COSTAIN GROUP PLC IFRS TRANSITION

CONTENTS

SECTION 1

INTRODUCTION

In July 2002 the European Union (EU) approved a regulation (IAS Regulation EC 1606/2002) requiring all EU listed companies to prepare consolidated financial statements in accordance with International Financial Reporting Standards (IFRS), adopted for use in the EU (adopted IFRSs). The regulation applies to accounting periods beginning on or after 1 January 2005. Costain Group PLC will publish its 2005 Interim Report and 2005 Annual Report and Accounts in accordance with recognition and measurement requirements of IFRSs in issue that are either endorsed by the EU and effective (or available for early adoption) at 31 December 2005 or are expected to be endorsed and effective (or available for early adoption) at 31 December 2005.

This report has been prepared in order to provide financial information showing the impact of Costain Group PLC's transition from a UK Generally Accepted Accounting Principles (UK GAAP) basis to an IFRS basis, in advance of the publication of its first financial reporting under IFRS. The adoption of IFRS will have no impact upon the underlying cash flows or trading activities of the Group.

OVERVIEW OF IMPACT

The impact of applying IFRS on the headline 2004 financial information is summarised below:

£million	Half-year to 30 June 2004		Year to
	UK GAAP	IFRS	UK GAAP
Revenue	324.2	324.2	673.2
Profit of operations	7.9	4.7	18.9
Profit before tax	8.1	5.4	19.5
Profit for the period	6.4	4.5	15.2
Basic earnings per share (p)	1.8p	1.3p	4.3p
Net assets (excl net pension liability)	23.6	20.9	32.5
Net liabilities	(30.5)	(33.6)	(36.7)

Areas affected by IFRS

Financial impact to 31 December 2004

- IAS 18 - Revenue: profit of joint ventures in year to 31 December 2004 reduced by £6.4m
- IFRS 2 - Share based payment: adjustment immaterial in 2004
- IAS 19 - Employee benefits: financial assets to be valued at bid price, not mid-market price - pension liability (net) increased by £0.4m

Potential financial impact from 1 January 2005

- IAS 32 & IAS 39 - Financial Instruments (from 1 January 2005): discussed in Section 6

Presentation/classification impact

- IAS 38 - Intangible assets: reclassification of capitalised software costs from tangible assets
- IAS 1 - Presentation of financial statements: current/non-current asset and liability reclassification on balance sheet and equity accounted investments' return shown net of interest and tax below operating profit
- IAS 12 - Income taxes: pension deferred tax asset shown separately from pension liability
- IAS 21 - The effects of changes in foreign exchange rates: currency translation differences held within separate reserve from 1 January 2004
- IAS 19 - Employee benefits: finance income and expense shown separately on

face of income statement

Section 2 contains Costain Group PLC's IFRS accounting policies and Sections 3 to 5 contain detailed reconciliations from UK GAAP to IFRS.

SECTION 2

IFRS ACCOUNTING POLICIES

Based on the adopted and unadopted IFRSs currently in issue, the directors have made assumptions about the accounting policies expected to be applied, when the first annual IFRS financial statements are prepared for the year ending 31 December 2005. In particular, the directors have assumed that IAS 19 (revised) will be adopted in sufficient time that it will be available for use in the annual IFRS financial statements for the year ending 31 December 2005. These policies have been consistently applied to the years presented.

In addition, the adopted IFRSs that will be effective (or available for early adoption) in the annual financial statements for the year ending 31 December 2005 are still subject to change and to additional interpretations and therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period will be determined finally only when the annual financial statements are prepared for the year ending 31 December 2005.

The preparation of financial statements in conformity with IFRS requires the Directors to make judgments and assumptions that affect the reported amounts of assets and liabilities and income and expense during the reported periods. Although these judgments and assumptions are based on the Directors' best knowledge of the amount, events or actions, actual results may differ from these estimates.

First time adoption

IFRS 1 permits companies adopting International Financial Reporting Standards for the first time to take exemptions from the full requirements of IFRS in the transition period. This financial information has been prepared on the basis of taking the following exemptions.

- Business combinations prior to 1 January 2004 have not been restated to comply with IFRS 3 'Business Combinations'.

- All cumulative actuarial gains and losses with respect to employee benefits have been recognised in shareholders' equity at 1 January 2004.

