Significant accounting policies

Basis of consolidation
The consolidated financial statements comprise the financial statements of the Company and its subsidiary undertakings. The financial statements of the major subsidiaries are prepared for the same reporting year as the Company, using consistent accounting policies.

All intra-Group balances and transactions, including unrealised profits arising from intra-Group transactions, have been eliminated in full. Transfer prices between business segments are set on a basis of charges reached through negotiation with the respective businesses.

Subsidiaries are consolidated from the date on which control is obtained by the Group and cease to be consolidated from the date on which control is no longer held by the Group. Where the Group ceases to hold control of a subsidiary, the consolidated financial statements include the results for the part of the reporting year during which the Group held control.

Non-controlling interests represents the portion of profit/loss, gains/losses and net assets relating to subsidiaries that are not attributable to members of the Company. The non-controlling interests balance is presented within equity in the consolidated balance sheet, separately from parent shareholders' equity.

Changes in accounting policy and disclosures
The accounting policies applied in the preparation of these financial statements are consistent with those in the Annual Report and Financial Statements for the year ended 29 March 2015, except for a change in policy in respect of pensions administration costs as detailed in Note 1 on page 94, and the adoption of new and amended accounting standards with effect from 30 March 2015 as detailed below:

New accounting standard amendments adopted in 2015-16
Annual improvements 2010 – 2012

Annual improvements 2011-2013

IAS 19 (Amended) 'Defined benefit plans: Employee contributions'

The adoption of these amendments to the standards has not had a material impact on the financial performance or position of the Group.

Key sources of estimation uncertainty and critical accounting judgements
The preparation of consolidated financial statements necessarily requires Management to make estimates and assumptions that can have a significant impact on the financial statements. These estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The areas involving a higher degree of judgement or complexity, or areas where assumptions and estimates are significant to the consolidated financial statements are disclosed below.

Pensions
The value of defined benefit pension plan liabilities and assessment of pension plan costs are determined by long-term actuarial assumptions. These assumptions include discount rates (which are based on the long-term yield of high-quality corporate bonds), inflation rates and mortality rates. Differences arising from actual experience or future changes in assumptions will be reflected in the Group's consolidated statement of comprehensive income. The Group exercises its judgement in determining the assumptions to be adopted, after discussion with a qualified actuary. Details of the key actuarial assumptions used and of the sensitivity of these assumptions are included within Note 10.

Deferred revenue
The Group recognises advance customer payments on its balance sheet, predominantly relating to stamps and meter credits purchased by customers but not yet used at the balance sheet date (see Note 19). The valuation of this deferred revenue is based on a number of different estimation and sampling methods using external specialist resource as appropriate.

The majority of this balance is made up of stamps sold to the general public. For sales to the general public, estimates of stamp volumes held are made on the basis of monthly surveys performed by an independent third party. In order to avoid over-estimation of the typical number of stamps held, Management applies a cap to the results to exclude what are considered to be abnormal stamp holdings from the estimate. The level at which holdings are capped is judgemental and is currently set at 99 of each stamp type per household. The impact of applying alternative capping values on the year end public stamp deferred revenue balance is shown in the table below.

	Capped			Uncapped
At 27 March 2016	**30**	**As reported 99**	**300**	
Public stamp holdings value (£m)	157	195	218	226

The value of stamps and meter credits held by retail and business customers are more directly estimated through the analysis of sales volumes and monthly meter sampling. Further adjustments are also made for each type of sale to take into account volume purchasing of stamps when price changes are announced.

The results of the above procedures are reviewed by Management in order to make a judgement of the carrying amount of the accrual. The total accrual is held within current trade and other payables but a portion (which cannot be measured) will relate to stamps and meter credits used one year or more after the balance sheet date.

Significant accounting policies (continued)

Provisions
Due to the nature of provisions, a significant part of their determination is based upon estimates and/or judgements concerning the future. Of the provisions in place, the transformation costs and industrial diseases claims provisions are considered to be the areas where the application of judgement has the most significant impact.

Transformation costs provisions relating to redundancy and project costs, are derived based upon the most recent business plans where these are sufficiently detailed and where appropriate, communication to those affected has been undertaken. These plans include the expected number of employees impacted and expected rate of compensation per employee.

