Accounting policies

General information

This document constitutes the Annual Report and Financial Statements in accordance with UK Listing Rules requirements and the Annual Report on Form 20-F in accordance with the US Securities Exchange Act of 1934. In previous years the Group issued separate documents.

The Consolidated Financial Statements of InterContinental Hotels Group PLC (the Group or IHG) for the year ended 31 December 2013 were authorised for issue in accordance with a resolution of the Directors on 17 February 2014. InterContinental Hotels Group PLC (the Company) is incorporated and domiciled in Great Britain and registered in England and Wales.

Comparatives for 2011

The comparative information presented for the year ended 31 December 2011 is that previously issued on Form 20-F for that year which differs from the Consolidated Financial Statements issued to the UK listing authorities for 2011. The difference arose in respect of a litigation provision of $22m ($13m net of tax) which was recorded on Form 20-F in the year ended 31 December 2010 but not in the UK Consolidated Financial Statements until the following year. An unfavourable court judgement on 23 February 2011, between the authorisation of the respective documents (UK Consolidated Financial Statements on 14 February 2011 and Form 20-F on 11 April 2011), resulted in the litigation provision being recorded as an adjusting post balance sheet event in the Financial Statements for the year ended 31 December 2010 issued on Form 20-F.

The respective numbers reported were as follows:

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td></td>
<td>Form 20-F</td>
<td>UK filing</td>
<td>Form 20-F</td>
</tr>
<tr>
<td>Profit before tax ($m)</td>
<td>554</td>
<td>532</td>
<td>554</td>
</tr>
<tr>
<td>Profit for the year ($m)</td>
<td>473</td>
<td>460</td>
<td>473</td>
</tr>
<tr>
<td>Net assets ($m)</td>
<td>555</td>
<td>555</td>
<td>11</td>
</tr>
<tr>
<td>Basic earnings per ordinary share (cents)</td>
<td>163.7</td>
<td>159.9</td>
<td>163.7</td>
</tr>
<tr>
<td>Diluted earnings per ordinary share (cents)</td>
<td>163.7</td>
<td>159.9</td>
<td>163.7</td>
</tr>
</tbody>
</table>

1 These numbers form the basis of the comparatives included in this document and exclude the litigation provision described above.
2 Before restatement for the adoption of IAS 19R ‘Employee Benefits’ (see below).

Changes in accounting policies

With effect from 1 January 2013, the Group has adopted IAS 19 (Revised) ‘Employee Benefits’ which introduces a number of changes to accounting for defined benefit plans. The key change that impacts the Group is the removal of expected returns on plan assets from the income statement and its replacement with a requirement to recognise interest on the net defined benefit asset/liability (after any asset restrictions), calculated using the discount rate used to measure the defined benefit obligation.

The impact of this change in accounting policy on the current and prior year Financial Statements, which have been restated, is as follows:

<table>
<thead>
<tr>
<th>Group income statement</th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Administrative expenses</td>
<td>6</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Operating profit and profit before tax</td>
<td>6</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Tax</td>
<td>2</td>
<td>2</td>
<td>3</td>
</tr>
<tr>
<td>Profit for the year</td>
<td>4</td>
<td>7</td>
<td>8</td>
</tr>
</tbody>
</table>

Group statement of comprehensive income

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Profit for the year</td>
<td>(4)</td>
<td>(7)</td>
<td>(8)</td>
</tr>
<tr>
<td>Re-measurement gains, net of related tax charge of $2m [2012 $1m, 2011 $1m]</td>
<td>4</td>
<td>8</td>
<td>10</td>
</tr>
<tr>
<td>Tax related to pension contributions</td>
<td>–</td>
<td>(1)</td>
<td>(2)</td>
</tr>
<tr>
<td>Total comprehensive income for the year</td>
<td>–</td>
<td>–</td>
<td>–</td>
</tr>
</tbody>
</table>

Earnings per share

<table>
<thead>
<tr>
<th></th>
<th>2013</th>
<th>2012</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Basic</td>
<td>(1.5)</td>
<td>(2.4)</td>
<td>(2.8)</td>
</tr>
<tr>
<td>Diluted</td>
<td>(1.5)</td>
<td>(2.4)</td>
<td>(2.7)</td>
</tr>
</tbody>
</table>

There has been no change to previously reported retained earnings, balance sheet amounts or cash flows, other than consequential adjustments to the analysis of operating cash flows.