- Cumulative translation differences on foreign operations are deemed to be zero at 1 January 2004. Any gains and losses recognised in the consolidated income statement on subsequent disposals of foreign operations will therefore exclude translation differences arising prior to the transition date.

- The Group has elected to apply IFRS 2 only to all relevant share-based payment transactions granted after 7 November 2002 and not vested at 1 January 2005.

- IAS 32 and IAS 39 have been adopted from 1 January 2005, with no restatement of comparative information.

- In March 2005, the International Financial Reporting Interpretations Committee (IFRIC) issued draft guidance on accounting for service concession arrangements (IFRICs D12-D14). The Group has not applied the draft interpretations, as they may change before being finalised.

The accounting policies set out below have been used to prepare the financial information. These include the accounting policies for financial instruments both before and after the adoption of IAS 32 and IAS 39 on 1 January 2005.

Basis of accounting

The financial statements are prepared in accordance with adopted International Financial Reporting Standards. The following principal accounting policies have been applied consistently in dealing with items that are considered material in relation to the Group's financial statements.

Basis of consolidation

a) The Group financial statements include the accounts of Costain Group PLC and subsidiaries controlled by the Group. Control exists where the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. In assessing control, potential voting rights that presently are exercisable are taken into account. The financial statements of subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases.

b) Associates are operations over which the Group has the power to exercise significant influence but not control, generally accompanied by a share of between 20% and 50% of the voting rights. Associates are accounted for using the equity method. If the Group's share of losses in an associate equals its investment, the Group does not recognise further losses, unless it has incurred obligations or made payments on behalf of the associate.

c) Jointly controlled entities are those entities over whose activities the Group has joint control, established by contractual agreement. Jointly controlled entities are accounted for using the equity method from the date that the jointly controlled entity commences until the date that joint control of the entity ceases.

d) Jointly controlled operations are those joint ventures over which the Group has joint control, established by contractual agreement, which are not entities. The consolidated financial statements include the Group's proportionate share of the jointly controlled operation's assets, liabilities, revenue and expenses with items of a similar nature on a line-by-line basis from the date that the jointly controlled operation commences until the date that jointly controlled operation ceases.

e) Intragroup balances and transactions together with any unrealised gains arising from intragroup transactions are eliminated in preparing the consolidated financial statements. Unrealised gains arising from transactions with jointly controlled entities and jointly controlled operations are eliminated to the extent of the Group's interest in the entity. The Group's share of unrealised gains arising from transactions with associates is eliminated against the investment in the associate. The Group's share of unrealised losses is eliminated in the same way as unrealised gains, but only to the extent that there is no evidence of impairment.

Goodwill

Goodwill arising on consolidation represents the excess of the fair value of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, jointly controlled entity or associate at the date of acquisition.

The classification and accounting treatment of business combinations that occurred prior to 1 January 2004 have not been reconsidered in preparing the Group's opening IFRS balance sheet at 1 January 2004.

Positive goodwill is stated at cost less any accumulated impairment losses and is reviewed for impairment at least annually. Any impairment is recognised immediately in the income statement. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment in the associate. Negative goodwill arising on an acquisition is recognised directly in income statement.

Other intangible assets

Other intangible assets are carried at cost less accumulated amortisation and impairment losses. Amortisation begins when an asset is available for use and is calculated on a straight-line basis to allocate the cost of assets over their estimated useful lives. Subsequent expenditure on capitalised intangible assets is capitalised only when it increases the future economic benefits embodied in the specific asset to which it relates. All other expenditure is expensed as incurred.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, net of value added tax. Revenue from the sale of goods is recognised when the Group has transferred the significant risks and rewards of ownership of the goods to the buyer, the amount of revenue can be measured reliably and it is probable that the economic benefits associated with the transaction will flow to the Group. Revenue includes the Group's share of revenue of jointly controlled operations.

Revenue from construction contracts is recognised in accordance with the Group's accounting policy on construction contracts. Rental income is recognised in the income statement on a straight-line basis over the term of the lease. Lease incentives are recognised as an integral part of the total rental income.

Construction contracts

Where the outcome of a construction contract can be estimated reliably and it is probable that the contract will be profitable, revenue and costs are recognised by reference to the stage of completion of the contract activity at the balance sheet date, as measured by the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs.

