Centrica plc Annual Report and Accounts 2005

Centrica report

Annual Report and Accounts 2005

Investing in our customers' future

Our Glens of Foudland wind farm, Aberdeenshire

centrica

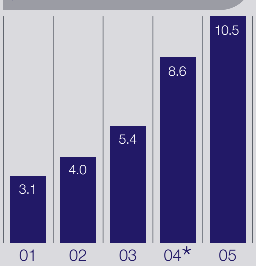
Our vision is to be a leading supplier of energy and related services in our chosen markets, in order to maximise value to shareholders. In 2005 we focused on investing for our customers' future.

Financial Highlights

12 months ended 31 December	**2005**	2004
Financial highlights		
Group turnover^	**£13.4bn**	£11.4bn
Operating profit*^	**£1,513m**	£1,362m
Adjusted basic earnings per share	**18.2p**	18.1p
Ordinary dividend per share	**10.5p**	8.6p
Statutory results		
Group turnover^	**£13.4bn**	£11.4bn
Operating profit^	**£1,957m**	£1,263m
Basic earnings per share	**27.4p**	38.0p

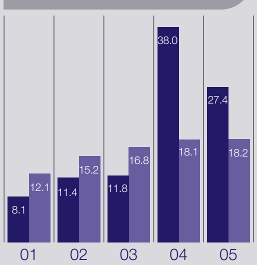
^ from continuing operations
* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements

Ordinary dividend
pence



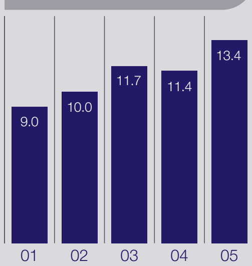
* excludes special dividend of 25p

Earnings per share
pence



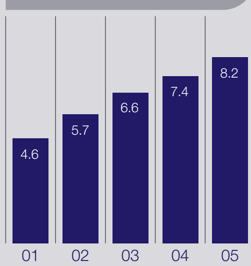
■ Basic earnings per share
■ Adjusted basic earnings per share (before exceptional items and certain re-measurements)

Group turnover *
£ billion



* from continuing operations

Community investment worldwide £ million



Based on London Benchmarking Group methodology

The Group adopted IFRS with effect from 1 January 2005. The comparative data for 2004 has been restated accordingly. IAS 32 and IAS 39 were adopted with effect from 1 January 2005, and the comparative data for 2004 does not reflect the effect of these standards. Amounts in years prior to 2004 are presented in accordance with generally accepted accounting standards (GAAP) in the UK prevailing at the time. Turnover prior to 2004 excludes Accord trading revenue.

Earnings and operating profit numbers are stated, throughout the commentary, before exceptional items and certain re-measurements where applicable – see page 44 for definitions. The Directors believe this measure assists with better understanding the underlying performance of the Group. The equivalent amounts after exceptional items and certain re-measurements are reflected in note 5 and are reconciled at Group level in the Group Income Statement. Certain re-measurements and exceptional items are described in note 7. Adjusted earnings and adjusted basic earnings per share are reconciled to their statutory equivalents in note 12.

All current financial results listed are for the 12 months ended 31 December 2005. All references to 'the prior year', '2004' and 'last year' mean the 12 months ended 31 December 2004 unless otherwise specified.

Throughout this Report references to British Gas include Scottish Gas.

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As always, we will manage our business with shareholder value firmly at the top of our agenda.

Roger Carr, Chairman

Our strategic priorities

- **Rigorous cost reduction across the Group**
- **Proactive marketing to strengthen customer loyalty**
- **Positive price management to sustain profitability**
- **Building growth in our service and energy businesses at home and abroad**
- **Absolute financial discipline in acquisition and capital investment**

Wholesale commodity prices escalated to unprecedented levels in 2005 creating considerable challenges for management in an increasingly competitive marketplace.

Against this background we delivered a strong financial performance in the year. The executive team focused on vigorously reducing those costs within their control and developing attractive propositions for both new and existing customers in a difficult market, resulting in improved levels of customer retention.

In the UK, growth opportunities in services and commercial markets were targeted by more focused management teams, whilst in both continental Europe and North America we made good progress in expanding our footprint.

Cost control remains a high priority for the Company. Key system developments and process improvements which reduce costs both in the near and medium term were successfully progressed by dedicated and professional teams. In parallel, a review of our central overhead costs was undertaken in the continued pursuit of achieving the efficiencies necessary to meet our objective to be the lowest cost-to-serve energy supplier.

Undoubtedly the benefits of both system evolution and corporate cost contraction will serve to underpin our 2006 performance in what will be a year of further challenge.

We continued to search for value-creating opportunities upstream and successfully acquired gas and oil assets in the UK with an attractive earnings profile to enhance our ability to deliver a competitive cost of goods. We remain committed to deploying our cash to create value for shareholders and throughout the year applied our strict financial disciplines to the evaluation of acquisition and investment opportunities.