The Group has also adopted IAS 1 (Amendment) ‘Presentation of Items of Other Comprehensive Income’, which changes the grouping of items presented in the Group statement of comprehensive income so that items which may be reclassified to profit or loss in the future are presented separately from items that will never be reclassified. The amendment affects presentation only and has had no impact on the Group’s financial position or performance.

In addition, with effect from 1 January 2013, the Group has implemented IAS 28 (Amendment) ‘Investments in Associates and Joint Ventures’, IFRS 10 ‘Consolidated Financial Statements’, IFRS 11 ‘Joint Arrangements’, IFRS 12 ‘Disclosure of Interests in Other Entities’ and IFRS 13 ‘Fair Value Measurement’. The adoption of these standards has had no material impact on the Group’s financial performance or position and there has been no requirement to restate prior year comparatives. IFRS 13 has resulted in new disclosures which are provided in note 24.

In accordance with IFRS 7 ‘Financial Instruments: Disclosures – Offsetting Financial Assets and Financial Liabilities’ (Amendments to IFRS 7) additional disclosures have been made in note 18 regarding the Group’s cash pooling arrangements.

Summary of significant accounting policies

Basis of preparation

The Consolidated Financial Statements of IHG have been prepared in accordance with International Financial Reporting Standards (IFRSs) as issued by the IASB and in accordance with IFRS as adopted by the European Union (EU) and as applied in accordance with the provisions of the Companies Act 2006. IFRS as adopted by the EU differs in certain respects from IFRS as issued by the IASB. However, the differences have no impact on the Group’s Consolidated Financial Statements for the years presented.

Presentational currency

The Consolidated Financial Statements are presented in millions of US dollars following a management decision to change the reporting currency from sterling during 2008. The change was made to reflect the profile of the Group’s revenue and operating profit which are primarily generated in US dollars or US dollar-linked currencies.

The currency translation reserve was set to nil at 1 January 2004 on transition to IFRS and this reserve is presented on the basis that the Group has reported in US dollars since this date. Equity share capital, the capital redemption reserve and shares held by employee share trusts are translated into US dollars at the rates of exchange on the last day of the period; the resultant exchange differences are recorded in other reserves.
Accounting policies continued

The functional currency of the parent company remains sterling since this is a non-trading holding company located in the United Kingdom that has sterling denominated share capital and whose primary activity is the payment and receipt of interest on sterling denominated external borrowings and inter-company balances.

Basis of consolidation

The Consolidated Financial Statements comprise the Financial Statements of the parent company and entities controlled by the Group. Control exists when the Group has:

- power over an investee (i.e. existing rights that give it the current ability to direct the relevant activities of the investee);
- exposure, or rights, to variable returns from its involvement with the investee; and
- the ability to use its power over the investee to affect its returns.

All intra-group balances and transactions are eliminated on consolidation.

The assets, liabilities and results of those businesses acquired or disposed of are consolidated for the period during which they were under the Group’s control.

The Group operates a deferred compensation plan in the US under the Group’s control. The Group’s interest in the plan is not realised during any one period. The Group’s liability is for the pensionable salary paid to employees during their employment in the US. The amounts paid into the plan are recorded as assets. The assets of the trust are held solely for the benefit of the participating employees and to pay plan expenses, other than in the case of a company insolvency in which case they can be claimed by the general creditors of the company. At 31 December 2013, the trust had assets with a fair value of $135m (2012 $113m).