When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable.

Construction work in progress is stated at cost plus profit recognised to date less a provision for foreseeable losses and less progress billings. Cost includes all expenditure related directly to specific projects and an allocation of fixed and variable overheads incurred in the Group's contract activities based on normal operating capacity.

Currency translation

Transactions in foreign currencies are translated at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are translated to pounds sterling at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the income statement.

Exchange differences arising from the translation of the net investment in foreign operations and of related hedges, that have arisen since 1 January 2004, the date of transition to IFRS, are presented as a separate component of equity. They are released into the income statement upon disposal. Translation differences that arose before the date of transition to IFRS in respect of all foreign entities are not presented as a separate component.

Property, plant and equipment

Property, plant and equipment are carried at cost less accumulated depreciation and impairment losses. Where parts of an item of property, plant and equipment have different useful lives, they are accounted for as separate items. Cost comprises purchase price and directly attributable costs. Freehold land is not depreciated. For all other property, plant and equipment, depreciation is calculated on a straight-line basis to allocate cost less residual values of the assets over their estimated useful lives as follows:

Freehold buildings	50 years
Leasehold buildings	Shorter of 50 years or lease term
Plant and equipment	Remaining useful life (generally 3 - 121/2 years)

Taxation

The tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on the taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date. Such assets and liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill or other assets and liabilities (other than in a business combination) in a transaction that affects neither the taxable profit not the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates and interest in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Leases

Leases are classified as finance leases where substantially all the risks and rewards of ownership are transferred to the Group. Finance leases are capitalised at the inception of the lease at the lower of the fair value of the leased asset and the present value of the minimum lease payments. Lease payments are apportioned between the liability and finance charge to produce a constant rate of interest on the finance lease balance outstanding. Assets capitalised under finance leases are depreciated over the shorter of the useful life of the asset or the lease term and adjusted for impairment losses. The interest expense component of finance lease payments is recognised in the income statement using the effective tax rate method.

Leases other than finance leases are classified as operating leases. Payments made under operating leases are recognised as an expense in the consolidated income statement on a straight-line basis over the lease term. Any incentives to enter into operating leases are recognised as a reduction of rental expense over the lease term on a straight-line basis. Operating lease income is credited to the income statement as it is earned.

Inventories

Inventories, including land held for and in the course of development, are stated at the lower of cost and net realisable value. Net realisable value is the estimated selling price in the ordinary course of business, less the estimated costs of completion and selling expenses.

Trade and other receivables

Trade and other receivables are stated at their cost less impairment loss.

Retirement benefit obligations

The Group operates a pension scheme providing benefits based on final pensionable salary. The assets of the scheme are held separately from those of the Group.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability. The liability recognised in the balance sheet in respect of defined benefit pension plans is the present value of the defined benefit obligation less the fair value of scheme assets at the balance sheet date.

The increase in the present value of the liabilities of the Group's defined benefit pension scheme expected to arise from employee service in the period is charged to the profit from operations. The expected return on the scheme's assets and the increase during the period in the present value of the scheme's liabilities arising from the passage of time are included in finance income or finance costs respectively. Actuarial gains and losses are recognised in the consolidated statement of recognised income and expense.

Share based payments

The Group operates various equity share option schemes. For equity settled share options, the services received from employees are measured by reference to the fair value of the share options. The fair value is calculated at grant date and recognised in the consolidated income statement, together with a corresponding increase in shareholders' equity, on a straight line basis over the vesting period, based on an estimate of the number of options that will eventually vest. Vesting conditions, other than market conditions, are not taken into account when estimating the fair value.

IFRS 2 has been applied, in accordance with IFRS 1, to equity settled share options granted after 7 November 2002 and not vested at 1 January 2005.

Provisions

A provision is recognised in the balance sheet when the Group has a legal or constructive obligation as a result of a past event and it is probable that an outflow of economic benefits will be required to settle the obligation. If the effect is material, provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision for onerous contracts is recognised when the expected benefits to be derived by the Group from a contract are lower than the unavoidable cost of meeting its obligations under the contract.

