

**Business review****Basis of preparation**

This business review complies with the recommendations of the European Union (EU) Modernisation Directive, the Companies Act 2006 (Contents of Directors' report: Business review) and is in line with current best practice. It is addressed to, and written for, the members of Aviva plc with the aim of providing a fair review of our business development, performance and position at the current time. In producing this review, we aim to present a view that is balanced and comprehensive and that is consistent with the size and complexity of our business. The review is written in the context of the risks and uncertainties facing our business. We anticipate that the format and content of the review will evolve over time, along with developments in our business and the external environment.

**Key Performance Indicators**

The Companies Act requires that a fair review of the business contains financial and, where applicable, non-financial key performance indicators (KPIs). We consider that our financial KPIs are those that communicate to the members the financial performance and strength of the group as a whole. These KPIs comprise:

Earnings per share (International Financial Reporting Standards basis)
Proposed ordinary dividend per share and dividend cover
Operating profit (Market Consistent Embedded Value basis)
Operating profit (IFRS basis)
Long-term new business sales (PVNBP)
Return on equity shareholders' funds

Management also use a variety of Other Performance Indicators (OPIs) in both running and assessing the performance of individual business segments and units, rather than the group as a whole. OPIs include measures such as new business margins, combined operating ratio and underwriting profit.

In addition to reporting on our financial performance, it is important that as a forward thinking company we are aware of our wider responsibilities and report on the non-financial aspects of our performance. We consider that our employees and customers are fundamental to the success of our business; as such, they form the basis for our non-financial measures, and include:

Leadership and employee engagement
Customer satisfaction

**Forward-looking statements**

This business review contains "forward-looking statements" about:

Our future plans
Our current goals
Our expectations of our future financial condition, performance and results

By their nature, all forward-looking statements involve risk and uncertainty because they relate to future events that are beyond our control. For example, certain insurance risk disclosures are dependent on our choices about assumptions and models, which by their nature are estimates. As such, actual future gains and losses could differ materially from those that we have estimated. Other factors that could cause actual results to differ materially from those estimated by the forward-looking statement include, but are not limited to:

Global economic business conditions
Monetary and interest rate policies
Foreign currency exchange rates
Equity and property prices
The impact of competition, inflation and deflation
Changes to regulations, taxes and legislation
The timing and impact of acquisitions and business combinations in relevant industries
Natural and other disasters
Changes to consumer saving and spending habits
Our success in managing the above factors

Consequently, our actual future financial condition, performance and results could differ materially from the plans, goals and expectations set out in our forward-looking statements. We undertake no obligation to update the forward-looking statements contained in this review or any other forward-looking statements we make.

**Accounting basis of preparation**

In addition to presenting our results and financial position on an International Financial Reporting Standards basis, we also use Market Consistent Embedded Value (MCEV) as an alternative performance measure. Details of the accounting basis of preparation are set out on the following page.

## Accounting basis of preparation

### International Financial Reporting Standards (IFRS)

Our consolidated financial statements are prepared under IFRS, using standards issued by the International Accounting Standards Board (IASB) and endorsed by the EU. In addition to fulfilling this legal obligation, the group has also complied with IFRS as issued by the IASB and applicable at 31 December 2008.

The financial data contained in the report and accounts has been prepared using the group's accounting policies set out on pages 125 to 139. Where applicable, the financial statements have also been prepared in accordance with the Statement of Recommended Practice (SORP) on accounting for insurance business issued by the Association of British Insurers (ABI) in December 2005, as amended in December 2006.

Following a review of our general insurance reserving policy, we have restated the 2007 comparative figures to discount our long-term latent claims provisions. We have also reviewed our policy on the consolidation of managed funds and, as a result, have made further restatements for the effect of third party participation. Details are given in note 2 to the financial statements.

### Market Consistent Embedded Value (MCEV) basis of reporting

We present the results and financial position of our life and related businesses on an MCEV basis, in addition to the IFRS basis. MCEV methodology represents a more meaningful basis of reporting the value of the group's life and related businesses and the drivers of performance than IFRS methodology. This basis values cashflow from assets consistently with market prices and is consistent with the way pricing is assessed and the business is managed.

The MCEV methodology adopted is in accordance with the MCEV Principles published by the CFO Forum in June 2008, with the exception of the use of an adjusted risk-free yield due to current market conditions for immediate annuities in the UK and Netherlands and for all US contracts. Under the MCEV methodology, the total profit recognised over the full lifetime of an insurance policy is the same as under the IFRS basis of reporting. However, the MCEV basis gives a fairer indication of the profitability of business on inception. Additionally, shareholders' funds on an MCEV basis incorporate internally generated additional value of in-force business (AVIF), which is excluded for IFRS reporting. Our incentive schemes and internal management reporting are focused broadly evenly between IFRS and MCEV performance. These financial statements include supplementary information on MCEV reporting in the "Alternative method of reporting long-term business" section.

### Longer term investment return

The long-term nature of most of our operations means that short-term realised and unrealised gains and losses are shown as an adjustment to operating profit. We focus instead on operating profit incorporating a longer term investment return (LTIR). Our rates of return that we use for equity and property in our LTIR methodology are aligned with the rates that we use under MCEV principles. For fixed interest securities, we include the amortisation of premiums or discounts arising on purchase, thereby producing an LTIR that is equivalent to the gross redemption yield.

### Critical accounting policies and estimates

The preparation of financial statements requires the group to select accounting policies and make estimates and assumptions that affect items reported in the consolidated income statement, balance sheet, other primary statements and notes to the financial statements. These are set out on pages 125 to 139.

#### Critical accounting policies

The major areas of judgement on policy application are considered to be over whether group entities should be consolidated (set out in policy D), on product classification (set out in policy F) and in the classification of financial investments (set out in policy S).

#### Use of estimates

All estimates are based on management's knowledge of current facts and circumstances, assumptions based on that knowledge and their predictions of future events and actions. Actual results can always differ from those estimates, possibly significantly.

The table below sets out those items that we consider particularly susceptible to changes in estimates and assumptions, and the relevant accounting policy.

Item	Accounting policy
Insurance and participating investment contract liabilities	F & K
Goodwill, AVIF and other intangible assets	N
Fair value of financial investments	S
Impairment of financial investments	S
Fair value of derivative financial instruments	T
Deferred acquisition costs and other assets	W
Provisions and contingent liabilities	Z
Pension obligations	AA
Deferred income taxes	AB

### Future accounting developments

We continue to take an active role in the development of new accounting standards, via industry forums and working parties, and reviewing and providing comment on proposals from the IASB. Phase II of the IASB's project on insurance contracts continues to be the most significant area of development for us. We commented on the IASB discussion paper published in 2007 and continue actively to engage in the debate. We fully support the timely development of a global standard for insurance accounting that reflects the economics of our business, and are working directly and through the CFO Forum of leading European insurers, to achieve this. These developments are still at a relatively early stage, so it is too soon to assess the impact this change in accounting will have. While this standard is under development, we will continue to focus on MCEV as the best measure of value for our long-term business. We continue to monitor other major IASB projects, including financial statement presentation, liabilities, revenue recognition, pensions accounting and fair value measurement.