

## Principal accounting policies

### BASIS OF PREPARATION

The Financial Statements for the year ended 31 December 2007 have been prepared in accordance with International Financial Reporting Standards (IFRS), and International Financial Reporting Interpretations Committee (IFRIC) interpretations. These include standards and interpretations adopted by the EU. In addition, the Financial Statements have been prepared in accordance with those parts of the Companies Act 1985 applicable to companies reporting under IFRS. The Financial Statements have been prepared primarily using historical cost principles except that, as disclosed in the accounting policies below, certain items, including derivatives, are measured at fair value.

The preparation of Financial Statements in conformity with Generally Accepted Accounting Principles (GAAP) requires management to make judgments and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the Financial Statements and the reported revenues and expenses during the reporting period. Actual results could differ from these estimates. BG Group believes that the accounting policies associated with exploration expenditure, depreciation, decommissioning, impairments, financial instruments including commodity contracts, and revenue recognition are the policies where changes in estimates and assumptions could have a significant impact on the Financial Statements. Further discussion on these policies, estimates and judgments can be found in the Financial review, pages 28 to 37; note 6, page 93; note 11, page 96; and note 21, page 104.

The presentation adopted by the Group for its results under IFRS is explained in note 2, page 82.

### BASIS OF CONSOLIDATION

The Financial Statements comprise a consolidation of the accounts of the Company and its subsidiary undertakings and incorporate the results of its share of jointly controlled entities and associates using the equity method of accounting. Consistent accounting policies have been used to prepare the consolidated Financial Statements.

Most of BG Group's Exploration and Production activity is conducted through jointly controlled operations. BG Group accounts for its own share of the assets, liabilities and cash flows associated with these jointly controlled operations using the proportional consolidation method.

The results of undertakings acquired or disposed of are consolidated from or to the date when control passes to or from the Company. For the Company Financial Statements only, investments in subsidiary undertakings are stated at cost less provision for impairment.

### PRESENTATION OF RESULTS

The Group presents its results in the income statement to separately identify the contribution of disposals, certain re-measurements and impairments in order to provide readers with a clear and consistent presentation of the underlying operating performance of the Group's ongoing business, see note 2, page 82 and note 10, page 96.

### SEGMENT REPORTING

The Group's primary format for segment reporting is business segments and the secondary format is geographical segments. This reflects the fact that the risks and returns of the Group's operations are primarily based on its business activities rather than the geographical location of the Group's operations.

### BUSINESS COMBINATIONS AND GOODWILL

In the event of a business combination, fair values are attributed to the net assets acquired. Goodwill, which represents the difference between the purchase consideration and the fair value of the net assets acquired, is capitalised and subject to an impairment review at least annually, or more frequently if events or changes in circumstances indicate that the goodwill may be impaired. Goodwill is treated as an asset of the relevant entity to which it relates, including foreign entities. Accordingly, it is re-translated into pounds Sterling at the closing rate of exchange at each balance sheet date.

### PROPERTY, PLANT AND EQUIPMENT EXCLUDING DECOMMISSIONING ASSETS

All property, plant and equipment is carried at depreciated historical cost. Additions represent new, or replacements of specific components of, property, plant and equipment.

Contributions received towards the cost of property, plant and equipment (including government grants) are included in creditors as deferred income and credited to the income statement over the life of the assets. Finance costs associated with borrowings used to finance major capital projects are capitalised up to the point at which the asset is ready for its intended use.

### DEPRECIATION AND AMORTISATION

Freehold land is not depreciated. Other property, plant and equipment, except exploration and production assets, is depreciated on a straight-line basis at rates sufficient to write off the historical cost less residual value of individual assets over their estimated useful economic lives. The depreciation periods for the principal categories of assets are as follows:

Freehold and leasehold buildings	up to 50 years
Mains, services and meters	up to 60 years
Plant and machinery	5 to 30 years
Motor vehicles and office equipment	up to 10 years

Exploration and production assets are depreciated from the commencement of production in the fields concerned, using the unit of production method based on the proved developed reserves of those fields, except that a basis of total proved reserves is used for acquired interests and for facilities. Changes in these estimates are dealt with prospectively.

Asset lives are kept under review and complete asset life reviews are conducted periodically. Residual values are reassessed annually.

Intangible assets in respect of contractual rights are recognised at cost less amortisation. They are amortised on a straight-line basis over the term of the related contracts.