We reinforced our absolute focus on energy and related services with the disposal of Onetel, our last remaining peripheral business, at the end of 2005. This additional clarity of focus will be beneficial in the year ahead to ensure that all management endeavours and financial resources are channelled to our core business.

Our lobbying in Europe started to show signs of success with some clear moves towards greater transparency and market access which we believe will be instrumental in ensuring our international competitiveness in the years ahead.

Returns to shareholders

The Board of Directors is proposing a final dividend of 7.4 pence per share to be paid in June 2006, bringing our full year dividend to 10.5 pence per share. This represents a 22% year-on-year increase and is in line with our previous commitment to increase the payout ratio.

As previously stated, for the period 2006 and beyond the Board intends to deliver real growth per annum in the ordinary dividend per share. Going forward the interim dividend will be set at a level equivalent to 30% of the prior full-year dividend.

We concluded our first £500 million share repurchase programme in September 2005 and immediately commenced our second £500 million programme. In total during 2005 we bought back £385 million of shares. However, in the light of current market conditions, the increased working capital requirements associated with higher wholesale costs, and the potential impact of our retail price increase on our cash profile, together with the recent volatility in our share price, has caused us to pause the share buyback programme until calmer and more predictable conditions prevail. The Board remains committed to the principle of capital discipline and it believes this move is prudent in the current circumstances. It will monitor the position with a view to recommencing the programme at an appropriate time.

Management

During 2005 we continued to strengthen our Board. In January Jake Ulrich, Managing Director of Centrica Energy, was appointed as an Executive Director and in September the Board was joined by Andrew Mackenzie as a Non-Executive Director. Both Jake and Andrew have brought upstream expertise to the Board which is crucial as we continue to develop our upstream portfolio in the UK and overseas.

The organisational changes announced in September have now been fully implemented. We have a strong and experienced team fully focused on the varied challenges and opportunities facing our business.

In September, Sir Roy Gardner announced his intention to retire and hand over the reins to his new successor by the summer of 2006.

Our employees

This was another difficult year for our people. Our drive for cost reduction has inevitably created a tough environment and staff have acted professionally to produce high levels of customer service, to retain current and attract new customers, and to support one another in the delivery of stretching business targets. I am grateful for their continued dedication and commitment.

Outlook

The items that were on our agenda in 2005 will remain as important in 2006 and will continue to be driven by Sir Roy during his remaining months as Chief Executive.

Our pricing policy seeks to recover the wholesale cost of gas over time and acknowledges that the long-term strength of the Group is dependent on British Gas delivering a fair and reasonable profit. We will manage our sales, marketing and customer service activities to reduce the impact of competitor activity and minimise customer churn resulting from the recent retail price increase. Cost reduction remains key to maintaining margins in this continued environment of high commodity prices. We look forward to the expansion of the infrastructure that brings gas into the UK and hope to see downward pressure on prices in the latter part of the year which could protect consumers from further retail price increases across the industry. However, the additional tax on upstream profits announced by the government in December and effective from 1 January 2006 is applying further pressure in an already difficult year.

Continuing to seek out and evaluate opportunities for upstream investment will be a priority. As in 2005 this will include the consideration of opportunities outside the UK Continental Shelf and in fields which have so far remained undeveloped. Patience and discipline will remain our watchwords and as always we will manage our business with shareholder value firmly at the top of our agenda. Market conditions are volatile and will remain challenging in 2006 but management resolve to deliver a strong performance remains unchanged.

Roger Carr, Chairman
23 February 2006

In 2005 we saw the highest wholesale gas and power prices since Centrica was formed in 1997 and the greatest year-on-year rises in the cost of both fuels.

Sir Roy Gardner, Chief Executive

Operational highlights

- **1.25 million customers moved to new billing system**
- **Sale of Onetel reinforced focus on energy**
- **British Gas Services turnover exceeded £1 billion**
- **North American operating profits up 40%**
- **Expanded presence in Europe with two strategic acquisitions**
- **Centrica Storage operating profits more than doubled**
- **Strengthened upstream asset position**

Overview of the year

The substantial rise in wholesale prices clearly presented a massive challenge for all energy retailers and in particular for British Gas, as the largest supplier of both gas and electricity to the residential marketplace. The result was the unfortunate but inevitable round of tariff increases across the industry. British Gas' innovative product propositions and the marketing and selling efforts of the team minimised the impact on our customer base, with customer losses in the second half of the year substantially lower than the first half. With the unprecedented rise in commodity costs we chose not to pass through the full impact immediately to our customers. This led to a substantial fall in British Gas operating profits*, down by 63% on the previous year, with an operating loss* in the second half. We managed to offset some of the commodity impact on the business by fundamentally reviewing and streamlining all non-customer-facing activities and at the end of the year we achieved a major goal in the transformation of British Gas with the first large-scale migration of 1.25 million customer accounts to our new billing system. We also laid out a cost reduction plan which will take us to 2007 and beyond with the aim of becoming the lowest cost-to-serve provider.

