Avon Insurance plc
Annual Report 2005

Board of Directors

Chairman
Sir Don Curry, C.B.E., F.R.Ag.S.

Vice-Chairman
I. D. Grant, C.B.E., F.R.Ag.S.

Chief Executive
I. S. Geden, F.C.I.I.

A. Harris, M.B.A., F.C.I.I.

W. J. M. Schouten, M.B.A.

Registered no. 209606

Directors' Report

Principal Activities

The principal activity of the Company is the transaction of Personal Accident insurance business and management of the run off of its broker and intermediary business.

Review of Business

Following the sale on the 31st December 2002 of the broker and intermediary business to The National Insurance and Guarantee Corporation Limited, both the level of continuing business and the year end financial position remain satisfactory. Both net written premiums and net earned premiums for the year amounted to £28.6m. Net claims released were £7.1m. After taking into account investment income from the Non-Technical Account and making provision for expenses, unearned premiums, less deferred acquisition costs, a surplus of £32.3m has been transferred from the Technical Account. After adding the balance of investment income, less expenses, the profit before taxation was £45.4m. The profit after tax was £31.7m, and after the paid dividend of £8.0m, the balance to be transferred from reserves amounts to a profit of £23.7m.

Directors

In accordance with the Articles of Association, Mr I. Geden retires, and being eligible, offers himself for re-election. The appointment of Mr W. J. M. Schouten is to be confirmed at the AGM.

Statement of Directors' Responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the Company as at the end of the financial year and of the profit for that period. In preparing those financial statements the directors confirm:-

- suitable accounting policies have been selected and applied consistently;
- judgements and estimates made are reasonable and prudent;
- applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements; and
- the financial statements are prepared on the going concern basis.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the Company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Corporate Governance

Corporate governance matters are dealt with at Group level and are reported in detail in the parent company's Annual Report.

Shareholder Engagement and Voting Policy

The Shareholder Engagement and Voting Policy of the investment department of the Group takes account of the Institutional Shareholders' Committee* principles. These principles set out best practice for institutional shareholders in relation to their responsibilities in respect of investee companies. The investment managers of the Group are encouraged to engage with investee companies where this may secure or enhance value in a cost effective way. A statement of the policy on shareholder engagement and voting is available on request.

(*Institutional Shareholders' Committee members are: the Association of British Insurers; the Association of Investment Trust Companies; the National Association of Pension Funds; and the Investment Management Association.)

Management of insurance and financial risk

The Company issues contracts that transfer insurance risk or financial risk or both. This section summarises these risks and the way the Group manages them.

Insurance risk

The risk under any one insurance contract is the possibility that the insured event occurs and the uncertainty of the amount of the resulting claim. By the very nature of an insurance contract, this risk is random and therefore unpredictable.

For a portfolio of insurance contracts where the theory of probability is applied to pricing and provisioning, the principal risk that the Company faces under its insurance contracts is that the actual claims and benefit payments exceed the carrying amount of the insurance liabilities. This could occur because the frequency or severity of claims and benefits are greater than estimated. Insurance events are random and the actual number and amount of claims and benefits will vary from year to year from the level established using statistical techniques.

Experience shows that the larger the portfolio of similar insurance contracts, the smaller the relative variability about the expected outcome will be. The Company has developed its insurance underwriting strategy to achieve a sufficiently large population of risks to reduce the variability of the expected outcome.

Factors that aggravate insurance risk include lack of risk diversification in terms of class and amount of risk, and geographical location.

General insurance contracts

Frequency and severity of claims

The frequency and severity of claims can be affected by several factors, such as the risk profile of the business, inflation, legal rulings, and weather events. The Group manages these risks through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling. The underwriting strategy attempts to ensure that the underwritten risks are well controlled in terms of class and amount of risk, industry and geography.

Underwriting limits are in place to enforce appropriate acceptance criteria. As General Insurance contracts are generally issued on an annual basis, the Company has the right not to renew individual policies, it can impose deductibles and it has the right to reject the payment of a fraudulent claim. Insurance contracts also entitle the Company to pursue third parties for payment of some or all costs (i.e. subrogation). In the UK, legislation requires that the maximum loss under each motor contract is never lower than a prescribed amount. All the Company motor insurance contracts offer unlimited third party insurance cover in compliance with such minimums.

The reinsurance arrangements include risk excess and catastrophe coverage. In addition to the overall Company reinsurance programme, individual business units are permitted to purchase additional reinsurance protection (facultative).