Foreign currencies

Transactions in foreign currencies are translated to functional currency at the exchange rates ruling on the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are retranslated to the functional currency at the relevant rates of exchange ruling on the last day of the period. Foreign exchange differences arising on translation are recognised in the income statement except on foreign currency borrowings that provide a hedge against a net investment in a foreign operation. These are taken directly to the currency translation reserve until the disposal of the net investment, at which time they are recycled against the gain or loss on disposal.

The assets and liabilities of foreign operations, including goodwill, are translated into US dollars at average rates of exchange on the last day of the period. The revenues and expenses of foreign operations are translated into US dollars at average rates of exchange for the period. The exchange differences arising on the retranslation are taken directly to the currency translation reserve. On disposal of a foreign operation, the cumulative amount recognised in the currency translation reserve relating to that particular foreign operation is recycled against the gain or loss on disposal.

Property, plant and equipment

Property, plant and equipment are stated at cost less depreciation and any impairment.

Repairs and maintenance costs are expensed as incurred.

Land is not depreciated. All other property, plant and equipment are depreciated to a residual value over their estimated useful lives, namely:

- buildings – lesser of 50 years and unexpired term of lease; and
- fixtures, fittings and equipment – three to 25 years.

All depreciation is charged on a straight-line basis. Residual value is re-assessed annually.

Property, plant and equipment are tested for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable. Assets that do not generate independent cash flows are combined into cash-generating units. If carrying values exceed their estimated recoverable amount, the assets or cash-generating units are written down to the recoverable amount. Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is assessed based on estimated future cash flows discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. Impairment losses, and any subsequent reversals, are recognised in the income statement.

On adoption of IFRS, the Group retained previous revaluations of property, plant and equipment which are included at deemed cost as permitted by IFRS 1 ‘First-time Adoption of International Financial Reporting Standards’.

Goodwill

Goodwill arises on consolidation and is recorded at cost, being the excess of the cost of acquisition over the fair value at the date of acquisition of the Group’s share of identifiable assets, liabilities and contingent liabilities. With effect from 1 January 2010, transaction costs are expensed and therefore not included in the cost of acquisition. Following initial recognition, goodwill is measured at cost less any accumulated impairment losses.

Goodwill is tested for impairment at least annually by comparing carrying values of cash-generating units with their recoverable amounts. Impairment losses cannot be subsequently reversed.

Intangible assets

Software

Acquired and internally developed software are capitalised on the basis of the costs incurred to acquire and bring to use the specific software. Costs are amortised over estimated useful lives of three to five years on a straight-line basis.

Internally generated development costs are expensed unless forecast revenues exceed attributable forecast development costs, in which case they are capitalised and amortised over the estimated useful life of the asset.

Management contracts

When assets are sold and a purchaser enters into a franchise or management contract with the Group, the Group capitalises as part of the gain or loss on disposal an estimate of the fair value of the contract entered into. The value of management contracts is amortised over the life of the contract which ranges from six to 50 years on a straight-line basis.

Other intangible assets

Amounts paid to hotel owners to secure management contracts and franchise agreements are capitalised and normally amortised over the shorter of the contracted period and 10 years on a straight-line basis. Intangible assets are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Borrowing costs

Borrowing costs attributable to the acquisition or construction of property, plant and equipment or in respect of software projects that necessarily take a substantial period of time to prepare for
their intended use, or sale, are capitalised as part of the asset cost. Borrowing costs consist of interest and other costs that an entity incurs in connection with the borrowing of funds. All borrowing costs relating to projects commencing before 1 January 2009 were expensed.

**Associates and joint ventures**

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the entity, but does not have control or joint control over those policies.

