

AA LIMITED (FORMERLY AA TOP CO LIMITED)
ANNUAL REPORT AND FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2006

Registered Number 5149111



AA LIMITED

CHAIRMAN'S FOREWORD

This has been another year of rapid progress at the AA. The financial story is an impressive one: revenue increased by 5.2% (6.7%¹ on a like-for-like basis) and operating profit² by 28.8%. Over the last two years, the picture is even better, with operating profit² almost doubling.

Our improved profitability has been derived as much from growth as it has been from cost reduction. During 2006 the business completed a major restructuring, and at the same time has embarked on a programme of investment that will support growth in the future.

The AA is now operating more efficiently, in particular central costs are significantly lower, and productivity has increased sharply in our Roadside Operations. However, the investments made by the business are also improving the experience of our customers. Here are just two examples: the new Vehicle Recovery System (VRS) being installed across the patrol fleet will enable our patrols to recover more unfixed breakdowns, saving customers time and improving service, and improvements to our systems will allow our insurance customers to renew policies online, saving them time and increasing retention.

The AA has reinvested a proportion of its efficiency savings into marketing and the Company's successful advertising campaigns are now driving record sales online and increased calls into our call centres. I am convinced that our decision to maintain our call centre operations in the UK was right, if not the lowest cost option in the short term, and this is reflected in the positive response of many AA customers.

2006 will be remembered for its hot summer, and our patrols demonstrated why they are the bedrock of the business on some extremely busy days. I would like to congratulate all of the AA's staff for their dedication to the needs of our customers, whether by the side of the road or in the demanding environment of our call centres. The AA has won a number of awards this year for customer service, marketing, finance, fleet operations and HR and these are a richly deserved tribute to all our people.

During the year, we took a decision that we would once again operate our own Public Affairs team as we have for the majority of our 100 year history. As a consequence, the AA's involvement with the AA Motoring Trust came to a close at the end of 2006. We are pleased that the Trust's charitable activities will be taken forward by the much respected charity, The Institute of Advanced Motorists. As part of re-establishing an AA Public Affairs team, the AA will be forming an external Advisory Group of experts to help ensure that policy on motoring affairs remains independent and informed.

In addition, the AA has taken the decision to be one of the UK's first private companies to move to IFRS as the basis of preparation for its financial statements.

In 2006 the AA acquired Direct Choice, a successful and growing Insurance broker. The management team is now looking at other opportunities to develop the business, organically and by acquisition. We have always believed that the AA, as the UK's premier motoring brand, has many exciting growth opportunities. Some first steps have been taken to realise this potential – with promising results. The Board is confident of trading prospects in the year ahead, as well as the successful expansion of the Group's activities in the medium term.

¹ Excluding terminated reinsurance contract (see page 7)

² Before amortisation of intangible assets and exceptional items

AA LIMITED

CHIEF EXECUTIVE'S REVIEW OF THE BUSINESS

This Annual Report reviews the second full year of the programme of transformation following the acquisition of the AA in 2004

During this last year, many of the projects started in 2005 have been completed, with significant improvements to the efficiency of the AA's operations. However, the main thrust of 2006 has been to reinvigorate the revenue line of the business and to implement a major programme of investment designed to strengthen the long-term competitiveness of the AA. This has included several important systems replacements and changes to the way people work, that will improve the experience of our customers. An important theme of 2006 has been further investment in marketing spend by our two core activities of breakdown and insurance, particularly online. Last year also saw the first acquisition by the AA for several years. Direct Choice is already making a significant contribution to the success of AA Insurance.

I am pleased to report that this renewed momentum in the marketplace has contributed to the strong trading of the Group during 2006. Revenue increased by 5.2% (6.7% on a like-for-like basis¹) and operating profit² increased from £195.3m to £251.6m, a rise of 28.8%. Profit after tax for the year was £36.0m representing an increase of £95.3m on 2005.

The operating profit² of Roadside Services rose 25.2% from £138.7m to £173.7m, operating profit² in Insurance Services increased by 59.8% from £38.1m to £60.9m. Other businesses collectively contributed £12.1m in 2006, up from £7.0m in 2005.

Exceptional charges fell sharply in 2006 to £25.3m from £121.1m in 2005. This reflects the more limited restructuring activities during 2006, and fewer changes to operations.

The Group was again strongly cash generative, with a net cash inflow from continuing operational activities (but before exceptional items) of £256.4m (2005: £214.1m).

These results are especially pleasing in view of the unusually high level of breakdowns attended during 2006. It was a year of meteorological extremes with long hot spells in the summer and several bouts of heavy rain or intense cold. These contributed to an increase of 4% in breakdown cases over 2005, an interruption to the longer-term, downward trend.

The year saw the economics of unsecured personal lending change fundamentally. An increase in the number of people opting for Individual Voluntary Arrangements (IVAs) was the main cause of rising bad debt provisions. Commissions from insurance-related products are also in decline. These factors, in conjunction with generally more competitive conditions, led to a fall in the AA's share of profit in the joint venture with HBOS, from £12.6m to £5.1m.

Discussions are now under way with HBOS with a view to the development of a less volatile business model that takes account of changing conditions in the marketplace.

During the course of the year we steadily improved service levels by the side of the road and in our call centres. The conclusion of the restructuring programmes in 2005 resulted in leaner staffing levels and this left us exposed when demand rose above forecast levels in the early months of 2006. We have responded by increasing the number of patrols and staff in our call centres to a level that can more readily absorb such unforeseen spikes in demand. There have been some strains placed on the system but as we enter 2007, we are exceeding our service delivery targets.

Productivity in the AA's patrol force remains high, and we have built on some of the changes made during 2005 to improve the delivery of the service. We have more flexibility in planning working hours, and improvements have also been made to the demand forecasting process. We have started a programme to renew and standardise the vehicle fleet, introducing innovative new technology that will drive improvements in the member experience.

We have had an excellent year in AA Insurance. Competition continues to be fierce in the personal lines market, but our insurance business has made good progress. Motor sales have been driven by effective advertising campaigns and also the rapidly developing aggregator sector. The motor portfolio has grown by 4.7% to 1,034,388 policies, and our portfolio of home policies has increased slightly by 0.5% to 643,876. During the year, we also launched two new products: commercial vehicle and motorcycle.

There has been significant growth of business online in 2006. The AA website has been redesigned, with much simpler and easier navigation through transactional pages. The results have been encouraging: over 18% of personal membership is sold online and the web now accounts for in excess of 40% of insurance policy sales. The AA website is one of the most frequently-visited commercial websites in the UK (placed 95 amongst all websites visited by UK residents by Hitwise in December) with over 154 million visitors a year to the Routes and Maps facility. The new travel portal, allowing visitors to access a range of additional information on any destination, is also proving popular.

¹ Excluding terminated reinsurance contract (see page 7)

² Before amortisation of intangible assets and exceptional items

CHIEF EXECUTIVE'S REVIEW OF THE BUSINESS (continued)

During 2006, the AA made a substantial investment in IT projects with a total spend of £37m. A wide-ranging programme to overhaul the desktop platform right across the business, at a cost of £17m, was completed. Systems replacements, many long overdue, were made to every area of the business and in addition, the AA changed both its mobile and fixed telecoms network. An extensive programme to support price optimisation in Insurance has gone well, and further progress has been made to update the Insurance call centre systems. This will make it much easier to manage information required to generate quotations and also to make cross-sales.

The AA's marketing campaigns have provided strong impetus to sales across the product range. The "You've Got AA Friend" campaign has underpinned the highest membership sales performance since 2003. The "AA Team" campaign has developed the AA's distinctive message of getting the best value insurance for customers from a large panel of underwriters.

The AA's other operations have also performed very well during 2006. The Driving School made good progress with a new commercial model increasing operating profit by 52.6%, and the Publishing business, benefiting from an exciting range of new titles, lifted operating profit by 184.6%. AA Ireland posted an increase in operating profit of 43.6%.

The performance of our business would not have been possible without the positive role played by our Central Support teams in IT, Finance, HR and Legal. The outstanding nature of these teams is winning external recognition through several awards – two good examples are the award of "Business Finance Team of 2006" by Accountancy Age and "HR Excellence Award 2006" by HR Magazine.

It is our view that the investments made during the course of the last year have laid a secure foundation for growth in the future. The market for breakdown services is competitive, but the AA has the UK's largest patrol force and a brand which is emblematic of motoring. As we frequently remind ourselves, there are an estimated 8 million people who do not have breakdown cover, and we have firm plans to recruit an even higher proportion of young motorists.

AA Insurance is the UK's largest personal lines insurance broker, and one of the top 5 insurance brands. With a strong pricing proposition and an efficient underwriting purchasing model, the business now has firm momentum in the marketplace.

Having remoulded the business, our priorities for the future are to develop our core activities, and to seek new opportunities for growth through acquisition. We also see great potential for the AA as the leading brand for motoring-related business online.

I commented last year that the AA is more than just a business, and that our company occupies a unique position in the British motoring landscape. We are entirely dependent on our people for this enviable reputation, whether based in the office or patrolling the roads. I would like to thank everyone for another year of great endeavour on behalf of our members and customers.

Roadside Services

During the year the AA attended 3.6 million breakdowns, up 4% on 2005. This was driven partly by increased membership but predominantly by the extra demand experienced across the industry due to extremely hot weather in the summer. Despite this sharply increased workload, our patrols coped valiantly and response times were similar to last year, with over 90% of jobs completed by the patrol who first attended. Productivity continued to improve across all areas of Road Operations, with repair rates rising above 79%.

We have slightly increased our Personal membership holding, following the significant investments made in 2005. This means that 2006 marks the first year in the last four in which the Personal membership holding has not declined. In total, the holding grew by 0.7% in 2006.

New business sales volumes have increased by an encouraging 11%. The re-launch of the Direct Sales Force early in the year has been a major contributor, with sales performance improving every quarter driven by headcount growth, new site development and maintaining productivity levels. The team have been shortlisted in the "Direct Sales Team of the Year" category at the 2007 National Sales Awards. The internet channel grew strongly in 2006 up 34% on 2005. This has been driven by increases in marketing investment at key points of the year as well as improvements in online sales processes. We have also added new customer functionality to our website in 2006, with further development planned for 2007. In May, we joined the Nectar scheme, and continue to drive revenue generating opportunities through this channel.

We launched our second "You've Got AA Friend" brand campaign, building on 2005's campaign to raise brand consideration levels by focusing on our key differentiator – the scale and quality of our patrol force. The campaign was well received, delivering the highest tracking scores of all recent AA advertising and also exceeding the highest benchmark in other motor and non-motor categories. The AA came 36th out of 500 in the UK's Superbrands survey in 2006 and in April, we were named as "the most trusted brand" in the UK motoring category by the Reader's Digest magazine.

CHIEF EXECUTIVE'S REVIEW OF THE BUSINESS (continued)

Roadside Services (continued)

Call centre restructuring has allowed us to handle more calls, with fewer people and with better service levels in 2006 than before. We have made significant investment in our call centre infrastructure, completing a refurbishment of the Cheadle site as well as delivering IT investment projects. In addition, our sales and upgrade conversion rates are at an all time high, despite strong competition. We were finalists in the Call Centre Association, Call Centre of the Year Awards in 2006 and one of our managers is a finalist in the "Sales Leader of the Year" category at the 2007 National Sales Awards. Our back office and administration department, Member Care, has been relocated from Basingstoke to Cheadle, delivering a significant improvement in customer response levels as well as an additional, multi-skilled resource to deal with peaks in telephony demand. The telemarketing department was also brought back onshore into Cheadle in May. The transition was seamless and we are now delivering excellent results. There is a significant amount of work under way to optimise this channel, which will be a key strand in delivering sales and service in 2007.

The AA Members Club was launched in early 2006 to reinforce the benefits of AA Membership to our members. As part of this initiative, we have distributed nearly 11 million member magazines, making this the second largest membership magazine publication in the UK. This initiative has delivered significant growth in redemption of member discounts, internal cross-sales and improved the retention of customers who receive the magazine.

We re-launched our previous Parts & Labour Cover product as Breakdown Repair Cover in March. The new product provides significant customer benefits compared to the previous one, and we have seen substantial improvements in sales as a result.

Our Business Services team enjoyed a year of rapid growth with sales increasing 9%. This reflected the impact of new contracts won in 2005, namely Ford, Peugeot, Citroen, Lombard and Leaseplan, as well as holdings growth on the Lloyds TSB contract. During 2006 we were unsuccessful in renewing the VW Group account which includes the VW, SEAT and Skoda brands. However, part of this shortfall will be made up by the ARC pan European Mercedes contract won towards the end of the year.

The team also won a number of awards during 2006

- Fleet Excellence Awards 2006 – "Best Vehicle Recovery" & "Best Service Supplier"
- Fleet News Awards – "Best Breakdown Service Company"
- Institute of Transport Management – "Breakdown and Recovery Company 2006"

In April, we implemented a four-year fleet replacement programme with an investment of nearly £15 million which will see all the patrol and recovery vehicles replaced with a new liveried vehicle. The new roadside patrol vans are equipped with new, bespoke technology – Vehicle Recovery System (VRS) – that enables recovery of the majority of cars by the attending patrol. This facilitates a 'one-stop shop' by our own, dedicated patrols which research confirms is an important factor for our members. In September, we launched the AA Academy Apprenticeship programme, in collaboration with the apprentice learning division of Carter & Carter Group plc, one of the leading providers of government funded learning for the motor industry. This type of investment in the future will ensure the right skills and resources are available within the motor industry.

We have completed our call centre consolidation, increasing the number of Teleworkers and we have updated our mapping, location and diagnostic capabilities. This reflects a significant investment in technology along with savings on occupancy costs.

Insurance Services

In 2006, AA Insurance has successfully built on the foundations laid down in 2005. Having returned to growth in the previous year, the business in 2006 has seen an increase in customers for all key products and the continued expansion in the range of products.

Private motor customer numbers broke through the 1 million barrier in March (for the first time since the mid-90's) and have grown every week since March 2005. Similarly, the historic decline in household policy numbers that was arrested in 2005 resumed growth in 2006 with total policies now just short of 650,000.

Cross-sales remain a real focus for AA Insurance, with not only the traditional routes of motor to home and vice versa being maximised, but also exploring the opportunities for the sale of AA Roadside membership. The net result of our customer service focus is that retention remains very strong with over 4 out of 5 people choosing to renew their policies with us.

As the year progressed, AA Insurance re-entered two key markets – motorcycle insurance and commercial vehicle insurance. These completed the product range enabling us to offer a full service to all our customers. In less than a full year's trading, just under 5,000 customers have chosen to place their motorcycle or commercial vehicle insurance with us, showing the relevance, competitiveness and quality of these offers.

AA LIMITED

CHIEF EXECUTIVE'S REVIEW OF THE BUSINESS (continued)

Insurance Services (continued)

The acquisition of Direct Choice in 2006 complements our offering to customers, bringing a new brand to deploy tactically in the marketplace, particularly in the expanding aggregator space

Following our restructuring in 2005, the benefits both in terms of cost and performance are now being realised. We now have the depth and quality of people to provide superior levels of customer service that will ultimately provide real differentiation for AA Insurance. The performance and professionalism of our employees has also received external recognition and during the year, AA Insurance won the following awards:

- Insurance Times – "Personal Lines Broker of the Year"
- Cardiff Customer Service Unit won "Customer Services Award" at the Welsh Contact Centre Awards
- Review Centre website users chose AA Insurance as – "Best Car Insurer 2006"

Personal Finance

The AA has operated a joint venture with HBOS for over 23 years with the main products being unsecured personal lending in the form of credit cards and loans. During 2006, we have commenced a strategic review of the joint venture given the volatility of earnings created by industry-wide problems around personal indebtedness and the rapid increase and availability of IVAs in the UK market.

