By measuring voluntary expenditure, we can obtain a measure of the extent to which the group seeks to exceed the expected level of performance.

An assessment of performance of a specific company, based on the stated policies and objectives.
The specific company we will consider is the BOC Group, and we will be using the Group's 2002 Annual Report.

As we have already noted, the group has a number of stated objectives, and the assessment of performance should be undertaken in the light of these objectives.

The objectives are stated in the Chairman's statement and the Chief Executive's Review:

Profitability – 'superior returns . . . in the form of dividends'
Capital growth – 'share price appreciation'
Return on capital – 'improving the efficiency and productivity of capital'
Growth – 'grow the scale and scope of your company' 'consistent drive for profitable growth'
Environmental – 'improve environmental stewardship'
'develop the choices of social investment donations'
'broaden . . . . involvement in social programmes around the world'

We are assessing the performance of the group in the context of a potential investor. It is therefore important to consider the extent to which the group's stated objectives are consistent with the objectives of a potential investor. One important point to be made in this regard is that in addition to the normal measures of shareholder value, we can assume that you are also interested in investing in a company which can demonstrate that it is going about its business in an environmentally friendly and ethical manner. If that wasn't the case, you wouldn't be here!

In that regard, the BOC Group scores highly. The stated objectives for profitability, capital growth, return on capital are closely aligned with the normal measures of shareholder value. In addition, it must be said that if a company can achieve those objectives, while at the same time ensuring that growth is profitable, most potential investors would be satisfied. If, in addition to that, the business is conducted so that the environmental goals are achieved then investors such as you will also be satisfied. Therefore, on the basis of the stated objectives, we have a potentially attractive investment.

The extent to which the stated objectives have been achieved now needs to be considered through the use of a number of appropriate measures of performance. (See Appendix 1 for details of the sources of information used to calculate the measures.)

The profit generated before interest and tax has fallen in each of the last two years. Clearly this is not a positive trend. On a more positive note, Return on Capital Employed (ROCE) improved in 2002. However, this improvement merely means that ROCE for 2002 has returned to the level achieved in 1998. Before drawing any conclusion, it is necessary to consider the underlying influences and the stated objective.

The BOC Edwards line of business has a significant influence on group results. In the Group Profile, it is stated that 'Sales opportunities for much of BOC Edwards' semiconductor equipment business are dependent upon capital investment by the semiconductor industry. Management believes that semiconductor production remains on a long term growth trend but capital investment by semiconductor manufacturers has been subject to sharp variation for a number of reasons.'

On page 15 it is reported that this line of business contributed 17% of group turnover and 5% of operating profit, while the Chief Executive's Review notes that the falls in turnover and operating profit were 19% and 66% respectively. From the segmental information we can calculate that if these falls had not occurred, Turnover would have increased by £187m and Operating Profit would have increased by £50·7m. This would have led to a 7% growth in profit in 2002 as compared to 2001, while ROCE would have improved to 12·7%.

Of course one of the tasks facing the management of a complex business such as BOC is to manage the portfolio of different business interests. Such a portfolio based strategy means the that if one sector is experiencing low demand, this may be offset by positive factors in other sectors. In that sense, downturns such as that in the semiconductor industry could be considered normal.

However it is worth noting that the downturn in question is widely regarded as unprecedented. In addition, although BOC Edwards is a significant business sector, the group as a whole is somewhat protected, as this sector represents less than 18% of the business, whether measured in terms of turnover or capital employed. A further factor is that the group seeks 'sustained and sustainable growth' (Annual Report P4). The key point is whether the portfolio is structured to provide the protection which is discussed above.

In this context, it can be seen that the performance could be regarded as being sound. Although a significant sector of the business has experienced a major downturn, return on capital employed has been sustained.

This leads to a consideration of the factors which have influenced this measure.

Underlying profitability, as measured by the net profit margin, has fallen slightly in the last year. Over the last two years, however, the fall is more marked. Over the same period, asset turnover has improved from 80% to almost 102%. This is significant, as the business is capital intensive. The level of capital investment, and consequent depreciation charges mean that maintaining a high level of activity is essential. It can be seen therefore, that the group has been successful in maintaining profitability by careful management of the utilisation of the investment. Once again, based on this measure, the conclusion would be that performance is sound.