A joint venture exists when two or more parties have joint control over, and rights to the net assets of, the venture. Joint control is the contractually agreed sharing of control which only exists when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Associates and joint ventures are accounted for using the equity method unless the associate or joint venture is classified as held for sale. Under the equity method, the Group’s investment is recorded at cost adjusted by the Group’s share of post-acquisition profits and losses and other movements in the investee’s reserves. When the Group’s share of losses exceeds its interest in an associate or joint venture, the Group’s carrying amount is reduced to $nil and recognition of further losses is discontinued except to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of an associate or joint venture.

**Financial assets**

The Group classifies its financial assets into one of the two following categories: loans and receivables or available-for-sale financial assets. Management determines the classification of financial assets on initial recognition and they are subsequently held at amortised cost (loans and receivables) or fair value (available-for-sale financial assets). Interest on loans and receivables is calculated using the effective interest rate method and is recognised in the income statement as interest income. Changes in fair values of available-for-sale financial assets are recorded directly in equity within the unrealised gains and losses reserve. On disposal, the accumulated fair value adjustments recognised in equity are recycled to the income statement. Dividends from available-for-sale financial assets are recognised in the income statement as other operating income and expenses.

Financial assets are assessed for impairment at each period-end date. In the case of an equity investment classified as available-for-sale, a significant or prolonged decline in fair value below cost is evidence that the asset is impaired. If an available-for-sale financial asset is impaired, the difference between original cost and fair value is transferred from equity to the income statement to the extent of any cumulative loss recorded in equity, with any excess charged directly to the income statement. Subsequent impairment reversals relating to previously impaired equity instruments are recorded in equity.

**Inventories**

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

**Trade receivables**

Trade receivables are recorded at their original amount less provision for impairment. It is the Group’s policy to provide for 100% of the previous month’s aged receivables balances which are more than 180 days past due. Adjustments to the policy may be made due to specific or exceptional circumstances when collection is no longer considered probable. The carrying amount of the receivable is reduced through the use of a provision account and movements in the provision are recognised in the income statement within cost of sales. When a previously provided trade receivable is uncollectable, it is written off against the provision.

**Cash and cash equivalents**

Cash comprises cash in hand and demand deposits.

Cash equivalents are short-term highly liquid investments with an original maturity of three months or less that are readily convertible to known amounts of cash and subject to insignificant risk of changes in value.

In the statement of cash flows, cash and cash equivalents are shown net of short-term overdrafts which are repayable on demand and form an integral part of the Group’s cash management.

**Assets held for sale**

Non-current assets and associated liabilities are classified as held for sale when their carrying amount will be recovered principally through a sale transaction rather than continuing use and a sale is highly probable and expected to complete within one year. For a sale to be highly probable, management need to be committed to a plan to sell the asset and the asset must be actively marketed for sale at a price that is reasonable in relation to its current fair value.

Assets designated as held for sale are held at the lower of carrying amount at designation and fair value less costs to sell.

Depreciation is not charged against property, plant and equipment classified as held for sale.

**Financial liabilities**

Financial liabilities are measured at amortised cost using the effective interest rate method. A financial liability is derecognised when the obligation under the liability expires, is discharged or cancelled.

**Trade payables**

Trade payables are non-interest-bearing and are stated at their nominal value.

**Bank and other borrowings**

Bank and other borrowings are initially recognised at the fair value of the consideration received less directly attributable transaction costs. They are subsequently measured at amortised cost. Finance charges, including the transaction costs and any discount or premium on issue, are recognised in the income statement using the effective interest rate method.

Borrowings are classified as non-current when the repayment date is more than 12 months from the period-end date or where they are drawn on a facility with more than 12 months to expiry.

**Derivative financial instruments and hedging**

Derivatives are initially recognised and subsequently re-measured at fair value. The method of recognising the re-measurement depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged.

Changes in the fair value of derivatives designated as cash flow hedges are recorded in other comprehensive income and the unrealised gains and losses reserve to the extent that the hedges are effective. When the hedged item is recognised, the cumulative gains and losses on the related hedging instrument are reclassified to the income statement.