While 2006 was a difficult year with total new gross lending falling 15% to £900m, our acquisition costs are reducing significantly as we develop increasingly effective marketing tools and we optimise our channel strategy. Our current approach is to develop a pipeline of unique propositions such as the six month, free warranty offered with a car loan. We plan to limit growth in 2007 across all channels in order to reduce new business credit risk and increase margins.

The business opened over 28,000 new cards in the year, up 31% from 2005. Total card borrowing is up 15% on 2005 with acquisition mainly via loan applications. There are plans for an improved online proposition and also an enhanced offer to members.

Other Businesses

Publishing

A streamlined management team has implemented a programme of restructuring. Emphasis is on product innovation, developing new channels to market and opening up emerging sales territories. As a result, and in spite of tough trading conditions on the UK High Street, AA Publishing increased its operating profit¹ by 184.6% for 2006.

Focus for the International Sales team is on new market opportunities in Scandinavia and Latin America and the new product development programme has seen encouraging initial results – "The Guest List" featured on the "Richard and Judy Christmas Book Club" on Channel 4. Podcasts and downloadable travel guides are also under development.

AA Publishing has continued to attract accolades:

- ESRI User Conference – "Special Achievement Award" for its cartographic database system
- British Cartographic Society Awards – "Commended" for its Electronic Mapping
- Ordnance Survey Commercial and Partner Alliance Programme 2006 – nominated as "Platinum Partner of the Year"

Almost £1m was spent on the AA.com/travel web portal in 2006, further extending the appeal of the successful Route Planner which served 154 million routes this year.

¹ Before amortisation of intangible assets and exceptional items

CHIEF EXECUTIVE'S REVIEW OF THE BUSINESS (continued)

Other Businesses (continued)

Driving School

In 2006, revenue increased by 21% and operating profit¹ rose 52.6%. This was an excellent result, and was due, in the main, to the re-launch of the instructor franchise package introduced at the beginning of the year. Instructor holdings rose by 6% in the year to end on the highest holdings figure in Driving School's 16 year history.

Over the year, pupil numbers increased by 16%, driven mainly by a 5 point increase in contact centre call conversion. This was aided by strong performance from the website, assisted by the launch of a new online 'learn to drive' knowledge centre, primarily aimed at new drivers. The Driving Instructor Training product, launched late in 2005, has grown strongly and created a valuable pipeline of future AA franchise instructors. We also commenced trading in Northern Ireland and invested significantly more on awareness and online marketing.

During the year, Driving School completed the majority of the work on an IT programme that will revolutionise the existing operating platform and supporting call centre technology. Completion is scheduled for May 2007.

Signs

AA signs maintained its position as market leader in event road signage and erected over 76,000 temporary road signs across the UK in 2006.

New contracts this year included the Leeds Festival and the Bristol half marathon while retaining prestigious events such as Royal Ascot and Wimbledon.

We developed new sign design, schedule and mapping software and began implementing a new signs manufacturing process – all providing significant benefits for the coming year.

Republic of Ireland

Operating profit¹ increased 43.6% on last year reflecting strong sales growth across the businesses. Total Membership holding increased by 27% in 2006 to 396,000, another record year for membership growth.

The first full year for the Ford contract made a significant contribution, and we also won the accounts for Volkswagen, Audi and Skoda. The Personal Membership holding has grown by 8% in 2006, and, more encouragingly, the number of members opting for the full package grew by 14%. The growth in holding has, inevitably, resulted in increased demand for the Breakdown Service and calls for assistance were up 19% on last year. While this and the continuing severe traffic congestion has been the cause of a slight reduction in our service level performance, plans are in place to ensure improvements in 2007.

The combined Insurance Portfolio is up 16% this year to 145,000 policyholders. Acquisitions added 8% to the portfolio growth and organic growth added a further 8%.

Towards the end of 2006, AA Finance was launched in the Republic of Ireland offering car loans and this will be extended to unsecured loans and credit cards in 2007.

AA Ireland was the chosen partner for directional signs for the 2006 Ryder Cup and with AA Roadwatch playing its part on radio, significant brand exposure was achieved.

Conclusion

Our focus in the AA in 2006 has been to further improve and build on the changes we made in 2005. This has not been without its challenges but our teams have worked hard throughout the year to overcome these and I am delighted with the progress we are making. Our investment programme has enabled us to make significant improvements to our operating efficiency, customer service and competitiveness not only now, but also in the long-term. There are exciting growth opportunities in the future for the AA to pursue and I look forward to reporting on our further progress in due course.

¹ Before amortisation of intangible assets and exceptional items

AA LIMITED

FINANCE DIRECTOR'S REVIEW

The full income statement for the year is set out on page 13

Summary of Results

	2006 Continuing operations £m	2006 Acquisitions £m	2006 Total £m	2005 Total £m
Revenue				
Roadside Services	542.7	-	542.7	525.1
Insurance Services excl AARe Churchill ¹	168.4	8.5	176.9	152.3
Other Businesses	74.6	-	74.6	66.7
Total – excl AARe Churchill ¹	785.7	8.5	794.2	744.1
AA Reinsurance – Churchill Contract ¹	-	-	-	11.0
Total	785.7	8.5	794.2	755.1

Operating Profit

Before amortisation and exceptional items

Roadside Services	173.7	-	173.7	138.7
Insurance Services	57.8	3.1	60.9	38.1
Personal Finance	4.9	-	4.9	11.5
Other Businesses	12.1	-	12.1	7.0
Total operating profit before amortisation of intangible assets and exceptional items	248.5	3.1	251.6	195.3

Income statement

Trading results

Revenue on continuing operations was up by £41.6m to £785.7m (5.6%) Including 6 months results for Direct Choice, revenue on continuing operations increased by £50.1m to £794.2m (6.7%)

Operating profit on continuing operations before amortisation of intangible assets and exceptional items of £248.5m grew by £53.2m representing a 27.2% increase Including 6 months results for Direct Choice, operating profit before amortisation of intangible assets and exceptional items increased by £56.3m to £251.6m (up 28.8%) This improvement was driven by stronger results across all our businesses with the exception of our Personal Finance business

Exceptional Items

Exceptional items during the year amounted to £25.3m (2005 £121.1m) These related mainly to the completion of the separation and transition programme from Centrica, IT systems changes within the Insurance business, and various headcount reduction initiatives

Finance costs

Group net finance costs were £201.7m (2005 £209.2m), of which £150.8m (2005 £122.5m) related to interest on bank loans and overdrafts £124.7m (2005 £94.7m) was payable in cash and £26.1m (2005 £27.8m) was capitalised

Following the refinancing of the Group's borrowings on 15 March 2006, £545.0m of Subordinated Preference Certificates and £111.1m of bank borrowings were repaid and augmented by additional bank borrowings of £622.0m This reduced the average funding costs on bank borrowings from 12.2% at 31 December 2005 to 9.3% at 31 December 2006 Further details of the Group's borrowings are in note 23

Taxation

The tax credit for the year on continuing operations was £11.9m (2005 £67.9m) This is mainly due to a deferred tax credit of £11.2m (2005 £69.3m) as the Group has benefited from the availability of brought forward tax losses and capital allowances

Profit after tax

Overall, the Group made a profit after tax and discontinued operations of £36.0m (2005 loss after tax and discontinued operations of £59.3m)

¹ The Group terminated its contract to reinsure a 50% quota share of the Churchill motor book on 4 May 2004 The impact on operating profit was broadly neutral

FINANCE DIRECTOR'S REVIEW (continued)

Acquisitions

In July 2006, the Group completed the acquisition of Direct Choice, an insurance intermediary for a consideration of £57.8m. Net of cash on the balance sheet, the consideration was £55.8m. This gave rise to goodwill of £41.5m. This acquisition contributed £3.1m to operating profit before amortisation of intangible assets and exceptional items during the year.

Cash Flow

The Group continues to be strongly cash generative on its operating activities. Net cash inflow from continuing operating activities and before exceptional items was £256.4m (2005: £214.1m). In addition the Group received £9.2m (2005: £11.9m) of interest and £0.3m (2005: £6.0m) from the surrender of tax losses. Of this, £103.5m (2005: £134.9m) was applied in exceptional items, £9.9m (2005: £16.5m) on discontinued operations and £185.8m (2005: £236.4m) in financing activities. There was a £55.4m cash outflow in respect of the acquisition of Direct Choice offset by £10.0m (2005: £8.0m) received as an adjustment to the consideration on the acquisition of AA Corporation Limited in 2004.

Cash and cash equivalents and financial assets – short term deposits at the year end amounted to £112.6m (2005: £196.5m) of which £99.2m (2005: £104.1m) was held within the Group's insurance subsidiaries to meet regulatory requirements.

Financial Risks

The Group is exposed to limited financial risks. The Group's overall risk management programme focuses on the unpredictability of financial markets and seeks to minimise potential risks for the Group. The Board reviews and agrees policies for managing risks. The most important components of financial risk impacting the Group are interest rate risk, credit risk and liquidity risk.

Interest rate risk

The Group's income and operating cash flows, with the exception of the Personal Lending joint venture, are largely independent of changes in interest rates. Revenue from the Personal Lending joint venture is substantially derived from products with fixed rates of interest. The joint venture manages its interest rate risk by funding its business primarily through fixed rate borrowings and matching, where possible, the term of its borrowings to the anticipated customer repayment profile.

The Group mainly finances its operations through bank borrowings. The Group's borrowings are in sterling and at the year end, LIBOR was fixed using interest rate swaps on £1,034.5m, representing 55% of the Group's borrowings.

Credit risk

Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The Group's policy is to limit counterparty exposures by setting credit limits for each counterparty, where possible, by reference to published credit ratings. Surplus cash is invested in short-term financial instruments and only deposited with counterparties meeting a minimum credit rating requirement set by the Board.

Liquidity risk

Liquidity risk is the risk that cash may not be available to pay obligations when due. Cash forecasts identifying the liquidity requirements of the Group are produced frequently. These are reviewed regularly by the Board to ensure that sufficient financial headroom exists for at least a 12 month period. The Group's policy includes maintaining a minimum level of committed facilities and that a proportion of debt should be long-term, spread over a range of maturities. As at 31 December 2006, the Group had undrawn committed facilities of £89.2m.

Foreign currency risk

The Group has limited exposure to foreign currency risk with one overseas subsidiary in the Republic of Ireland and shareholdings in several Euro based entities. In addition, certain subsidiaries are exposed to exchange rate movements as a result of selling or purchasing in foreign currencies. The principal currencies to which the Group is exposed are the Euro and the US Dollar. The Board has reviewed the net exposure to foreign exchange risk and has concluded that no hedging is required. This policy is subject to periodic review.

AA LIMITED

FINANCE DIRECTOR'S REVIEW (continued)

Basis of preparation

UK listed companies are required to comply with the European regulation to report consolidated financial statements in conformity with International Financial Reporting Standards (IFRSs) from 1 January 2005 onwards

To facilitate a more consistent basis of interpretation with these companies, the AA has voluntarily elected to present its consolidated results for the year ended 31 December 2006 on an IFRS basis and the comparative information for 2005 has been restated accordingly. Note 38 to the financial statements summarises the impact of first time adoption of IFRS and provides a reconciliation of the Group's IFRS balance sheet from 31 December 2004 on a UK GAAP basis to 1 January 2005 under IFRS.

AA LIMITED

STATUTORY DIRECTORS' REPORT

The directors present their report and audited financial statements of AA Limited (formerly AA Top Co Limited) for the year ended 31 December 2006. The Company changed its name to AA Limited on 22 December 2006.

DIRECTORS

The directors, who held office in the year, were as follows:

Sir Trevor Chinn	
Derek Elliott	(resigned 24 October 2006)
Pevenl Hooper	(appointed 24 November 2006)
Jonathan Kaye	(resigned 24 November 2006)
Robert Lucas	
Philip Muelder	(appointed 24 October 2006)
Timothy Parker	
Charles Sherwood	
Paul Woolf	

Details of the shareholdings and remuneration of the directors are included in note 34 to the financial statements.

PRINCIPAL ACTIVITIES

The Group's principal activities are the provision of roadside and financial services in the UK and Ireland.

REVIEW OF BUSINESS AND FUTURE DEVELOPMENTS

A review of the business and future developments is contained in the Chief Executive's Review of the Business on pages 2 to 6 and the Finance Director's Review on pages 7 and 9.

The directors do not recommend the payment of a dividend for the period (2005: £nil) and accordingly, the profit for the year is transferred to reserves.

EMPLOYMENT POLICIES

It is the policy of the Group to ensure that all disabled people, whether registered or not, should receive full and fair consideration for all appropriate job vacancies, training and development opportunities. Employees, who become disabled during employment, will be retained in employment wherever possible and will be given assistance with any retraining that is required.

The Group is committed to keeping employees and their representatives fully informed on all matters affecting them both of a financial and non-financial nature. This is achieved through a range of formal and informal briefings, publications and the use of electronic media.

CHARITABLE DONATIONS

The Group contributed £2.1m (2005: £1.0m) to charities, principally the AA Motoring Trust, during the period. There were no political donations.

AA LIMITED

STATUTORY DIRECTORS' REPORT (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Annual Report and the financial statements in accordance with applicable laws and regulations

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group for that period. Under that law the directors have prepared group financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, and the parent company financial statements in accordance with United Kingdom Accounting Standards. The directors are required to prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the Company and the Group will continue in business.

The directors confirm that suitable accounting policies have been used and consistently applied. They also confirm that reasonable and prudent judgements and estimates have been made in preparing the financial statements for the period ended 31 December 2006 and that applicable accounting standards have been followed.


The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group 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 the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

DISCLOSURE OF INFORMATION TO AUDITORS

In the case of each of the persons who are directors at the time when the report is approved:

- So far as the director is aware, there is no relevant audit information (that is, information needed by the Company's auditors in connection with preparing their report) of which the Company's auditors are unaware, and
- The director has taken all the steps that he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

BY ORDER OF THE BOARD



SIR TREVOR CHINN
DIRECTOR
28 February 2007

Registered Office
Fanum House
Basing View
Basingstoke
Hampshire
RG21 4EA

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF AA LIMITED

We have audited the group financial statements of AA Limited for the year ended 31 December 2006 which comprise the Consolidated Income Statement, the Consolidated Balance Sheet, the Consolidated Cash Flow Statement, the Consolidated Statement of Recognised Income and Expense and the related notes. These group financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent company financial statements of AA Limited for the year ended 31 December 2006.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the group financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the group 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 group financial statements give a true and fair view and whether the group financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the group financial statements.

In addition we report to you if, in our opinion, 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 group financial statements. The other information comprises only the Statutory Directors' Report, the Chairman's Foreword, the Chief Executive's Review of the Business and the Finance Director's Review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the group financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

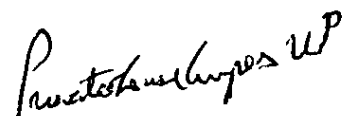
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the group financial statements. It also includes an assessment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

Opinion

In our opinion:

- the group financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2006 and of its profit and cash flows for the year then ended,
- the group financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the group financial statements.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
28 February 2007

AA LIMITED

CONSOLIDATED INCOME STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 Before exceptional items £m	2006 Exception- al items £m	2006 Total £m	2005 Before exceptional items £m	2005 Exception- al items £m	2005 Total £m
Continuing operations excluding terminated contract*		794 2	-	794 2	744 1	-	744 1
Terminated contract		-	-	-	11 0	-	11 0
Revenue	3,4	794 2	-	794 2	755 1	-	755 1
Operating expenses before amortisation of intangible assets	5	(547 7)	(25 3)	(573 0)	(572 4)	(121 1)	(693 5)
Share of net profit of joint ventures and associates	16	5 1	-	5 1	12 6	-	12 6
Operating profit before amortisation of intangible assets		251 6	(25 3)	226 3	195 3	(121 1)	74 2
Amortisation of intangible assets	13	(3 3)	-	(3 3)	(3 3)	-	(3 3)
Operating profit	3	248 3	(25 3)	223 0	192 0	(121 1)	70 9
Finance income	8			20 6			19 4
Finance costs	9			(222 3)			(228 6)
Profit/(loss) before taxation				21 3			(138 3)
Taxation credit	10			11 9			67 9
Profit/(loss) after tax from continuing operations				33 2			(70 4)
Profit from discontinued operations	11			2 8			11 1
Profit/(loss) for the year	29			36 0			(59 3)

*The Group terminated its contract to reinsure a 50% quota share of the Churchill Motor book on 4 May 2004. The impact on operating profit is broadly neutral.