The chairman noted 'Our principal objective is to deliver superior returns to our shareholders, both in the form of dividends and share price appreciation.' It has to be said that in this regard, performance is less positive. While the total dividend payment has increased by 3% in the last year (and 6% in the previous year), the dividend per share and earnings per share are at the lowest in the last five years, while dividend cover is at its lowest for three years. What this may imply is that the group have taken the view that the uncertainty in the equity markets, combined with the highly publicised scandals, lead to a lack of certainty with regard to capital appreciation. Therefore shareholders are more concerned with receiving their return in the form of dividends which they can choose to consume or reinvest (either in the company itself, or in another company). However a policy of maintaining the dividend payment can be risky if the underlying profitability and cash generation are insufficient to support the payments.

On that basis, it is hard to conclude that the *principal* objective of delivering *superior* returns has been met.

Arising from that observation, is the need to assess the attitude of the shareholders, as demonstrated by the share price. This can be combined with earnings per share to calculate the Price/Earnings (P/E) Ratio. The annual report provides some data on share prices. If we consider the simple average of the highest and lowest prices during the final quarter of each year to be a reasonable measure of the share price, the P/E ratio has improved in each of the last two years. While it has not fully recovered from the significant fall in the year to 30 September 2000, this does suggest that there is a good degree of market confidence in the performance of the group. This is further indicated by the slight appreciation in the share price in the last year - although, once again, the substantial fall in the 2000 year has not been fully recovered.

A further consideration is whether the level of dividend payment is supported by cash generation. The cash flow statement reports that a total of £21·4m of cash was generated. This was after issuing £25m of new share capital, and raising loans of £64·1m. These cash flows, combined with the fact that there was a net cash outflow before use of liquid resources and financing suggest that the underlying cash flow is not positive. However it is necessary to consider some of the other cash flows. The group had a total outflow of £540m in respect of capital expenditure and acquisitions. It would be normal to expect that such outflows would be financed by issuing share capital and raising loans. Given that the total inflow from these sources was only £141·7m we can see that as well as providing cash for expenses, tax and dividends, the cash generated by operations was sufficient to keep the additional borrowings in respect of long term investment at a relatively low level. Given the earlier comments regarding dividends, it is reasonable to conclude that the goal of providing a return to the shareholders in the form of dividends has been achieved. Nevertheless there is a question mark about whether or not this return can be classified as 'superior'.

Assessing the extent to which the environmental objectives have been achieved is difficult due to the nature of the information provided. Earlier we had considered that appropriate measures might be:

Number of external standards achieved
(e.g. ISO 14001 environmental certification)
Number of external standards still to be achieved
Number of operations covered by external standards
Incidence of non-compliance with legal requirements
Incidence of avoidable accidents
Level of voluntary expenditure on environmental protection

The annual report provides a number of measures (pages 25 and 26). All but one of these show an encouraging downward trend. It is noticeable that the most significant trend is in the amount of ozone depleting potential substances which have been released. Against that, the level of hazardous waste has been virtually static for the last three years.

According to the note on page 26, there are 30 sites certified to ISO 14001 standard. This includes some of the largest sites, not only in the group, but in the industry. While this can only be regarded as positive, it is difficult to place the achievement in context, as no data is available on how many sites the group has. This means that the extent to which operations are covered – and are not covered – by the certification cannot be assessed. The table on page 27 for non compliance with laws suggests that the group operate at least 100 sites, which suggests that the level of non-certification is around 70%.

The table on page 27 indicates that non compliance has been reduced, but it must be noted that this shows the number of sites reporting incidents, not the number of incidents. It is possible that the overall level of non-compliance may not be falling as dramatically as this table suggests.

The incidence of avoidable accidents for both passenger cars and trucks has fallen, although there is some suggestion that this may be levelling out. Once again no conclusion can be drawn, as site accidents are not reported.

There is no data on the level of voluntary expenditure on environmental protection. On page 26, it is reported that a saving of £340,000 has been made in fuel costs, and that this has also resulted in a lower level of carbon dioxide emissions. Again this is welcome, but it may be a case of making a virtue of necessity. The Chief Executive notes that the group continues 'to apply pressure to (the) cost base'. The saving referred to may be significant in headline terms, but it represents less than 1 in 10,000 of turnover and less than $^1/_{10}$ of 1% of profit before interest and taxation. In these terms it can be seen that the saving is not material in any assessment of performance.

Overall, therefore, it is difficult to come to any conclusion on environmental performance.

Perhaps the most telling comment is on page 27, where it is noted that 'BOC was compliant with external standards, but did not comply with all internal codes and practices.' This suggests that the commitments referred to in the annual report are real, and are backed up with internal standards, targets and reporting. It also suggests that the aspired level of performance in this area is higher than the legal minimum. This in itself is an indicator of a serious commitment to the environment. However it may also be that the aspiration is unrealistic – to ensure that BOC 'causes no harm to people or the environment'. The final comment may be that to seek such a high level of safety and environmental concern can only be welcomed, but that measured against that standard, actual performance is always likely to fall short. While this may seem to be less than successful, it is arguable that the overall impact is positive, and the company ought to be applauded for making serious and determined efforts in this regard.