The industrial diseases claims provision arose as a result of a Court of Appeal's judgement in 2010 and relates to individuals who were employed in the General Post Office Telecommunications division prior to October 1981. The provision requires estimates to be made of the likely volume and cost of future claims and is based on the best information available as at the year end, which incorporates independent expert actuarial advice.

Onerous property provisions require an estimate of the period for which the property is likely to remain vacant and any expected decommissioning costs. The carrying values of all provisions are included within Note 22.

Deferred tax
Assessment of the deferred tax asset requires an estimation of future profitability. Such estimation is inherently uncertain in a market subject to various competitive pressures. Should estimates of future profitability change in future years, the amount of deferred tax recognised will also change accordingly. Prior to recording deferred tax assets for tax losses, relevant tax law is considered to determine the availability of the losses to offset against the future taxable profits. The carrying values of the deferred tax assets and liabilities are included within Note 7.

Revenue
Revenue recognised in the income statement is net of value added tax and comprises turnover which principally relates to the rendering of services as follows:

UK Parcels, International & Letters
Account revenue is derived from specific contracts and recognised when the delivery of an item is complete. Contracted services that have not yet been rendered at the balance sheet date are designated as deferred income.

Revenue from direct sales of products or services is recognised when services are rendered, goods are delivered and the amount of revenue that will flow to the Group can be measured reliably. Where payments are received for a service to be provided over a specified length of time, payments received are recognised as deferred revenue and released to the income statement over the period that the service is performed.

Revenue derived from Network Access agreements is recognised when the delivery of the related items is complete. Where products are sold through third party agents, the revenue receivable is recognised gross with any commission payments being charged to operating costs.

Revenue relating to public, retail and business stamp and meter sales is recognised when the sale is made, adjusted to reflect a value of stamp and meter credits held but not used by the customer. Further details on this 'deferred revenue' adjustment are provided in the 'Key sources of estimation uncertainty and critical accounting judgements' section above.

General Logistics Systems
Revenue is derived from specific contracts and is recognised when the delivery of an item is complete.

People costs
These are costs incurred in respect of the Group's employees and comprise wages and salaries, pensions and social security costs.

Distribution and conveyance costs
Distribution and conveyance costs relate to non-people costs incurred in transporting and delivering mail. These include conveyance by rail, road, sea and air, together with costs incurred by international mail carriers and Parcelforce Worldwide delivery operators and GLS. These costs are disclosed separately on the face of the income statement.

Infrastructure costs
These are costs primarily relating to the day-to-day operation of the delivery network and include depreciation/amortisation, IT and property facilities management costs.

Share-based payments
The Group operates a number of equity settled, share-based compensation schemes under which the Group receives services from employees as consideration for equity instruments (shares) of the Company. These include the tax-advantaged (Employee Free Shares) Share Incentive Plan (SIP) and the Save As You Earn (SAYE) scheme. Both schemes are based on non-market conditions and do not vest until the employee completes a specific period of service. Share-based payments awarded as part of Long-Term Incentive Plans (LTIP) vest based on a combination of non-market and market conditions. The fair value of the employee services received in exchange for the grant of the shares is recognised as an expense in the income statement, with a corresponding credit entry in equity, as per the requirements of IFRS 2 'Share-based Payment'. The total amount expensed is determined by reference to the fair value of the equity instruments at the date on which they are granted. The fair value of each award is measured using the Black-Scholes share option pricing model where appropriate.

Significant accounting policies (continued)

The total expense is recognised over the vesting period, which is the period over which all of the specified vesting conditions are to be satisfied. No expense is recognised for awards that do not ultimately vest. At each balance sheet date before vesting, the cumulative expense is calculated, representing the extent to which the vesting period has expired and Management's best estimate of the achievement or otherwise of service conditions and of the number of equity instruments that will ultimately vest. The movement in cumulative expense since the previous balance sheet date is recognised in the income statement, with a corresponding entry in equity. The social security contributions payable in connection with the grant of Shares is considered an integral part of the grant itself, and the charge is treated as a cash-settled transaction.

