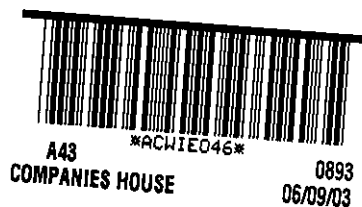


Priory Childcare Services Limited

Directors' report and financial statements

Year ended 31 December 2002

Registered number 2838284



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Directors' report

The directors present their annual report and the audited financial statements for the year ended 31 December 2002.

Principal activities

The company's principal activity is the provision of residential care for adolescents who have learning disabilities combined with some degree of behavioural disturbances or with severe abuse and neglect.

Business review

The results for the year are set out in the profit and loss account on page 5.

On 7 October 2002, the company acquired the entire issued share capital of Farleigh Schools Limited for a consideration of £4,372,000.

On 23 December 2002, as part of a general re-organisation of the Group's structure, the company:

- acquired the beneficial ownership of Sheridan House from Priory Hospitals Limited (a fellow subsidiary undertaking) for a consideration of £245,000 to be left outstanding as a debt repayable on demand;
- acquired the legal title of Sheridan House from Priory Healthcare Limited (a fellow subsidiary undertaking) for a consideration of £1.
- acquired the entire issued share capital of Priory Services for Young People (Isle of Man) Limited from Priory Healthcare Holdings Limited (a fellow subsidiary undertaking) for a consideration of £428,000. The consideration was satisfied by the issue of shares in the company;
- acquired the entire issued share capital of Priory Healthcare Limited from Priory Specialist Health Limited (a fellow subsidiary undertaking) for a consideration of £47,390,000 to be left outstanding as a debt repayable on demand;
- acquired the beneficial ownership of Eden Grove and Jacques Hall from Priory Healthcare Limited (a fellow subsidiary undertaking) at amount equivalent to market value; and
- acquired the legal title of Eden Grove and Jacques hall from Priory Hospitals Limited (a fellow subsidiary undertaking) for a consideration of £1.

Dividends

The directors do not recommend the payment of a dividend (2001: *£nil*).

Directors' report *(continued)*

Directors and directors' interests

The directors who held office during the year were as follows:

AG Heywood (resigned 30 April 2002)

Dr CB Patel

JD Weight (resigned 10 June 2002)

Ms S J Stewart (appointed 10 June 2002, resigned 5 December 2002)

PJ Greensmith (appointed 13 September 2002)

In accordance with the articles of association, no directors retire by rotation. None of the directors who held office at the end of the financial year had any disclosable interest in the shares of the company.

The interests of Dr CB Patel and PJ Greensmith in the shares of Priory Healthcare Investments Limited (the ultimate parent company) are disclosed in the financial statements of that company.

Auditors

In accordance with Section 384 of the Companies Act 1985, a resolution for the re-appointment of PricewaterhouseCoopers LLP as auditors of the company is to be proposed at the forthcoming Annual General Meeting.

By order of the board



P J Greensmith
Company secretary

Priory House
Randalls Way
Leatherhead
Surrey
KT22 7TP

8 May 2003

Statement of directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss for that period. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records which disclose with reasonable accuracy at any time the financial position of the company and to enable them to ensure that the financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

Independent auditors' report to the members of Priory Childcare Services Limited

We have audited the financial statements, which comprise the profit and loss account, the balance sheet and the related notes.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities.

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

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

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. The other information comprises only the directors' report.

Basis of audit opinion

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

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

Opinion

In our opinion the financial statements give a true and fair view of the state of the company's affairs as at 31 December 2002 and of its profit for the year then ended and have been properly prepared in accordance with the Companies Act 1985.



PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London

8 May 2003

Profit and loss account
for the year ended 31 December 2002

	Note	2002 £000	2001 £000
Turnover		6,845	5,691
Cost of sales		(5,367)	(4,282)
Gross profit		1,478	1,409
Administrative expenses		(156)	(463)
Operating profit		1,322	946
Loss on disposal of fixed assets		(153)	-
Interest payable and similar charges	5	(75)	-
Profit on ordinary activities before taxation	2	1,094	946
Tax on profit on ordinary activities	6	(383)	(293)
Retained profit for the financial year	15	711	653

The results for the both the current and prior year derive from continuing activities.