Thus, the overall assessment of the performance of the group, based on the stated objectives, is:

Objective: Profitability – 'superior returns . . . in the form of dividends'

Comment: The group has been successful in maintaining the level of profitability, and the dividend payment. Given that a major sector of the business (BOC Edwards) has been operating in a depressed market, this is a sound performance. However, the level of dividend payment has not increased. The conclusion from this is that the 'superior' aspect of the objective has not been met. Nevertheless, the performance is sound, and the indications are that a decent return on investment is likely.

Objective: Capital growth – 'share price appreciation'

Comment: The share price has shown a 17% increase over the past four years. At first sight this looks like another sound performance. However, there was a dramatic appreciation in the 1999 year, followed by an equally dramatic fall in 2000. Against the background of falling equity prices, the gradual and sustained improvement is to be welcomed. This suggests that the group is outperforming the market. This is confirmed by the graph on page 5 which shows that the total shareholder return, whilst moving almost exactly in line with the FTSE 100, is constantly and significantly above the FTSE 100.
All in all therefore, this indicates that the group is a sound investment.

Objective: Return on capital – 'improving the efficiency and productivity of capital'

Comment: As noted in the analysis of profitability, the Group has been successful in improving the utilisation of assets. Indeed, it could be argued that this has been the most successful aspect of performance.

Objective: Growth – 'grow the scale and scope of your company' 'consistent drive for profitable growth'

Comment: Although the results do not indicate anything other than marginal growth in overall terms, it must be remembered that the BOC Edwards sector is depressed. To maintain the overall level of turnover is therefore a further aspect that could be assessed as sound, rather than high. There has been further investment by way of acquisitions, which provide the opportunity for future growth. Overall, therefore, this means that although this objective was not achieved, there is reason for optimism regarding the future.

Objective: 'improve environmental stewardship'

Comment: There is significant evidence of the Group's commitment in this area, but there is not really enough data to undertake a thorough assessment.

Objective: 'develop the choices of social investment donations'

Comment: The report indicates that there is a degree of social investment, and social involvement on the part of staff. However, once again, more data would be needed to allow assessment.

Objective: 'broaden …. involvement in social programmes around the world'

Comment: Again, more data is needed before a conclusion can be drawn.

Additional information we might require to carry out a more detailed analysis of performance, including why this is needed.
The starting point for deciding what information is required is to consider the needs of the user of the annual report. As we have already noted, the group's stated objectives encompass the normal measures of shareholder value as well as objectives which would be acceptable to investors interested in environmental and ethical practices. Our analysis indicates that there is sufficient information in the annual report to form the basis of an assessment of the measures of shareholder value.

The most obvious need for additional information is in respect of the environmental targets set by the group. The group seeks to improve environmental stewardship, develop the choices of social investment donations and broaden involvement in social programmes around the world. Perhaps the key point here is that these aspirations are beneficial to the environment and indicate a desire to be perceived as a leader in this context. What is not so clear is exactly what is meant by these statements. For example, it is possible to improve environmental stewardship but still not be environmentally responsible. This would occur if the improved standard is measured against a unacceptably low level of previous performance. It would therefore be useful to know what the internal codes and practices referred to in the group profile are, and what performance measures are used. This would allow an assessment of the environmental performance against the group's target.

The same point regarding standards can be made about the other two objectives.

Following on from this and the comments about performance assessment, the other specific information, and the reasons why this information would be useful, are:

Information	Why the information would be useful
Number of external standards achieved	This would allow an assessment of the level of the group's compliance with recognised standards.
Number of external standards still to be achieved	This would place the compliance with recognised standards in context, and would allow the group's commitment to compliance to be assessed.
Number of operations covered by each specific external standard	This would confirm if compliance is group-wide, or is confined to a few 'star' operations.
Total number of operations	As discussed above, the level of commitment to compliance could be assessed by this measure.
Plans to achieve certification of compliance with outstanding external standards	If the group is planning to increase the level of certification, it will be clear that there is an ongoing commitment to environmental standards.
Plans to increase the number of operations achieving external standards	If the group is planning to roll out the compliance programme, this will provide evidence of commitment.
Incidence of non-compliance with legal requirements	As noted above, the statistics reported are for sites reporting incidents, not the number of incidents. The statistics as reported do not indicate whether performance is improving.
Level of voluntary expenditure on environmental protection	While the group is clearly involved in aspects of environmental protection, it is difficult to assess as no information is given on voluntary expenditure. The only firm statistic is the saving in fuel costs, which is clearly beneficial to the group. Therefore the motivation and commitment is unclear.