Financial Instruments

Financial risk management objectives

The Company is exposed to financial risk through its financial assets, financial liabilities, reinsurance assets and policyholder liabilities. The key financial risk which the Group manages is that the proceeds from financial assets are not sufficient to fund the obligations arising from contracts with policyholders. The most important components of this financial risk are interest rate risk and credit risk.

The Company does not use hedge accounting.

Interest rate risk

The Company monitors interest rate risk by modelling the effect of changes in interest rates, and bond yields on the assets and liabilities held on the Balance Sheet. Where appropriate, assets will be held which react to changes in yields in the same way as the underlying liabilities - by purchasing bonds of an appropriate yield and term. Where this is not appropriate, capital is held to ensure that by taking this mis-matched position, the Company is operating within the risk appetite set by the Board.

The Company has a defined investment policy which sets out limits on the Groups' concentration of exposure to bonds in any one counterparty. Group Investment Committee meetings are held quarterly. At these, senior management, including investment managers, representing all Group companies meet to discuss investment return, mix and concentration across the Group.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. Key areas where the Company is exposed to credit risk are:

- exposure to corporate bonds,
- reinsurers' share of insurance liabilities,
- amounts due from reinsurers in respect of claims already paid,
- amounts due from insurance contract holders,

- amounts due from insurance intermediaries, and
- counterparty risk with respect to derivative transactions.

The Group places limits on its exposure to a single counterparty, or groups of counterparty.

Reinsurance is used to manage insurance risk. This does not, however, discharge the Company's liability as primary insurer. If a reinsurer fails to pay a claim, the Company remains liable for the payment to the policyholder. The creditworthiness of reinsurers is considered on a regular basis by reviewing their financial strength, particularly prior to finalisation of any contract. In addition, the recent payment history of reinsurers is used to update the reinsurance purchasing strategy.

Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. The Group Investment Committee monitors the amount of cash required to meet obligations on a quarterly basis and ensures that sufficient cash will be available from holdings and/or maturing funds.

Auditors

A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the company will be proposed at the annual general meeting.

Sir Don Curry	I. S. Geden
Chairman	*Chief Executive*

Stratford-upon-Avon, 22nd March, 2006

Profit & Loss Account
Technical Account – General Business

for the year ended 31st December, 2005	2005 £m	2004 £m
Gross premiums written (note 2)		
Continuing operations	47.1	47.7
Discontinued operations	0.8	2.6
	47.9	50.3
Outwards reinsurance	(19.3)	(21.3)
Net premiums written	28.6	29.0
Change in the gross provision for unearned premiums	0.3	0.9
Change in the provision for unearned premiums, reinsurers' share	(0.3)	(0.3)
Decrease in the net provision for unearned premiums	0	0.6
Earned premiums, net of reinsurance	28.6	29.6
Allocated investment return transferred from the non-technical account	3.5	4.9
Other technical income	–	0.1
Total technical income	32.1	34.6
Gross claims paid	25.0	31.5
Reinsurers' share	(5.0)	(7.1)
Net claims paid	20.0	24.4
(Decrease) in the gross provision for claims	(29.6)	(34.3)
Decrease in reinsurers' share	2.5	3.5
(Decrease) in the net provision for claims	(27.1)	(30.8)
Claims incurred, net of reinsurance	(7.1)	(6.4)
Changes in other technical provisions, net of reinsurance	(0.2)	(0.1)
Net operating expenses (note 5)	12.0	13.2
(Decrease) in the equalisation provision	(4.9)	–
Total Technical (Income) / Charges	(0.2)	6.7
Surplus on the technical account - general business	32.3	27.9

Profit & Loss Account
Non-Technical Account

for the year ended 31st December, 2005	2005 £m	2004 £m *As restated*
Surplus on the technical account - general business	32.3	27.9
Investment income (note 6)	12.5	12.8
Investment expenses and charges (note 6)	–	(0.1)
Unrealised gains on investments (note 6)	1.0	0.1
Allocated investment return transferred to the general business technical account (note 7)	(3.5)	(4.9)
Other income	–	0.9
Other charges	(0.2)	(0.2)
Continuing operations *(note 3)*	14.6	15.7
Discontinued operations *(note 3)*	27.5	20.8
Total operating profit	42.1	36.5
Profit on sale of premium renewal rights (note 8)	3.3	0.5
Profit on ordinary activities before tax (note 10)	45.4	37.0
Taxation on profits on ordinary activities (note 11)	(13.7)	(11.5)
Profit on ordinary activities after taxation	31.7	25.5
Paid dividend (note 12)	(8.0)	(10.0)
Retained profit for the financial year *(note 15)*	23.7	15.5