The company has no recognised gains or losses other than the profit for the year.

The historical cost profit and the reported profit are the same.

Balance sheet
at 31 December 2002

	Note	2002 £000	2001 £000
Fixed assets			
Intangible assets	7	87	114
Tangible assets	8	5,536	807
Investments	9	52,036	-
		<u>57,659</u>	<u>921</u>
Current assets			
Debtors	10	4,580	2,546
Cash at bank and in hand		3,221	163
		<u>7,801</u>	<u>2,709</u>
Creditors: amounts falling due within			
One year	11	(61,608)	(1,305)
		<u>(53,807)</u>	<u>1,404</u>
Net current (liabilities)/assets			
		<u>3,852</u>	<u>2,325</u>
Total assets less current liabilities			
Creditors: amounts falling due after			
more than one year	12	(148)	(20)
Provisions for liabilities and charges	13	(260)	-
		<u>3,444</u>	<u>2,305</u>
Net assets			
Capital and reserves			
Called up share capital	14	428	-
Profit and loss account	15	3,016	2,305
		<u>3,444</u>	<u>2,305</u>
Shareholders' funds – equity	15		
		<u>3,444</u>	<u>2,305</u>

These financial statements were approved by the board of directors on 8 May 2003 and were signed on its behalf by:



P J Greensmith
Director

Notes

(forming part of the financial statements)

1 Accounting policies

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the company's financial statements.

Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards and under the historical cost accounting rules.

The company is exempt by virtue of section 228 of the Companies Act 1985 from the requirement to prepare group accounts. These financial statements present information about the company as an individual undertaking and not about its group.

Under Financial Reporting Standard 1 (revised) the company is exempt from the requirement to prepare a cash flow statement on the grounds that a parent undertaking includes the company in its own published consolidated financial statements.

As the company is a wholly owned subsidiary of Priory Healthcare Investments Limited, the company has taken advantage of the exemption contained in Financial Reporting Standard 8 and has therefore not disclosed transactions or balances with entities which form part of the group.

Goodwill

Goodwill relating to acquisitions of businesses is capitalised in the balance sheet in the year of acquisition and amortised over a period not exceeding 20 years. Unamortised goodwill attributable to businesses disposed of is charged to the profit and loss account.

Fixed assets and depreciation

Depreciation is provided to write off the cost or valuation less the estimated residual value of tangible fixed assets by equal instalments over their estimated useful economic lives as follows:

Freehold buildings and long leasehold properties	-	50 years
Short leasehold properties	-	over the period of the lease
Plant, fixtures and fittings	-	3 to 10 years
Motor vehicles	-	4 years

No depreciation is provided on freehold land.

Fixed asset investments are stated at cost less provision for any impairment in value.

Leases

Operating lease rentals are charged to the profit and loss account on a straight-line basis over the period of the lease.

Post-retirement benefits

The company operates a defined contribution pension scheme. The assets of the scheme are held separately from those of the company in an independently administered fund. The amount charged against profits represents the contributions payable to the scheme in respect of the accounting period.

Stocks

Stocks are stated at the lower of cost and net realisable value.

Notes (continued)

1 Accounting policies (continued)

Taxation

The charge for taxation is based on the profit for the year and takes into account taxation deferred. Deferred tax is recognised, without discounting, in respect of all timing differences between the treatment of certain items for taxation and accounting purposes which have arisen but not reversed by the balance sheet date, except as otherwise required by FRS 19.

Group relief

Payment is generally made for group relief at a rate of 30% at the time of first estimating the tax provision. To the extent that amendments are subsequently made to the group relief plan, there is generally no payment or receipt in respect of change.

Turnover and revenue recognition

Turnover represents the amounts (excluding value added tax) derived from the provision of services to customers. Revenue is recognised as the services are provided.

2 Profit on ordinary activities before taxation

	2002 £000	2001 £000
Profit on ordinary activities before taxation is stated after charging		
Auditors' remuneration (inclusive of VAT):		
Audit	15	8
Other services - fees paid to the auditor and its associates	7	-
Depreciation and other amounts written off tangible fixed assets:		
Owned	108	124
Leased	20	1
Amortisation of capitalised goodwill	28	28
Hire of other assets - operating leases	29	86
	<hr/>	<hr/>

3 Remuneration of directors

The directors received no emoluments for services to the company during the year (2001: £nil).