AA LIMITED

CONSOLIDATED STATEMENT OF RECOGNISED INCOME AND EXPENSE

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £m	2005 £m
Actuarial gain recognised in the retirement benefit obligation	26	119 6	15 3
Deferred tax arising on the actuarial gain in the retirement benefit obligation	14	(35 7)	(5 6)
Exchange translation differences	28	-	0 3
Cashflow hedges			
Fair value gains		24 7	5 6
Recycled and reported in net profit		(5 2)	(5 0)
Deferred tax arising on gains on cashflow hedges	14	(5 8)	3 5
Net income recognised directly in equity		97 6	14 1
Profit/(loss) for the year		36 0	(59 3)
Total recognised income/(expense) for the year		133 6	(45 2)

AA LIMITED

CONSOLIDATED BALANCE SHEET AT 31 DECEMBER 2006

	Notes	2006 £m	2005 £m
NON-CURRENT ASSETS			
Goodwill	12	1,734.5	1,694.9
Intangible assets	13	26.8	8.7
Deferred tax asset	14	49.4	110.3
Property, plant and equipment	15	80.1	79.9
Interests in joint ventures and associates	16	2.5	3.2
Held-to-maturity investments		1.6	1.3
Retirement benefit asset	26	68.9	-
		<u>1,963.8</u>	<u>1,898.3</u>
CURRENT ASSETS			
Deferred tax asset	14	30.6	-
Inventories	17	8.0	7.9
Trade and other receivables	18	195.4	197.1
Non-current assets held for sale	19	-	1.1
Financial assets – derivative financial instrument		7.9	-
Financial assets – short term deposits	20	15.4	14.6
Cash and cash equivalents	20	97.2	181.9
		<u>354.5</u>	<u>402.6</u>
TOTAL ASSETS	3	<u>2,318.3</u>	<u>2,300.9</u>
CURRENT LIABILITIES			
Financial liabilities	21	(124.6)	(35.5)
Trade and other payables	22	(221.6)	(216.1)
Deferred income		(261.3)	(267.7)
Current tax liability		(15.2)	(19.1)
Current provisions	25	(20.0)	(58.8)
		<u>(642.7)</u>	<u>(597.2)</u>
NON-CURRENT LIABILITIES			
Financial liabilities	21	(1,763.6)	(1,808.6)
Non-current provisions	25	(62.0)	(79.8)
Retirement benefit liability	26	(48.6)	(147.5)
		<u>(1,874.2)</u>	<u>(2,035.9)</u>
TOTAL LIABILITIES	3	<u>(2,516.9)</u>	<u>(2,633.1)</u>
NET LIABILITIES		<u>(198.6)</u>	<u>(332.2)</u>
EQUITY			
Called up share capital	27	0.2	0.2
Share premium	28	0.8	0.8
Hedging and translation reserve	28	5.7	(8.0)
Retained earnings	29	(205.3)	(325.2)
EQUITY SHAREHOLDERS' DEFICIT	29	<u>(198.6)</u>	<u>(332.2)</u>

The financial statements on pages 13 to 52 were approved by the board of directors on 28 February 2007 and were signed on its behalf by


SIR TREVOR CHINN
DIRECTOR

The notes on pages 17 to 52 form part of these financial statements

AA LIMITED

CONSOLIDATED CASH FLOW STATEMENT

FOR THE YEAR ENDED 31 DECEMBER 2006

	Notes	2006 £m	2005 £m
CASH FLOWS FROM OPERATING ACTIVITIES			
Cash generated from continuing operations	30	256 4	214 1
Cash outflow from exceptional items	30	(103 5)	(134 9)
Cash outflow from discontinued operations	30	(9 9)	(16 5)
Interest received		9.2	11 9
Taxation paid		(1.1)	(1 1)
Receipts from surrender of tax losses from joint ventures		0 3	6 0
NET CASH FROM OPERATING ACTIVITIES		151 4	79 5
CASH FLOWS FROM INVESTING ACTIVITIES			
Acquisition of subsidiaries	32	(45 4)	(8 0)
Investment in associates		(0 3)	-
Purchase of property, plant and equipment		(7 2)	(1 6)
Proceeds from the sale of property, plant and equipment		6 7	6 7
Purchase of intangible assets		(6 5)	(5 0)
Proceeds from the sale of joint venture and investments		-	24 5
NET CASH FROM INVESTING ACTIVITIES		(52 7)	16 6
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issue of ordinary share capital		-	0 4
Purchase of own shares and borrowings		-	(0 1)
Net proceeds from issue of new borrowings		622 0	-
Repayment of borrowings		(656 1)	(89 6)
Interest paid on borrowings		(124 7)	(94 7)
Issue costs of borrowings		(9 7)	(30 3)
Bank charges		(2 2)	(1 5)
Finance lease payments		(14 3)	(14 8)
Net change in financial assets – short term deposits		(0 8)	(5 8)
NET CASH FROM FINANCING ACTIVITIES		(185.8)	(236 4)
NET DECREASE IN CASH AND CASH EQUIVALENTS		(87.1)	(140 3)
Cash and cash equivalents net of overdraft at 1 January	31	180 8	321 1
CASH AND CASH EQUIVALENTS NET OF OVERDRAFT AT 31 DECEMBER	31	93 7	180 8

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS

1 BASIS OF PREPARATION

General information

AA Limited is a limited liability company incorporated in England and Wales and domiciled in the UK. The address of the registered office is Fanum House, Basing View, Basingstoke, Hampshire, RG21 4EA. The Company is the ultimate parent undertaking of the Group.

These financial statements are presented in pounds sterling which is the currency of the primary economic environment in which the Group operates.

The financial statements were authorised for issue by the directors on [] March 2007.

2 ACCOUNTING POLICIES

The consolidated financial statements of AA Limited have been prepared for the first time in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union, International Financial Reporting Interpretation Council (IFRIC) interpretations and those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRS are given in note 38.

The consolidated financial statements have been prepared under the historic cost convention as modified by the classification of derivatives at fair value.

The principal accounting policies are set out below.

Consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries). Control is achieved where the Company has the power to govern the financial and operating policies of entities in which it has invested in order to obtain economic benefit from its activities.

Business combinations have been accounted for by applying the purchase method. On acquisition, the assets, liabilities and contingent liabilities assumed in a business combination are measured at their fair values at the date of acquisition. Any excess of the consideration paid over the fair values of the identifiable net assets acquired is recognised as goodwill.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies into line with those used by the Group. All intra-group transactions, balances, income and expenses are eliminated on consolidation.

Interests in joint ventures and associates

A joint venture is an undertaking in which the Group has a long-term interest and shares control with one or more co-venturers through a contractual agreement.

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participating in the financial and operating policy decisions of the investee.

The results, assets and liabilities of joint ventures and associates are incorporated in these financial statements using the equity method of accounting except when classified as held for sale (see below). Investments in joint ventures and associates are carried in the Group balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets less any impairment in the value of individual investments. Losses of the joint venture or associate in excess of the Group's interest in those joint ventures and associates are not recognised unless the Group is contractually obliged to make good those losses, in which case the Group's share of any net liabilities of joint ventures and associates is shown within provisions.

The Group's investment in joint ventures and associates includes goodwill identified on acquisition, net of any accumulated impairment losses.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

2 ACCOUNTING POLICIES (continued)

Foreign currencies

Transactions in currencies other than the functional currency of each consolidated undertaking are recorded at rates of exchange prevailing on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are translated into the respective functional currency at rates of exchange ruling at the balance sheet date. Gains and losses arising on the translation of assets and liabilities are taken to the income statement.

The results of overseas operations are translated into sterling at average rates of exchange for the period. Exchange differences arising on the retranslation of the opening net assets of overseas operations are transferred to the Group's cumulative translation reserve in equity.

Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identified assets and liabilities of a subsidiary at the date of acquisition. Goodwill is recognised as an asset and reviewed for impairment annually. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, the attributable amount of goodwill is included in the determination of the profit or loss on disposal which is taken to the income statement.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date.

Intangible assets

Intangible assets other than goodwill which are acquired separately are stated at cost. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition.

Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and accumulated impairment losses. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired.

Amortisation is charged on the following bases:

Brand	5% - 10%
Customer relationships	10% - 20%
Software	20% - 33 33%

Property, plant and equipment

Land and buildings held for use in the production of goods and services or for administrative purposes are stated in the balance sheet at cost or fair value at acquisition less any subsequent accumulated depreciation and impairment losses. No capitalised interest is included in the cost of items of property, plant and equipment.

Vehicles, fixtures and equipment are stated at fair value at acquisition less accumulated depreciation and any recognised impairment loss.

Depreciation is charged so as to write off the cost or valuation of assets, other than land, over their estimated useful lives, using the straight line method on the following bases:

Freehold properties	2%
Long leasehold properties	2%
Short leasehold properties	Over lease term
Vehicles	14% - 33 33%
Fixtures and equipment	5% - 33 33%

Assets held under finance leases are depreciated on a straight line basis over the lease term.

Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. The sale should be expected to qualify for recognition as a completed sale within one year from the date of classification.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

2 ACCOUNTING POLICIES (continued)

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost comprises design costs, raw materials and direct labour. Net realisable value is the estimated selling price less applicable selling expenses.

Trade receivables

Trade receivables are recognised initially at fair value less provision for impairment. A provision for impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances and call deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form an integral part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the consolidated cash flow statement.

Trade payables

Trade payables are not interest bearing and are recognised at fair value.

Insurance contracts – payables and receivables

Payables and receivables are recognised when they fall due. These include amounts due to and from insurance contract holders to which inward reinsurance contracts have been issued by the Group.

At each balance sheet date, liability adequacy tests are performed to ensure the adequacy of the insurance contract liabilities. In performing these tests, current best estimates of future contractual cash flows and claims handling and administration expenses are used. Any deficiency is immediately charged to the income statement by increasing claims accruals.

Financial instruments

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument. They are classified according to the substance of the contractual arrangements entered into.

Debt instruments

Debt is initially recognised in the balance sheet at fair value less transaction costs incurred directly in connection with the issue of the instrument. Finance costs in respect of the instruments, including discounts on issue, are capitalised at inception and charged to the income statement over the term of the instrument using the effective interest method.

Equity instruments

An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all its liabilities. Equity instruments are recognised at proceeds received less direct issue costs.

Derivative financial instruments

The Group's activities expose it to the financial risk of changes in interest rates. The Group uses interest rate swap contracts to hedge these exposures. In order to qualify for hedge accounting, the Group is required to document from inception the relationship between the item being hedged and the hedging instrument. The Group is also required to document and demonstrate an assessment of the relationship between the hedged item and the hedging instrument, which shows that the hedge will be highly effective on an ongoing basis. This effectiveness testing is performed at each period end to ensure that the hedge remains highly effective.

Derivative financial instruments are recorded in the balance sheet at fair value. The fair value of derivative financial instruments is determined by reference to market values for similar financial instruments. Changes in the fair value of derivative financial instruments that are designated and highly effective as hedges of future cashflows are recognised directly in equity. Amounts accumulated in equity are recycled in the income statement in the period when the hedged item affects profit or loss. The gain or loss relating to the effective portion of interest rate swaps hedging variable rate borrowings is recognised in the income statement within finance costs. When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement.

NOTES TO THE FINANCIAL STATEMENTS (continued)

2 ACCOUNTING POLICIES (continued)

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all of the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Assets held under finance leases are recognised as assets of the Group at their fair value or, if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The corresponding liability to the lessor is included on the balance sheet as a financial liability. Lease payments are apportioned between finance charges and the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to the income statement.

Rentals payable under operating leases are charged to the income statement on a straight-line basis over the term of the relevant lease. Benefits received and receivable as an incentive to enter into an operating lease are spread on a straight line basis over the lease term.

Provisions

A provision is required when the Group has a present legal or constructive obligation as a result of a past event and it is probable that settlement will be required of an amount that can be reliably estimated.

Provisions for restructuring costs are recognised when the Group has a detailed formal plan for the restructuring that has been communicated to affected parties. Provisions are discounted where the impact is material.

In relation to unoccupied properties, where a decision has been made prior to the year end to permanently vacate the property, provision is made for future rent and similar costs net of any rental income expected to be received up to the estimated date of final disposal. Provision is made on a discounted basis.

Retirement benefit obligation

The cost of providing benefits under defined benefit retirement schemes is determined using the Projected Unit Credit Method discounted using the interest rate of a corporate high quality bond denominated in the currency in which the benefits will be paid and that they have terms to maturity approximately to the terms of the related pension liability. Valuations are updated by an actuary at each balance sheet date. Actuarial gains and losses are recognised in full in the period in which they occur in the statement of recognised income and expense.

Past service cost is recognised immediately in the income statement to the extent that benefits are already vested, or is otherwise amortised on a straight-line basis over the average period until vesting occurs. Curtailment and settlement gains and losses are recognised immediately in the income statement. Interest costs arising due to the increase in the present value of the defined benefit obligation are recognised in finance costs in the income statement.

The retirement benefit obligation recognised in the balance sheet represents the present value of the defined benefit liability as adjusted for unrecognised past service cost, and as reduced by the fair value of scheme assets.

Treasury shares

Where the Company or its subsidiaries purchase or fund the purchase of the Company's share capital, the consideration paid is shown as a deduction from total shareholders' equity.

Revenue recognition

Revenue is measured at the fair value of the consideration receivable in respect of goods and services provided net of discounts, value added tax and other sales related taxes.

Roadside membership subscriptions and premiums receivable on other insurance products are shown gross of any commission due to intermediaries and are exclusive of insurance premium tax. Premiums are recognised over the period in which the Group is liable for risk cover. The proportion of the premiums written relating to the period of the policy that has not expired at the balance sheet date is shown within deferred income.

Sales of goods are recognised when goods are delivered and title has passed.

Revenue is recognised for commission receivable on products serviced by third party companies at the point that the Group has completed its contractual obligations and, therefore, obtained the right to the commission.

Interest revenue in respect of trade receivables is accrued on a time basis, by reference to the principal outstanding and at the effective rate of interest applicable, which is the rate that discounts future estimated cash receipts through the expected life of the financial asset to the asset's net carrying amount. All other interest income is presented under the heading 'Finance income'.

NOTES TO THE FINANCIAL STATEMENTS (continued)

2 ACCOUNTING POLICIES (continued)**Insurance contracts**

Insurance contracts are defined as those containing significant insurance risk. Significant insurance risk arises if an insured event could cause an insurer to pay benefits or incur costs at the inception of the contract. Such contracts remain designated as insurance contracts until all rights and obligations are extinguished or expire.

Insurance contracts continue to be measured and accounted for under existing accounting practices at the date of transition to IFRS. Accounting for Roadside recovery services is described in the 'Revenue recognition' accounting policy. The majority of the Group's insurance contracts are outside the scope of the ABI SORP.

