

Notes on the Group financial statements

F: Income statement notes

F1: Segmental information

The Group's primary and secondary segments are described in detail in note B6.

Primary segment information

The segment results for the years ended 31 December 2008 and 2007 are as follows:

	2008 £m	2007 £m
Revenue		
Insurance operations	(10,798)	31,555
Asset management	664	1,397
Unallocated corporate	157	186
Intra group revenue eliminated on consolidation	(290)	(268)
Total revenue, net of reinsurance, per income statement^{note i}	(10,267)	32,870
Analysed as:		
Investment returns ^{note iii}	(30,202)	12,225
Other items	19,935	20,645
	(10,267)	32,870
Charges (before income tax attributable to policyholders and unallocated surplus of long-term insurance funds)		
Insurance operations, including post-tax transfers from (to) unallocated surplus of with-profits funds	8,980	(30,533)
Asset management	(524)	(1,053)
Unallocated corporate	(553)	(494)
Intra group charges eliminated on consolidation	290	268
Total charges, net of reinsurance, per income statement^{note i}	8,193	(31,812)
Segment results – revenue less charges (continuing operations)		
Insurance operations	(1,818)	1,022
Asset management	140	344
Unallocated corporate	(396)	(308)
(Loss) profit before tax (<i>being tax attributable to shareholders' and policyholders' returns</i>) ^{note ii}	(2,074)	1,058
Tax attributable to policyholders' returns	1,624	5
(Loss) profit before tax attributable to shareholders ^{B1}	(450)	1,063
Tax attributable to shareholders' (loss) profit	59	(354)
(Loss) profit from continuing operations after tax	(391)	709
Segment results – discontinued operations		
Banking ¹⁹	–	241
(Loss) profit for the year	(391)	950

Notes

- i Total revenue for 2008 is negative £10,267 million whilst charges are a credit of £8,193 million. These abnormal effects arise from the basis of preparation whereby revenue includes investment appreciation, which is negative in 2008, and charges reflect the allocation, where appropriate, of investment return to policyholder benefits.
- ii The measure is the formal (loss) profit before tax measure under IFRS but is not the result attributable to shareholders.
- iii Investment return principally comprises
- Interest and dividends;
 - Realised and unrealised gains and losses on securities and derivatives classified as fair value through profit and loss under IAS 39; and
 - Realised gains and losses, including impairment losses, on securities classified as available-for-sale under IAS 39.

In its capacity as fund manager to fellow Prudential plc subsidiaries, M&G earns fees for asset management and related services. These services are charged at appropriate arm's length prices, typically priced as a percentage of funds under management.

Total charges include a credit of £25,419 million (2007: charge of £11,295 million) for non-cash expenses other than depreciation and amortisation mainly due to the impact of negative market returns experienced during the year on benefit claims and movement in unallocated surplus of with-profits funds.

Secondary segment information

Although the Company is UK registered, the Group manages its business on a global basis. The operations are based in three main geographical areas: UK, US and Asia.

	2008 £m	2007 £m
Revenue		
UK	(12,213)	17,890
US	915	8,271
Asia	1,321	6,977
Intra group revenue	(290)	(268)
Total revenue per income statement	(10,267)	32,870

F2: Revenue

	2008 £m	2007 £m
Long-term business premiums		
Insurance contract premiums	17,573	17,308
Investment contracts with discretionary participation feature premiums	964	874
Inwards reinsurance premiums	454	177
Less: reinsurance premiums ceded	(202)	(171)
Earned premiums, net of reinsurance	18,789	18,188
Realised and unrealised gains and losses on securities at fair value through profit and loss	(34,157)	2,634
Realised and unrealised gains and losses on derivatives at fair value through profit and loss	(5,261)	270
Realised gains and losses on available-for-sale securities, previously recognised directly in equity	(487)	13
Realised gains and losses on loans	210	47
Interest ^{note i}	6,739	5,857
Dividends	2,023	2,730
Other investment income	731	674
Investment income	(30,202)	12,225
Fee income from investment contract business and asset management ^{note ii}	1,109	1,039
Income from venture investments of the PAC with-profits funds ^{note iii}	37	1,418
Other income	1,146	2,457
Total revenue	(10,267)	32,870

Notes

- i Interest income includes £11 million (2007: £2 million) accrued in respect of impaired securities.
- ii Fee income includes £7 million (2007: £31 million) relating to financial instruments that are not held at fair value through profit and loss. These fees primarily related to prepayment fees, late fees and syndication fees.
- iii In November 2007 the Group sold PPM Capital and as a result the Group no longer controls venture fund investments managed by the sold entity and consequently has ceased to consolidate these operations from that date.