Non-GAAP measures of performance
In the reporting of financial information, the Group uses certain measures that are not defined under IFRS, the Generally Accepted Accounting Principles (GAAP) under which the Group reports. Management believe that these non-GAAP measures assist with the understanding of the performance of the business.

These non-GAAP measures are not a substitute, or superior to, any IFRS measures of performance but they have been included as Management consider them to be an important means of comparing performance year-on-year and they include key measures used within the business for assessing performance.

Transformation costs
These costs relate to the ongoing transformation of the business, and include voluntary redundancy, project costs and other transformation-related payments.

Reported operating profit before transformation costs
This is the operating profit including the 'pension charge to cash difference' operating specific item (see below for definition) and before transformation costs.

Reported operating profit after transformation costs
This is the operating profit including the 'pension charge to cash difference' operating specific item and after transformation costs.

Operating specific items
These are recurring or non-recurring items of income or expense of a particular size and/or nature relating to the operations of the business that in the Directors' opinion require separate identification. These items are included within 'reported' results but are excluded from 'adjusted' results.

These items include: the recurring 'pension charge to cash difference' (resulting from the increasing difference between the Group's income statement pension charge and the actual cash cost of pensions, including deficit payments); and other items that have resulted from events that are non-recurring in nature, even though related income/expense can be recognised in subsequent periods. These items currently include the charge for Employee Free Shares, legacy costs (for example, movements in the industrial diseases provision) and impairments.

Non-operating specific items
These are recurring or non-recurring items of income or expense of a particular size and/or nature which do not form part of the Group's trading activity and which in the Directors' opinion require separate identification. These items include profit on disposal of property, plant and equipment and businesses, the IAS 19 non-cash pension interest credit, and profit on disposal of discontinued operations.

Adjusted operating profit before transformation costs
This is operating profit excluding the 'pension charge to cash difference' operating specific item and before transformation costs. This is a key performance indicator in the Corporate Balanced Scorecard which is used to determine employee incentives.

Adjusted operating profit margin before transformation costs
This is operating profit excluding the 'pension charge to cash difference' operating specific item and before transformation costs, expressed as a percentage of revenue.

Adjusted operating profit after transformation costs
This is operating profit excluding the 'pension charge to cash difference' operating specific item and after transformation costs.

Adjusted operating profit margin after transformation costs
This is operating profit excluding the 'pension charge to cash difference' operating specific item and after transformation costs, expressed as a percentage of revenue.

Adjusted earnings per share
Basic earnings per share, excluding operating and non-operating specific items.

Free cash flow
Free cash flow is based on statutory (reported) net cash flow before financing activities, adjusted to include finance costs paid and exclude net cash generated from the purchase/sale of financial asset investments.

Significant accounting policies (continued)

Net debt
Net debt is calculated by netting the value of financial liabilities (excluding derivatives) against cash and other liquid assets.

Income tax and deferred tax
The charge for current tax is based on the results for the reporting year, adjusted for items that are non-assessable or disallowed. It is calculated using rates that have been substantively enacted at the balance sheet date.

Deferred income tax assets and liabilities are recognised for all taxable and deductible temporary differences and unused tax assets and losses except:

- Initial recognition of goodwill;
- The initial recognition of an asset or liability in a transaction that is not a business combination and, at the time of the transaction, affects neither the accounting profit nor taxable profit and loss;
- Taxable temporary differences associated with investments in subsidiaries, associates and interest in joint ventures, where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future; and
- Deferred tax assets are recognised only to the extent that it is probable that taxable profit will be available against which they can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and increased or reduced to the extent that it is probable that sufficient taxable profit will be available to allow them to be utilised.

Deferred tax assets and liabilities are measured at the tax rates that are expected to apply to the period when the tax asset is realised or the liability is settled, based on tax rates (and tax laws) that have been substantively enacted at the balance sheet date. Deferred tax balances are not discounted.

Current and deferred tax is charged or credited directly to equity if it relates to items that are credited or charged directly to equity, otherwise it is recognised in the income statement.