Notes (continued)

4 Staff numbers and costs

The average number of persons employed by the company (including directors) during the period, analysed by category, was as follows:

	Number of employees	
	2002	2001
Teachers and social workers	157	148
Administrative staff	48	49
	<hr/>	<hr/>
	205	197
	<hr/>	<hr/>

The aggregate payroll costs of these persons were as follows:

	2002 £000	2001 £000
Wages and salaries	2,924	2,787
Social security costs	227	221
Other pension costs	74	46
	<hr/>	<hr/>
	3,225	3,054
	<hr/>	<hr/>

5 Net interest payable and similar charges

	2002 £000	2001 £000
Inter-company interest payable	71	-
Finance charges payable in respect of finance leases	4	-
	<hr/>	<hr/>
	75	-
	<hr/>	<hr/>

Notes (continued)

6 Taxation

	2002 £000	2001 £000
<i>UK corporation tax</i>		
Current tax on income for the period at 30%	379	293
Deferred tax	4	-
	<u>383</u>	<u>293</u>

The tax charge of £379,000 (2001: £293,000) on profits for the period has been relieved by the surrender of losses by other group companies in exchange for payment of the same amount.

The standard rate of tax for the year, based on the UK standard rate of corporation tax is 30%. The actual tax charge for the year is above the standard rate for the reasons set out in the following reconciliation:

	2002 £000	2001 £000
Profit on ordinary activities before tax	1,094	946
Tax on profit on ordinary activities at standard rate	328	284
<i>Factors affecting charge for the year</i>		
Capital allowances for year in excess of depreciation	(10)	-
Depreciation of non-qualifying assets	2	9
Profit/loss on non-qualifying assets	46	-
Expenses not deductible for tax purposes	13	-
Total actual amount of current tax	<u>379</u>	<u>293</u>

Notes (continued)

7 Intangible fixed assets - goodwill

	Total £000
Cost	
At beginning of the year	276
Amortisation	
At beginning of the year	161
Charge for the year	28
At end of the year	189
Net book value	
At 31 December 2002	87
At 31 December 2001	115

8 Tangible assets

	Freehold land and buildings £000	Assets in course of construction £000	Fixtures and fittings £000	Motor vehicles £000	Total £000
Cost					
At beginning of the year	-	444	819	83	1,346
Additions	14	5	168	186	373
Disposals	-	-	-	(50)	(50)
Inter-company additions	4,933	(449)	-		4,484
At end of the year	4,947	-	987	219	6,153
Depreciation					
At beginning of the year	-	-	482	57	539
Charge for the year	7	-	96	25	128
On disposals	-	-	-	(50)	(50)
At end of the year	7	-	578	32	617
Net book value					
At 31 December 2002	4,940	-	409	187	5,536
At 31 December 2001	-	444	337	26	807

Included in the total net book value of motor vehicles is £185,000 (2001: £26,000) in respect of assets held under finance leases. Depreciation for the year on these assets was £20,000 (2001: £1,000).

Notes (continued)

9 Fixed asset investments

	Total £000
<i>Shares in group undertakings</i>	
<i>Cost</i>	
At the beginning of the year	-
Additions	52,190
	<hr/>
At end of the year	52,190
	<hr/>
<i>Provisions</i>	
At beginning of the year	-
Provided in the year	154
	<hr/>
At end of the year	154
	<hr/>
<i>Net book value</i>	
At 31 December 2002	52,036
	<hr/>
At 31 December 2001	-
	<hr/>

The undertakings in which the company's interest at the year end is more than 20% are as follows:

	Principal activities	Class and percentage of share held
<i>Subsidiary undertakings</i>		
Priory Services for Young People (IOM) Limited	Specialist schools for children with behavioural difficulties	100% ordinary
Priory Healthcare Limited	Non-trading	100% ordinary
Farleigh Schools Limited	Specialist schools for children with Asperger Syndrome	100% ordinary

All subsidiary and associated undertakings are registered in England and Wales with the following exceptions:

Priory Services for Young People (IOM) Limited registered in the Isle of Man

Notes (continued)