Insurance contracts – operating expenses

Commissions and other acquisition costs that vary with, and are related to, securing new and renewing existing insurance contracts are expensed to the income statement at the point they are incurred.

Claims incurred comprise claims and related expenses paid in the year and changes in the accruals for outstanding claims, including accruals for claims incurred but not reported and any other adjustments to claims from previous years. Claims incurred include the cost of providing breakdown assistance which is expensed as incurred.

Exceptional items

Exceptional items are events or transactions that fall within the activities of the Group and which by virtue of their size or incidence have been disclosed in order to improve a reader's understanding of the financial statements.

Borrowing costs

Borrowing costs are recognised in the income statement in the period in which they are incurred.

Taxation

The taxation expense in the income statement comprises the sum of current and deferred tax.

Current tax is based on taxable profit for the year. Taxable profit differs from net profit as reported in the income statement because it excludes items of income and 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 computed using tax rates that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amount 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. Such assets and liabilities are not recognised if the temporary difference arises from goodwill or from the initial recognition of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries and associates and interests 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.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset realised. Deferred tax is charged or credited to 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.

Segmental analysis

The Group reports its operations for segmental purposes under the headings Roadside services, Insurance services, Personal Finance and Other businesses. These are the segments that are reported for management purposes. Segments are based on business operations because this is where Group risk and return is focussed. The Group's exposure to risk derived from geographical considerations is limited as its operations are focussed primarily in the UK.

NOTES TO THE FINANCIAL STATEMENTS (continued)

2 ACCOUNTING POLICIES (continued)**Segmental analysis (continued)**

Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Finance income arising from amounts held for regulatory purposes by the Group's insurance subsidiary undertakings is allocated to segments.

Critical accounting estimates and judgements

Estimates and judgements are evaluated continually and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. The Group makes estimates and assumptions about the future. The resulting accounting estimates will, by definition, seldom equal the related actual results. The principal estimates and assumptions that have a risk of causing an adjustment to the carrying amounts of assets and liabilities within the next financial period are discussed below.

Income taxes

The Group is subject to income taxes in the UK and the Republic of Ireland. At each financial period end, judgement is required in determining the provision for income taxes. The Group recognises liabilities for anticipated tax issues based on the best estimates at the balance sheet date. Where the final tax outcome of these matters is different from the amounts that were initially recorded, such differences will impact the income tax and deferred tax provisions in the period in which such determination is made.

Vacant property provisions

The Group makes a provision against the future lease costs of vacant properties for the remaining period of the lease, net of sub-letting income. The provision is calculated on a pre-tax discounted basis.

Retirement benefit obligation

The Group's retirement benefit obligation, which is assessed each period by actuaries, is based on key assumptions including return on plan assets, discount rates, inflation, future salary and pension costs. These assumptions may be different to the actual outcome.

Impairment of goodwill

The Group determines whether goodwill is impaired at least on an annual basis. This requires an estimation of the value in use of the cash generating unit to which goodwill is allocated. Estimating the value in use requires the Group to make an estimate of the expected future cash flows from the cash generating unit and apply an appropriate pre-tax discount rate.

Insurance contracts – claims costs

The estimation of the ultimate liability from claims made under insurance contracts is not considered to be one of the Group's most critical accounting estimates. This is because the principal insurance claims costs for the group relate to the provision of Roadside recovery services. There is a short period of time between the receipt of a claim, i.e. a breakdown, and the settling of that claim. Consequently there are no significant provisions for unsettled claims costs.

Accounting standards not yet effective

The following standards and interpretations are in issue but have not been applied in these financial statements as they are not yet effective:

- IFRS 8 'Operating Segments'
- IFRS 7 'Financial Instruments: Disclosures' and the related amendment to IAS 1 on capital disclosures
- IFRIC 12 'Service concession agreements'
- IFRIC 11 'IFRS 2 – Group and treasury share transactions'
- IFRIC 10 'Interim financial reporting and impairment'
- IFRIC 9 'Re-assessment of embedded derivatives'
- IFRIC 8 'Scope of IFRS 2'
- IFRIC 7 'Applying the restatement approach under IAS 29 financial reporting in hyperinflationary economies'

The directors anticipate the adoption of these standards and interpretations in future periods will have no material impact on the financial statements of the Group except for additional disclosures to capital and financial instruments when the relevant standards come into effect for periods commencing on or after 2 January 2006. No standards and interpretations that are in issue, but not yet effective, have been adopted early.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

3 SEGMENTAL ANALYSIS BY CLASS OF BUSINESS

In the directors' opinion, the Group's activities were managed in one geographical segment in the period, primarily the UK Segment results, assets and liabilities include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Unallocated inter-segment sales are not material. Segmental analysis of the Group's activities by class of business is given below.

Primary segment operating result

Year ended 31 December 2006	Roadside services	Insurance services	Personal Finance ²	Other Businesses	Total
	£m	£m	£m	£m	£m
Segment revenue					
Group revenue	542.7	176.9	-	74.6	794.2
Segment result					
Profit before amortisation of intangible assets, exceptional items, finance costs and taxation	173.7	60.9	4.9	12.1	251.6
Amortisation of intangible assets	(1.3)	(1.8)	-	(0.2)	(3.3)
Exceptional items	(11.8)	(13.1)	-	(0.4)	(25.3)
Profit before finance costs and taxation	160.6	46.0	4.9	11.5	223.0
Segment finance income	0.9	3.4	-	0.5	4.8
Segment result	161.5	49.4	4.9	12.0	227.8
Group net finance costs					(206.5)
Taxation credit					11.9
Profit from discontinued operations ³					2.8
Profit for the year					36.0

Year ended 31 December 2005	Roadside services	Insurance services	Personal Finance ²	Other Businesses	Total
	£m	£m	£m	£m	£m
Segment revenue					
Group revenue excluding terminated contract ¹	525.1	152.3	-	66.7	744.1
Terminated contract	-	11.0	-	-	11.0
Group revenue	525.1	163.3	-	66.7	755.1
Segment result					
Profit before amortisation of intangible assets, exceptional items, finance costs and taxation	138.7	38.1	11.5	7.0	195.3
Amortisation of intangible assets	(2.3)	(0.9)	-	(0.1)	(3.3)
Exceptional items	(88.1)	(30.8)	-	(2.2)	(121.1)
Profit before finance costs and taxation	48.3	6.4	11.5	4.7	70.9
Segment finance income	0.9	7.7	-	0.3	8.9
Segment result	49.2	14.1	11.5	5.0	79.8
Group net finance costs					(218.1)
Taxation credit					67.9
Profit from discontinued operations ³					11.1
Loss for the year					(59.3)

Further details on each segment are contained in the Chief Executive's Review of the Business on pages 2 to 6

¹The Group terminated its contract to reinsure a 50% quota share of the Churchill Motor book on 4 May 2004. The impact on operating profit was broadly neutral.

²Joint ventures all relate to the Personal Finance segment.

³Discontinued operations all relate to Other Businesses.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

3 SEGMENTAL ANALYSIS BY CLASS OF BUSINESS (continued)

Segment assets and liabilities

As at 31 December 2006	Roadside services £m	Insurance services £m	Personal Finance £m	Other Businesses £m	Total £m
Assets					
Segment assets	1,425.9	687.8	0.3	100.5	2,214.5
Investments in joint ventures and associates	1.3	-	1.2	-	2.5
	<u>1,427.2</u>	<u>687.8</u>	<u>1.5</u>	<u>100.5</u>	<u>2,217.0</u>
Unallocated corporate assets					
Financial asset – derivative financial instrument					7.9
Cash and financial assets available for group purposes					13.4
Deferred tax asset					80.0
Consolidated total assets					<u>2,318.3</u>
Liabilities					
Segment liabilities	(373.8)	(173.6)	(1.1)	(102.0)	(650.5)
Unallocated corporate liabilities					
Overdraft					(3.5)
Derivative financial instrument					(0.2)
Borrowings					(1,862.7)
Consolidated total liabilities					<u>(2,516.9)</u>
Capital additions					
- Property plant and equipment	26.3	0.3	-	2.5	29.1
- Intangible assets	2.1	4.1	-	0.3	6.5
Depreciation of property, plant and equipment	18.7	1.7	-	0.7	21.1
As at 31 December 2005					
	Roadside services £m	Insurance services £m	Personal Finance £m	Other Businesses £m	Total £m
Assets					
Segment assets	1,395.7	596.0	-	103.3	2,095.0
Investments in joint ventures and associates	1.0	-	2.2	-	3.2
	<u>1,396.7</u>	<u>596.0</u>	<u>2.2</u>	<u>103.3</u>	<u>2,098.2</u>
Unallocated corporate assets					
Cash and financial assets available for group purposes					92.4
Deferred tax asset					110.3
Consolidated total assets					<u>2,300.9</u>
Liabilities					
Segment liabilities	(471.8)	(208.9)	(3.6)	(123.2)	(807.5)
Unallocated corporate liabilities					
Overdraft					(1.1)
Borrowings					(1,812.7)
Derivative financial instrument					(11.8)
Consolidated total liabilities					<u>(2,633.1)</u>
Capital additions					
- Property plant and equipment	0.1	1.5	-	-	1.6
- Intangible assets	1.5	1.9	-	1.6	5.0
Depreciation of property, plant and equipment	20.7	1.1	-	0.7	22.5

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

4 REVENUE

Analysis by category of revenue – continuing operations

	2006 £m	2005 £m
Insurance contracts excluding terminated contract	503 5	483 4
Insurance contracts – terminated contract*	-	11 0
Insurance contracts	503 5	494 4
Revenue from services	226 4	195 4
Sales of goods	35 0	36 3
Interest	29 3	29 0
	<u>794 2</u>	<u>755 1</u>

Revenue from insurance contracts can be allocated to segments as follows

	£m	£m
Roadside Services	472 4	455 2
Insurance Services	15 6	25 2
Other Businesses	15 5	14 0
	<u>503 5</u>	<u>494 4</u>

* The Group terminated its contract to reinsure a 50% quota share of the Churchill Motor book on 4 May 2004

5 OPERATING EXPENSES

Operating expenses are stated after charging

	2006 £m	2005 £m
Employment costs (see note 6)	235 0	248 0
Depreciation of owned property, plant and equipment (see note 15)	10 7	12 7
Depreciation of leased property, plant and equipment (see note 15)	10 4	9 8
Operating lease rentals		
- Vehicles	7 7	5 7
- Land and buildings	3 6	5 2
Other operating expenses	262 0	270 4
Raw materials and consumables	17 2	19 5
Auditors' remuneration	1 1	1 1
Operating costs before amortisation of intangible assets and exceptional items	<u>547 7</u>	<u>572 4</u>
Amortisation of intangible assets (see note 13)	3 3	3 3
Exceptional items (see note 7)	25 3	121 1
Total operating costs	<u>576 3</u>	<u>696 8</u>

Services provided by the Group's auditor and network firms are as follows

	2006 £m	2005 £m
Fees payable to the Company's auditor for the audit of the Company's annual financial statements	0 2	0 2
Fees payable to the Company's auditor and its associates for other services		
The audit of the Company's subsidiaries pursuant to legislation	0 4	0 4
All other services	0 5	0 5
	<u>1 1</u>	<u>1 1</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

6 EMPLOYEES

The average number of persons employed by the Group, including executive directors, during the period was as follows

	2006 number	2005 number
Roadside Services	4,896	5,490
Insurance Services	1,541	1,691
Other Businesses	748	761
	<u>7,185</u>	<u>7,942</u>

Staff costs during the period amounted to

	2006 £m	2005 £m
Wages and salaries	192.3	203.5
Social security costs	17.9	18.2
Retirement benefit costs	24.8	26.3
	<u>235.0</u>	<u>248.0</u>

The Company has no employees (2005 nil)

7 EXCEPTIONAL ITEMS

	2006 £m	2005 £m
Restructuring costs	<u>25.3</u>	<u>121.1</u>

Restructuring costs in both years relate primarily to redundancy costs (including retirement benefit adjustments – see note 26), professional fees and the re-organising of group operations

8 FINANCE INCOME

	2006 £m	2005 £m
Bank interest receivable	9.2	11.9
Other finance income in respect of retirement benefit obligations (see note 26)	11.4	7.5
	<u>20.6</u>	<u>19.4</u>

9 FINANCE COSTS

	2006 £m	2005 £m
Interest on bank loans and overdraft	150.8	122.5
Unwinding of discount on subordinated preference certificates	38.3	94.5
Amortisation of issue costs of bank loans	27.1	7.6
Bank charges	3.9	1.5
Unwinding of discount rate on provisions	0.6	-
Finance lease interest	1.0	1.8
Other interest payable	0.6	0.7
	<u>222.3</u>	<u>228.6</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

10 TAXATION

	2006 £m	2005 £m
The taxation credit is made up as follows		
Current tax		
- Current year	0 9	0 3
- Adjustment in respect of prior years	(0 4)	(3 4)
	<u>0 5</u>	<u>(3 1)</u>
Deferred tax		
- Retirement benefits	14 2	7 1
- Fixed assets	(7 8)	(3 3)
- Tax losses	(3 0)	(66 9)
- Other short term timing differences	(14 6)	(6 2)
	<u>(11 2)</u>	<u>(69 3)</u>
	(10 7)	(72 4)
Tax on discontinued operations (see note 11)	(1 2)	4 5
Total tax credit for the year	<u>(11 9)</u>	<u>(67 9)</u>
Reconciliation of effective tax charge for continuing operations		
	2006 £m	2005 £m
Profit/(loss) before tax	<u>21.3</u>	<u>(138.3)</u>
Tax on profit/(loss) at standard UK Corporation tax rate of 30%	6 4	(41 5)
Effects of		
Income on incorporated joint ventures	(0 8)	(3 7)
Sale of fixed assets and businesses	(1 7)	(2 9)
Lower rate of overseas tax	(0 8)	(0 5)
Losses sold at below 30%	-	0 2
Other	0 9	2 5
Adjustments in respect of prior years	(4 8)	-
Current year adjustment on unrecognised deferred tax	(11 1)	(22 0)
Group tax credit for the year	<u>(11 9)</u>	<u>(67 9)</u>

11 DISCONTINUED OPERATIONS

The post-tax results of discontinued operations that have been included in the consolidated income statement were as follows

	2006 £m	2005 £m
Revenue	-	1 0
Operating expenses	-	(0 7)
Share of profit of joint ventures	-	0 2
Profit from sale of investment in joint ventures	-	20 9
Profit/(loss) from the termination of operations	6 8	(11 9)
Profit before finance costs and taxation	<u>6 8</u>	<u>9 5</u>
Unwinding of discount on provisions	(2 8)	(2 9)
Profit before tax	<u>4 0</u>	<u>6 6</u>
Attributable tax (charge)/credit	(1 2)	4 5
Profit after tax	<u>2 8</u>	<u>11 1</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

11 DISCONTINUED OPERATIONS (continued)

The profit from the termination of operations is analysed below

	2006 £m	2005 £m
Closure of Service Centres	6 2	(14 5)
Other closure costs	0 6	2 3
Profit on disposal of business	-	0 3
	<u>6 8</u>	<u>(11 9)</u>

Service Centre closure costs arose from the transfer of a number of sites to a third party and the closure of the remaining sites and include rent, professional fees and other property costs. Provision for property costs has been made on a pre-tax discounted basis. The profits in 2006 relate to the release of prior year provisions due to faster than planned transfer of empty properties.

Other closure costs relate to the termination of tyre-fitting services and vehicle inspections and principally comprise redundancy costs. The profits in 2006 and 2005 relate to the release of the 2004 provision that was not utilised.

Discontinued operations are Service Centres, tyre-fitting services, vehicle inspections and external training facilities. The discontinued joint venture is Motorfile Limited.

Cash flows in respect of discontinued operations can be found in note 30.