Earnings per share (EPS)
Basic EPS from continuing operations is calculated by dividing the profit from continuing operations (adjusted for non-controlling interests' share of profit) by the weighted average number of ordinary shares in issue. The Group EPS is calculated in the same way, except that it also includes profit or loss from discontinued operations.

Diluted EPS is calculated by adjusting the weighted average number of ordinary shares in issue on the assumption of conversion of all potentially dilutive ordinary shares arising from share-based payment schemes. These potential shares are treated as dilutive only when their conversion to ordinary shares would decrease EPS from continuing operations.

Segment information
The Group's operating segments are organised and managed separately according to the nature of the products and services provided, with each segment representing a business unit that offers different products and serves largely different markets. The Board (Chief Operating Decision Maker as defined by IFRS 8) monitors the operating results of its main business units separately for the purpose of making decisions about resource allocation and performance assessment. Segment performance is evaluated based on adjusted operating profit before transformation costs.

There is no aggregation of operating segments. The business units that make up the three operating segments are included in Note 2.

The operating segments comprise operations in both the UK and other parts of Europe, the latter being relevant to the GLS business unit.

The UK operations comprise the UKPIL business unit plus the Other operating segment.

Segment revenues have been attributed to the respective countries based on the primary location of the service performed.

Transfer prices between segments are set at arm's length/fair value on a basis of charges reached through negotiation with the respective business units that form part of the segments.

There are no differences in the measurement of the respective segments' profit/loss and the consolidated financial statements prepared under IFRS.

Significant accounting policies (continued)

Property, plant and equipment
Property, plant and equipment is recognised at cost, including directly attributable costs in bringing the asset into working condition for its intended use. Depreciation of property, plant and equipment is provided on a straight-line basis by reference to cost, the useful economic lives of assets and their estimated residual values. The useful lives and residual values are reviewed annually and adjustments, where applicable, are made on a prospective basis. The lives assigned to major categories of property, plant and equipment are:

Land and buildings:	
Freehold land	Not depreciated
Freehold buildings	Up to 50 years
Leasehold buildings	The shorter of the period of the lease, 50 years or the estimated remaining useful life
Plant and machinery	3-15 years
Motor vehicles and trailers	2-12 years
Fixtures and equipment	2-15 years

An item of property, plant and equipment is derecognised upon disposal or when no future economic benefits are expected from its use or disposal. Any gain or loss arising at de-recognition of the asset (calculated as the difference between the net disposal proceeds and the carrying amount of the asset) is included in the income statement in the year that the asset is de-recognised. Gains or losses from the disposal of assets are recognised in the income statement when all significant risks and rewards of ownership are transferred to the customer.

All subsequent expenditure on property, plant and equipment is capitalised if it meets the recognition criteria, and the carrying amount of those parts replaced is de-recognised where appropriate. All other expenditure, including repairs and maintenance expenditure, is recognised in the income statement as incurred.

Goodwill
Business combinations on or after 29 March 2004 are accounted for under IFRS 3 'Business Combinations' using the purchase method. Any excess of the cost of the business combination over the Group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities at the date of acquisition is recognised in the balance sheet as goodwill and is not amortised.

After initial recognition, goodwill is stated at cost less any accumulated impairment losses. Goodwill arising from business combinations is reviewed for impairment annually or more frequently if events or changes in circumstances indicate that the carrying value may be impaired. For the purpose of such impairment reviews, goodwill is allocated to the relevant cash generating units.

An impairment loss is recognised in the income statement for the amount by which the carrying value of the goodwill (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Goodwill arising on the acquisition of equity-accounted entities is included in the cost of those entities and therefore not reported in the balance sheet as goodwill.