Statement of Total Recognised Gains and losses

	2005 £m	2004 £m
Profit on ordinary activities after taxation	31.7	25.5
Revaluation of subsidiary	1.2	0.9
Total recognised gains relating to the year	32.9	26.4

Balance Sheet

As at 31st December, 2005	2005 £m	2004 £m
Assets		
Investments		
Shares in subsidiaries (note 13a)	25.9	24.7
Listed British Government and local authority securities	97.2	95.9
Listed fixed interest stocks	72.0	64.1
Mortgages, loans and deposits	38.5	61.9
Other financial investments (note 13b)	207.7	221.9
	233.6	246.6
Reinsurers' share of technical provisions		
Provision for unearned premiums	0.4	0.7
Claims outstanding	26.2	28.7
Other technical provisions - provisions for unexpired risks	0.2	0.3
	26.8	29.7
Debtors		
Due from policyholders	0.2	0.3
Due from intermediaries	0.3	0.3
Debtors arising out of direct insurance operations	0.5	0.6
Debtors arising out of reinsurance operations	1.6	1.3
Due from Parent Society	-	1.0
Other debtors	0.2	0.5
	2.3	3.4
Other assets		
Cash at bank and in hand	1.0	1.4
Prepayments and accrued income		
Accrued interest and rent	2.5	2.5
	2.5	2.5
Total assets	266.2	283.6

Balance Sheet

As at 31st December, 2005	2005 £m	2004 £m *As restated*
Liabilities		
Capital and reserves		
Called up share capital (note 14)	20.0	20.0
Profit and loss account (note 15)	135.3	111.6
Revaluation Reserve (note 16)	13.9	12.7
Shareholders' funds attributable to equity interests (note 17)	169.2	144.3
Technical provisions		
Provision for unearned premiums	0.4	0.7
Claims outstanding	82.2	111.8
Claims equalisation provision (note 18)	-	4.9
Other technical provisions - provision for unexpired risk	0.5	0.7
	83.1	118.1
Provision for other risks and charges (note 20)	-	0.7
Creditors		
Creditors arising out of direct insurance operations	2.6	3.9
Creditors arising out of reinsurance operations	2.9	3.1
Due to Group undertaking	-	5.5
Due to Parent Society	0.1	-
Corporation tax	7.6	7.3
Other	0.3	0.3
Other taxation	0.4	0.4
Other creditors including taxation and social security	8.3	8.0
	13.9	21.2
Total liabilities	266.2	283.6

These financial statements were approved by the directors at a meeting on 22nd March, 2006 and were signed on their behalf by:-

Sir Don Curry
Chairman

I. S. Geden
Chief Executive

Stratford-upon-Avon

Cash Flow Statement

for the year ended 31st December, 2005	2005 £m	2004 £m
Net cash inflow from continuing operating activities (note 23a)	1.5	4.9
Returns on investments and servicing of Finance	(8.0)	(10.0)
Taxation paid	(13.4)	(18.2)
Acquisitions and Disposals	3.5	1.1
Net cash (Outflow)	(8.0)	(22.2)
Cash flows were invested/(applied) as follows:		
(Decrease)/Increase in cash holdings (note 23b)	(0.4)	0.6
Net portfolio investment		
Fixed Income securities (note 23d)	7.4	(3.5)
Deposits with credit institutions (note 23c)	(23.4)	(19.3)
	(16.0)	(22.8)
Net (Application) of cash flows	(16.4)	(22.2)

Notes to Financial Statements

1 Accounting Policies

The financial statements have been prepared in accordance with Section 255 and 255A of, and Schedule 9A to, the Companies Act 1985 (as amended) and applicable accounting standards in the United Kingdom and with the Statement Of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers (ABI) dated December 2005.

The more important accounting policies, which unless otherwise stated have been applied consistently are set out below.

a) Changes in Accounting Policy

The company has adopted Financial Reporting Standard 21 (FRS 21) - 'Events after the balance sheet date" during the year. This has meant that dividends proposed are no longer treated as a liability in the accounts. This has had the effect in 2004 of decreasing profit after tax by £2m and reducing liabilities as at 31 December 2004 by £8m. This has increased the Profit and Loss Reserves at the end of 2004 by £8m.

b) Translation and Conversion of Foreign Currencies

Foreign currency transactions have been converted into sterling at rates of exchange ruling during the year. Assets and liabilities in foreign currencies have been translated at the rates of exchange ruling at the end of the year. Exchange differences are taken to the Profit and Loss account.

c) General Insurance Business

Premiums written relate to business incepted during the year, together with any differences between booked premiums for prior years and those previously accrued, and include estimates of premiums due but not yet receivable or notified to the company, less an allowance for cancellations. Bonuses granted to policyholders on future renewal of their policies are recognised as a reduction to premiums written when policies are renewed. Related reinsurance premiums are accounted for when paid or payable.