10 Debtors

	2002 £000	2001 £000
Trade debtors	2,025	1,596
Amounts owed by group undertakings	2,502	921
Other debtors	48	2
Prepayments and accrued income	5	27
	<u>4,580</u>	<u>2,546</u>

11 Creditors: amounts falling due within one year

	2002 £000	2001 £000
Obligations under finance lease contracts	38	-
Trade creditors	129	95
Amounts owed to group undertakings	60,682	547
Group relief payable	379	293
Other taxes and social security	308	166
Other creditors	13	8
Accruals and deferred income	59	196
	<u>61,608</u>	<u>1,305</u>

12 Creditors: amounts falling due after more than one year

	2002 £000	2001 £000
Obligations under finance lease contracts	148	20
	<u>148</u>	<u>20</u>

Obligations under finance leases are payable as follows:

	2002 £000	2001 £000
Within one year or less	38	-
Within one to two years	38	20
Within two to five years	110	-
	<u>186</u>	<u>20</u>

Notes (continued)

13 Provisions for liabilities and charges

	£000
<i>Deferred tax</i>	
At beginning of the year	-
Transfers	256
Charge for the year	4
	<hr/>
At end of year	260
	<hr/>

Deferred tax has been provided in full as follows:

	2002 £000
Difference between accumulated depreciation and capital allowances	260
	<hr/>

No provision has been made for deferred tax on the excess of the cost to the company over the tax base cost on the company's properties since it is not expected that any such potential tax liability will be crystallised in the foreseeable future.

14 Called up share capital

	2002 £	2001 £
Authorised		
500,100 (2001: 100) Ordinary shares of £1 each	500,100	100
	<hr/>	<hr/>
Allotted, called up and fully paid		
428,002 (2001: 2) Ordinary shares of £1 each	428,002	2
	<hr/>	<hr/>
<i>Movements in Ordinary shares during the year</i>		
At beginning of the year		2
Issue of Ordinary shares		428,000
		<hr/>
At end of the year		428,002
		<hr/>

Notes (continued)

15 Reconciliation of movement in shareholders' funds

	Share Capital £000	Profit and loss account £000	Total 2002 £000
At beginning of the year	-	2,305	2,305
Retained profit for the financial year	-	711	711
Shares issued	428	-	428
	<hr/>	<hr/>	<hr/>
At end of financial year	428	3,016	3,444
	<hr/>	<hr/>	<hr/>

16 Contingent liabilities

- (a) The company has entered into banking facilities set-off agreements in respect of which guarantees have been given. The aggregate amount outstanding under the agreements was £nil at 31 December 2002 (2001:£396,000).
- (b) An intermediate parent undertaking has obtained a secured bank loan amounting to £190,000,000 as at 31 December 2002 (2001:£101,750,000). This loan is secured on the freehold and leasehold properties of the company's fellow subsidiaries. In addition, the company's share capital has been pledged as security for this loan.

17 Commitments

Annual commitments under non-cancellable operating leases are as follows:

	Land and buildings £000	2002 Other £000	Land and buildings £000	2001 Other £000
Operating leases which expire:				
Within one year	-	14	-	24
In the second to fifth years inclusive	-	-	-	20
Over five years	-	-	-	-
	<hr/>	<hr/>	<hr/>	<hr/>
	-	14	-	44
	<hr/>	<hr/>	<hr/>	<hr/>

Notes (continued)

18 Pension scheme

The company operates a defined contribution pension scheme. The pension cost charge for the period represents contributions payable by the company to the fund and amounted to £70,000 (2001: £42,000).

There were no outstanding or prepaid contributions at either the beginning or end of the financial year.

The company participated in the Teachers' Pension Scheme ("the scheme") which is a government funded final salary scheme. The pension charge for the year was £4,000 (2001: £4,000). The company is unable to identify its share of the underlying assets and liabilities of the scheme in which it participates on a consistent and reliable basis. It has therefore taken advantage of the exemption under Financial Reporting Standard 17 paragraph 9 to treat the scheme as a defined contribution scheme.

19 Ultimate parent company

The company is a subsidiary undertaking of Priory Securitisation Limited which is incorporated in England.

The largest group in which the results of the company are consolidated is that headed by Priory Healthcare Investments Limited. No other group accounts include the results of the company.