12 GOODWILL

	£m
Cost	
At 1 January 2005 and 2006	1,694 9
Acquisition (see note 32)	41 5
Adjustment to acquisitions in prior years	(1 9)
At 31 December 2006	<u>1,734 5</u>
Aggregate impairment losses	
At 31 December 2005 and 2006	<u>-</u>
Net book value	
At 31 December 2006	<u>1,734 5</u>
At 31 December 2005	<u>1,694 9</u>

The adjustment to acquisitions in the prior years relates to an adjustment to the consideration relating to the purchase of AA Corporation Limited in 2004.

At the year end, goodwill of £1,277.6m has been allocated to Roadside Services and goodwill of £392.4m has been allocated to Insurance Services.

Impairment test for goodwill

The Group tests goodwill for impairment on an annual basis, or more frequently if there are indications that goodwill might be impaired.

The recoverable amounts of the cash generating units (CGUs) are determined from value-in-use calculations. The key assumptions for the value-in-use calculations are those regarding the discount rates, growth rates and expected changes to selling prices and direct costs during the period for which the Group has detailed plans. Discount rates are estimated using pre-tax rates that reflect current market assessments of the time value of money and the risks specific to the CGU being measured. The rate used to discount forecast cash flows for Roadside Services is 10%, and for Insurance Services and Personal Finance it is 11%. Changes in the selling prices and direct costs are based on past practices and expectations of future changes in the market. The Group prepares cash flow forecasts derived from the most recent financial budgets approved by management for the next three years and extrapolates cash flows after that period based on the historic UK long-run growth rate.

Following detailed review, no impairment losses have been recognised in the year.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

13 INTANGIBLE ASSETS

	Brand £m	Customer relationships £m	Software £m	Total £m
Cost				
At 1 January 2005	-	-	8 2	8 2
Additions	-	0 6	4 4	5 0
At 31 December 2005	-	0 6	12 6	13 2
Additions	-	0 2	6 3	6 5
Disposals	-	-	(1 0)	(1 0)
Acquisitions (see note 32)	0 3	14 6	-	14 9
At 31 December 2006	0 3	15.4	17.9	33 6
Amortisation				
At 1 January 2005	-	-	1 2	1 2
Charge for the year	-	-	3 3	3 3
At 31 December 2005	-	-	4 5	4 5
Charge for the year	-	1 1	2 2	3 3
Disposals	-	-	(1 0)	(1 0)
At 31 December 2006	-	1 1	5 7	6 8
Net book value				
At 31 December 2006	0 3	14 3	12.2	26.8
At 31 December 2005	-	0 6	8 1	8 7

14 DEFERRED TAXATION

The following are the major deferred tax (liabilities) and assets recognised by the Group and the movements thereon

	Pension £m	Losses £m	Fixed assets £m	Other £m	Total £m
At 1 January 2005	43 1	-	-	-	43 1
Income statement credit	(7 1)	66 9	3 3	6 2	69 3
Taken to equity	(5 6)	-	-	3 5	(2 1)
At 31 December 2005	30 4	66 9	3 3	9 7	110 3
Income statement credit	(14 2)	3 0	7 8	14 6	11 2
Taken to equity	(35 7)	-	-	(5 8)	(41 5)
At 31 December 2006	(19 5)	69 9	11.1	18 5	80 0

At the balance sheet date, the Group had an unrecognised deferred tax asset of £11.5m (2005 £22.8m). The income statement credit of £3.0m relating to losses has been reduced by £8.3m due to the disclaiming of capital allowances.

	2006 £m	2005 £m
Current deferred tax asset	30 6	-
Non-current deferred tax asset	49 4	110 3
	80 0	110 3

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

15 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Vehicles £m	Fixtures and equipment £m	Total £m
Cost				
At 1 January 2005	32 0	49 0	36 5	117 5
Additions	0 2	0 4	1 0	1 6
Disposals	(2 8)	(3 5)	(0 3)	(6 6)
Reclassified as held for sale	(1 1)	-	-	(1 1)
Exchange movement	0 1	(0 1)	(0 1)	(0 1)
At 31 December 2005	<u>28 4</u>	<u>45 8</u>	<u>37 1</u>	<u>111 3</u>
Additions	0 1	23 5	5 5	29 1
Acquisitions (see note 32)	0 1	-	1 4	1 5
Disposals	(2 8)	(10 4)	(0 7)	(13 9)
Exchange movement	0 1	0 1	0 1	0 3
At 31 December 2006	<u>25 9</u>	<u>59 0</u>	<u>43 4</u>	<u>128 3</u>
Depreciation				
At 1 January 2005	0 2	5 7	3 4	9 3
Charge for year	0 9	15 1	6 5	22 5
Disposals	(0 1)	(0 3)	-	(0 4)
At 31 December 2005	<u>1 0</u>	<u>20 5</u>	<u>9 9</u>	<u>31 4</u>
Charge for year	0 8	11 5	8 8	21 1
Disposals	(0 2)	(3 8)	(0 3)	(4 3)
At 31 December 2006	<u>1 6</u>	<u>28 2</u>	<u>18 4</u>	<u>48 2</u>
Net book value				
At 31 December 2006	<u>24 3</u>	<u>30 8</u>	<u>25 0</u>	<u>80 1</u>
At 31 December 2005	<u>27 4</u>	<u>25 3</u>	<u>27 2</u>	<u>79 9</u>

As at 31 December 2005 and 31 December 2006, a fixed and floating charge was in place over all property, plant and equipment in relation to the Group's Senior Facility (see note 23)

Vehicles include the following assets held under finance leases

	2006 £m	2005 £m
Cost	55 6	42 6
Accumulated depreciation	<u>(26 2)</u>	<u>(19 0)</u>
Net book value	<u>29 4</u>	<u>23 6</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

16 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

The Group's share of the assets and liabilities comprising the Group's interests in joint ventures are shown below

	2006 £m	2005 £m
Non-current assets	618 3	625 2
Current assets	340 0	316 7
Current liabilities	(577 0)	(466 8)
Non-current liabilities	(380 1)	(475 2)
	<u>1 2</u>	<u>(0 1)</u>
Transferred to provisions	-	2 3
Investment in associates	1 3	1 0
	<u>2 5</u>	<u>3 2</u>

At 31 December 2005, the share of net liabilities of £2 3m in the joint venture, Automobile Association Personal Finance Limited, was shown within provisions (see note 25)

The Group's interests in the income and expenses of joint ventures are shown below

	2006 £m	2005 £m
Income	77 5	73 8
Expenses	(72 9)	(59 5)
Profit before tax	4 6	14 3
Tax	0 5	(1 5)
	<u>5 1</u>	<u>12 8</u>

The share of interest in joint ventures' income and expenses can be analysed as follows

	2006 £m	2005 £m
Continuing operations	5 1	12 6
Discontinued operations	-	0 2
	<u>5 1</u>	<u>12 8</u>

Joint ventures within continuing operations all relate to Personal Finance activities

17 INVENTORIES

	2006 £m	2005 £m
Work in progress	0.8	1 6
Finished goods	7.2	6 3
	<u>8 0</u>	<u>7 9</u>

There is no material difference between book value and fair value. At the balance sheet date, the provision for obsolete and slow moving stock was £1 3m (2005 £1 3m)

18 TRADE AND OTHER RECEIVABLES

	2006 £m	2005 £m
Trade receivables	182 0	165 7
Other receivables	3 0	11 1
Prepayments and accrued income	9 2	17 3
Amounts due from related parties (see note 36)	1.2	3 0
	<u>195.4</u>	<u>197 1</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

19 NON-CURRENT ASSETS HELD FOR SALE

	2006 £m	2005 £m
Property held for sale	-	1 1

20 FINANCIAL ASSETS – SHORT TERM DEPOSITS AND CASH AND CASH EQUIVALENTS

Financial assets – short term deposits and cash and cash equivalents included £99 2m (2005 £104 1m) which were held by the Group's insurance subsidiary undertakings. These sums are not readily available to be used for other purposes within the Group.

21 FINANCIAL LIABILITIES

	2006 £m	2005 £m
Current		
Bank overdraft	3 5	1 1
Secured bank loans (see note 23)	111 4	13 3
Derivative financial instruments	0 2	11 8
Finance lease liabilities	9 5	9 3
	<u>124 6</u>	<u>35 5</u>
Non-current		
Secured bank loans (see note 23)	1,639.5	1,201 1
Debenture loans Subordinated preference certificates (see note 23)	111 8	598 3
Finance lease liabilities	12 3	9 2
	<u>1,763 6</u>	<u>1,808 6</u>
Total financial liabilities	<u>1,888.2</u>	<u>1,844 1</u>

22 TRADE AND OTHER PAYABLES

	2006 £m	2005 £m
Trade payables	87.2	70 0
Other payables	15 3	18 0
Accruals	119.1	128 1
	<u>221.6</u>	<u>216 1</u>

23 BANK AND OTHER BORROWINGS

	2006 £m	2005 £m
Maturity of debt		
In less than one year, or on demand	111 4	13 3
In one to two years	56 8	32 8
In two to three years	73 7	56 8
In three to four years	86 6	73 7
In four to five years	95 3	86 2
In more than five years	1,438 9	1,549 9
	<u>1,862 7</u>	<u>1,812 7</u>

Borrowings are stated net of unamortised issue costs of £34 8m (2005 £54 6m)

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

23 BANK AND OTHER BORROWINGS (continued)

Details of the Group's bank borrowings, excluding subordinated preference certificates and unamortised issue costs are outlined below

	Balance at 31 December 2006 £m	Balance at 31 December 2005 £m	Interest payable	Capital interest (a)	Repayment date
Securitisation	97 0	-	Base + 0.5%	-	14 March 2009
Senior facility					
Revolving credit	5 0	-	LIBOR + 2.25%	-	9 January 2007
Tranche A	347 0	392 0	LIBOR + 2.25%	-	(b)
Tranche B	400 9	211 6	LIBOR + 2.50% (c)	-	30 June 2012 and 31 December 2012
Tranche C	391 5	206 7	LIBOR + 3.00% (c)	-	31 December 2013
Tranche D	130 0	-	LIBOR + 4.50%	-	30 June 2014
Mezzanine facility					
Tranche A	143 3	175 9	LIBOR + 3.50% (d)	4.75% (d)	31 December 2014
Tranche B	169 1	169 7	LIBOR + 4.00%	3.5%	31 December 2014
Junior Mezzanine facility	98 3	89 3	-	LIBOR + 10.00%	31 January 2015

(a) Capital interest is compounded annually

(b) Repayments are made in increasing instalments every six months from 30 September 2007 to 31 March 2011, with the final instalment due on 31 December 2011

(c) Until 15 March 2006, interest was payable on the Senior facility as follows: Tranche B at LIBOR + 2.75% and Tranche C at LIBOR + 3.25%

(d) Until 15 March 2006, the Mezzanine facility Tranche A had interest payable of LIBOR + 4.00% and capital interest of 6.5%

A further £95.0m is available at 31 December 2006 under the revolving credit facility, for which a commitment fee of 0.75% per annum is payable. £5.8m of this facility has been utilised to provide letters of credit (2005: £2.7m)

The securitisation facility is secured on certain trade receivables. All of the other bank loans are secured by a fixed and floating charge over UK properties and shares in subsidiary undertakings and a floating charge over all other assets of the Company and certain principal subsidiary companies, except over financial assets – short term deposits and cash and cash equivalents both held for insurance regulatory purposes

Subordinated preference certificates

The subordinated preference certificates are redeemable on 30 September 2015. The certificates are included in the balance sheet at the value of their proceeds plus amortised discount to the balance sheet date. The discount is charged to finance costs in the income statement over the term of the instrument to give an effective rate of 16.5%, compounded quarterly. The certificates are unsecured.

Priority of repayment

The Senior facility has priority of repayment, followed by the Mezzanine facility and then the Junior Mezzanine facility. The rights of the holders of the subordinated preference certificates are subordinated to the rights of all creditors of the Group, including the borrowings referred to above.

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 FINANCIAL INSTRUMENTS

Financial Risk Management Objectives

The Group is exposed to a variety of financial risks. The Group's overall risk management programme is discussed further in the Finance Director's Review on pages 7 to 9.

Hedging Activities

To mitigate its exposure to fluctuations in interest payments and increased cash outflows, the Group has entered into swap arrangements for part of its secured bank loans. Under this arrangement, contracts with nominal values of £534.5m have fixed interest payments of 5.49% (reducing to £522.5m by 31 December 2007) and £500.0m have fixed interest payments at 4.78% (increasing to £750.0m by 31 December 2008). Both swaps are designated as an effective cashflow hedge and the fair value has been transferred to the hedging reserve.

Fair values of financial instruments

There is no difference between the book value and the fair value of financial instruments.

Maturity and interest rate profiles of financial assets and liabilities

The maturity and interest rate profiles of financial assets and liabilities after taking account of interest rate swaps were as follows:

31 December 2006

	Fixed	Floating	Non- interest bearing	Total
	£m	£m	£m	£m
Financial liabilities				
Sterling borrowings				
Due within one year	15.0	102.0	3.5	120.5
Due after one year but not more than two years	62.3	-	-	62.3
Due after more than two years but not more than five years	269.8	-	-	269.8
Due after more than five years	802.8	645.7	-	1,448.5
	<u>1,149.9</u>	<u>747.7</u>	<u>3.5</u>	<u>1,901.1</u>
Finance lease obligations				
Due within one year	9.5	-	-	9.5
Between one and five years	12.3	-	-	12.3
	<u>21.8</u>	<u>-</u>	<u>-</u>	<u>21.8</u>
Financial liabilities	<u>1,171.7</u>	<u>747.7</u>	<u>3.5</u>	<u>1,922.9</u>
Financial assets				
Financial assets – short term deposits	-	15.4	-	15.4
Cash and cash equivalents	-	97.2	-	97.2
Held-to-maturity investments	-	1.6	-	1.6
Financial assets	<u>-</u>	<u>114.2</u>	<u>-</u>	<u>114.2</u>

Total debt issue costs of £34.8m are excluded from the financial liabilities detailed above.

Cash, cash equivalents and financial assets – short term deposits all mature in less than one year and have an effective interest rate of 4.9%.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

24 FINANCIAL INSTRUMENTS (continued)

Maturity and interest rate profiles of financial assets and liabilities (continued)

31 December 2005

	Fixed	Floating	Non- interest bearing	Total
	£m	£m	£m	£m
Financial liabilities				
Sterling borrowings				
Due within one year	10 6	8 3	1 1	20 0
Due after one year but not more than two years	38 5	-	-	38 5
Due after more than two years but not more than five years	234 3	-	-	234 3
Due after more than five years	1,067 9	507 7	-	1,575 6
	<u>1,351 3</u>	<u>516 0</u>	<u>1 1</u>	<u>1,868 4</u>
Finance lease obligations				
Due within one year	9 3	-	-	9 3
Between one and five years	9 2	-	-	9 2
	<u>18 5</u>	<u>-</u>	<u>-</u>	<u>18 5</u>
Financial liabilities	<u>1,369 8</u>	<u>516 0</u>	<u>1 1</u>	<u>1,886 9</u>
Financial assets				
Financial assets – short term deposits	-	14 6	-	14 6
Cash and cash equivalents	-	181 9	-	181 9
Held-to-maturity investments	-	1 3	-	1 3
Financial assets	<u>-</u>	<u>197 8</u>	<u>-</u>	<u>197 8</u>

Total debt issue costs of £54 6 million are excluded from the financial liabilities detailed above

Cash, cash equivalents and financial assets – short term deposits all mature in less than one year and have an effective interest rate of 4 4%

Finance lease liabilities

Future finance lease commitments are as follows

	2006 £m	2005 £m
Capital value of minimum lease payments		
Amounts payable		
Within one year	9 5	9 3
Between one and five years	12 3	9 2
	<u>21 8</u>	<u>18 5</u>
Minimum lease payments		
Amounts payable		
Within one year	10 4	10 2
Between one and five years	13 5	10 0
	<u>23 9</u>	<u>20 2</u>
Less future finance charges	(2 1)	(1 7)
Present value of lease obligation	<u>21 8</u>	<u>18 5</u>

The effective interest rate on finance leases for the year is 6 2% (2005 6 6%)

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

25 PROVISIONS

	Investment in net liabilities of joint ventures	Restructuring	Property	Other	Total
	£m	£m	£m	£m	£m
At 1 January 2006	2 3	35 9	97 5	2 9	138 6
Unwinding of discount	-	-	3 4	-	3 4
Charge for the year	-	1 9	-	-	1 9
Unutilised provision released	-	(0 5)	(6 8)	-	(7 3)
Utilised in the year	-	(32 7)	(18 1)	(2 0)	(52 8)
Acquisitions	-	-	0 5	-	0 5
Transfer to investments in joint ventures	(2 3)	-	-	-	(2 3)
At 31 December 2006	-	4.6	76 5	0 9	82 0

Provisions have been analysed between current and non-current as follows

	2006 £m	2005 £m
Current provisions	20 0	58 8
Non-current provisions	62 0	79 8
	82 0	138 6

Investments

The Group's share of net liabilities in the joint venture relates to Automobile Association Personal Finance Limited. Further information on this joint venture is contained in note 16.