The balance on the Technical Account – General Business is determined after making provision for unearned premiums, unexpired risks and outstanding claims.

Unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force at the balance sheet date.

Provision for unearned premiums is calculated on a 365th inception basis.

Provision for unexpired risks is maintained, when required, to cover the estimated excess of liabilities over the associated unearned premium after taking into account future investment return.

Claims incurred comprise claims and related expenses paid in the year and changes in the provisions for outstanding claims, incuding provisions for claims incurred but not reported and related expenses, together with any other adjustments to claims from previous years. Where applicable, deductions are made for salvage and other recoveries.

Claims Provisions

Provision is made at the year end for the estimated cost of claims incurred but not settled at the balance sheet date, including the cost of claims incurred but not yet reported to the company. The provision calculated takes account of handling costs, salvage and other known recoveries, anticipated inflation, legal costs and trends in settlement.

Notified outstanding claims reserves

The cost of notified but not settled claims are estimated on an individual case by case basis by claims handlers using their experience of past settlements and known and expected legislative changes.

Incurred but not reported claims reserves

The estimation of claims incurred but not reported (IBNR) is generally subject to a greater degree of uncertainty. Classes of business, such as employers' liability, where the IBNR proportion of the total reserve is high will typically display greater variations between initial estimates and final outcomes because of the greater degree of difficulty of estimating these reserves.

IBNR claims are estimated using statistical techniques, which use past trends to forecast separately the expected number of claims and the expected average cost of claims. Separate allowance is made for large claims. An allowance is made for expected changes in future trends, such as changes in company processes, changes in the legal environment, changes in mix of business and changes in expected claims inflation. In addition, exposure based techniques are adopted to estimate reserves required for new sources of loss not significantly evident in historic data.

Equalisation provisions have been established in accordance with the requirements of the Interim Prudential Sourcebook for Insurers to mitigate exceptional high loss ratios for classes of business displaying a high degree of claims volatility.

Provisions are calculated gross of any reinsurance recoveries. A separate estimate is made of the amount that will be recoverable from reinsurers based upon the gross provisions and having due regard to collectability.

Reinsurance recoveries

Reinsurance recoveries in respect of estimated claims incurred but not reported are assumed to be consistent with the historical pattern of such recoveries, adjusted to reflect changes in the nature and extent of the company's reinsurance programme over time. An assessment is also made of the recoverability of reinsurance recoveries having regard to market data on the finacial strength of each of the reinsurance companies.

d) Investment Return

Investment return comprises investment income, including investment gains and losses and movements in unrealised gains and losses, net of investment expenses and charges.

Account is taken of dividend income when the related investment goes 'ex-dividend' and other investment income is included on an accruals basis.

Realised gains and losses on investments carried at market value are calculated as the difference between net sales proceeds and purchase price. Movements in unrealised gains and losses on investments represent the difference between the valuation at the balance sheet date and their purchase price or, if they have been previously valued, their valuation at the last balance sheet date, together with the reversal of unrealised gains and losses recognised in earlier accounting periods in respect of investment disposals in the current period.

Movement in unrealised gains and losses in investments are included in the Profit and Loss Account other than those in respect of the investment in subsidiaries and associates which are taken to the revaluation reserve.

Gains and losses on realisation of investments are included within investment income or investment expenses in the Non-Technical Account. Unrealised gains and losses are also included within the Non-Technical Account. Allocations from the Non-Technical Account are made to the Technical Account - General Business of the longer term investment return on investments supporting the general insurance technical provisions.

The longer term rate of investment return is an estimate of the long-term trend investment return having regard to past performance over the past forty years, current trends and future expectations.

e) Taxation

United Kingdom and overseas taxation charged in the Non-Technical Account and the Technical Account General Business based on profits and income including realised gains and losses on all investments for the year as determined in accordance with the relevant tax legislation, together with adjustments in respect of earlier years. Deferred taxation is calculated on the liability method and consists of the estimated taxation, or relief from taxation, which is expected to arise in the foreseeable future from material timing differences, including unrealised appreciation of investments. Deferred tax is not discounted and is calculated at the rates at which it is expected that the tax will arise and the pattern of the expected realisation of investments. Movements in this taxation provision are charged to the Non-Technical Account.

f) Investments

Investments are shown at market value. Unlisted investments and mortgages are included at directors' valuation. The investments in subsidiaries are valued at current value.

g) Retirement Benefits Scheme

Employees have the opportunity to become members of the NFU Mutual Insurance Society Retirement Benefit Scheme, a defined benefit scheme. Details of this fund and its latest actuarial valuation are given in the Annual Accounts of National Farmers Union Mutual Insurance Society Limited.