Financial instruments (accounting policy applicable for periods prior to 1 January 2005)

The Group protects the sterling value of overseas income and payments, where appropriate, by means of forward sales and purchase contracts. Profits or losses arising from these arrangements are accounted for in the period in which the contracts are due to mature. Accordingly, no account is taken of unrealised profits or losses arising on such forward contracts.

Financial instruments (accounting policy applicable from 1 January 2005)

Derivative financial instruments are measured at fair value and those utilised by the Group's treasury operations and its associated investments include interest rate and Retail Price Index swaps and forward foreign exchange contracts. Certain derivative financial instruments are designated as hedges in line with the Group's risk management policies. Hedges are classified as follows:

(a) Fair value hedges that hedge the exposure to changes in the fair value of a recognised asset or liability.

(b) Cash flow hedges that hedge exposure to variability in cash flows that is either attributable to a particular risk associated with a recognised asset or liability or a forecast transaction.

(c) Net investment hedges that hedge exposure to changes in the value of the Group's interests in the net assets of foreign operations.

For fair value hedges, any gain or loss from re-measuring the hedging instrument at fair value is recognised in the consolidated income statement and any gain or loss on the hedged item is adjusted against the carrying amount of the hedged item and similarly recognised in the consolidated income statement.

For cash flow hedges and net investment hedges, the portion of the gain or loss on the hedging instrument that is determined to be an effective hedge is recognised in shareholders' equity, with any ineffective portion recognised in the consolidated income statement. When hedged cash flows result in the recognition of a non-financial asset or liability, the associated gains or losses previously recognised in shareholders' equity are included in the initial measurement of the asset or liability. For all other cash flow hedges, the gains or losses that are recognised in shareholders' equity are transferred to the consolidated income statement in the same period in which the hedged cash flows affect the consolidated income statement.

Any gains or losses arising from changes in fair value of derivative financial instruments not designated as hedges are recognised in the consolidated income statement. Borrowings are measured at amortised cost except where they are part of an effective fair value hedge relationship, in which case the carrying value is adjusted to reflect the fair value movements associated with the hedged risk. Where borrowings are used to hedge the foreign currency risk of the Group's interests in the net assets of foreign operations, the portion of the foreign currency gain or loss on the borrowings that is determined to be an effective hedge is recognised in shareholders' equity.

Other financial assets are measured as follows:

(a) At fair value for available for sale financial assets. Gains and losses are recognised as a separate component of shareholders' equity except for impairment losses, interest and dividends arising from these assets, which are recognised in the consolidated income statement.

(b) At amortised cost for held to maturity financial assets. Trade and other receivables are measured at amortised cost less any provision for impairment. Trade and other receivables are discounted when the time value of money is considered material.

SECTION 3

As set out in section 2 above, the adopted IFRSs that will be effective (or available for early adoption) in the annual financial statements for the year ending 31 December 2005 are still subject to change and to additional interpretations and therefore cannot be determined with certainty. Accordingly, the accounting policies for that annual period will be determined finally only when the annual financial statements are prepared for the year ending 31 December 2005.

The primary statements within the financial information contained in this document have been presented substantially in accordance with IAS1 'Presentation of Financial Statements'. However, the format and presentation may require modification in the event that further guidance is issued and as practice develops.

Reconciliations - UK GAAP to IFRS

CONSOLIDATED INCOME STATEMENT
Half year ended 30 June 2004

		Impact of transition to IFR		
	Under UK GAAP	Alcaidesa	Joint Ventures/ Associates	Financin
Notes (page 11)		A	B	
	£m	£m	£m	£
Revenue	324.2			
Cost of sales	(309.8)			
Gross profit	14.4			
Administrative expenses	(9.9)			
Group operating profit	4.5			
Group share of joint ventures operating results	3.4	(2.4)	(1.0)	
Share of profit of joint ventures and associates			0.2	
Profit of operations	7.9	(2.4)	(0.8)	
Other finance charges	(0.5)			0.
Net interest	0.7		0.5	(1.2

Finance income				11.
Finance costs				(11.2
Profit before tax	8.1	(2.4)	(0.3)	
Taxation	(1.7)	0.5	0.3	
Profit for the period	6.4	(1.9)	-	
Attributable to:				
Equity holders of the parent	6.4	(1.9)	-	
Minority interests	-	-	-	
Earnings per share - basic	1.8p	(0.5p)	-	
Earnings per share - diluted	1.8p	(0.5p)	-	