The extent to which the current UK framework of accounting and the organisation's accounting policies assist (or impede) the assessment of performance.

Perhaps the previous discussion indicates at least one way in which the UK framework of accounting assists in assessment of performance. Because there are specific requirements for financial reporting with regard to the format and content of financial statements, certain key information is available. As this information must be audited before being published, there is a reasonable level of assurance that it can be relied on. In addition the framework provides for a degree of consistency from one company to another, which assists in making comparisons.

For example, the need to analyse liabilities into those falling due in less than one year and those falling due in more than more than one year means that the annual report provides some useful information about the timing of future cash outflows.

Of course, it is not the case that the framework leads to absolute clarity and certainty. The reader is still called on to make a number of value judgements. Examples of such judgements are the need to consider the importance and potential repetition of exceptional items, the bases of asset valuations, and the calculation of earnings per share.

The requirements of specific standards ensure that there is greater certainty about the picture presented by certain aspects of the financial statements. Three key standards in this respect are FRS3 – Reporting Financial Performance, FRS 12 – Provisions, contingent liabilities and contingent assets and FRS 15 – Tangible Fixed Assets.

Let's look at these points for a few moments.

Although FRS 3 defines exceptional items as falling within ordinary activities, and requires three types of exceptional items to be specifically reported on the face of the profit and loss account, there is still a degree of judgement to be exercised with regard to other items. The FRS states that exceptional items are those which 'need to be disclosed by virtue of their size or incidence if the financial statements are to give a true and fair view.' This has the effect of allowing significant charges which are subject to management control to be classified as exceptional. An example of this is a major bad debt. While the ultimate failure of the customer may be outside the control of the management, it is often the case that such exposure arises due to some breakdown or failure in management control. The implication of classifying the charge as exceptional is that it is an external event. This is reinforced by the fact that the financial statements will often report key figures 'excluding exceptional items'. In the specific case of BOC, the financial statements include a charge for restructuring costs in each of the last two years. Given the complexity of the group's business, and the fact that acquisitions are made in order to achieve the growth objective, it is reasonable to expect that such a charge will recur. The Group chooses to augment the disclosure of earnings per share by reporting the figure before exceptional items. The point need hardly be made that this measure of eps is higher than basic eps. While it would be totally inappropriate to suggest that there is any attempt to mislead the reader, it is the case that the implication is that if matters that are not wholly under management control are excluded, performance is better than suggested by the basic (or official) figure. As already discussed, there is an argument that major elements of the exceptional items *are* under management control. It has to be said, of course, that FRS 3 did at least improve the reliability of the eps figure by establishing that in the first place, there is no case for classifying costs as extraordinary, and secondly that in the unlikely event that such an item should arise, it is deducted from the earnings figure used to calculate eps. This is a significant improvement on the situation before the FRS was introduced, when some companies tended to manipulate results by classifying costs as 'extraordinary' and then excluding them from the calculation of eps.

FRS 12 has provided greater clarity as to whether a potential liability is to be recognised in the financial statements, disclosed by way of note, or excluded entirely from the financial statements. This has meant that the scope for profit smoothing (i.e. either dampening down the reported profit by including unnecessary liabilities, or boosting profit by releasing provisions that had previously been built up in that way) has been reduced. In addition, the requirement to disclose contingent liabilities means that the reader of the financial statements is informed about possible liabilities. Without the requirement to report contingent liabilities, there may be substantial future liabilities which are not drawn to the reader's attention.

Note 13(b) provides information on the Group's contingent liabilities. From this we can see at least two important things. First, if the liabilities crystallise, the group will be called upon to pay a total of £158m. While this is a significant figure, it represents 11% of total capital and reserves and 19% of retained profit. We can therefore conclude that while crystallisation of these liabilities would be unwelcome, but would not adversely affect the ability of the group to continue trading.