### IMPAIRMENT OF NON-CURRENT ASSETS

Any impairment of non-current assets is calculated as the difference between the carrying values of cash generating units (including associated goodwill) and their recoverable amount, being the higher of the estimated value in use or fair value less costs to sell at the date the impairment loss is recognised. Value in use represents the net present value of expected future cash flows discounted on a pre-tax basis.

### ASSETS HELD FOR SALE

When an asset or disposal group's carrying value will be recovered principally through a sale transaction rather than through continuing use, it is classified as held for sale and stated at the lower of carrying value and fair value less costs to sell. No depreciation is charged in respect of non-current assets classified as held for sale.

**INVENTORIES**

Inventories, including inventories of gas, liquefied natural gas (LNG) and oil held for sale in the ordinary course of business, are stated at weighted average historical cost less provision for deterioration and obsolescence or, if lower, net realisable value.

**REVENUE RECOGNITION**

Revenue associated with exploration and production sales (of crude oil and petroleum products including natural gas) is recorded when title passes to the customer. Revenue from the production of natural gas and oil in which the Group has an interest with other producers is recognised based on the Group's working interest and the terms of the relevant production sharing contracts (entitlement method). Differences between production sold and the Group's share of production are not significant.

Sales of LNG and associated products are recognised when title passes to the customer. LNG shipping revenue is recognised over the period of the relevant contract.

Revenue from gas transmission and distribution activities is recognised in the same period in which the related volumes are delivered to the customer.

For power stations which are contracted based on availability, revenue is recognised based on the availability status of the power station to produce at a given point in time. Where power output is sold under pool or other contractual arrangements and where revenue is linked to the costs of actual production, revenue is recognised when the output is delivered.

All other revenue is recognised when title passes to the customer.

**EXPLORATION EXPENDITURE**

BG Group uses the 'successful efforts' method of accounting for exploration expenditure. Exploration expenditure, including licence acquisition costs, is capitalised as an intangible asset when incurred and certain expenditure, such as geological and geophysical exploration costs, is expensed. A review of each licence or field is carried out, at least annually, to ascertain whether proved reserves have been discovered. When proved reserves are determined, the relevant expenditure, including licence acquisition costs, is transferred to property, plant and equipment and depreciated on a unit of production basis. Expenditure deemed to be unsuccessful is written off to the income statement. Exploration expenditure is assessed for impairment when facts and circumstances suggest that its carrying amount exceeds its recoverable amount. For the purposes of impairment testing, exploration and production assets may be aggregated into appropriate cash generating units based on considerations including geographical location, the use of common facilities and marketing arrangements.

**DECOMMISSIONING COSTS**

Where a legal or constructive obligation has been incurred, provision is made for the net present value of the estimated cost of decommissioning at the end of the producing lives of fields.

When this provision gives access to future economic benefits, an asset is recognised and then subsequently depreciated in line with the life of the underlying producing field, otherwise the costs are charged to the income statement. The unwinding of the discount on the provision is included in the income statement within finance costs. Any changes to estimated costs or discount rates are dealt with prospectively.

**FOREIGN CURRENCIES**

On consolidation, assets and liabilities denominated in foreign currencies are translated into pounds Sterling (the functional currency of the Company and the presentation currency of the Group) at closing rates of exchange. Trading results of overseas subsidiary undertakings, jointly controlled entities and associates are translated into pounds Sterling at average rates of exchange. Differences resulting from the retranslation of the opening net assets and the results for the year are taken to reserves. Any differences arising from 1 January 2003, the date of transition to IFRS, are presented as a separate component of equity.

Exchange differences on monetary assets and liabilities are taken to the income statement, with the exception of exchange differences on monetary items that form part of a net investment in a foreign operation. These differences are taken to reserves until the related net investment is disposed of. All other exchange movements are dealt with through the income statement.

**CASH AND CASH EQUIVALENTS**

Cash and cash equivalents comprise cash on hand, deposits with a maturity of three months or less, and other short-term highly liquid investments that are readily convertible to known amounts of cash.

**DEFERRED TAX**

Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the Financial Statements. Currently enacted tax rates are used in the determination of deferred income tax. Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available, against which the temporary differences can be utilised.

Deferred income tax is provided on temporary differences arising on investments in subsidiaries, jointly controlled entities and associates, except where the timing of the reversal of the temporary difference can be controlled and it is probable that the temporary difference will not reverse in the foreseeable future.

**LEASES**

Assets held under finance leases are capitalised and included in property, plant and equipment at the lower of fair value and the present value of the minimum lease payments as determined at the inception of the lease. The obligations relating to finance leases, net of finance charges in respect of future periods, are determined at the inception of the lease and included within borrowings. The interest element of the rental obligation is allocated to accounting periods during the lease term to reflect the constant rate of interest on the remaining balance of the obligation for each accounting period.