CONSOLIDATED INCOME STATEMENT
Year ended 31 December 2004

		Impact of transition to IFRS		
	Under UK GAAP	Alcaidesa	Joint Ventures/ Associates	Financing
Notes (page 11)		A	B	C
	£m	£m	£m	£m
Revenue	673.2			
Cost of sales	(645.0)			
Gross profit	28.2			

Administrative expenses	(18.0)			
Group operating profit	10.2			
Group share of joint ventures operating results	8.9	(9.2)	0.3	
Group share of associates operating results	(0.2)		0.2	
Share of profit of joint ventures and associates			(0.9)	
Profit from operations	18.9	(9.2)	(0.4)	
Other finance charges	(1.1)			1.1
Net interest	1.7		0.6	(2.3)
Finance income				22.9
Finance costs				(21.7)
Profit before tax	19.5	(9.2)	0.2	-
Taxation	(4.3)	2.8	(0.2)	-
Profit for the period	15.2	(6.4)	-	-
Attributable to:				
Equity holders of the parent	15.2	(6.4)	-	-
Minority interests	-	-	-	-

Earnings per share - basic	4.3p	(1.8p)	-	-
Earnings per share - diluted	4.3p	(1.8p)	-	-

Changes in Accounting Policies - Income Statement

Explanatory notes on the impact of IFRS adjustments to the consolidated income statement

A IAS 18 Revenue Recognition

Alcaidesa, the Group's Spanish property development interest, has sold parcels of land that were subject to the completion of certain infrastructure. Sales and profits in respect of such developments were recognised on exchange of contract with costs to complete on the infrastructure element recognised accordingly.

Under IFRS, these developments fall within the scope of IAS 18, where reference is specifically made to situations where the seller is obliged to perform substantial acts to complete under the contract. Revenue and thus profit in respect of such acts should be recognised only when the act is performed.

Given the specific circumstances existing within these developments we consider that the appropriate treatment under IFRS is to view these arrangements, where separable, as two transactions, firstly the sale of the land and secondly the provision of the infrastructure. In such circumstances, revenue and profit are recognised on the land sale element of each transaction on exchange of legal title and when all conditions for revenue recognition under IAS 18 are met. In respect of the infrastructure, the proportion of revenue and profit related to the provision of these facilities is deferred until such works are complete.

The impact of IAS 18 has been to defer the amount of profit shown within the

Group's share of profits from joint ventures and associates. Profit after tax for the six months to 30 June 2004 and 12 months to 31 December 2004 has reduced by £1.9m and £6.4m respectively.

B IAS 28 Investments in Associates and IAS 31 Interests in Joint Ventures

Under UK GAAP, the group share of operating profits of associates was presented on the face of the income statement after group operating profit. The group share of interest and tax of associates was included within the relevant Group totals. Under IFRS, the Group share of profit after tax of associates is presented on the face of the income statement after Group operating profit.

C IAS 1 Income Statement Reclassifications and IAS 19 Retirement Benefit Obligations

There are a number of reclassifications between income statement and balance sheet captions that arise from the application of various IFRS. Under IFRS the expected return on assets of the pension scheme and interest income are shown as finance income and the interest on pension scheme liabilities and interest and finance charges payable are shown as finance costs.

SECTION 4

CONSOLIDATED STATEMENTS OF RECOGNISED INCOME AND EXPENSE
Half year ended 30 June 2004

	Under UK GAAP
Notes (page 11)	
	£m
Exchange differences on translation of foreign operations	(1.2)
Actuarial losses on defined benefit pension schemes (net of	-

tax)	
Net expense recognised directly in equity	(1.2)
Profit for the period	6.4
Total recognised income and expense in the period	5.2
Attributable to:	
Equity holders of the company	5.2
Equity minority interests	-

CONSOLIDATED STATEMENTS OF RECOGNISED INCOME AND EXPENSE
Year ended 31 December 2004

	Under UK GAAP
Notes (page 11)	
	£m
Exchange differences on translation of foreign operations	(0.2)
Actuarial losses on defined benefit pension schemes (net of tax)	(16.0)
Net expense recognised directly in equity	(16.2)
Profit for the period	15.2