Changes in the fair value of derivatives designated as net investment hedges are recorded in other comprehensive income and the currency translation reserve to the extent that the hedges are effective. The cumulative gains and losses remain in equity until a foreign operation is sold, at which point they are reclassified to the income statement.

Changes in the fair value of derivatives which have either not been designated as hedging instruments or relate to the ineffective portion of hedges are recognised immediately in the income statement.
Provisions are recognised when the Group has a present obligation as estimated based on historical trends and actuarial data. Projected settlements in respect of self insured risks include projected settlements for known and incurred but not reported claims. Self insurance relationship requires the interest to be taken to reserves.

An onerous contract provision is recognised when the unavoidable costs of meeting the obligations under a contract exceed the economic benefits expected to be received under it.

In respect of litigation, provision is made when management consider it probable that payment may occur even though the defence of the related claim may still be ongoing through the court process.

Taxes
Current tax
Current income tax assets and liabilities for the current and prior periods are measured at the amount expected to be recovered from or paid to the tax authorities including interest. The tax rates and tax laws used to compute the amount are those that are enacted or substantively enacted at the end of the reporting period.

Deferred tax
Deferred tax assets and liabilities are recognised in respect of temporary differences between the tax base and carrying value of assets and liabilities including accelerated capital allowances, unrelieved tax losses, unremitted profits from subsidiaries, gains rolled over into replacement assets, gains on previously revalued properties and other short-term temporary differences.

Deferred tax assets are recognised to the extent that it is regarded as probable that the deductible temporary differences can be realised. The recoverability of all deferred tax assets is re-assessed at the end of each reporting period.

Deferred tax is calculated at the tax rates that are expected to apply in the periods in which the asset or liability will be settled, based on rates enacted or substantively enacted at the end of the reporting period.

Retirement benefits
Defined contribution plans
Payments to defined contribution schemes are charged to the income statement as they fall due.

Defined benefit plans
Plan assets, including qualifying insurance policies, are measured at fair value and plan liabilities are measured on an actuarial basis, using the projected unit credit method and discounting at an interest rate equivalent to the current rate of return on a high-quality corporate bond of equivalent currency and term to the plan liabilities. The difference between the value of plan assets and liabilities at the period-end date is the amount of surplus or deficit recorded in the statement of financial position as an asset or liability. An asset is recognised when the employer has an unconditional right to use the surplus at some point during the life of the plan or on its wind-up. If a refund would be subject to a tax other than income tax, as is the case in the UK, the asset is recorded at the amount net of the tax. A liability is also recorded for any such tax that would be payable in respect of funding commitments based on the accounting assumption that the related payments increase the asset.

The service cost of providing pension benefits to employees, together with the net interest expense or income for the year, is charged to the income statement within ‘administration expenses’. Net interest is calculated by applying the discount rate to the net defined benefit asset or liability, after any asset restriction. Past service costs and gains, which are the change in the present value of the defined benefit obligation for employee service in prior periods resulting from plan amendments, are recognised immediately the plan amendment occurs.

Re-measurements comprise actuarial gains and losses, the return on plan assets (excluding amounts included in net interest) and changes in the amount of any asset restrictions. Actuarial gains and losses in respect of the plan assets may result from: differences between the actuarial assumptions underlying the plan liabilities and actual experience during the year or changes in the actuarial assumptions used in the valuation of the plan liabilities. Re-measurement gains and losses, and taxation thereon, are recognised in other comprehensive income and are not reclassified to profit or loss in subsequent periods.

Actuarial valuations are normally carried out every three years and are updated for material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the end of the reporting period.

Revenue recognition
Revenue arises from the sale of goods and provision of services where these activities give rise to economic benefits received and receivable by the Group on its own account and result in increases in equity.

Revenue is derived from the following sources: franchise fees; management fees; owned and leased properties and other revenues which are ancillary to the Group’s operations, including technology fee income.