On a triennial basis, a formal valuation of the NFU Mutual Insurance Society Retirement Benefit Scheme is undertaken by an independent actuary. The most recent full valuation of the Fund was performed as at 31 December 2002. There were no contributions to the NFU Mutual Insurance Society Retirement Benefit Scheme in the year (2004: £nil); they are based on the assumptions of the Group as a whole which are determined in accordance with the advice of the independent actuary and are agreed with the Scheme Trustees.

The provisions of FRS 17, Retirement Benefits, are included in the accounts of NFU Mutual Insurance Society. The NFU Mutual Insurance Society Retirement Benefit Scheme had a net pension surplus for FRS 17 purposes at 31 December 2005 of £92m (2004: £88m), having taken into account a related deferred tax liability of £40m (2004: £38m). Since the company is unable to identify its share of the underlying assets and liabilities of the Scheme, under FRS 17, contributions to the Scheme are accounted for as if they were contributions to a defined contribution scheme.

h) Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to contractual provisions of the instrument.

Debtors
Trade debtors are measured at initial recognition at the value transferred. Subsequent measurements are made having an appropriate allowance for estimated irrecoverable amounts.

Investments
Investments are recognised and derecognised on the trade date where a purchase or sale of an investment is under a contract whose terms require delivery of the investment within the timeframe established by the market concerned, and are initially measured at cost, including transaction costs.

Cash and cash equivalents
Cash and cash equivalents comprise cash on hand, demand deposits and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of change in value.

Creditors
Trade creditors are valued at the initial value of the transaction.

2 Segmental Information

a) Gross Premiums Written

The gross premium income for the year by major class of business was as follows:-

	2005 £m	2004 £m
Continuing operations		
Personal	47.1	47.7
Discontinued operations		
Fire and Accident	0.8	1.1
Motor	-	1.3
Personal	-	0.2
	0.8	2.6
	47.9	50.3

b) Gross Premiums Earned

	2005 £m	2004 £m
Continuing operations		
Personal	47.1	47.7
Discontinued operations		
Fire and Accident	0.6	1.5
Motor	0.4	1.7
Personal	0.1	0.3
	1.1	3.5
	48.2	51.2

c) Gross Claims Incurred

	2005 £m	2004 £m
Continuing operations		
Personal	5.2	6.4
Discontinued operations		
Fire and Accident	(6.2)	(3.3)
Motor	(2.7)	(4.3)
Personal	(0.8)	(1.6)
Reinsurance Accepted	(0.1)	-
	(9.8)	(9.2)
	(4.6)	(2.8)

d) Gross Operating Expenses

	2005 £m	2004 £m
Continuing operations		
Personal	13.1	12.5
Discontinued operations		
Fire and Accident	(0.2)	0.7
Motor	-	1.0
	(0.2)	1.7
	12.9	14.2

e) Reinsurance Balance

	2005 £m	2004 £m
Continuing operations		
Personal	15.8	15.1
Discontinued operations		
Fire and Accident	1.3	(2.0)
Motor	(0.6)	4.0
Personal	(0.2)	0.17
	0.5	2.1
	16.3	17.2

The reinsurance balance represents the charge to the technical account from the aggregate of all items relating to reinsurance outwards.

f) Analysis by geographic area

Gross written premiums

	2005 £m	2004 £m
United Kingdom		
Continuing operations	47.1	47.7
Discontinued operations	0.8	2.6
	47.9	50.3

Profit before taxation and minority interests

	2005 £m	2004 £m
United Kingdom		
Continuing operations	13.6	15.7
Discontinued operations	31.8	21.3
	45.4	37.0

Net Assets

	2005 £m	2004 £m *As restated*
United Kingdom		
Continuing operations	17.2	17.3
Discontinued operations	151.8	126.8
Overseas	0.2	0.2
	169.2	144.3