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F3: Acquisition costs and other operating expenditure

	2008 £m	2007 £m
Acquisition costs ^{notes i,ii}	1,185	1,030
Staff and pension costs ⁱⁱ	913	1,402
Administrative and operating costs ^{note iv}	361	2,427
Total acquisition costs and other operating expenditure ^{notes iii,iv}	2,459	4,859

Notes

- i Acquisition costs in 2008 comprise amounts related to insurance contracts of £1,048 million (2007: £939 million), and investment contracts and asset management contracts of £137 million (2007: £91 million). These costs include amortisation of £520 million (2007: £410 million) and £15 million (2007: £3 million) respectively.
- ii Acquisition costs also include fee expenses relating to financial liabilities held at amortised costs of £nil (2007: £1 million).
- iii The total depreciation and amortisation expense is £618 million (2007: £523 million). Of this amount, £535 million (2007: £413 million) relates to amortisation of deferred acquisition costs of insurance contracts and asset management contracts, which is primarily borne by the long-term business segment. Of the remainder of the depreciation and amortisation charge of £83 million (2007: £110 million), £57 million (2007: £98 million) relates to long-term business, £10 million (2007: £8 million) to asset management and £16 million (2007: £4 million) to other operations.
- iv In November 2007, the Group sold PPM Capital and as a result, the Group no longer controls venture fund investments managed by the sold entity and consequently has ceased to consolidate these operations from that date with this resulting in a reduction of associated operating expenditure.

F4: Finance costs: Interest on core structural borrowings of shareholder-financed operations

Finance costs consist of £161 million (2007: £158 million) interest on core debt of central companies and £11 million (2007: £10 million) on US operations' surplus notes.

F5: Tax

a Total tax credit (charge) by nature of expense

An analysis of the total tax benefit (expense) of continuing operations recognised in the income statement by nature of benefit (expense) is as follows:

	2008 £m	2007 £m
Current tax benefit (expense):		
Corporation tax	(225)	(806)
Adjustments in respect of prior years	359	185
Total current tax	134	(621)
Deferred tax arising from:		
Origination and reversal of temporary differences	1,629	222
(Expense) benefit in respect of a previously unrecognised tax loss, tax credit or temporary difference from a prior period	(77)	50
Write down or reversal of a previous write down of a deferred tax asset	(3)	–
Total deferred tax credit	1,549	272
Total tax credit (charge)	1,683	(349)

The total tax benefit (expense) arises as follows:

	2008 £m	2007 £m
Current tax benefit (expense):		
UK	280	(377)
Foreign	(146)	(244)
	134	(621)
Deferred tax credit:		
UK	1,478	349
Foreign	71	(77)
	1,549	272
Total	1,683	(349)

The total tax credit of £1,683 million for 2008 (2007: charge of £349 million) comprises a credit of £1,758 million (2007: charge of £28 million) for UK tax and a charge of £75 million (2007: £321 million) for overseas tax. This tax credit comprises tax attributable to policyholders and unallocated surplus of with-profits funds, unit-linked policies and shareholders. The tax credit attributable to shareholders of £59 million for 2008 (2007: charge of £354 million) comprises a credit of £95 million (2007: charge of £148 million) for UK tax and a charge of £36 million (2007: £206 million) for overseas tax.

The prior year adjustments primarily relate to the settlement of issues with HM Revenue Customs (HMRC) at an amount below previously provided, the reduction in amounts previously provided on outstanding issues with HMRC and the routine revision of tax returns.

The total deferred tax credit (charge) arises as follows:

	2008 £m	2007 £m
Unrealised gains and losses on investments	1,521	225
Short-term timing differences	(29)	(10)
Capital allowances	2	4
Balances relating to investment and insurance contracts	(239)	41
Unused tax losses	294	12
Deferred tax credit (charge)	1,549	272

In April 2008 the standard corporation tax rate for the UK changed from 30% to 28%. Deferred tax at the end of 2007 for UK operations had been provided at the new rate of 28 per cent on the basis that materially all of the temporary differences are expected to reverse once the new rate took effect. The effect on the deferred tax assets and liabilities at 31 December 2007 was £20 million.

In 2008, a deferred tax credit of £637 million (2007: £54 million) has been taken directly to reserves. Other movements in deferred tax totalling a £21 million credit is mainly comprised of foreign exchange movements. When these amounts are taken with the deferred tax credit shown above the result is a decrease of £2.2 billion (or £2.1 billion taking into account the restated 2007 comparative deferred tax as a result of the interpretation of IFRIC 14) in the Group's net deferred tax liability (2007 decrease of £419 million).