Intangible assets
Intangible assets acquired as part of a business combination are capitalised separately from goodwill if the fair value can be measured reliably on initial recognition. Intangible assets acquired separately or development costs that meet the criteria to be capitalised are initially recognised at cost and are assessed to have either a finite or indefinite useful life. Those with a finite life are amortised over their useful life and those with an indefinite life are reviewed for impairment annually or more frequently if events, or changes in circumstances, indicate that the carrying value may be impaired. An impairment loss is recognised in the income statement for the amount by which the carrying value of the intangible asset exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Amortisation of intangible assets with finite lives is charged annually to the income statement on a straight-line basis as follows:

Customer listings	3 to 4 years
Master franchise licences	7 to 10 years
Software	3 to 10 years

Investment in associates
The Group's investment in its associate companies is accounted for under the equity method of accounting. Under this method, the investment is carried in the balance sheet at cost plus post-acquisition changes in the Group's share of the net assets of the associates, less any impairment in value. The income statement reflects the Group's share of annual post-tax profits from the associates (netted off other operating costs as the values are not material enough for separate disclosure).

Any goodwill arising on acquisition of an associate, representing the excess of the cost of the investment compared to the Group's share of the net fair value of the identifiable assets, liabilities and contingent liabilities acquired, is included in the carrying amount and not amortised.

Significant accounting policies (continued)

Non-current assets held for sale and discontinued operations
Non-current assets classified as held for sale are measured at the lower of their carrying amount and fair value less costs to sell.

Non-current assets are classified as held for sale if their carrying amounts will be recovered principally through a sale transaction, rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification. Following their classification as held for sale, the assets (including those in a disposal group) cease being depreciated.

A discontinued operation is a component of the Group's business that represents a separate major line of business or geographical area of operations, that has been disposed of, or that meets the criteria to be classified as held for sale. Discontinued operations are presented in the consolidated statement of comprehensive income as a single line which comprises the post-tax profit or loss of the discontinued operation up to the date of disposal, and the post-tax gain or loss recognised on any remeasurement of the disposal group to fair value less costs to sell, or on disposal of the assets or disposal groups constituting discontinued operations.

Impairment reviews
Unless otherwise disclosed in these accounting policies, assets and cash generating units are reviewed for impairment if events or changes in circumstances indicate that the carrying value may be impaired. The Group assesses at each reporting date whether such indications exist. Where appropriate, an impairment loss is recognised in the income statement for the amount by which the carrying value of the asset (or cash generating unit) exceeds its recoverable amount, which is the higher of an asset's net realisable value and its value in use.

Leases
Finance leases, where substantially all the risks and rewards incidental to ownership of the leased item have passed to the Group, are capitalised at the inception of the lease with a corresponding liability recognised for the fair value of the leased item or, if lower, at the present value of the minimum lease payments. Lease payments are apportioned between the finance charges and capital element of the lease liability to achieve a constant rate of interest on the remaining balance of the liability. Capitalised leased assets are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Leases where substantially all the risks and rewards of ownership of the asset are retained by the lessor, are classified as operating leases and rentals are charged to the income statement over the lease term. The aggregate benefit of incentives is recognised as a reduction of rental expense over the lease term on a straight-line basis.

A leasehold land payment is an upfront payment to acquire a long-term leasehold interest in land. This payment is stated at cost and is amortised on a straight-line basis over the period of the lease.

In addition to lease contracts, other significant arrangements or contracts are assessed (by reference to IFRIC 4) to determine whether, in substance, they are, or contain, a lease. This assessment is based on the substance of the arrangement at inception date, including whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets or the arrangement conveys a right to use the asset.

Trade receivables
Trade receivables are recognised and carried at the original invoice amount less an allowance for any non-collectable amounts. An estimate for doubtful debts is made when collection of the full amount is no longer probable with the amount of the loss recognised in the income statement within operating costs. When a bad debt is recognised, it is written off against the allowance for trade receivables. Subsequent recoveries of amounts previously written off are credited against operating costs in the income statement.

Inventories
Inventories are valued on a weighted average cost basis and carried at the lower of cost and net realisable value. Cost includes all direct expenditure and other costs attributable in bringing inventories to their present location and condition. The principal stock balance consists of engineering spare parts.

Trade payables
Trade payables are recorded initially at fair value and subsequently measured at amortised cost. Generally this results in their recognition at their nominal value.

Financial instruments
Financial assets within the scope of IAS 39 'Financial Instruments: Recognition and Measurement' are classified as: financial assets at fair value through profit and loss (FVTPL) if they are not part of an effective hedge designation (held for trading); held to maturity investments; loans and receivables or available for sale financial assets as appropriate. Financial liabilities within the scope of IAS 39 are classified as either financial liabilities at FVTPL or financial liabilities measured at amortised cost.