Generally, revenue represents sales (excluding VAT and similar taxes) of goods and services, net of discounts, provided in the normal course of business and recognised when services have been rendered. The following is a description of the composition of revenues of the Group.

Franchise fees – received in connection with the license of the Group’s brand names, usually under long-term contracts with the hotel owner. The Group charges franchise royalty fees as a percentage of rooms revenue. Revenue is earned and recognised on a monthly basis.

Management fees – earned from hotels managed by the Group, usually under long-term contracts with the hotel owner. Management fees include a base fee, generally a percentage of hotel revenue, which is earned and recognised on a monthly basis and an incentive fee, generally based on the hotel’s profitability or cash flows and recognised when the related performance criteria are met under the terms of the contract.

Owned and leased – primarily derived from hotel operations, including the rental of rooms and food and beverage sales from owned and leased hotels operated under the Group’s brand names. Revenue is recognised when rooms are occupied and food and beverages are sold.

Franchise fees and management fees include liquidated damages received from the early termination of contracts.
Share-based payments
The cost of equity-settled transactions with employees is measured by reference to fair value at the date at which the right to the shares is granted. Fair value is determined by an external valuer using option pricing models.

The cost of equity-settled transactions is recognised, together with a corresponding increase in equity, over the period in which any performance or service conditions are fulfilled, ending on the date on which the relevant employees become fully entitled to the award (vesting date).

The income statement charge for a period represents the movement in cumulative expense recognised at the beginning and end of that period. No expense is recognised for awards that do not ultimately vest, except for awards where vesting is conditional upon a market or non-vesting condition, which are treated as vesting irrespective of whether or not the market or non-vesting condition is satisfied, provided that all other performance and/or service conditions are satisfied.

The Group has taken advantage of the transitional provisions of IFRS 2 ‘Share-based Payment’ in respect of equity-settled awards and has applied IFRS 2 only to equity-settled awards granted after 7 November 2002 that had not vested before 1 January 2005.

Leases
Operating lease rentals are charged to the income statement on a straight-line basis over the term of the lease.

Assets held under finance leases, which transfer to the Group substantially all the risks and benefits incidental to ownership of the leased item, are capitalised at the inception of the lease, with a corresponding liability being recognised for the fair value of the leased asset or, if lower, the present value of the minimum lease payments. Lease payments are apportioned between the reduction of the lease liability and finance charges in the income statement so as to achieve a constant rate of interest on the remaining balance of the liability. Assets held under finance leases are depreciated over the shorter of the estimated useful life of the asset and the lease term.

Disposal of non-current assets
The Group recognises sales proceeds and any related gain or loss on disposal on completion of the sales process. In determining whether the gain or loss should be recorded, the Group considers whether it:

- has a continuing managerial involvement to the degree associated with asset ownership;
- has transferred the significant risks and rewards associated with asset ownership; and
- can reliably measure and will actually receive the proceeds.

Fair value measurement
The Group measures available-for-sale equity securities and derivatives at fair value on a recurring basis and other assets when impaired by reference to fair value less costs to sell. Additionally, the fair value of other financial assets and liabilities require disclosure.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value is measured by reference to the principal market for the asset or liability assuming that market participants act in their economic best interests.

The fair value of a non-financial asset assumes the asset is used in its highest and best use, either through continuing ownership or by selling it.

The Group uses valuation techniques that maximise the use of relevant observable inputs using the following valuation hierarchy:

Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities.
Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly.
Level 3: techniques which use inputs which have a significant effect on the recorded fair value that are not based on observable market data.

Further disclosures on the particular valuation techniques used by the Group are provided in note 24.

For impairment testing purposes and where significant assets (such as property) are valued by reference to fair value less costs to sell, an external valuation will normally be obtained using professional valuers who have appropriate market knowledge, reputation and independence.