Restructuring

The restructuring provision relates to redundancy and other related costs following restructuring within the Group. It is anticipated that the balance at 31 December 2006 will be utilised in 2007.

Property

The property provision relates to future lease costs of vacant properties for the remaining period of the lease, net of expected sub-letting income. A significant element of this provision relates to Service Centre sites not transferred to a third party. These sums are expected to be paid out annually over the next 15 years. The provision has been calculated on a pre-tax discounted basis.

Other

Other provisions relate to a number of onerous contracts and are expected to be utilised over the next three years.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

26 RETIREMENT BENEFIT OBLIGATION

Substantially all of the Group's employees at 31 December 2006 were members of either the AA pension scheme or the AA Ireland pension scheme which are both defined benefit schemes

The AA pension scheme and the AA Ireland pension scheme are subject to independent valuations at least every three years, on the basis of which the qualified actuary recommends the rate of employers' contributions. This contribution rate, together with the specified contributions payable by the employees and proceeds from the schemes' assets, are expected to be sufficient to fund the benefits payable under the schemes. The actuarial valuations were last carried out on 31 March 2004 and 31 December 2004 respectively and updated for each year end

During 2005, the prior service liabilities and the associated assets of certain employees were transferred from Centrica Plc pension funds under the terms agreed on the acquisition of AA Corporation Limited in 2004

Certain employees are also members of a post retirement private medical insurance scheme, which is an unfunded defined benefit scheme. This scheme had a triennial independent actuarial valuation undertaken at 31 December 2004

The actuarial valuations have been updated by a qualified independent actuary

The major assumptions used for the actuarial valuations were

	2006 %	2005 %
Discount rate	5.10	4.90
Expected rate of return on plan assets	6.80	6.70
Rate of salary increases	4.00	3.85
Rate of inflation	2.90	2.65
Medical cost inflation	6.90	6.65

Reconciliation of net retirement benefit obligation

	2006 £m	2005 £m
Present value of defined benefit liabilities		
- Funded	(1,125.3)	(1,129.1)
- Unfunded (private medical insurance scheme)	(45.0)	(43.6)
	<u>(1,170.3)</u>	<u>(1,172.7)</u>
Plan assets at fair value	1,190.6	1,025.2
Net retirement benefit obligation	<u>20.3</u>	<u>(147.5)</u>

Reconciliation of net retirement benefit obligation in the balance sheet

	2006 £m	2005 £m
Retirement benefit asset	68.9	-
Retirement benefit liability	<u>(48.6)</u>	<u>(147.5)</u>
Net retirement benefit obligation	<u>20.3</u>	<u>(147.5)</u>

The major categories of plan assets as a percentage of total plan assets are as follows

	2006 %	2005 %
Equities	60.8	64.4
Bonds	26.8	27.8
Property	5.2	4.9
Other	7.2	2.9
Total	<u>100.0</u>	<u>100.0</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

26 RETIREMENT BENEFIT OBLIGATION (continued)

Reconciliation of the fair value of plan assets

	2006 £m	2005 £m
Fair value of plan assets at 1 January	1,025.2	810.8
Expected return on assets	68.0	61.9
Actuarial gain on assets	64.2	85.7
Company contributions	61.2	34.2
Employee contributions	6.6	7.7
Benefits paid from fund	(34.6)	(37.5)
Bulk transfer	-	62.4
Fair value of plan assets at 31 December	<u>1,190.6</u>	<u>1,025.2</u>

Reconciliation of present value of defined benefit liability

	2006 £m	2005 £m
Present value of defined benefit liability at 1 January	1,172.7	996.4
Current service cost	24.8	26.3
Past service cost recognised in year	0.6	3.2
Curtailment gain	(1.0)	(10.6)
Interest cost	56.6	54.4
Employee contributions	6.6	7.7
Actuarial (gain)/loss	(55.4)	70.4
Benefits paid	(34.6)	(37.5)
Bulk transfer	-	62.4
Present value of defined benefit liability at 31 December	<u>1,170.3</u>	<u>1,172.7</u>

Components of the retirement benefit expense recognised in the income statement

	2006 £m	2005 £m
Analysis of the amount charged to operating expenses		
Current service cost	24.8	26.3
Analysis of amounts charged to exceptional items		
Curtailment gain	(1.0)	(10.6)
Past service cost recognised in the year	0.6	3.2
	<u>(0.4)</u>	<u>(7.4)</u>
	<u>24.4</u>	<u>18.9</u>
Analysis of the amount charged/(credited) to finance costs/(income)		
Expected return on assets (net of expenses)	(68.0)	(61.9)
Interest cost	56.6	54.4
	<u>(11.4)</u>	<u>(7.5)</u>
Total retirement benefit expense	<u>13.0</u>	<u>11.4</u>

History of experience gains and (losses)

	2006	2005
Difference between the expected and actual return on the plan assets		
Amount (£m)	64.2	85.6
Percentage of plan assets	5.4%	8.4%
Experience gains and (losses) on defined benefit liabilities		
Amount (£m)	2.1	50.9
Percentage of the present value of defined benefit liabilities	0.2%	4.3%

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

26 RETIREMENT BENEFIT OBLIGATION (continued)

The estimated amount of contributions expected to be paid to the scheme during the current financial year ending 31 December 2007 is £37.5 million

Medical cost trend

The effects of a 1% change in the medical cost trend on the defined benefit obligation, the interest cost and the service cost are as follows

Year ended 31 December 2006	Medical cost trend rates of 1.0% p.a. lower	Medical cost trend rates adopted	Medical cost trend rates of 1.0% p.a. higher
Defined benefit obligation	37.8	45.0	52.2
Interest cost	1.8	2.1	2.5
Service cost	0.1	0.2	0.2

Year ended 31 December 2005	Medical cost trend rate of 1.0% p.a. lower	Medical cost trend rate adopted	Medical cost trend rate of 1% p.a. higher
Defined benefit obligation	36.4	43.6	50.6
Interest cost	1.7	2.1	2.4
Service cost	0.2	0.2	0.3

Year ended 31 December 2004	Medical cost trend rate of 1.0% p.a. lower	Medical cost trend rate adopted	Medical cost trend rate of 1% p.a. higher
Defined benefit obligation	32.7	39.3	45.7
Interest cost	1.6	1.9	2.1
Service cost	0.3	0.4	0.5

27 CALLED UP SHARE CAPITAL

	2006 £	2005 £
Authorised		
1,000,000 'A' ordinary shares of £0.10 each	100,000	100,000
1,047,120 'B' ordinary shares of £0.10 each	104,712	104,712
	<u>204,712</u>	<u>204,712</u>
Allotted, called up and fully paid		
1,000,000 'A' ordinary shares of £0.10 each	100,000	97,913
999,995 'B' ordinary shares of £0.10 each	100,000	99,896
	<u>200,000</u>	<u>197,809</u>

During 2006, the Company issued 20,871 'A' ordinary shares for cash consideration of £20,767 and 1,040 'B' ordinary shares for cash consideration of £104

The 'A' ordinary shares are entitled to a distribution of profits in advance of the 'B' ordinary shares, the 'A' ordinary shares carry no right to vote in any respect with regard to general meetings of the Company

The Company has also issued 45,000 warrants to subscribe in cash for par of £0.10 for 'B' ordinary shares on 30 September 2004. Each warrant entitles the holder to subscribe for such sum of ordinary share capital as represented by 0.0001% of the 'B' ordinary shares of the fully diluted share capital. The warrants are exercisable on the occurrence of a specific future event and lapse if not exercised at that time.

In 2005, an employee share trust was established to operate the employee share ownership plan, under which the trust holds shares on behalf of participating employees. If participating employees leave the Group, they must surrender their beneficial interest in those shares which are then treated as Treasury shares as defined in note 2. At 31 December 2006, the trust held 4,141 (2005: 371) 'B' ordinary shares with a nominal value of £414.10 (2005: £37.10) which had been surrendered by former employees. These shares represent 0.414% (2005: 0.037%) of the total issued 'B' ordinary shares of the Group.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

28 RESERVES

	Share premium £m	Translation reserve £m	Hedging reserve £m
At 1 January 2005	0.5	-	(12.4)
Fair value movements on cash flow hedges net of deferred tax	-	-	4.1
Exchange translation differences	-	0.3	-
Premium on 'A' ordinary shares	0.3	-	-
At 31 December 2005	0.8	0.3	(8.3)
Fair value movements on cash flow hedges net of deferred tax	-	-	13.7
At 31 December 2006	0.8	0.3	5.4

Exchange translation differences arise on consolidation and relate to currency differences on the retranslation of foreign operations

29 STATEMENT OF CHANGES IN EQUITY

	Share capital and premium £m	Hedging and trans- lation reserve £m	Retained earnings £m	Total £m
At 1 January 2005	0.6	(12.4)	(275.6)	(287.4)
Loss for the financial year	-	-	(59.3)	(59.3)
Actuarial gain on retirement benefit liability net of deferred tax	-	-	9.7	9.7
Fair value movements on cash flow hedges net of deferred tax	-	4.1	-	4.1
Exchange translation differences	-	0.3	-	0.3
Issue of shares	0.4	-	-	0.4
At 31 December 2005	1.0	(8.0)	(325.2)	(332.2)
Profit for the financial year	-	-	36.0	36.0
Actuarial gain on retirement benefit liability net of deferred tax	-	-	83.9	83.9
Fair value movements on cash flow hedges net of deferred tax	-	13.7	-	13.7
At 31 December 2006	1.0	5.7	(205.3)	(198.6)

30 CASH FLOW FROM OPERATING ACTIVITIES

Reconciliation of profit/(loss) to net cash inflow/(outflow) from operating activities	2006 Continuing before exceptional items £m	2006 Exceptional items £m	2006 Dis- continued operations £m
Profit/(loss) per income statement	248.3	(25.3)	2.8
Depreciation charge	21.1	-	-
Amortisation of intangible assets	3.3	-	-
Change in inventories	(0.1)	-	-
Change in receivables	2.4	-	2.9
Change in payables	(18.9)	-	-
Change in retirement benefit obligation	3.8	(40.4)	-
Change in provisions	(2.0)	(36.6)	(16.8)
Dividends from joint ventures	3.6	-	-
Share of profits of joint ventures and associates	(5.1)	-	-
Profit on disposal of fixed assets	-	(1.2)	-
Tax charge on discontinued operations	-	-	1.2
Net cash inflow/(outflow) from operating activities	256.4	(103.5)	(9.9)

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

30 CASH FLOW FROM OPERATING ACTIVITIES (continued)

Reconciliation of profit/(loss) to net cash inflow/(outflow) from operating activities	2005 Continuing before exceptional items £m	2005 Exceptional items £m	2005 Dis- continued operations £m
Profit/(loss) per income statement	192 0	(121 1)	11 1
Depreciation charge	22 5	-	-
Amortisation of intangible assets	3 3	-	-
Change in inventories	(1 9)	-	-
Change in receivables	12 9	-	-
Change in payables	(5 9)	-	-
Change in retirement benefit obligation	(4 7)	(10 6)	-
Change in provisions	(1 1)	(0 9)	(2 0)
Dividends from joint ventures	9 6	-	-
Share of profits of joint ventures and associates	(12 6)	-	(0 2)
Profit on disposal of fixed assets	-	(2 3)	-
Profit on disposal of investment in joint ventures	-	-	(20 9)
Tax credit on discontinued operations	-	-	(4 5)
Net cash inflow/(outflow) from operating activities	214.1	(134 9)	(16 5)

31 RECONCILIATION OF MOVEMENT IN CASH AND CASH EQUIVALENTS

	Cash and cash equivalents £m	Overdraft £m	Total £m
At 1 January 2005	321 1	-	321 1
Cashflow	(139 2)	(1 1)	(140 3)
At 31 December 2005	181 9	(1 1)	180 8
Cashflow	(84 7)	(2 4)	(87 1)
At 31 December 2006	97 2	(3 5)	93 7

32 BUSINESS COMBINATIONS

The Group purchased 100% of the assets and trade of Taylor Pnce and Co, trading as Direct Choice, on 7 July 2006
The acquisition method of accounting was adopted

	Pre- acquisition book values £m	Fair value £m
Intangible assets	-	14.9
Property, plant and equipment	1 6	1.5
Inventories	0 1	-
Receivables	13 2	11.9
Cash and cash equivalents	4 3	4 3
Payables	(14 6)	(14 6)
Financial liabilities	(2 3)	(1 2)
Provisions	-	(0 5)
Net assets acquired	2 3	16 3
Goodwill (see note 12)		41 5
Consideration		57 8
Consideration satisfied by Cash (including fees)		57 8

During the year ended 31 December 2006, fair values were determined on a provisional basis

The goodwill recognised on the acquisition of Taylor Pnce and Co of £41.5m represents the value of the workforce and synergies, both in increased revenues and reduced costs, expected to arise as a result of the acquisition

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

32 BUSINESS COMBINATIONS (continued)

The intangible assets acquired as part of the acquisition of Taylor Price and Co is analysed as follows

	£m
Brand	0.3
Customer relationships	14.6
	<u>14.9</u>

From the date of acquisition to 31 December 2006, the acquired business contributed £3.1m to operating profit before amortisation of intangible assets and exceptional items and £1.6m to profit before tax. If the acquisition had been made at the beginning of the year, the pro forma consolidated group revenue would be £803.3m and pro forma consolidated group profit before tax would be £23.6m.

The outflow of cash and cash equivalents on acquisitions is calculated as follows

	£m
Cash consideration (including fees) in respect of Taylor Price and Co	(57.4)
Cash and cash equivalents net of overdrafts acquired in respect of Taylor Price and Co	2.0
Adjustment to consideration in respect of the acquisition of AA Corporation Limited in 2004	10.0
Cash outflow on acquisitions for the year ended 31 December 2006	<u>(45.4)</u>

33 INSURANCE CONTRACTS

The Group's principal insurance contracts are contracts for the provision of Roadside recovery services for a fixed fee, under which insurance risk is assumed by the Group.

Other contracts written by the Group are

- Legal assistance. These contracts mainly arise from the Claims Assistance product sold with third party motor insurance policies and the Legal Expenses product sold with third party home insurance policies.
- Reinsurance. These are inward motor reinsurance contracts under which the contract holder is another insurer.