Another area in which there is less clarity than may seem to be the case at first sight is the valuation of fixed assets. Although it is permissible to revalue fixed assets, it is not a requirement. This means that the fixed asset values in the financial statements are often a mixture of historic cost and revalued amounts. Not only does this distort the picture in the financial statements of the individual company, but it hinders comparison of asset based measures from one company to another. In the case of BOC, we can see on page 72 (Accounting policy note – Tangible fixed assets) that prior to the introduction of FRS 15, land and buildings had been revalued. The group's response to the introduction of FRS 15 was to treat the revalued amount at that date as the historical cost, and to cease to revalue land and buildings. What is particularly interesting about this is that while it is permissible under the FRS, it is not the usual interpretation. The total value of £438.5 for land and buildings represents a little more than 12% of the capital employed. From note 8 (d) we can see that the value of properties which had previously been revalued was £136·4m, while the properties which have been acquired since revaluations ceased have a value of £302·1m. If we consider that there were no additions to Land and Buildings in the 2002 year, we can conclude that the value attributed to at least 12% of the capital employed is at least one year out of date. Furthermore, 45% of the value of land and buildings is at least four years out of date. This means that the results calculated above for ROCE and Asset Turnover are overstated, as the asset base is understated.

Conclusion

Overall therefore, we can say that the Group has performed well, in the context of the global economy, and that there is evidence of a real concern for, and attention to, matters of environmental and ethical policy, but more data is needed to fully assess performance. Given that the Group has expressed a clear commitment to the environment, we would wish to include this in our assessment. However, it is difficult to obtain specific information in respect of the environmental and ethical objectives. This means that our final conclusion is only based on a number of the stated objectives, rather than a comprehensive analysis.

APPENDIX

Calculation of measures of performance

			2002	2001	2000	1999	1998
Return on capital employed							
Profit before interest and tax	P12/P66	£m	405·4	425·9	504·5	443·0	383·3
Capital employed	P 13	£m	3,593·1	3,974·5	4,453·2	3,721·8	3,389·1
ROCE %			11·3	10·8	11·3	11·9	11·3
As reported by group	P13		12·3	12·9	12·5	13·1	13·4
Net profit margin							
Profit before interest and tax	P12/P66	£m	405·4	425·9	504·5	443·0	383·3
Turnover	P12	£m	3,657·7	3,772·9	3,579·7	3,052·7	3,079·2
NP margin %			11·1	11·3	14·1	14·5	12·4
Asset turnover (T'over/Cap Emp'd%)			101·8	94·9	80·4	82·0	90·9
Dividend cover							
Profit for financial year	P66/P12	£m	202·9	224·1	278·6	250·1	162·8
Dividend			186·6	180·3	170·2	n/a	n/a
Dividend cover (times)			1·1	1·2	1·6		
Price earnings ratio							
eps (basic on published profit)	P12	p	41·4	46·0	57·2	51·4	33·5
Average share price 4th quarter	P114	p	935·5	920·0	945·5	1307·5	799·2
P/E ratio			22·6	20·0	16·5	25·4	23·8
Share price appreciation							
Average share price 4th quarter	P114						
1998 = 100			117·0	115·1	118·3	163·6	100·0
Chain based index			101·7	97·3	72·3	163·6	100·0
Year on year growth in revenue							
Turnover chain based index	P12		96·9	105·4	117·3	99·1	n/a

1 Briefly explain how an assessment of the group's performance will be affected by the environmental and ethical policies identified in the annual report.

Awareness of importance of strategy / objectives	2
If stated, such policies are part of strategy	2
Therefore, these policies give rise to objectives	2
	6

2 Identify and explain measures which could be used to assess performance in respect of environmental and ethical policies.

Objectives identified 2 marks each, to a maximum of	4
Measures suggested:	
1 mark for each measure if some link to strategy / objectives	
2 marks if clearly linked to strategy / objectives to a maximum of	8
for providing a justification of measure, up to 2 marks each to a maximum of	8
	20

3 From the perspective of a potential investor, assess the group's performance, based on the stated policies and objectives.

'Traditional' measures selected:	
linked to strategy / objectives, up to 2 marks each to a maximum of	12
for providing a justification of measure, up to 2 marks each to a maximum of	12
All measures:	
Interpretation / discussion, up to 2 marks each to a maximum of	12
Overall conclusion maximum	4
	40

4 Identify, and explain the need for, any additional information required to carry out a more detailed analysis of performance.

For each item of information, up to 2 marks each to a maximum of	8
For justification of need for each item of information, up to 2 marks each to a maximum of	8
For reference to information needs of user	1
For reference to shareholder value a maximum of	2
	19

5 Discuss the extent to which the current UK framework of accounting, and the organisation's accounting policies, assist (or impede) an assessment of performance.

Discussion of accounting framework a maximum of	5
Consideration of specific FRS, 1 each to a maximum of	2
Selection of accounting policies:	
understanding of policy, up to 2 to a maximum of	4
analysis of each policy, up to 2 to a maximum of	4
	15
	100