Exceptional items
The Group discloses certain financial information both including and excluding exceptional items. The presentation of information excluding exceptional items allows a better understanding of the underlying trading performance of the Group and provides consistency with the Group’s internal management reporting. Exceptional items are identified by virtue of either their size or nature so as to facilitate comparison with prior periods and to assess underlying trends in financial performance. Exceptional items can include, but are not restricted to, gains and losses on the disposal of assets, impairment charges and reversals, restructuring costs and the release of tax provisions.

Treasury shares
Own shares repurchased by the Company and not cancelled (treasury shares) are recognised at cost and deducted from retained earnings. If reissued, any excess of consideration over carrying amount is recognised in the share premium reserve.

Critical accounting policies and the use of judgements, estimates and assumptions
In determining and applying the Group’s accounting policies, management are required to make judgements, estimates and assumptions. An accounting policy is considered to be critical if its selection or application could materially affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management consider accounting for the System Fund to be a critical judgement and that critical estimates and assumptions are used in impairment testing and for measuring the loyalty programme liability, retirement and other post-employment obligations, tax assets and liabilities, and litigation provisions, as discussed in further detail below. Estimates and assumptions are evaluated by management using historical experience and other factors believed to be reasonable based on current circumstances. Actual results could differ under different policies, judgements, estimates and assumptions or due to unforeseen circumstances.

System Fund – in addition to management or franchise fees, hotels within the IHG System pay cash assessments and contributions which are collected by IHG for specific use within the System Fund (the Fund). The Fund also receives proceeds from the sale of IHG Rewards Club points. IHG exerts significant influence over the operation of the Fund, however the Fund is managed for the benefit of hotels in the System with the objective of driving revenues for the hotels. The Fund is used to pay for marketing, the IHG Rewards Club loyalty programme and the global reservation system. The Fund is planned to operate at breakeven with any short-term timing surplus or deficit carried in the Group statement of financial position within working capital.
Accounting policies continued

As all Fund income is designated for specific purposes and does not result in a profit or loss for the Group, the revenue recognition criteria as outlined in the accounting policy above are not met and therefore the income and expenses of the Fund are not included in the Group income statement.

The assets and liabilities relating to the Fund are included in the appropriate headings in the Group statement of financial position as the related legal, but not beneficial, rights and obligations rest with the Group. These assets and liabilities include the IHG Rewards Club liability, short-term timing surpluses and deficits and any receivables and payables related to the Fund.

The cash flows relating to the Fund are reported within ‘cash flow from operations’ in the Group statement of cash flows due to the close interrelationship between the Fund and the trading operations of the Group.

Further information on the Fund is included in note 34.

Loyalty programme – the hotel loyalty programme, IHG Rewards Club, enables members to earn points, funded through hotel assessments, during each qualifying stay at an IHG branded hotel and redeem points at a later date for free accommodation or other benefits. The future redemption liability is calculated by multiplying the number of points expected to be redeemed by the redemtion cost per point. On an annual basis the Group engages an external actuary who uses statistical formulas to assist in the estimate of the number of points that will never be redeemed (‘breakage’). Actuarial gains and losses on the future redemption liability are borne by the System Fund and any resulting changes in the liability would correspondingly adjust the amount of short-term timing surpluses and deficits held in the Group statement of financial position. The future redemption liability, which is included in trade and other payables, was $649m at 31 December 2013. Based on the conditions existing at the balance sheet date, a 5% decrease in the breakage estimate would increase this liability by approximately $31m.

Impairment testing – intangible assets, property, plant and equipment are tested for impairment when events or circumstances indicate that their carrying value may not be recoverable. Goodwill is subject to an impairment test on an annual basis or more frequently if there are indicators of impairment. Assets that do not generate independent cash flows are combined into cash-generating units.