Insurance contracts as defined above are not comparable with the activities of the segment 'Insurance Services' as detailed in note 3.

Amount, timing and uncertainty of profit and loss and future cashflows

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. The nature of the business written by the Group is generally of one year or less in duration, however it is still subject to some unpredictability. The key risks the Group faces are significant fluctuations in the frequency, timing and severity of claims relative to expectations.

The risk and level of service required for Roadside recovery contracts is dependent upon the occurrence of uncertain future events, in particular, the number of breakdowns and the nature of each breakdown. Breakdowns are sensitive to the reliability of cars as well as the impact of weather conditions. The Group employs a patrol force which attends over 90% of all breakdown calls received. In the event that a patrol is unable to attend a breakdown, the Group has built up an extensive network of garages with pre-agreed prices to ensure that all breakdowns are attended on a timely basis. The Group uses historical data and statistical techniques to predict levels of claims and therefore actively manages the size and location of its patrol force. The Group continually invests in its patrol force, for example the introduction of the new Vehicle Recovery System, to improve their efficiency in attending breakdowns. There is no concentration of risk due to the large size of the Group's membership base across the UK and Ireland.

For other insurance contracts, the Group only enters into contracts with insurance risk where it has experience of the market. Claims must be made within a short time of the policy expiring, and most claims are settled within one year. This allows the Group to achieve a high degree of certainty about the estimated cost of claims and therefore future cashflows. The Group manages its insurance risk by constantly monitoring the level of claims for each product and has the ability to adjust prices in the future to reflect any change in claims experience. The Group has a claims handling process which includes the right to review and reject fraudulent claims. There is limited concentration of risk due to the large size of the Group's portfolio.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

33 INSURANCE CONTRACTS (continued)

Income and expenses arising directly from insurance contracts

	2006 £m	2005 £m
Revenue excluding terminated contract	503.5	483.4
Terminated contract*	-	11.0
Revenue – premiums earned	<u>503.5</u>	<u>494.4</u>
Operating expenses		
Claims costs	211.8	252.5
Other expenses	<u>90.5</u>	<u>84.2</u>
	<u>302.3</u>	<u>336.7</u>

* The Group terminated its contract to reinsure a 50% quota share of the Churchill Motor book on 4 May 2004. The impact on operating profit was broadly neutral.

Operating expenses arising directly from insurance contracts primarily relate to breakdown assistance and include employment costs, vehicle depreciation and other operating expenses.

Assets and liabilities arising directly from insurance contracts

	2006 £m	2005 £m
Assets		
Receivables arising out of direct insurance operations	26.9	21.1
Prepayments	<u>18.2</u>	<u>14.2</u>
	<u>45.1</u>	<u>35.3</u>
Liabilities		
Deferred income arising from unearned premiums	250.8	252.5
Claims accruals	51.1	60.4
Other accruals	6.3	5.2
Payables arising out of direct insurance operations	17.6	17.1
Provision for onerous insurance contracts	<u>0.1</u>	<u>0.7</u>
	<u>325.9</u>	<u>335.9</u>

Claims accruals include payables and accruals relating to breakdown assistance expenses.

Reconciliation of movement in insurance liabilities

Deferred income arising from unearned premiums	2006 £m	2005 £m
At 1 January	252.5	262.0
Revenue – premiums earned	(503.5)	(494.4)
Premiums written	<u>501.8</u>	<u>484.9</u>
At 31 December	<u>250.8</u>	<u>252.5</u>
Claims accruals		
At 1 January	60.4	59.1
Claims incurred	211.8	252.5
Claims paid	<u>(221.1)</u>	<u>(251.2)</u>
At 31 December	<u>51.1</u>	<u>60.4</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

34 DIRECTORS' SHAREHOLDINGS AND REMUNERATION

The beneficial interests of the directors in the shares of the Company at 31 December 2006 were

	'A' ordinary shares 2006	'B' ordinary shares 2006	'A' ordinary shares 2005	'B' ordinary shares 2005
Sir Trevor Chinn	80,000	5,568	80,000	5,568
Timothy Parker	400,000	27,870	400,000	27,870
Paul Woolf	72,500	3,625	72,500	3,625

In addition, Paul Woolf had a beneficial interest in 15 86 'B' ordinary shares and subordinated preference certificates acquired at a cost of £9,998 on 25 February 2005, both of which are held through the employee share trust. During 2006 subordinated preference certificates with a cost of £8,421 were redeemed resulting in a gain of £2,301.

On 5 September 2005, Sir Trevor Chinn and Timothy Parker exercised options and acquired subordinated preference certificates. Following the exercise of these options, there are no further options outstanding. Sir Trevor Chinn acquired subordinated preference certificates at a cost of £1,131,235. Timothy Parker acquired subordinated preference certificates at a cost of £4,524,936. Both acquired their holdings from existing holders.

During 2006, subordinated preference certificates were redeemed. £952,813 of Sir Trevor Chinn's subordinated preference certificates were redeemed, realising a gain of £177,316. £3,811,250 of Timothy Parker's subordinated preference certificates were redeemed, realising a gain of £709,264.

Information on directors' remuneration is as follows:

	2006 £m	2005 £m
Total directors' emoluments	1.6	1.4
Remuneration of the highest paid director	1.0	1.0

One (2005: one) of the directors is a member of a pension scheme to which the Group makes a contribution.

The services of Derek Elliott, Philip Muelder and Charles Sherwood are provided by Permira Advisers Limited and the services of Peveril Hooper, Jonathan Kaye and Robert Lucas are provided by CVC Capital Partners Limited. No part of their remuneration is specifically attributed to services to the Group. Philip Muelder and Charles Sherwood have an indirect economic interest in the B ordinary shares and the subordinated preference certificates held by Permira funds. The Permira funds hold 40.8% of the B ordinary shares and 42.9% of the subordinated preference certificates. Peveril Hooper and Robert Lucas have an indirect economic interest in the B ordinary shares and the subordinated preference certificates held by the CVC funds. The CVC funds hold 40.8% of the B ordinary shares and 42.9% of the subordinated preference certificates.

35 COMMITMENTS

Operating leases

The Group had gross outstanding commitments for future minimum lease payments under non-cancellable operating leases which fall due as follows:

	Land and buildings	
	2006 £m	2005 £m
Next year	13.0	13.2
Second to fifth year from balance sheet date	49.8	51.8
After five years	52.8	62.1
	<u>115.6</u>	<u>127.1</u>
	Vehicles	
	2006 £m	2005 £m
Next year	2.1	2.2
Second to fifth year from balance sheet date	1.0	1.2
	<u>3.1</u>	<u>3.4</u>

Land and buildings operating lease payments represent rentals payable by the Group on its property portfolio. The average lease period remaining is 8 years and rentals are fixed for an average of 5 years.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

35 COMMITMENTS (continued)

Where a property is no longer used by the Group for operational purposes, tenants are sought to reduce the Group's exposure to lease payments. Where the future minimum lease payments are in excess of any expected rental income due, a provision is made. At the balance sheet date, properties with gross future minimum lease payments of £62.6m (2005: £73.7m) were included in the vacant property provision (see note 25).

The average lease period for vehicles is 3 years and rentals are fixed for the duration of the lease.

The Group had contracted with tenants for the following minimum lease receipts:

	Land and buildings	
	2006	2005
	£m	£m
Next year	4.3	3.6
Second to fifth year from balance sheet date	16.3	12.9
After five years	17.2	14.2
	<u>37.8</u>	<u>30.7</u>

Property, plant and equipment commitments

At 31 December 2006, the Group had contractual commitments for property, plant and equipment of £0.8m (2005: £1.1m).

36 RELATED PARTY TRANSACTIONS

The Group entered into the following transactions with related parties who are not members of the Group:

Joint Ventures and Associates	Type of transactions – income/(expenditure) and receivable/(payable)	2006	2005
		£m	£m
ACTA S A	Call handling fees	(3.7)	(3.2)
	Amounts payable at 31 December	-	-
ARC Transistance S A	Revenue	0.8	-
	Registration fees	(0.5)	(0.3)
	Amounts payable at 31 December	(0.1)	-
	Deferred income at 31 December	(0.8)	-
Automobile Association Personal Finance Limited	Intermediary services provided	3.1	2.1
	Amounts receivable at 31 December	0.7	0.7
AA Financial Services	Amounts receivable at 31 December ¹	0.5	2.3

¹ Amounts receivable by the Group in relation to the trade of AA Financial Services.

Other related party transactions

The Group was charged monitoring fees and expenses of £0.2m (2005: £0.2m) by CVC with a balance outstanding at 31 December 2006 of £0.1m (2005: £0.1m) and £0.2m (2005: £0.2m) by Permira with a balance outstanding at 31 December 2006 of £0.1m (2005: £0.1m).

Related party transactions with key management personnel

Key management personnel comprise members of the Board and members of the executive committee. The remuneration of members of the board is disclosed under note 34. The aggregate remuneration of key management personnel excluding directors is disclosed below:

Remuneration of key management personnel	2006	2005
	£m	£m
Salaries and short term benefits	1.8	1.0
Post employment benefits	0.1	0.1

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

37 PRINCIPAL SUBSIDIARIES, JOINT VENTURES AND ASSOCIATES

The principal subsidiaries, joint ventures and associates at 31 December 2006 were as follows

Company	Country of incorporation	% holdings in ordinary shares	Principal activity
<u>Subsidiary undertakings</u>			
AA SPC Co Limited	England	100	Holding company
AA Junior Mezzanine Co Limited	England	100	Holding company
AA Acquisition Co Limited	England	100	Holding company
AA Senior Co Limited	England	100	Holding company
AA Corporation Limited	England	100	Holding company
The Automobile Association Limited	Jersey	100	Roadside services
Automobile Association Developments Limited	England	100	Roadside and other services
Automobile Association Underwriting Services Limited	England	100	Roadside and insurance services
Volkswagen Assistance Limited	England	100	Roadside services
AA Ireland Limited	Ireland	100	Roadside and insurance services
Automobile Association Insurance Services Limited	England	100	Roadside and insurance services
A A Reinsurance Company (Guernsey) Limited	Guernsey	100	Insurance services
Taylor Price Insurance Services Limited	England	100	Insurance services
Premium Funding Limited	England	100	Insurance services
<u>Joint Ventures</u>			
Automobile Association Personal Finance Limited	England	50	Personal Finance
AA Financial Services	(c)	(c)	Personal Finance
<u>Associates</u>			
ARC Transistance S A	Belgium	20	Roadside services
A C T A Assistance S A	France	20	Roadside services
A C T A Assurance S A	France	20	Roadside and insurance services
A C T A S A	France	20	Roadside services

- (a) All principal undertakings are indirectly held by the Company, except for AA SPC Co Limited, which is a direct subsidiary undertaking
- (b) The subsidiary undertakings listed above are those which, in the opinion of the directors, principally affected the results for the year or the net assets of the Group. All subsidiary undertakings have been included in the consolidation
- (c) AA Financial Services is an unincorporated joint venture in which the Group has a 50% interest. Its principal place of business is Capital House, Queen's Park Road, Hardbridge, Chester, CU88 3AN
- (d) The percentage voting rights are the same as the percentage holding in ordinary shares

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS

The Group's date of transition to IFRS is 1 January 2005

IFRS 1 'First-time adoption of International Financial Reporting Standards' provides a number of optional exemptions to the general principles of full retrospective application of IFRS. The Group has elected to take advantage of the following optional exemptions from full retrospective application at the date of transition:

Business combinations

A first time adopter may elect not to apply IFRS 3 'Business Combinations' retrospectively to business combinations that occurred before the date of transition to IFRS. The Group has elected to take advantage of this exemption. Business combinations that occurred before the date of transition have been consolidated in accordance with UK GAAP. Any unamortised goodwill at 1 January 2005 has been recognised in the IFRS financial information at amortised cost.

Cumulative translation differences

The Group has elected to reset cumulative translation differences arising on the retranslation of foreign operations to zero at the transition date.

Reconciliations of UK GAAP to IFRS

The Group has prepared a reconciliation between the shareholders' equity recognised under UK GAAP and under IFRS at 1 January 2005, the date of transition to IFRS. In addition, reconciliations have been prepared from the latest UK GAAP financial statements prepared for the year ended 31 December 2005 to the restated IFRS financial statements.

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (continued)

Reconciliation of equity at 1 January 2005 (date of transition to IFRS)

	Notes	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
ASSETS				
NON-CURRENT ASSETS				
Goodwill	a,b,q	1,807 7	(112 8)	1,694 9
Intangible assets	d	-	7 0	7 0
Deferred tax asset	b,n	-	43 1	43 1
Property, plant and equipment	d,f,g,h	82 2	26 0	108 2
Investment in joint ventures and associates	b,h,i	4 4	(2 5)	1 9
Held-to-maturity investments		1 3	-	1 3
		<u>1,895 6</u>	<u>(39 2)</u>	<u>1,856 4</u>
CURRENT ASSETS				
Inventories		6 0	-	6 0
Trade and other receivables	b,g,h,i	231 1	(14 8)	216 3
Financial assets – short term deposits	j	105 5	(96 7)	8 8
Cash and cash equivalents	j	224 4	96 7	321 1
Non-current assets held for sale	h	-	5 3	5 3
		<u>567 0</u>	<u>(9 5)</u>	<u>557 5</u>
TOTAL ASSETS		<u>2,462 6</u>	<u>(48 7)</u>	<u>2,413 9</u>
LIABILITIES				
CURRENT LIABILITIES				
Financial liabilities	b,g,l	(6 3)	(24 6)	(30 9)
Trade and other payables	b,k	(258 4)	(6 0)	(264 4)
Deferred income		(269 3)	-	(269 3)
Current tax liability		(17 9)	-	(17 9)
Current provisions	m	-	(69 0)	(69 0)
		<u>(551 9)</u>	<u>(99 6)</u>	<u>(651 5)</u>
NON-CURRENT LIABILITIES				
Financial liabilities	b,g	(1,795 8)	7 1	(1,788 7)
Non-current provisions	b,m	(132 4)	56 9	(75 5)
Retirement benefit liability	b,n	(139 8)	(45 8)	(185 6)
		<u>(2,068 0)</u>	<u>18 2</u>	<u>(2,049 8)</u>
TOTAL LIABILITIES		<u>(2,619 9)</u>	<u>(81 4)</u>	<u>(2,701 3)</u>
NET LIABILITIES		<u>(157 3)</u>	<u>(130 1)</u>	<u>(287 4)</u>
EQUITY				
Called up share capital		0 1	-	0 1
Share premium		0 5	-	0 5
Retained earnings		(157 9)	(117 7)	(275 6)
Hedging and translation reserve	i	-	(12 4)	(12 4)
TOTAL SHAREHOLDERS' DEFICIT		<u>(157 3)</u>	<u>(130 1)</u>	<u>(287 4)</u>

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (continued)

Reconciliation of profit for the year ended 31 December 2005 (last UK GAAP financial statements)