The tax credit related to discontinued banking operations in 2007 which was all attributable to shareholders, amounted to £19 million.

b Reconciliation of effective tax rate

The total tax expense is attributable to shareholders and policyholders as summarised in the income statement.

i Summary of pre-tax (loss) profit and tax credit (charge)

The income statement includes the following items:

	2008 £m	2007 £m
(Loss) profit before tax	(2,074)	1,058
Tax attributable to policyholders' returns	1,624	5
(Loss) profit before tax attributable to shareholders	(450)	1,063
Tax attributable to shareholders' (losses) profits:		
Tax credit (charge)	1,683	(349)
Less: tax attributable to policyholders' returns	(1,624)	(5)
Tax attributable to shareholders' (losses) profits	59	(354)
(Loss) profit from continuing operations after tax	(391)	709

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F5: Tax continued

ii Overview

For the purposes of explaining the relationship between tax expense and accounting profit, it is appropriate to consider the sources of profit and tax by reference to those that are attributable to shareholders and policyholders, as follows:

	2008 £m			2007 £m		
	Attributable to shareholders	Attributable to policyholders*	Total	Attributable to shareholders	Attributable to policyholders*	Total
(Loss) profit before tax	(450)	(1,624)	(2,074)	1,063	(5)	1,058
Taxation charge:						
Expected tax rate	41%	100%	87%	31%	100%	30%
Expected tax charge	187	1,624	1,811	(327)	5	(322)
Variance from expected tax charge (note v(ii))	(128)	–	(128)	(27)	–	(27)
Actual tax credit (charge)	59	1,624	1,683	(354)	5	(349)
Average effective tax rate	13%	100%	81%	33%	100%	33%

* For the column entitled 'Attributable to policyholders', the profit before tax represents income, net of post-tax transfers to unallocated surplus of with-profits funds, before tax attributable to policyholders and unallocated surplus of with-profits funds and unit-linked policies.

Due to the requirements of the financial reporting standards IAS 1 and IAS 12, the profit before tax and tax charge reflect the aggregate of amounts that are attributable to shareholders and policyholders.

Profit before tax comprises profit attributable to shareholders and pre-tax profit attributable to policyholders of linked and with-profits funds and unallocated surplus of with-profits funds.

The total tax charge for linked and with-profits business includes tax expense on unit-linked and with-profits funds attributable to policyholders, the unallocated surplus of with-profits funds and the shareholders' profits. This feature arises from the basis of taxation applied to life and pension business, principally in the UK, but with similar bases applying in certain Asian operations, and is explained in note (iii) below.

Furthermore, the basis of preparation of Prudential's financial statements incorporates the additional feature that, as permitted under IFRS 4, the residual equity of the Group's with-profits funds, i.e. unallocated surplus, is recorded as a liability with transfers to and from that liability reflected in pre-tax profits. This gives rise to anomalous effective tax rates for profits attributable to policyholders (as described in note (iv) below).

In meeting the reconciliation requirements set out in paragraph 811 of IAS 12, the presentation shown in this disclosure note seeks to ensure that the explanation of the relationship between tax expense and accounting profit draw properly the distinction between the elements of the profit and tax charge that are attributable to policyholders and shareholders as explained below in notes (iv) and (v) respectively. Due to the nature of the basis of taxation of UK life and pension business (as described in note (iii) below), and the significance of the results of the business to the Group, it is inappropriate to seek to explain the effective tax rate on profit before tax by traditional approach that would apply for other industries.

The shareholder elements are the components of the profit and tax charge that are of most direct relevance to investors, and it is this aspect that the IAS 12 requirement is seeking to explain for companies that do not need to account for both with-profits and unit-linked funds, where tax is borne by the Company on the policyholders' behalf and which is not contemplated by IFRS requirement.

iii Basis of taxation for UK life and pension business

Different rules apply under UK tax law for taxing pension business and life insurance business and there are detailed rules for apportioning the investment return and profits of the fund between the types of business.

The investment return referable to pension business, and some other less significant classes of business, is exempt from taxation, but tax is charged on the profit that shareholders derive from writing such business at the corporate rate of tax. The rules for taxing life insurance business are more complex. Initially, the UK regime seeks to tax the regulatory basis investment return less management expenses (I-E) on this business as it arises. However, in determining the actual tax charge, a calculation of the shareholder profits for taxation purposes from writing life insurance business also has to be made and compared with the I-E profit.

If the shareholder profit is higher than the I-E amount, extra income is attributable to the I-E calculation until the I-E profit equals the shareholder profit. If on the other hand, the I-E profit is the greater, then an amount equal to the shareholder profit is taxed at the corporate rate of tax, with the remainder of the I-E profit being taxed at the lower policyholder rate of tax.