The impairment testing of individual assets or cash-generating units requires an assessment of the recoverable amount of the asset or cash-generating unit. If the carrying value of the asset or cash-generating unit exceeds its estimated recoverable amount, the asset or cash-generating unit is written down to its recoverable amount. Recoverable amount is the greater of fair value less costs to sell and value in use. Value in use is assessed based on estimated future cash flows discounted to their present value using a pre-tax discount rate that is based on the Group’s weighted average cost of capital adjusted to reflect the risks specific to the business model and territory of the cash-generating unit or asset being tested. The outcome of such an assessment is subjective, and the result sensitive to the assumed future cash flows to be generated by the cash-generating units or assets and discount rates applied in calculating the value in use.

At 31 December 2013, the Group had intangible assets of $438m and property, plant and equipment of $1,169m, none of which were subject to an impairment charge during the year. In respect of those assets requiring an impairment test and depending on how recoverable amount was assessed, neither a 10% reduction in fair value or estimated future cash flows would have resulted in an impairment loss. Information on impairment testing of goodwill, which had a net book value of $80m at 31 December 2013, is included in note 12.

Pensions and other post-employment benefit plans – accounting for pensions and other post-employment benefit plans requires the Group to make assumptions including, but not limited to, discount rates, rates of inflation, life expectancies and healthcare costs. The use of different assumptions could have a material effect on the accounting values of the relevant liabilities which could result in a material change to the cost of such liabilities as recognised in the income statement over time. These assumptions are subject to annual review and are determined with the assistance of an external actuary. A sensitivity analysis to changes in the key assumptions is included in note 26.

On 15 August 2013, the UK defined benefit plan completed a buy-in transaction whereby the assets of the plan were invested in a bulk insurance annuity contract that fully insures the benefits payable to the members of the plan. As the contract has been structured to enable the plan to move to full buy-out (following which the insurance company would become directly responsible for the pension payments) and the intention is to proceed on this basis, the buy-in transaction has been accounted for as a settlement with the loss arising of $147m recorded in the income statement as an exceptional item. An acceptable alternative accounting treatment would have been to record the loss as an actuarial loss in other comprehensive income.

Income taxes – deferred tax assets are recognised to the extent that it is regarded as probable that deductible temporary differences can be realised. The Group estimates deferred tax assets and liabilities based on current tax laws and rates, and in certain cases, business plans, including management’s expectations regarding the manner and timing of recovery of the related assets. Changes in these estimates may affect the amount of deferred tax liabilities or the valuation of deferred tax assets and therefore the tax charge in the income statement.

Provisions for tax liabilities require judgements on the interpretation of tax legislation, developments in case law and the potential outcomes of tax audits and appeals which may be subject to significant uncertainty. Therefore the actual results may vary from expectations resulting in adjustments to provisions, the valuation of deferred tax assets, cash tax settlements, and therefore the tax charge in the income statement.

Exceptional tax charges and credits have arisen in 2013, 2012 and 2011 as explained in note 7.

Litigation – from time to time, the Group is subject to legal proceedings the ultimate outcome of each being always subject to many uncertainties inherent in litigation. A provision for litigation is made when it is considered probable that a payment will be made and the amount of the loss can be reasonably estimated. Significant judgment is made when evaluating, amongst other factors, the probability of an unfavourable outcome and the ability to make a reasonable estimate of the amount of potential loss. Litigation provisions are reviewed at each accounting period and revisions made for changes in facts and circumstances.

New standards issued but not effective

IFRS 9 ‘Financial Instruments: Classification and Measurement’ introduces new requirements for classifying and measuring financial assets and financial liabilities and, when finalised, will address hedge accounting and impairment of financial assets. The Group will assess the impacts when the final standard is issued. The effective date for IFRS 9 is not expected to be before 1 January 2017.

The amendments to existing accounting standards that are effective from 1 January 2014, ‘Offsetting Financial Assets and Financial Liabilities’ (Amendments to IAS 32) and ‘Recoverable Amount Disclosures for Non-Financial Assets’ (Amendments to IAS 36), are not expected to have a material impact on the Group’s reported income or financial position.