The Group determines the classification of its financial instruments at initial recognition and re-evaluates this designation at each reporting date. When financial instruments are recognised initially, they are measured at fair value, being the transaction price plus, in the case of financial instruments not at FVTPL, any directly attributable transactional costs. The Group only has loans and receivables, financial liabilities measured at cost and derivative assets and liabilities measured at FVTPL if they are not part of an effective hedge designation.

Significant accounting policies (continued)

The subsequent measurement of financial instruments depends on their classification as follows:

Loans and receivables
Non-derivative financial assets with fixed or determinable payments, that are not quoted on an active market, do not qualify as trading assets and have not been designated as either at FVTPL or available for sale, are carried at amortised cost using the effective interest rate method if the time value of money is significant. Gains and losses are recognised in the income statement when the loans and receivables are derecognised or impaired, as well as through the amortisation process.

Financial liabilities measured at amortised cost
All non-derivative financial liabilities are classified as financial liabilities measured at amortised cost. Non-derivative financial liabilities are initially recognised at the fair value of the consideration received, less directly attributable issue costs. After initial recognition, non-derivative financial liabilities are subsequently measured at amortised cost using the effective interest method. Gains and losses are recognised in the income statement when the liabilities are derecognised or impaired, as well as through the amortisation process.

Cash and cash equivalents
Cash and cash equivalents in the balance sheet comprise cash at bank and in hand and short-term deposits (cash equivalents) with an original maturity date of three months or less. In addition, the Group uses money market funds as a readily available source of cash, and these funds are also categorised as cash equivalents. For the purpose of the statement of cash flows, cash and cash equivalents consist of cash and cash equivalents as defined above, net of bank overdrafts. Cash equivalents are classified as loans and receivables financial instruments.

Financial assets – pension escrow investments
Financial assets – pension escrow investments comprise a money market fund investment established to provide security to the Royal Mail Senior Executive Pension Plan (RMSEPP) in support of a deficit recovery plan agreed with the Trustee in 2013.

Financial assets – other investments
Financial assets – other investments comprise short-term deposits (other investments) with local government or banks with an original maturity of three months or more. Short-term deposits are classified as loans and receivables financial instruments.

Financial liabilities – interest-bearing loans and borrowings
All loans and borrowings are classified as financial liabilities measured at amortised cost. The €500 million bond is measured at amortised cost in Euro and converted to Sterling at the closing spot Sterling/Euro exchange rate.

Financial liabilities – obligations under finance leases
All obligations under finance leases are classified as financial liabilities measured at amortised cost. The Euro denominated finance lease payables is measured at amortised cost in Euro and converted to Sterling at the closing Sterling/Euro exchange rate.

Derivative financial instruments and hedging programmes
The Group uses derivative instruments such as foreign currency contracts in order to manage the risk profile of any underlying risk exposure of the Group, in line with the Group's treasury management policies. Such derivative financial instruments are initially stated at fair value. For the purpose of hedge accounting, hedges are classified as cash flow hedges where they hedge exposure to variability in cash flows that is attributable either to a particular risk associated with a recognised asset or liability, or to a highly probable forecast transaction.

In relation to cash flow hedges to hedge the interest rate, foreign exchange or commodity price risk of firm commitments that meet the conditions for hedge accounting, the portion of the gain or loss on the hedging instrument that is determined to relate to an effective hedge is recognised directly in equity and the ineffective portion is recognised in the income statement.

When the hedged firm commitment results in the recognition of a non-financial asset or non-financial liability, then at the time the asset or liability is recognised, the associated gains or losses that had previously been recognised in equity are included in the initial measurement of the acquisition cost or other carrying amount of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in equity are transferred to the income statement in the same reporting year in which the hedged firm commitment affects the net profit/loss, for example when the hedged transaction actually occurs.

For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the income statement in the year.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised, or no longer qualifies for hedge accounting. At that point, any cumulative gain or loss on the hedging instrument recognised in equity is kept in equity until the forecast transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement for the reporting year.