3 Analysis of Profit and Loss Account items

	2005 Continuing £m	2005 Discontinued £m	2005 Total £m	2004 Continuing £m	2004 Discontinued £m	2004 Total £m
Earned premiums, net of reinsurance	28.6	-	28.6	29.0	0.6	29.6
Other technical income	-	-	-	-	0.1	0.1
Allocated investment return transferred from the non-technical account	0.2	3.3	3.5	0.2	4.7	4.9
Claims incurred, net of reinsurance	(3.3)	10.4	7.1	(3.4)	9.8	6.4
Changes in other technical provisions	0.2	-	0.2	0.1	-	0.1
Net operating expenses	(12.3)	0.3	(12.0)	(11.6)	(1.6)	(13.2)
Change in equalisation provision	-	4.9	4.9	-	-	-
Balance on the technical account for general business	13.4	18.9	32.3	14.3	13.6	27.9
Investment income	1.3	11.2	12.5	1.6	11.2	12.8
Investment expenses and charges	-	-	-	-	(0.1)	(0.1)
Unrealised gains on investments	0.1	0.9	1.0	-	0.1	0.1
Allocated investment return transferred to the general business technical account	(0.2)	(3.3)	(3.5)	(0.2)	(4.7)	(4.9)
Other income	-	-	-	-	0.9	0.9
Other charges	-	(0.2)	(0.2)	-	(0.2)	(0.2)
Total operating profit	14.6	27.5	42.1	15.7	20.8	36.5

4 Movement in prior year's provisions for claims outstanding

Positive run off deviations of £5.2m (2004 - £2.8m) for Motor, £1.0m (2004 - £3.4m) for Liability and £2.9m (2004 - £3.4m) for Property were experienced for the year.

5 Net Operating Expenses

	2005 £m	2004 £m
Acquisition costs	9.4	8.6
Administration expenses	3.5	5.6
Reinsurance commissions and profit participation	(0.9)	(1.0)
	12.0	13.2

Total commission for direct insurance accounted for during the year 2005 amounted to £6.5m (2004 - £6.3m).

6 Investment Return

	2005 £m	2004 £m
Income from other investments	11.7	12.5
Net gains on the realisation of investments	0.8	0.3
Investment income	12.5	12.8
Investment expenses and charges	-	(0.1)
Movement in unrealised investment gains	1.0	0.1
Investment return for the year	13.5	12.8

7 General Business Longer Term Investment Return

Analysed between:	2005 £m	2004 £m
Allocated investment return transferred to the Technical Account - General Business	3.5	4.9
Net investment return included in the Non-Technical Account	10.0	7.9
	13.5	12.8

	Longer term rates of investment return	
	2005 %	2004 %
Fixed interest Stock	5.7%	5.8%
Cash	4.2%	4.0%

There is no material difference between the actual return attributable to investments supporting the technical reserves and the longer term return credited to operating results.

8 Profit on sale of premium renewal rights

On the 31st December 2002 the right to invite renewal of Avon Insurance's broker and Intermediary business was sold to another party. The consideration for this transaction being commission payments based on the renewed Gross Premium Written in the following 12 months, and a share of any trading profit acheived in the 2 years following 31st December 2002 based on acheived Gross Loss Ratios.

The profit on disposal shown in the Profit and Loss account represents a share of the trading profit from 2004. In 2005 an amount of £3.3m (2004 - £0.5m) has been recognised.

9 Directors and Employee Information

The aggregate emoluments of the Company's directors were £66,442 (2004 - £70,866) all of which was in respect of fees for service as non-executive directors.

	2005 £	2004 £
Sir Don Curry	40,000	45,000
I.D.Grant	26,442	25,866
	66,442	70,866

A pension contribution of £3,865 (2004 - £nil) was made in respect of serving directors. Pensions to former directors amounted to £39,768 (2004 - £40,321).

The employees of the Company do not have contracts of service with Avon Insurance plc but with another Group Company, The National Farmers Union Mutual Service Company Limited.

The number of persons involved is :

	2005	2004
Administration and finance	55	55
Underwriting	-	-
Claims	5	4
	60	59

A recharge is made from The National Farmers Union Mutual Service Company Limited for the services of the above employees. This amounted to £1.1m (2004 - £1.0m).