	Note	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Group revenue	o	756 1	(1 0)	755.1
Operating costs before exceptional items and amortisation of intangible assets	d,f,g, k,n,o	(579 4)	7 0	(572 4)
Exceptional items	p	(123 4)	2 3	(121 1)
Amortisation of intangible assets	d	-	(3 3)	(3 3)
Operating costs		(702 8)	6 0	(696 8)
Share of net profit of joint ventures	l,o,q	-	12 6	12 6
		53 3	17 6	70 9
Share of operating profit of joint ventures	r	14 5	(14 5)	-
Non operating exceptional items	p	11 3	(11 3)	-
Profit before finance income/costs and taxation		79 1	(8 2)	70 9
Finance income	s	-	19 4	19 4
Finance costs	g,n,o,s	(209 5)	(19 1)	(228 6)
Loss before taxation		(130 4)	(7.9)	(138 3)
Taxation	e,o,r	74 7	(6 8)	67 9
Loss after tax from continuing operations		(55 7)	(14.7)	(70 4)
Loss for the year from discontinued operations	o,p	-	11 1	11 1
Loss for the year		(55 7)	(3.6)	(59 3)
Reconciliation of statement of recognised income and expenses for the year ended 31 December 2005				
Actuarial gain recognised in the retirement benefit liability		15 1	0 2	15 3
Deferred tax arising on actuarial gain in the retirement benefit liability		(5 6)	-	(5 6)
Exchange translation differences		0 3	-	0 3
Gains on cashflow hedges	l	-	5 6	5 6
Recycled and reported in net profit on cashflow hedges	l	-	(5 0)	(5 0)
Deferred tax arising on gains on cashflow hedges	l	-	3 5	3 5
Net income recognised directly in equity		9 8	4 3	14 1
Loss for the year		(55 7)	(3 6)	(59 3)
		(45 9)	0 7	(45 2)

AA LIMITED

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (continued)

Reconciliation of equity at 31 December 2005 (last UK GAAP financial statements)

	Notes	UK GAAP £m	Effect of Transition to IFRS £m	IFRS £m
ASSETS				
NON-CURRENT ASSETS				
Goodwill	c,q	1,801 5	(106 6)	1,694 9
Intangible assets	c,d	-	8 7	8 7
Deferred tax asset	e,l,n	-	110 3	110 3
Property, plant and equipment	d,f,g,h	71 8	8 1	79 9
Investment in joint ventures and associates	i	3 4	(0 2)	3 2
Held-to-maturity investments		1 3	-	1 3
		<u>1,878 0</u>	<u>20 3</u>	<u>1,898 3</u>
CURRENT ASSETS				
Inventories		7 9	-	7 9
Trade and other receivables	g,e	284 4	(87 3)	197 1
Non current assets held for sale	h	-	1 1	1 1
Financial assets – short term deposits	j	78 7	(64 1)	14 6
Cash and cash equivalents	j	117 8	64 1	181 9
		<u>488 8</u>	<u>(86 2)</u>	<u>402 6</u>
TOTAL ASSETS		<u>2,366 8</u>	<u>(65 9)</u>	<u>2,300 9</u>
LIABILITIES				
CURRENT LIABILITIES				
Financial liabilities	g,l	(14 4)	(21 1)	(35 5)
Trade and other payables	k	(214 1)	(2 0)	(216 1)
Deferred income		(267 7)	-	(267 7)
Current tax liability		(19 1)	-	(19 1)
Current provisions	m	-	(58 8)	(58 8)
		<u>(515 3)</u>	<u>(81 9)</u>	<u>(597 2)</u>
NON-CURRENT LIABILITIES				
Financial liabilities	g	(1,799 4)	(9 2)	(1,808 6)
Non-current provisions	m	(138 6)	58 8	(79 8)
Retirement benefit liability	n	(116 3)	(31 2)	(147 5)
		<u>(2,054 3)</u>	<u>18 4</u>	<u>(2,035 9)</u>
TOTAL LIABILITIES		<u>(2,569 6)</u>	<u>(63 5)</u>	<u>(2,633 1)</u>
NET LIABILITIES		<u>(202 8)</u>	<u>(129 4)</u>	<u>(332 2)</u>
EQUITY				
Share capital		0 2	-	0 2
Share premium		0 8	-	0 8
Hedging and translation reserve	i,t	-	(8 0)	(8 0)
Retained earnings		(203 8)	(121 4)	(325 2)
TOTAL SHAREHOLDERS' DEFICIT		<u>(202 8)</u>	<u>(129 4)</u>	<u>(332 2)</u>

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (continued)

Explanation of reconciling items between UK GAAP and IFRS

- a) Under UK GAAP, goodwill arising on the acquisition of the AA Group in 2004 was not amortised. This goodwill amounted to £1,800.9m. On transition to IFRS, the group takes full advantage of the exemption from IFRS 3 'Business Combinations' provided in IFRS 1 'First-time adoption of International Financial Reporting Standards' and any unamortised goodwill at 1 January 2005 has been carried forward at cost.
- b) As the acquisition of the AA Group took place in 2004, adjustments to the provisional fair values of £6.8m have been reflected as at 1 January 2005 in these IFRS financial statements. This increased the deferred tax asset by £1.1m, reduced investments in joint ventures by £4.3m, reduced trade receivables by £0.5m, increased trade payables by £4.3m, increased provisions by £12.1m, increased the retirement benefit liability by £3.0m and reduced debt by £29.9m due to the reclassification of fees.
- c) Customer lists of £0.6m at 31 December 2005 have been reclassified as intangible assets.
- d) In accordance with IFRS, capitalised software costs have been reclassified from plant and equipment to intangible assets. The impact of the reclassification on transition was £7.0m (December 2005 £8.1m). The software depreciation charge of £3.3m under UK GAAP for the year ended 31 December 2005 has been reclassified as amortisation with no net effect on the Group's income statement.
- e) Under UK GAAP, a deferred tax asset (excluding that relating to the pension scheme liability) is shown within current assets but is separately disclosed as an asset greater than one year. Under IFRS, this asset is shown as a non-current asset or deducted from the deferred tax liability. At 1 January 2005, £nil has been reclassified (December 2005 £80.3m). The adoption of IAS 12 has increased the deferred tax asset by £nil (December 2005 reduced by £3.9m). Impact on the income statement in 2005 is a reduction in the tax credit of £3.8m.
- f) Under UK GAAP, properties are valued using the existing use basis. Under IFRS, fair value is the open market value of the properties. At 1 January 2005, properties have been reduced in value by £6.7m (December 2005 £6.4m) and the impact in 2005 is a reduction in depreciation of £0.3m.
- g) A number of leases for commercial vehicles which were treated as an operating lease under UK GAAP have been reclassified as finance leases under IFRS. The impact of the reclassification at 1 January 2005 is an increase in plant and equipment of £40.9m (December 2005 £23.7m), a reduction in prepayments of £8.4m (December 2005 £7.0m) and an increase in financial liabilities of £35.0m (December 2005 £18.5m). For the year ended 31 December 2005, operating lease payments have reduced by £16.8m, depreciation has increased by £14.3m and interest payable on finance leases has increased by £1.8m.
- h) IFRS requires that non-current assets that are in the process of being sold and meet certain criteria detailed in IFRS 5 'Non-current assets held for sale and discontinued operations' are reclassified as a current asset. At 1 January 2005, £5.3m of assets have been reclassified. This balance comprises investments in joint ventures of £2.4m, available for sale investments of £1.7m (reclassified from debtors) and properties of £1.2m. At 31 December 2005, £1.1m has been reclassified from property, plant and equipment.
- i) Prior to the adoption of FRS 21 on 1 January 2005, under UK GAAP, dividends declared after the balance sheet date by the Group's joint ventures which related to the previous financial period were recognised as a receivable by the Group. IFRS requires that these dividends are not recognised until the shareholder is entitled to receive the dividend. At 1 January 2005, investments in joint ventures and associates have increased by £4.2m with a corresponding decrease in trade and other receivables. There is no impact at 31 December 2005.
- j) Under IFRS, cash and cash equivalents include cash deposits with a maturity of less than three months. At 1 January 2005, £96.7m (December 2005 £64.1m) has been reclassified as cash and cash equivalents with a corresponding decrease in financial assets – short term deposits.
- k) As part of operating lease agreements for buildings, the Group receives a number of lease incentives in the form of rent-free periods. Under IFRS, lease incentives are spread over the lease term. Under UK GAAP, they were spread over the shorter of the lease term or the period to the first rent review. At the date of transition, trade and other payables has increased by £1.7m (December 2005 £2.0m) and other operating expenses for the year ended 31 December 2005 have increased by £0.3m.
- l) At 1 January 2005, the Group recognised an additional financial liability under IAS 39 of £12.4m (December 2005 £11.8m) in relation to its interest rate swap derivative, an increase in the deferred tax asset of £nil (December 2005 £3.5m) with a corresponding change in the hedging reserve. There was no impact on the income statement relating to this adjustment. The share of profits from joint ventures has reduced by £0.2m in the year ended 31 December 2005 following the adoption of IAS 39.
- m) In accordance with IFRS, provisions have been split between current and non-current on the face of the balance sheet. At 1 January 2005, £69.0m (December 2005 £58.8m) has been reclassified as a current provision.

NOTES TO THE FINANCIAL STATEMENTS (continued)

38 RECONCILIATION OF NET ASSETS AND PROFIT UNDER UK GAAP TO IFRS (continued)

Explanation of reconciling items between UK GAAP and IFRS (continued)

- n) Accounting for pensions in accordance with IAS 19 'Employee Benefits' is different from FRS 17 'Retirement benefits'. The main differences are
 - Under FRS 17, pension balances are presented net of deferred tax on the face of the balance sheet. Under IFRS these balances are shown separately, as a liability for the pension scheme and as an asset for deferred tax. As a result, the Group's retirement benefit obligation at 1 January 2005 increased by £42.8m (December 2005 £31.2m) and the non-current deferred tax asset increased by £42.0m (December 2005 £30.4m).
 - Pension assets are valued at bid value under IFRS, whereas a mid-market valuation is used under FRS 17.
 - In the income statement for the year ended 31 December 2005, operating costs reduced by £0.5m and finance costs increased by £0.8m.
- o) Under IFRS, all results relating to discontinued operations are shown as one line on the income statement. In 2005, this reduced income by £1.0m, operating costs by £0.7m, share of profit of joint ventures by £0.2m, finance costs by £2.9m and the taxation credit by £4.5m. Exceptional items increased by £9.0m.
- p) Non operating exceptional costs of £11.9m and the profit on disposal of joint ventures of £20.9m have been reclassified as discontinued operations (see note o) and the profit on sale of fixed assets of £2.3m has been reclassified as operating exceptionals.
- q) Under IFRS, goodwill is allocated to segments. At the date of transition to IFRS, the group performed an impairment test on goodwill. Following a decline in profitability in the Personal Finance segment, goodwill allocated to the Personal Finance segment of £106.0m was impaired.
- r) The share of profit of joint ventures net of taxation is shown as a combined total in the income statement. In 2005, the taxation credit has been increased by £1.5m relating to the reclassification of joint ventures' taxation.
- s) Finance income is presented separately from finance costs.
- t) Exchange differences arising on the retranslation of overseas operations must be shown in a separate translation reserve. At 31 December 2005, £0.3m is shown in the translation reserve with a corresponding decrease in retained earnings.

Explanation of material differences to the cash flow statement for 2005

Receipts from the surrender of tax losses of £6.2m, income taxes paid of £1.1m, interest received of £11.9m and dividends received from joint ventures and associates of £9.4m have all been reclassified as operating activities under IFRS but were included in separate categories under UK GAAP. Cash and cash equivalents included £64.1m that are classified as short term deposits under IFRS. There are no other material differences between the cash flow statement presented under IFRS and the cash flow statement under UK GAAP.

INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF AA LIMITED

We have audited the parent company financial statements of AA Limited for the year ended 31 December 2006 which comprise the Balance Sheet and the related notes. These parent company financial statements have been prepared under the accounting policies set out therein.

We have reported separately on the group financial statements of AA Limited for the year ended 31 December 2006.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the parent company 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 parent company 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 parent company financial statements give a true and fair view and whether the parent company financial statements have been properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the parent company financial statements.

In addition we report to you if, in our opinion, 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 parent company financial statements. The other information comprises only the Statutory Directors' Report, the Chairman's Foreword, the Chief Executive's Review of the Business and the Finance Director's review. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent company financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

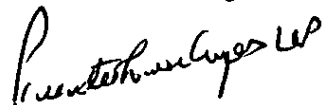
We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent company financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the parent company 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 parent company 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 parent company financial statements.

Opinion

In our opinion:

- the parent company 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 2006,
- the parent company financial statements have been properly prepared in accordance with the Companies Act 1985, and
- the information given in the Directors' Report is consistent with the parent company financial statements.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
28 February 2007

AA LIMITED

COMPANY BALANCE SHEET AT 31 DECEMBER 2006

	Notes	Company 2006 £m	Company 2005 £m
FIXED ASSETS			
Investments in group undertakings	III	0 5	0 5
Fixed asset investments	IV	0 1	0 1
		<u>0 6</u>	<u>0 6</u>
CURRENT ASSETS			
Debtors – Amounts due from group undertakings	V	0 3	0 2
NET ASSETS		<u>0 9</u>	<u>0 8</u>
CAPITAL AND RESERVES			
Called up share capital	27	0 2	0 2
Share premium	VI	0 8	0 8
Profit and loss account	VI	(0 1)	(0 2)
EQUITY SHAREHOLDERS' FUNDS	VII	<u>0 9</u>	<u>0 8</u>

The financial statements on pages 54 to 56 were approved by the board of directors on 28 February 2007 and were signed on its behalf by


SIR TREVOR CHINN
DIRECTOR

The notes on pages 55 to 56 form part of these financial statements

AA LIMITED

NOTES TO THE COMPANY BALANCE SHEET

(i) ACCOUNTING POLICIES

The financial statements have been prepared in accordance with applicable UK accounting standards and under the historical cost convention and the Companies Act 1985. The principal accounting policies, which have been applied on a consistent basis with the prior period, are set out below.

Basis of preparation

Under section 230(1) of the Companies Act 1985, the Company is exempt from the requirement to present its own profit and loss account. The Company is also exempt from the requirement to prepare a cash flow statement under FRS 1 (Revised). The financial risk management policies are consistent with those of the Group and are described on page 8 of the Finance Director's Review.

The Company is exempt from the requirement to disclose related party transactions with other group undertakings under FRS 8 which cancel on consolidation.

Investments

Fixed asset investments are included in the balance sheet at cost, less any permanent provisions for impairment.

Treasury shares

Where the Company purchases or funds the purchase of the Company's share capital, the consideration paid is shown as a deduction from total shareholders' equity.

(ii) DIRECTOR'S EMOLUMENTS

The emoluments of directors are disclosed in note 34.

(iii) INVESTMENTS IN GROUP UNDERTAKINGS

Cost	£m
At 1 January and 31 December 2006	<u>0.5</u>

A list of subsidiary undertakings is included in note 37.

(iv) FIXED ASSET INVESTMENTS

	2006 £m	2005 £m
Investment in subordinated preference certificates	<u>0.1</u>	<u>0.1</u>

In 2005, an employee share trust was established to operate the employee share ownership plan, under which the trust holds shares and subordinated preference certificates on behalf of participating employees. The investment in subordinated preference certificates relates to loans made to the trust to enable it to repurchase the holdings of participating employees who have left the Group.

(v) DEBTORS

The amounts owed by group undertakings are unsecured, have no repayment terms and bear interest at 16.5%.

(vi) RESERVES

	Share premium £m	Profit and Loss £m	Total £m
At 1 January 2006	0.8	(0.2)	0.6
Profit for the financial period	-	0.1	0.1
At 31 December 2006	<u>0.8</u>	<u>(0.1)</u>	<u>0.7</u>

AA LIMITED

NOTES TO THE COMPANY BALANCE SHEET (continued)

(vii) RECONCILIATION OF MOVEMENT IN SHAREHOLDERS' FUNDS

	2006 £m	2005 £m
Profit/(loss) for the financial year	0.1	(0.1)
Issue of ordinary share capital	-	0.4
Net increase in shareholders' funds	0.1	0.3
Shareholders' funds at 1 January	0.8	0.5
Shareholders' funds at 31 December	0.9	0.8

(viii) GUARANTEES

The Company's assets have been provided as security for bank loans provided to three of the Company's subsidiary undertakings, AA Junior Mezzanine Co Limited, AA Acquisition Co Limited and AA Senior Co Limited