

EXPLANATION OF TRANSITION TO IFRS

Chemring Group PLC presented its financial statements for the interim period to April 2006 under IFRS for the first time. The Group has applied IFRS1 *First Time Adoption of International Financial Reporting Standards* as a starting point for reporting under IFRS. The Group's date of transition to IFRS is 1 November 2004. Comparative information in the financial statements has been restated to reflect the Group's adoption of IFRS except where otherwise required or permitted by IFRS1.

As a general rule IFRS1 requires standards to be applied retrospectively to determine the IFRS opening balance sheet at the date of transition, 1 November 2004. IFRS1 provides a number of optional exemptions to this general principle. The most significant of these are set out below, together with a description, in each case, of the exemption adopted by the Group.

IFRS3 - Business Combinations

As permitted the Group has elected not to restate business combinations occurring before the date of transition on 1 November 2004.

IFRS2 - Share-Based Payments

The Group has elected to take advantage of the exemptions allowed in IFRS1 regarding IFRS2 *Share-Based Payments* for share-based payments granted on or before 7 November 2002. This means that only equity instruments granted after 7 November 2002 that vest after the effective date of IFRS2 on 1 January 2005 have been valued.

IAS19 - Employee Benefits

Under IAS19 accounting for defined benefit plans retrospectively is expected to be particularly onerous or impractical. The Group has therefore elected to utilise the optional exemption under IFRS1 allowing non-retrospective application of the actuarial gains and losses approach to valuation of the defined benefit plans. The initial recognition of the defined benefit schemes' deficits is recorded on the face of the Group balance sheet as at 1 November 2004 (date of transition).

IAS21 - The Effects of Changes in Foreign Exchange Rates

The Group has elected to take advantage of the exemption in IFRS1 regarding translation differences. Accordingly the Group has not separately disclosed the amount of cumulative translation differences for its overseas operations included within retained earnings at 1 November 2004.

IAS16 - Property, Plant and Equipment

A first time adopter may elect to measure individual items of property, plant and equipment at fair value or a revalued amount as deemed cost at the date of transition to IFRS. No adjustments have been made in this respect for the purposes of transition. Tangible assets have continued to be reported on the basis of depreciated historical cost, as under UK GAAP.

IAS32 - Financial Instruments: Disclosure and Presentation and IAS39 - Financial Instruments: Recognition and Measurement

As permitted by IFRS1, the Group adopted IAS32 *Financial Instruments: Disclosure and Presentation* and IAS39 *Financial Instruments: Recognition and Measurement*, prospectively from 1 November 2005. Therefore until 31 October 2005, the Group continued to account for financial instruments in accordance with UK GAAP, and hence the comparative financial statements exclude the impact of these standards.

DETAIL ON IFRS CHANGES IMPACTING PUBLISHED RESULTS

Significant changes to previously reported UK GAAP figures have been made in the following areas to comply with IFRS:

A) IFRS3 - Business Combinations

Under IFRS3 there is a specific requirement to recognise separately identifiable intangible assets that meet the IFRS3 criteria including acquired order back log, customer relationships and technology assets at fair value on acquisition and to amortise these over an appropriate period. This reduces the amount of residual goodwill recognised.

As stated above, under IFRS1 business combinations prior to the date of transition are not required to be restated. The adjustment is limited to the acquisitions completed since 1 November 2004. As at 31 October 2005 specific intangibles, net of amortisation, of £2,929,000 were identified from acquisitions at that date.

Total amortisation of £71,000 has been charged since the date of transition in the period to 31 October 2005.

B) IFRS2 - Share-Based Payments

Under IFRS2 charges are required for all share based remuneration schemes. These charges reflect the fair value of the shares at the date of the grant. The operating profit charge for the year to 31 October 2005 for all relevant schemes under this standard was £477,000. The opening IFRS balance sheet net assets are reduced by £76,000. Net assets at 31 October 2005 are reduced by £328,000.

C) IAS19 - Employee Benefits and Retirement Benefit Schemes

Under IAS19 there is a requirement to recognise the monetary value of employee benefits accruing to employees but not yet settled; typically holiday pay. There is a requirement to present the value of the liability for employee benefits to be paid in the future for services provided up to the reporting date. A review of employee benefits across the Group identified an opening balance sheet adjustment of £518,000.