Total recognised income and expense in the period	(1.0)
Attributable to:	
Equity holders of the company	(1.0)
Equity minority interests	-

SECTION 5

CONSOLIDATED BALANCE SHEET
As at 1 January 2004 (Transition)

			Impact of transition to IFRS		
	Under UK GAAP	Reclassified	Pension	Translation Reserve	Intangible Assets
Notes (pages 16-17)		A	B/C	D	E
	£m	£m	£m	£m	£m
ASSETS					
Non-current assets					
Property, plant & equipment	4.9				(0.2)
Intangible assets					0.2
Other debtors		3.2			
Deferred tax assets		2.6	23.5		
Investments in associates					
Investments in jointly controlled entities	17.6				
Loans to jointly controlled entities	2.5				
Loans to associates					
Other investments	1.0				
Total non-current assets	26.0	5.8	23.5	-	-

Current assets					
Inventories	1.6				
Trade and other receivables	122.4	(5.8)			
Cash & short term deposits	72.0				
Total current assets	196.0	(5.8)	-	-	-
Total assets	222.0	-	23.5	-	-
EQUITY					
Share capital	34.5				
Share premium	119.4				
Cum. translation reserve					
Retained earnings	(190.6)		(0.4)		
Minority interest	0.1				
Total equity	(36.6)	-	(0.4)	-	-
LIABILITIES					
Non-current liabilities					
Interest bearing loans and borrowings	0.9				
Retirement benefit obligations	54.5		23.9		
Other payables	1.7				
Non current tax liabilities					
Long term provisions		3.8			
Total non-current liabilities	57.1	3.8	23.9	-	-
Current liabilities					
Trade and other payables	193.9				
Interest bearing loans and borrowings	0.5				
Provisions and other liabilities	7.1	(3.8)			
Total current liabilities	201.5	(3.8)	-	-	-

Total liabilities	258.6	-	23.9	-	-
Total equity and liabilities	222.0	-	23.5	-	-

CONSOLIDATED BALANCE SHEET
As at 30 June 2004

	Under UK GAAP	Reclassified	Impact of transition to IFRS Pension	Translation Reserve	Intangible Assets
Notes (pages 16-17)		A	B/C	D	E
	£m	£m	£m	£m	£m
ASSETS					
Non-current assets					
Property, plant & equipment	4.5				(0.2)
Intangible assets					0.2
Other debtors		5.9			
Deferred tax assets		2.0	23.5		
Investments in associates					
Investments in jointly controlled entities	19.1				
Loans to jointly controlled entities	2.5				
Loans to associates					
Other investments	1.0				
Total non-current assets	27.1	7.9	23.5	-	-
Current assets					
Inventories	-				
Trade and other receivables	150.4	(7.9)			
Cash and short term deposits	66.8				
Total current assets	217.2	(7.9)	-	-	-
Total assets	244.3	-	23.5	-	-

EQUITY					
Share capital	35.3				
Share premium	119.5				
Cum. translation reserve				(1.2)	
Retained earnings	(185.4)		(0.4)	1.2	
Minority interest	0.1				
Total equity	(30.5)	-	(0.4)	-	-
LIABILITIES					
Non-current liabilities					
Interest bearing loans and borrowings	0.7				
Retirement benefit obligations	54.1		23.9		
Other payables					
Non current tax liabilities					
Long term provisions		4.2			
Total non-current liabilities	54.8	4.2	23.9	-	-
Current liabilities					
Trade and other payables	211.8				
Interest bearing loans and borrowings	0.4				
Provisions and other liabilities	7.8	(4.2)			
Total current liabilities	220.0	(4.2)	-		-
Total liabilities	274.8	-	23.9		-
Total equity and liabilities	244.3	-	23.5		-