The purpose of this approach is to ensure that the Company is always as a minimum taxed on the profit, as defined for taxation purposes by reference to the Company's regulatory returns (rather than IFRS basis results), that it has earned. The shareholders' portion of the long-term business is taxed at the shareholders' rate, with the remaining portion taxed at rates applicable to the policyholders.

It is to be noted that the calculations described are determined using data from the regulatory basis returns rather than the IFRS basis results. The differences between the regulatory and accounting bases are very significant and extremely complex rendering any explanation in general purpose financial statements to be of little if any use to users.

iv Profits attributable to policyholders and related tax

As noted above, it is necessary under IFRS requirements to include the total tax charge of the Company (both policyholder and shareholder elements) in the tax charge disclosed in the income statement.

For with-profits business, total pre-tax profits reflect the aggregate of profits attributable to policyholders and shareholders. However, amounts attributable to the equity of with-profits funds are carried in the liability for unallocated surplus. Also, as described in note (iii), UK with-profits business is taxed on a basis that affects policyholders' unallocated surplus of with-profits funds and shareholders. For the PAC with-profits sub-fund, transfers to and from unallocated surplus are recorded in the income statement, so that after charging the total tax borne by the fund, the net balance reflects the statutory transfer from the fund for the year. The statutory transfer represents 10 per cent of the actuarially determined surplus for the year that is attributable to shareholders.

For SAIF similar transfers are made. However, in the case of SAIF, a net nil balance is derived, reflecting the lack of shareholder interest in the financial performance of the fund (other than through asset management arrangements).

The accounting anomaly that arises under IFRS is that due to the fact that the net of tax profit attributable to with-profits policyholders is zero, the Company's presentation of pre-tax profit attributable to policyholders reflects an amount that is the mirror image of the tax charge attributable to policyholders.

For unit-linked business, pre-tax profits also reflect the aggregate of profits attributable to policyholders and shareholders. The pre-tax profits attributable to policyholders represent fees earned that are used to pay tax borne by the Company on policyholders' behalf. The net of tax profit attributable to policyholders for unit-linked business is thus zero.

The combined effect of these features is such that providing a reconciliation of the tax charge attributable to policyholders to an expected charge based on the standard corporate rate of tax on IFRS basis profits attributable to policyholders is not relevant.

In summary, for accounting purposes, in all cases and for all reporting periods, the apparent effective rate for profit attributable to policyholders and unallocated surplus is 100 per cent. However, it is to be noted that the 100 per cent rate does not reflect a rate paid on the profits attributable to policyholders. It instead reflects the basis of accounting for unallocated surplus coupled with the distinction made for performance reporting between sources of profit attributable to shareholders, policyholders and unallocated surplus and IFRS requirements in respect of reporting of all pre-tax profits and all tax charges irrespective of policyholder or shareholder economic interest.

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F5: Tax continued

v Reconciliation of tax charge on profits attributable to shareholders

	2008 £m				Total
	Asian insurance operations	US insurance operations	UK insurance operations	Other operations	
Profit before tax attributable to shareholders:					
Operating profit based on longer-term investment returns ^{note iii}	295	406	535	111	1,347
Short-term fluctuations in investment returns	(200)	(1,058)	(212)	(313)	(1,783)
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	(3)	–	–	(11)	(14)
Total	92	(652)	323	(213)	(450)
Expected tax rate: ^{note i}					
Operating profit based on longer-term investment returns ^{note iii}	24%	35%	28%	23%	29%
Short-term fluctuations in investment returns	27%	35%	28%	28%	32%
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	25%	–	–	28%	27%
Expected tax credit (charge) based on expected tax rates:					
Operating profit based on longer-term investment returns ^{note iii}	(70)	(142)	(150)	(26)	(388)
Short-term fluctuations in investment returns	54	370	59	88	571
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	1	–	–	3	4
Total	(15)	228	(91)	65	187
Variance from expected tax charge: ^{note ii}					
Operating profit based on longer-term investment returns ^{note iii}	(35)	17	57	57	96
Short-term fluctuations in investment returns	(23)	(173)	(8)	(19)	(223)
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	–	–	–	(1)	(1)
Total	(58)	(156)	49	37	(128)
Actual tax credit (charge):					
Operating profit based on longer-term investment returns ^{note iii}	(105)	(125)	(93)	31	(292)
Short-term fluctuations in investment returns	31	197	51	69	348
Shareholders' share of actuarial gains and losses on defined benefit pension schemes	1	–	–	2	3
Total	(73)	72	(42)	102	59
Actual tax rate: Operating profit based on longer-term investment returns	36%	31%	17%	(28%)	22%
Total	79%	11%	13%	48%	13%