10 Profit for the year

Profit for the year is stated after charging:-

	2005 £m	2004 £m
Auditors' fees for:		
Audit	0.1	0.1
Non audit	-	-

11 Taxation

	2005 £m	2004 £m
United Kingdom Taxation		
Corporation tax	13.7	11.5
Total United Kingdom Taxation	13.7	11.5

Factors affecting the tax charge for the period	2005 £m	2004 £m
Profit on ordinary activities before tax	45.4	37.0
Profit on ordinary activities multiplied by standard rate of corporate tax in the UK of 30% (2004 30%)	13.6	11.1
Investment Income (equities)	(0.2)	(0.1)
Unrealised gains on equities	0.1	0.1
Claims reserves	0.3	0.4
Adjustment to tax charge in respect of previous periods	(0.1)	-
Current tax charge for the period	13.7	11.5

Included in the tax charge for the period is an amount of £1.0m (2004 - £0.2m) in respect of the disposal of renewal rights.

12 Dividends

	2005 £m	2004 £m *As restated*
Equity Shares		
Dividend paid of 40p per share (2004 - 50p per share)	8.0	10.0
	8.0	10.0

13 Investments:

a) Shares in subsidiaries

Purchase price of Investments £12.0m (2004 - £12.0m)

The Company owns the whole of the issued share capital of Tiddington Investments Limited whose principal activity is a non dealing Investment Company, which is incorporated in Great Britain and registered in England and Wales. The Company is exempt under Section 228 of the Companies Act 1985 from the requirement to prepare consolidated financial statements as it and its subsidiary undertakings are included by full consolidation in the consolidated financial statements of its parent, The National Farmers Union Mutual Insurance Society Limited, a company incorporated in England and Wales. The value of the Company's interest in its subsidiaries is not less than the amount at which the interest is stated in the balance sheet.

b) Other financial investments

	2005 £m	2004 £m
Purchase price of other financial investments		
Listed British Government and Local Authority securities	96.5	95.7
Listed fixed interest stocks	67.8	60.4
With credit institutions	38.5	61.9
	202.8	218.0

14 Share Capital

The authorised capital at 31st December, 2005 was £100m (2004 - £100.0m) divided into shares of £1 each, of which twenty million (2004- twenty million) were issued and fully paid.

15 Profit and Loss Account

	2005 £m	2004 £m
		As restated
Balance at 1st January as previously stated	103.6	86.1
Prior year adjustment	8.0	10.0
Balance at 1st January as restated	111.6	96.1
Transfer from non-Technical account	23.7	15.5
Balance as at 31st December	135.3	111.6

16 Revaluation Reserve

	2005 £m
Balance at 1st January	12.7
Revaluation Movement	1.2
Balance at 31st December	13.9

17 Movements In Shareholders' Funds

	2005 £m	2004 £m
		As restated
Balance at 1st January as previously stated	144.3	117.9
Prior year adjustment	-	10.0
Balance at 1st January as restated	144.3	127.9
Profit and loss account (note 15)	23.7	15.5
Revaluation reserves	1.2	0.9
Balance at 31st December	169.2	144.3

18 Claims Equalisation Provision

Equalisation provisions are established in accordance with the requirements of the Interim Prudential Source book for Insurers. These provisions, which are in addition to the provisions required to meet the anticipated ultimate cost of settlement of outstanding claims at the balance sheet date, are required by Schedule 9A to the Companies Act 1985 to be included within technical provisions in the balance sheet notwithstanding that they do not represent liabilities at the balance sheet date. Following the sale of the renewal book in 2002 and an accordance with Equalisation Provision requirements during 2005 the reserve was released. The effect on profit on ordinary activities before taxation was £4.9m (2004 - no effect) in the financial statements.

19 Retirement Benefit Schemes

The Group operates the NFU Mutual Retirement Benefit Scheme which provides membership with benefits on a Defined Benefits and Defined Contribution basis that covers all material obligations to provide pensions to retired and current employees. The Group also sponsors pension schemes based in the Channel Islands for a small group of employees in that region; liabilities for these schemes are immaterial in comparison to those of the NFU Mutual Retirement Benefit Scheme. The figures in this note consolidate the results of all the Group's pension arrangements. Contributions made over the year were £nil (2004 - £nil).

The contributions for the schemes are determined by an independent qualified actuary on the basis of triennial valuations using the Projected Unit Method. As the NFU Mutual retirement benefit Scheme admits new members in a Defined Contribution basis and not a Defined Benefit basis, the current service cost in respect of Defined Contribution members will typically increase (as a percentage of pensionable pay) as the average age of the active membeship increases. The most recent valuation was at 31st December 2002. At this date the market value of the investments of the schemes was £461m. The assets of these schemes were in excess of the amount required to cover the benefits that had accrued to members after allowing for future increases in earnings.

As a result contributions to the Scheme by the Society are currently suspended. This will be reviewed as part of the valuation of the Scheme as at 31st December 2005, which is currently underway.