Significant accounting policies (continued)

Fair value measurement of financial instruments
All assets and liabilities for which fair value is measured or disclosed in the financial statements are categorised within the fair value hierarchy, described as follows, based on the lowest level input that is significant to the fair value measurement as a whole:

Level 1 – Quoted (unadjusted) market prices in active markets for identical assets or liabilities

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e. as prices) or indirectly (i.e. derived from prices).

Level 3 - Inputs for the asset or liability that are not based on observable market data (unobservable inputs).

The fair value of quoted investments is determined by reference to bid prices at the close of business on the balance sheet date.

Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions; reference to the current market value of another instrument which is substantially the same; and discounted cash flow analysis and pricing models. Specifically, in the absence of quoted market prices, derivatives are valued by using quoted forward prices for the underlying commodity/currency and discounted using quoted interest rates (both as at the close of business on the balance sheet date). Hence derivative assets and liabilities are within Level 2 of the fair value hierarchy as defined within IFRS 13.

The Group determines whether any transfers have occurred between levels in the hierarchy by reassessing categorisation at the end of each reporting year. For the purposes of disclosing the fair value of investments held at amortised cost in the balance sheet, in the absence of quoted market prices, fair values are calculated by discounting the future cash flows of the financial instrument using quoted equivalent interest rates as at close of business on the balance sheet date. For the €500 million bond, the disclosed fair value is calculated as the closing market bond price converted to Sterling using the closing spot Sterling/Euro exchange rate.

Borrowing costs
Interest on borrowings related to the construction or development of qualifying assets is capitalised, until such time as the assets are substantially ready for their intended use.

Provisions
Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation. If the effect of the time value of money is material, provisions are determined by discounting the expected future cash flows at an appropriate pre-tax rate. Accounting estimates used in calculating the provisions are discussed further in the 'Key sources of estimation uncertainty and critical accounting judgements' part of this accounting policies section.

Contingent liabilities
Contingent liabilities are possible obligations whose existence depends on the outcome of uncertain future events or present obligations where the outflows of resources are uncertain or cannot be measured reliably. Contingent liabilities are not recognised in the financial statements but are disclosed unless an outflow of resources is considered to be remote.

Dividends
Distributions to owners of the Company are not recognised in the income statement under IFRS, but are disclosed as a component of the movement in shareholders' equity. A liability is recorded for a dividend when the dividend is approved by the Company's shareholders but not paid at the year end. Interim dividends are recognised as a distribution when paid.

Pensions and other post-retirement benefits
The pension assets for the defined benefit plans are measured at fair value. Liabilities are measured on an actuarial basis using the projected unit credit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term. The resulting defined benefit asset or liability is presented separately on the face of the balance sheet. The amount of any pension surplus that can be recognised is limited to the economic benefits unconditionally available in the form of refunds or reductions in future contributions. Where the economic benefit to be obtained is in the form of a refund, this is recognised net of taxation withheld in line with IFRIC 14.

Full actuarial valuations are carried out at intervals not normally exceeding three years as determined by the Trustees and, with appropriate updates and accounting adjustments at each balance sheet date, form the basis of the surplus disclosed. All active members of defined benefit plans are contracted out of the earnings-related part of the State Second pension scheme.

For defined benefit plans, the amounts charged to operating profit are the current service costs and any gains and losses arising from settlements, curtailments and past service costs. The amount resulting from applying the Plan's discount rate (for liabilities) to the pension surplus at the beginning of the reporting year is recognised as net pension interest in the income statement. Remeasurement gains and losses are recognised immediately in the statement of comprehensive income. Any deferred tax movement associated with the remeasurement gains and losses is also recognised immediately in the statement of comprehensive income.

For defined contribution plans, the Group's contributions are charged to operating profit within People costs in the year to which the contributions relate. Overseas subsidiaries make separate arrangements for the provision of pensions and other post-retirement benefits.

Significant accounting policies (continued)

Foreign currencies
The functional and presentational currency of Royal Mail plc is Sterling (£). The functional currency of the overseas subsidiaries in Europe is mainly the Euro (€).