The Group has certain long-term arrangements under which it has acquired all of the capacity of certain property, plant and equipment. In circumstances where it is considered that the Group has the majority of the risks and rewards of ownership of the plant, the arrangement is considered to contain a finance lease.

Rentals under operating leases are charged to the income statement on a straight-line basis over the lease term.

**FINANCIAL INSTRUMENTS**

Derivative financial instruments are initially recognised and subsequently measured at fair value.

Derivative financial instruments utilised by the Group's treasury operations include interest rate swaps, foreign currency swaps,

cross currency interest rate swaps, forward rate agreements and forward exchange contracts.

Certain derivative financial instruments are designated as hedges in line with the Group's risk management policies. Gains and losses arising from the re-measurement of these financial instruments are either recognised in the income statement or deferred in equity depending on the type of hedging relationship. When a hedging instrument is sold or expires, any cumulative gain or loss previously recognised in equity remains in equity until the hedged transaction is recognised in the income statement.

Movements in the fair value of derivative financial instruments not included in hedging relationships are recognised in the income statement.

Loans held by the Group are initially measured at fair value and subsequently carried at amortised cost except where they form the underlying transaction in an effective fair value hedge relationship when the carrying value is adjusted to reflect fair value movements associated with the hedged risks. Such adjustments are reported in the income statement.

Other financial instruments such as receivable balances are measured at amortised cost less impairments. Liabilities associated with financial guarantee contracts are initially measured at fair value and re-measured at each balance sheet date.

#### COMMODITY INSTRUMENTS

Within the ordinary course of business the Group routinely enters into sale and purchase transactions for commodities. The majority of these transactions take the form of contracts that were entered into and continue to be held for the purpose of receipt or delivery of the commodity in accordance with the Group's expected sale, purchase or usage requirements. Such contracts are not within the scope of IAS 39.

Certain long-term gas sales contracts operating in the UK gas market have terms within the contract that constitute written options, and accordingly they fall within the scope of IAS 39. In addition, commodity instruments are used to manage certain price exposures in respect of optimising the timing and location of its physical gas and LNG commitments. These contracts are recognised on the balance sheet at fair value with movements in fair value recognised in the income statement, see Presentation of results above, note 2, page 82, and note 10, page 96.

The Group uses various commodity based derivative instruments to manage some of the risks arising from fluctuations in commodity prices. Such contracts include physical and net settled forwards, futures, swaps and options. Where these derivatives have been designated as cash flow hedges of underlying commodity price exposures, certain gains and losses attributable to these instruments are deferred in equity and recognised in the income statement when the underlying hedged transaction crystallises.

All other commodity contracts within the scope of IAS 39 are measured at fair value with gains and losses taken to the income statement.

Gas contracts and related derivative instruments associated with the physical purchase and re-sale of third-party gas are presented on a net basis within other operating income.

#### PENSIONS

The amount recognised on the balance sheet in respect of liabilities for defined benefit pension and post-retirement benefit plans represents the present value of the obligations offset by the fair value of plan assets and excluding actuarial gains and losses not recognised.

The cost of providing retirement pensions and related benefits is charged to the income statement over the periods benefiting from the employees' services. Current service costs are reflected in operating profit and financing costs are reflected in finance costs in the period in which they arise. Actuarial gains and losses that exceed the greater of 10% of plan assets or plan obligations are spread over the average remaining service lives of the employees participating in the plan and are reflected in operating profit.

Contributions made to defined contribution pension plans are charged to the income statement when payable.

#### SHARE-BASED PAYMENTS

The cost of providing share-based payments to employees is charged to the income statement over the vesting period of the related share options or share allocations. The cost is based on the fair value of the options or shares allocated and the number of awards expected to vest. The fair value of each option or share is determined using either a Black-Scholes option pricing model or a Monte Carlo projection model, depending on the type of award. Market related performance conditions are reflected in the fair value of the share. Non-market related performance conditions are allowed for using a separate assumption about the number of awards expected to vest; the final charge made reflects the number actually vesting.

#### RESEARCH AND DEVELOPMENT AND ADVERTISING EXPENDITURE

All research and advertising expenditure is written off as incurred.

Development expenditure is written off as incurred unless it meets the recognition criteria set out in IAS 38 'Intangible Assets'. Where the recognition criteria are met, intangible assets are capitalised and amortised over their useful economic lives.