CONSOLIDATED BALANCE SHEET
As at 31 December 2004

			Impact of transition to IFRS		
	Under UK GAAP	Reclassified	Pension	Translation Reserve	Intangible Assets
Notes (pages 16-17)		A	B/C	D	E
	£m	£m	£m	£m	£m
ASSETS					
Non-current assets					
Property, plant & equipment	5.4				(0.5)
Intangible assets					0.5
Other debtors		5.7			
Deferred tax assets		1.7	29.9		
Investments in associates					
Investments in jointly controlled entities	19.0				
Loans to jointly controlled entities	2.6				
Loans to associates	2.7				
Other investments	1.0				
Total non-current assets	30.7	7.4	29.9	-	-
Current assets					
Inventories	1.0				
Trade and other receivables	159.7	(7.4)			
Cash and short term deposits	64.1				
Total current assets	224.8	(7.4)	-	-	-
Total assets	255.5	-	29.9	-	-
EQUITY					
Share capital	35.3				
Share premium	119.5				
Cum. translation reserve				(0.2)	
Retained earnings	(191.6)		(0.4)	0.2	

Minority interest	0.1				
Total equity	(36.7)	-	(0.4)	-	-
LIABILITIES					
Non-current liabilities					
Interest bearing loans and borrowings	0.5				
Retirement benefit obligations	69.2		30.3		
Other payables	3.0				
Non current tax liabilities					
Long term provisions		3.1			
Total non-current liabilities	72.7	3.1	30.3	-	-
Current liabilities					
Trade and other payables	214.3				
Interest bearing loans and borrowings	1.0				
Provisions and other liabilities	4.2	(3.1)			
Total current liabilities	219.5	(3.1)	-	-	-
Total liabilities	292.2	-	30.3	-	-
Total equity and liabilities	255.5	-	29.9	-	-

Changes in Accounting Policies - Balance Sheet

Explanatory notes on the impact of IFRS adjustments to the consolidated balance sheet at 31 December 2004

A IAS 1 Current/non current assets and liabilities

An entity must present current and non-current assets and current and non-current liabilities as separate classifications on the face of the balance sheet in accordance with IAS 1.

Non-current receivables have been reclassified on the face of the balance sheet as non-current assets and provisions have been reallocated to non-current liabilities.

A distinction between current and non-current assets and liabilities arising from post-employment benefits is not required. In practice assets and liabilities relating to defined benefit plans generally are classified as non-current (IAS 19). Assets and liabilities relating to defined contribution plans normally are current and are classified as such.

B IAS 19 Employee benefits

Costain Group PLC adopted early the amendments to FRS 17 for UK GAAP reporting and has recognised the defined benefit pension plan liability (based on the projected unit credit method) in full as at 31 December 2003. The Group has nominated to recognise any actuarial gains or losses in the statement of recognised income and expense. There are no significant accounting differences between FRS 17 and IAS 19 in relation to accounting for defined benefit pension liabilities where the company has nominated to recognise actuarial losses directly in equity. However, the finance cost on the pension plan liabilities will be shown separately as a finance cost and the expected return on plan assets will be shown as finance income.

The Group intends to have actuarial updates at each half-year for the defined benefit pension plan and a full actuarial review at least every 2 years as required by the trust deed.

IAS 19 requires employee benefit schemes' financial assets to be valued at fair value. For relevant financial assets this means the bid price whereas FRS 17 specifies using mid market price. This has the effect of reducing asset values and thereby increasing the deficit by £0.6m.

C IAS 12 Income taxes

Costain Group has a significant defined benefit pension scheme liability. Under UK GAAP this has given rise to a deferred tax asset based on the company's UK corporation tax rate, which has been netted against the defined benefit pension scheme liability. IAS 12 requires that the deferred tax asset be grouped with other deferred tax assets.

Deferred tax assets relating to retirement benefit obligations have been reclassified from non-current liabilities to non-current assets.

D IAS 21 The effects of changes in foreign exchange rates

UK GAAP requires exchange differences on a monetary item forming part of a reporting entity's net investment in a foreign operation to be taken to the STRGL. Under IFRS, IAS 21 requires such exchange differences to be recognised in a separate component of equity in the reporting entity's consolidated financial statements.

Cumulative translation differences on foreign operations are deemed to be zero at 1 January 2004 (as per transitional options of IFRS 1 detailed in Section 2). A £0.2m exchange difference relating to 2004 has been moved from retained reserves to a cumulative translation reserve.

E IAS 38 Intangible assets

Under UK GAAP, computer software costs attributable to major business systems implementations and material software licenses were capitalised as property, plant and equipment. Under IFRS, software development, purchased software and software licences should be classified as an intangible asset.

At 31 December 2004, under IFRS, computer software of £0.5m has been reclassified from property, plant and equipment to intangible assets.