Under UK GAAP the Group accounted for defined benefit pension schemes in accordance with SSAP24, with disclosure as required under FRS17. Under IAS19 there is a requirement to value defined benefit scheme assets at bid price rather than mid market price, and to disclose the retirement benefit asset/obligation on the face of the balance sheet, with movement in the valuation of actuarial gains and losses through the statement of recognised income and expenditure (SORIE). At the date of transition, 1 November 2004, the initial increase in non-current liabilities is £16,115,000, with a corresponding deferred tax asset of £4,835,000 reported in non-current assets. In addition, the previous SSAP24 prepayment of £252,000 has been reversed. The charge to the income statement under IAS19 for retirement benefits includes three components, a service cost, the expected return on pension scheme assets and the unwinding cost of interest on the pension scheme liabilities.

D) IAS10 - Events after the Balance Sheet Date

There is a requirement under IFRS to only recognise the liability for dividends that have been proposed and approved at the balance sheet date.

E) IAS21 - The Effects of Changes in Foreign Exchange Rates

Under IAS21 all foreign currency transactions and balances must be converted to the reporting entity currency at the rate applicable on the last day of the reporting period, i.e. at the spot rate. UK GAAP permitted the use of an applicable forward currency contract rate instead of the spot rate.

F) IAS12 - Income Tax

Under UK GAAP deferred tax liabilities were discounted; under IFRS discounting is not permitted. The impact as at 1 November 2004 was to increase deferred tax liabilities by £824,000. The tax in the income statement for the year ended 31 October 2005 is £61,000 higher than it would have been under UK GAAP.

Under UK GAAP deferred tax liabilities on revaluation reserves were not provided for unless the Group entered into a binding contract to sell the revalued assets. Under IAS12 deferred tax must be provided for. The impact is to increase deferred tax liabilities as at 1 November 2004 by £1,081,000. The Group has available capital losses to offset against any potential gain arising on these assets. The impact as at 1 November 2004 is to recognise a deferred tax asset of £1,081,000. Netting-off of assets and liabilities is not permitted under IAS12.

The reconciliation of equity at 1 November 2004 (date of transition to IFRS) and at 31 October 2005 (date of last UK GAAP financial statements) and the reconciliation of profit for the year ended 31 October 2005, as required by IFRS1, are given below.

References to UK GAAP for the period 31 October 2005 are to the Group's policies as applied in its financial statements for the year ended 31 October 2005.

Reconciliation of equity at 1 November 2004 (date of transition to IFRS)

		Unaudited		
		UK GAAP	Effect of transition to IFRS	IFRS
	Note	£000	£000	£000
Non-current assets				
Development costs		2,841	-	2,841
Goodwill		27,984	-	27,984
Tangible assets		41,810	-	41,810
Investment in associate		1,073	-	1,073
Deferred tax asset	B,C,F	-	6,004	6,004
Total non-current assets		<u>73,708</u>	<u>6,004</u>	<u>79,712</u>
Current assets				
Inventories		25,090	-	25,090
Trade and other receivables	C	27,036	(252)	26,784
Cash and cash equivalents		9,933	-	9,933
Total current assets		<u>62,059</u>	<u>(252)</u>	<u>61,807</u>
Current liabilities				
Loans		(3,070)	-	(3,070)
Obligations under finance leases		(1,234)	-	(1,234)
Bank overdrafts		(17,463)	-	(17,463)
Trade and other payables	B,C,D,E	(25,208)	1,269	(23,939)
Corporation tax		(2,940)	-	(2,940)
		<u>(49,915)</u>	<u>1,269</u>	<u>(48,646)</u>
Non-current liabilities				
Loans		(17,055)	-	(17,055)
Obligations under finance leases		(1,119)	-	(1,119)
Other payables	B	-	(68)	(68)
Deferred tax liabilities	C,E,F	(3,431)	(1,837)	(5,268)
Long-term provisions		(626)	-	(626)
Preference shares		(62)	-	(62)
Retirement benefit obligations	C	-	(16,115)	(16,115)
		<u>(22,293)</u>	<u>(18,020)</u>	<u>(40,313)</u>
Net assets		<u><u>63,559</u></u>	<u><u>(10,999)</u></u>	<u><u>52,560</u></u>
Equity				
Share capital		1,449	-	1,449
Share premium account		26,710	-	26,710
Special capital reserve		12,939	-	12,939
Revaluation reserve	F	2,410	(723)	1,687
Retained earnings		19,787	(10,276)	9,511
Equity attributable to equity holders of the parent		63,295	(10,999)	52,296
Equity attributable to minority interests		264	-	264
Total equity		<u><u>63,559</u></u>	<u><u>(10,999)</u></u>	<u><u>52,560</u></u>