20 Provision for other risks and charges

a) Deferred Taxation

	2005 £m	2004 £m
Balance at 1st January	0.1	0.1
Charge for the year	–	–
Balance at 31st December	–	0.1

The provision for deferred taxation comprised:

	2005 £m	2004 £m
Unrealised gains on investments	0.1	0.1
Other short term timing differences	–	–
	0.1	0.1

There is no unprovided Deferred Taxation.

b) Motor Insurer's Bureau

The company is a member of the Motor Insurer's Bureau and as such has provided for its proportion of the proposed levy forecast.

	2005 £m
Balance at 1st January	0.1
Payments	(0.1)
(Release) to Technical Account	–
Balance at 31st December	–

c) Financial Services Compensation Scheme

It is currently anticipated that no levies will be requested in the foreseeable future and as a result 2004 provisions of £0.4m have been released.

	2005 £m
Balance at 1st January	0.5
Payments	(0.1)
(Release) to Technical Account	(0.4)
Balance at 31st December	–

21 Contingent Liabilities

There are no contingent liabilities.

22 Capital Expenditure

There were no capital commitments at 31st December, 2005 not provided for in these financial statements (2004 £nil).

23 Cash Flow Statement

a) Reconciliation of Profit Before Tax to Net Cash Inflow from Operating Activities

	2005 £m	2004 £m
Operating Profit	42.1	36.5
Decrease in debtors, prepayments and accrued income	0.9	0.4
(Decrease) in creditors, accruals and deferred income	(7.6)	(0.2)
(Decrease) in technical provisions	(32.1)	(31.4)
Realised and unrealised investment (gains)	(1.8)	(0.4)
Net cash Inflow from operating activities	1.5	4.9

b) Movement in portfolio investments net of financing

	2005 £m	2004 £m
(Decrease)/Increase in cash holdings	(0.4)	0.6
Cash (Outflow) on portfolio investments	(16.0)	(22.8)
Movement arising from cash flows	(16.4)	(22.2)
Changes in market value and currencies	1.8	0.4
Total movement in portfolio investments, net of financing	(14.6)	(21.8)
Portfolio investments, net of financing at 1st January	223.3	245.1
Portfolio investments, net of financing at 31st December	208.7	223.3

c) Cash flows invested in portfolio investments

	2005 £m	2004 £m
Purchase of debt securities and other fixed income securities	25.5	11.5
Sales of debt securities and other fixed income securities	(18.0)	(15.0)
Net (Decrease) in deposits with credit institutions	(23.3)	(19.3)
Net cash (Outflow) on portfolio investments	(15.8)	(22.8)

d) Movement in cash, portfolio investments net of financing

	As at 1st January, 2005 £m	Cash flow £m	Changes to Market values & currencies £m	As at 31st December 2005 £m
Cash at bank and in hand	1.4	(0.4)	-	1.0
Debt securities and other fixed income securities	160.0	7.4	1.8	169.2
Deposits with credit institutions	61.9	(23.4)	-	38.5
Total	223.3	(16.4)	1.8	208.7

24 Related Parties

The Company has taken advantage of the exemption set out in FRS8 not to disclose transactions with other Group Companies.

25 Ultimate Holding Company

The immediate parent company is NFU Mutual Management Company Limited, which is incorporated in England and Wales.
The company's ultimate controlling undertaking and parent company is The National Farmers Union Mutual Insurance Society Limited, which is incorporated in England and Wales. Copies of the consolidated accounts of the ultimate controlling party can be obtained from the Secretary at the following address: Tiddington Road, Stratford-upon-Avon, CV37 7BJ.

Independent Auditors' Report to the members of Avon Insurance plc

We have audited the financial statements of Avon Insurance plc for the year ended 31 December 2005 which comprise the Profit and Loss Account, the Balance Sheet, the Cash Flow Statement, the Statement of Total Recognised Gains and Losses and the related notes. These financial statements have been prepared under the accounting policies set out therein.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the Directors' Report is not consistent with the financial statements, if the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read other information contained in the Annual Report, and consider whether it is consistent with the audited financial statements. This other information comprises the Directors' Report. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Equalisation reserves

Our evaluation of the presentation of information in the financial statements has had regard to the statutory requirement for insurance companies to maintain equalisation reserves. The nature of equalisation reserves, the amount set aside at 31 December 2005, and the effect of the movement in those reserves during the year on the general business technical result and profit before tax, are disclosed in notes 1c) and note 18 respectively.

Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the company's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended; and
- have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London, 22nd March 2006