F IAS 18 Reserve Movement

The income statement IFRS adjustment required for Alcaidesa revenue recognition (as explained in Section 3A) causes a reduction in the carrying value of joint venture net assets of £0.8m at 1 January 2004, £2.7m at 30 June 2004 and £7.4m at 31 December 2004.

Others - no financial impact in comparative periods

IFRS 2 Share based payments

Under UK GAAP, a provision was recognised for cash settled options based on intrinsic value at the balance sheet date.

Costain Group has long-term incentive plans for several directors and key employees under which share options have been issued and, subject to certain performance conditions, will vest to the relevant option holders over a period of 3 years. The Group also has Save-As-You-Earn schemes under which options were granted to UK employees. In accordance with IFRS 2, the Group is required to recognise an expense for options granted after 7 November 2002 that have not vested as at 1 January 2005.

The options have been valued at the date of grant and an expense recognised over the period that the service benefit is to be provided by the employees under the terms of the schemes.

At 31 December 2004, under IFRS, the charge for equity settled options is immaterial and charges will commence in 2005.

SECTION 6

CONSOLIDATED CASH FLOW STATEMENT
For the year to 31 December 2004

	Under UK GAAP £m	Impact of transition to IFRS Alcaidesa £m
Cash flows from operating activities		
Profit for the period	15.2	(6.4)
Adjustments for:		
Depreciation	1.1	
Investment income	(22.9)	
Interest expense	22.3	
Share of profit of associates	(8.7)	6.4
Tax expense	4.3	
Operating profit before changes in working capital and provisions	11.3	-
(Increase)/decrease in inventories	0.6	
Decrease/(increase) in receivables	(38.3)	
(Decrease)/increase in payables	18.8	
Decrease in provisions	(2.9)	
Cash generated from the operations	(10.5)	-
Interest paid	(0.3)	
Net cash from operating activities	(10.8)	-
Cash flows from investing activities		
Interest received	2.6	
Acquisition of plant	(1.7)	
Additions to investments	(0.4)	
Capital repayments by investments	0.2	

Dividends received	4.4	
Amounts invested in joint ventures	(2.8)	
Net cash from investing activities	2.3	-
Cash flows from financing activities		
Issue of ordinary share capital by Costain Group PLC	0.9	
Net cash from financing activities	0.9	-
Net (decrease) in cash and cash equivalents	(7.6)	-
Cash and cash equivalents at beginning of year	70.6	-
Effect of foreign exchange rate changes	(0.4)	
Cash and cash equivalents at end of year	62.6	-

SECTION 7

FINANCIAL INSTRUMENTS - IAS 32 & IAS 39

Applicable from 1 January 2005

Costain Group PLC will not be adopting IAS 32 'Financial Instruments: Disclosure and presentation' and IAS 39 'Financial Instruments: Recognition and measurement' until 1 January 2005 as allowed under the transition rules for IFRS.

There are several financial instruments that have either been entered into prior to 2005 (and in place) that were not previously recognised (or had differential treatment) in the prime financial statements under UK GAAP.

These include:

1) Forward sales and purchases of foreign currency
2) Interest rate swaps

3) Inflation swaps

The forward sales and purchases of foreign currency will be required to be marked-to-market (fair value) under IAS 39 and will be revalued at each period end. At 31 December 2004, the unrecognised gain on these instruments was £0.3m and an adjustment will be made at 1 January 2005 to recognise this gain.

Interest rate swaps exist to fix the interest cost on variable rate financing on specific PFI projects and it will be a requirement to fair value these swaps under IAS 39. The cash flow hedging treatment is available (provided there is an effective risk match and appropriate hedging documentation is in place) resulting in fair value movements on these derivatives being recognised directly in equity (rather than through the income statement, which would be the case if 'cash flow' hedge accounting were not to apply).

Inflation swaps exist to hedge the risks associated with index-linked bond financing on specific PFI projects and are classed as derivatives under IAS 39 and need to be fair valued. Hedge accounting will be sought as these items are considered 'hedge instruments' of the inflation rate risk indentured in the bond. This will mean that changes in the fair value of these derivatives will be recognised directly in equity (as opposed to through the income statement, which would be the case if 'cash flow' hedge accounting were not available to apply).