Reconciliation of equity at 31 October 2005 (date of last UK GAAP Financial Statements)

		Unaudited	
		UK GAAP	Effect of transition to IFRS
	Note	£000	IFRS
			IFRS
			£000
Non-current assets			
Intangible assets	A	-	2,929
Development costs		541	-
Goodwill	A	35,058	(378)
Tangible assets		50,698	-
Investment in associate		1,068	-
Deferred tax assets	B,C,F	-	7,440
Total non-current assets		<u>87,365</u>	<u>9,991</u>
Current assets			
Inventories		27,821	-
Trade and other receivables	C,E	27,450	(282)
Cash and cash equivalents		7,774	-
Assets classified as held for sale		14,646	-
Total current assets		<u>77,691</u>	<u>(282)</u>
Current liabilities			
Loans		(1,957)	-
Obligations under finance leases		(925)	-
Bank overdrafts		(10,744)	-
Trade and other payables	B,C,D,E	(26,474)	1,226
Corporation tax		(1,150)	-
Liabilities classified as held for sale		(1,776)	-
		<u>(43,026)</u>	<u>1,226</u>
Non-current liabilities			
Loans		(46,320)	-
Obligations under finance leases		(602)	-
Other payables	B	-	(163)
Deferred tax liabilities	A,C,E,F	(4,457)	(4,501)
Long-term provisions		(170)	-
Preference shares		(62)	-
Retirement benefit obligations	C	-	(20,189)
		<u>(51,611)</u>	<u>(24,853)</u>
Net assets		<u>70,419</u>	<u>(13,918)</u>
Equity			
Share capital		1,459	-
Share premium account		27,274	-
Special capital reserve		12,939	-
Revaluation reserve	F	2,374	(734)
Retained earnings		26,096	(13,184)
Equity attributable to equity holders of the parent		<u>70,142</u>	<u>(13,918)</u>
Equity minority interest		277	-
Total equity		<u>70,419</u>	<u>(13,918)</u>

Reconciliation of profit for the year ended 31 October 2005

	Unaudited		
	UK GAAP	Effect of transition to IFRS	IFRS
	£000	£000	£000
Continuing operations:			
Revenue	120,963	-	120,963
Operating profit	22,623	(573)	22,050
Share of results of associate	197	-	197
Finance expense	(2,964)	-	(2,964)
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Profit before taxation	19,856	(573)	19,283
Tax	(5,778)	54	(5,724)
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Profit for the year from continuing operations	14,078	(519)	13,559
Discontinued operations:			
Loss for the year from discontinued operations	(4,790)	-	(4,790)
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Profit for the year	<u>9,288</u>	<u>(519)</u>	<u>8,769</u>

Analysis of movement due to IFRS

	Note	Operating profit	Profit before tax	Profit/(loss) for the period
		£000	£000	£000
UK GAAP		22,623	19,856	14,078
		<hr/>	<hr/>	<hr/>
Amortisation of acquired intangible assets	A	(71)	(71)	(71)
Share-based payments	B	(477)	(477)	(382)
Retirement benefit scheme fair value adjustment	C	17	17	12
Translation of foreign currency transactions	E	(48)	(48)	(34)
Accrued employee benefit adjustment	C	6	6	6
Income tax adjustment	F	-	-	(50)
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		(573)	(573)	(519)
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IFRS		<u>22,050</u>	<u>19,283</u>	<u>13,559</u>