The assets and liabilities of foreign operations are translated at the rate of exchange ruling at the balance sheet date. The trading results of foreign operations are translated at the average rates of exchange for the reporting year, being a reasonable approximation to the actual transaction rate. The exchange rate differences arising on the translation, since the date of transition to IFRS, are taken directly to the foreign currency translation reserve in equity.

Foreign currency exchange differences arising from translation of the €500 million bond and the Euro denominated finance leases (designated as hedges of the net investment in GLS) to closing Sterling/Euro exchange rates are deferred to the foreign currency translation reserve in equity. These exchange differences would be released from equity to the income statement as part of the gain or loss if GLS was sold.

Transactions in foreign currencies are initially recorded in the functional currency by applying the spot exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. Currently hedge accounting is not claimed for any monetary assets and liabilities. All differences are therefore taken to the income statement, except for differences on monetary assets and liabilities that form part of the Group's net investment in a foreign operation. These are taken directly to equity until the disposal of the net investment occurs, at which time they are recognised in profit or loss.

Non-monetary items that are measured in terms of their historic cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions. Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value is determined.

Accounting standards issued but not yet applied
The following new and amended/revised accounting standards are relevant to the Group and are in issue but were not effective (and in some instances have not yet been adopted by the EU) at the balance sheet date:

IAS 1 (Amended) Improving the Effectiveness of Disclosure in Financial Reporting

IAS 7 (Amended) Disclosure Initiative*

IAS 12 (Amended) Recognition of Deferred Tax Assets for Unrealised Losses*

IAS 16 (Amended) and IAS 38 (Amended) Acceptable Methods of Depreciation and Amortisation

IAS 27 (Amended) Equity Method in Separate Financial Statements

IFRS 9 Financial Instruments*

IFRS 10 (Amended) and IAS 28 (Amended) Sale of Assets between an Investor and its Associate or Joint Venture*

IFRS 11 (Amended) Accounting for Acquisitions of Interests in Joint Operations

IFRS 15 Revenue from Contracts with Customers*

IFRS 16 Leases*

Annual Improvements 2012-2014

* Not yet endorsed by the EU

Of the accounting standards listed above, the following are considered of particular relevance to the Group.

IFRS 9 'Financial Instruments'
This standard was issued in July 2014 and is a replacement of IAS 39 'Financial Instruments: Recognition and Measurement'. The standard is effective for accounting periods beginning on or after 1 January 2018 with early adoption permitted. The standard will affect the classification, measurement and derecognition of the Group's financial assets and liabilities and provides a new credit loss model for calculating impairment. IFRS 9 also introduces a new hedge accounting model. The changes to the measurement of financial instruments and the new hedge accounting rules are not currently considered likely to have a major impact on the Group's financial performance or position.

IFRS 15 'Revenue from Contracts with Customers'
This standard was issued in May 2014 and replaces IAS 18 'Revenue', IAS 11 'Construction Contracts' and related interpretations. The standard is effective for accounting periods beginning on or after 1 January 2018 with early adoption permitted. The standard introduces a single, five-step revenue recognition model that is based upon the principle that revenue is recognised at the point that control of goods or services is transferred to the customer. The standard also updates revenue disclosure requirements. Whilst an assessment of this new standard is ongoing, the Group does not expect its adoption to have a material impact on the Group's financial performance or position.

Significant accounting policies (continued)

IFRS 16 'Leases'
This standard was issued in January 2016 and replaces IAS 17 'Leases'. The standard is effective for accounting periods beginning on or after 1 January 2019 with early adoption permitted where IFRS 15 has also been adopted. The standard will bring the majority of leases previously classed as operating leases onto the balance sheet with a corresponding lease liability also recognised with some exemptions for small value or short leases. The Group is currently assessing the impact of IFRS 16 on the financial performance and position of the Group, however, it is expected that the adoption of the standard will result in a material increase in property, plant and equipment and corresponding lease liability balances; a decrease in operating costs; and an increase in finance costs. The classification of related cash flows will also change.

Currently, the Group does not expect to early adopt any of these standards.

The Directors do not expect that the adoption of the remaining standards listed above will have a material impact on the financial performance or position of the Group in future periods.