Notes

- i Expected tax rates for profit attributable to shareholders:
The expected tax rate for Other operations is lower than 2007. The tax rate of 23% reflects the mix of business between UK and overseas operations, which are taxed at a variety of rates. The rate will fluctuate from year to year dependent on the mix of profits between jurisdictions.
- ii For 2008, the principal variances arise from differences between the standard corporation tax rate and actual rates due to a number of factors, including:
 - a For Asian long-term operations, tax losses in several jurisdictions which are not expected to be available for relief against future profits, and losses on investments in jurisdictions which do not provide corresponding tax relief;
 - b For Jackson, the inability to fully recognise deferred tax assets on losses being carried forward which has partially been offset by the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;
 - c For UK insurance operations, prior year adjustments arising from the routine revisions of tax returns, the settlement of outstanding issues with HMRC at an amount below that previously provided and the different tax bases of UK life business; and
 - d For Other operations, the settlement of issues with HMRC at amounts below those previously provided and a reduction in amounts previously provided on outstanding issues with HMRC which has been partially offset by the inability to recognise a deferred tax asset on various tax losses.
- iii Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.

	2007 £m				Total
	Asian insurance operations	US insurance operations	UK insurance operations	Other operations	
Profit before tax attributable to shareholders:					
Operating profit based on longer-term investment returns ^{note iii}	174	444	521	62	1,201
Short-term fluctuations in investment returns	(71)	(18)	(47)	(1)	(137)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	–	–	–	(1)	(1)
Total	103	426	474	60	1,063
Expected tax rate: ^{note i}					
Operating profit based on longer-term investment returns ^{note iii}	21%	35%	30%	28%	30%
Short-term fluctuations in investment returns	25%	35%	30%	28%	28%
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	20%	35%	30%	28%	28%
Total	18%	35%	30%	28%	31%
Expected tax credit (charge) based on expected tax rates:					
Operating profit based on longer-term investment returns ^{note iii}	(37)	(155)	(156)	(17)	(365)
Short-term fluctuations in investment returns	18	6	14	–	38
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	–	–	–	–	–
Total	(19)	(149)	(142)	(17)	(327)
Variance from expected tax charge: ^{note ii}					
Operating profit based on longer-term investment returns ^{note iii}	(12)	22	(25)	(1)	(16)
Short-term fluctuations in investment returns	(17)	1	(2)	6	(12)
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	–	–	–	1	1
Total	(29)	23	(27)	6	(27)
Actual tax charge:					
Operating profit based on longer-term investment returns ^{note iii}	(49)	(133)	(181)	(18)	(381)
Short-term fluctuations in investment returns	1	7	12	6	26
Shareholders' share of actuarial and other gains and losses on defined benefit pension schemes	–	–	–	1	1
Total	(48)	(126)	(169)	(11)	(354)
Actual tax rate: Operating profit based on					
longer-term investment returns	28%	30%	35%	29%	32%
Total	47%	30%	36%	18%	33%

Notes

- i Expected tax rates for profit attributable to shareholders:
Expected tax rates shown in the table above reflect the corporate tax rates generally applied to taxable profits of the relevant country jurisdictions. For Asian operations the expected tax rates reflect the corporate tax rates weighted by reference to the source of profits of the operations contributing to the aggregate business result.
Expected rates for 2007 for Asia are lower than 2006 due to an increased proportion of profits in low tax jurisdictions. The expected rate for other operations is lower than 2006. The tax rate of 28 per cent reflects the mix of business between UK and overseas operations which are taxed at a variety of rates. The rates will fluctuate year on year dependent on the mix of profits between jurisdictions.
- ii Variances from expected tax charge for results attributable to shareholders:
For 2007, the principal variances arise from differences between the standard corporation tax rate and actual rates due to a number of factors, including:
- For UK insurance operations, disallowed expenses and prior year adjustments arising from routine revisions of tax returns;
 - For Jackson, the benefit of a deduction from taxable income of a proportion of dividends received attributable to the variable annuity business;
 - For Asian long-term operations, tax losses in several jurisdictions which are not expected to be available for relief against future profits, and losses on investments in jurisdictions which do not provide corresponding tax relief; and
 - For other operations, the availability of capital losses brought forward on which no deferred tax had previously been recognised, which have been used against capital gains in the period.
- iii Operating profit based on longer-term investment returns is net of attributable restructuring costs and development expenses.