We continued to sharpen our strategic focus during the year culminating in the sale of Onetel. We are proud of the fact that we built Onetel into a strong business that is a serious competitor to BT. The ability to offer a competitive telecoms product remains important but our priority is to deploy our capital closer to the energy core of our business.

We successfully strengthened our upstream business by acquiring interests in three North Sea gas and oil fields that have a production profile which maximises value during this high commodity price environment. We acquired the remaining 40% of the Humber power station in a further move towards our optimal vertical integration position in electricity.

The other businesses in the Group contributed over a third of the total operating profit* in the year. The results of Centrica Storage were particularly impressive with operating profit* in the year equivalent to half of the original acquisition price in 2002. The field delivered almost 100% reliability, testament to the enhanced level of investment from Centrica. Reflecting the greater appreciation of the value of storage, standard bundled units (SBUs) for the 2006/07 storage year were entirely sold out by December 2005.

In British Gas Services we continued to invest for future growth. By the end of the year we had more than 300 new fully qualified engineers and had also completed the

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

nationwide roll-out of the engineer deployment system to all central heating engineers. Even against this backdrop of investing for growth, operating profit rose by 54%. British Gas Business managed to strengthen its position in an environment of rising input costs in the UK.

The North American business once again proved an extremely valuable asset with continued growth. We also extended the reach of our energy business in continental Europe with the acquisition of Oxxio BV, an innovative low-cost organic growth business in The Netherlands, and a 25.5% stake in SPE SA, a Belgian generator into which we rolled our Luminus energy retailing operation. This provides us with a substantial platform for growth in this strategically important area.

In summary it was a year in which our fundamental view of the value of gas enabled us to optimise our portfolio. I am pleased that once again we delivered a robust set of results.

2006 operating plan

Looking forward it is already clear that the year will again be dominated by the cost of sourcing gas and electricity for customers. The increases in the market forward curve forced our decision on customer tariffs in February, with demand-weighted market costs of gas and electricity already 68% and 49% respectively up on 2005.

British Gas Residential Energy

In British Gas we will be concentrating our efforts in the first half of the year on minimising the impact of the pricing decision on the customer base. The size and strength of our sales force and the new propositions we are offering will support these efforts. While there can be no guarantees in such a volatile wholesale market we hope to avoid any need for further price rises this year. We will concentrate on controlling both our cost of goods and the operating cost base of our entire business in a year when the British Gas cost base will be challenged by the need to dual-run systems and train our customer service agents as we complete the roll-out of the billing platform.

Centrica Energy

Upstream we will continue to pursue the ideal integration position to support a business with our levels of demand in gas and electricity. We will maintain our disciplined approach to value creation as we investigate the opportunities to source commodity for the long term. We expect these opportunities to include asset positions as well as further contracts and we will seek to add further fuel diversity to our electricity portfolio. We will complete the construction of our second wind farm, our first offshore, at Barrow, giving us access to the total offtake from a 90MW source of green power. With the relevant permission, we, along with our partners, expect to move our plans for another LNG terminal for the UK at Canvey Island to the next stage; a terminal which could be capable of delivering an annualised gas capacity of 5.4 billion cubic metres (BCM) by the winter of 2010/11. We will carry out the initial seismic surveys to establish the feasibility of our licence blocks in Nigeria which, if viable, we could begin to develop as early as 2008.

We expect the overall profitability of our upstream business to be ahead of the previous year with a reduction in volumes from Morecambe of around 20% being more than offset by the still-rising gas price and increased production from other fields of around 20%. We expect the losses on the large legacy sales contracts to increase, leading to an operating loss* in the industrial and wholesaling segment currently forecast to be in excess of £300 million. The 10% additional supplementary tax charge on gas production profits was effective from 1 January 2006. Towards the end of 2005 we reviewed and restructured some aspects of our upstream operations which may reduce the overall Group tax charge. Assuming no positive impact of this restructuring, the 2006 charge would be in the region of 58%.

British Gas Services

In British Gas Services the new team will be establishing the optimal structure and growth plans for the business to maximise the opportunities in a wider customer arena while maintaining a close link to the residential energy business. Although the rate of bottom-line growth of 2005 may not be repeatable we expect operating profit to continue to grow at a rate commensurate with the market opportunities.

British Gas Business

In British Gas Business we will concentrate on the development of a new systems solution which will enable the operation to take full control of its pricing structures by migrating all of its customers from the legacy British Gas Residential Energy systems. We would expect the system to roll-out in 2007. Even after the anticipated increase in expensed spend of £14 million in 2006 we anticipate being able to keep operating profits broadly flat year-on-year.

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

Centrica Storage
Centrica Storage is forecast to have another year of improved financial performance, with all 2006/07 SBUs sold out at substantially higher prices. The multiplier within the SBU pricing formula rose by almost 10% from 2.3 to 2.5 between the 2005/06 and 2006/07 storage years, reflecting increasing recognition of the value of storage. We will continue to invest in the maintenance and upgrade of the field with a view to creating further storage space going forward.

Centrica North America
In North America there are many opportunities to develop our business. We will continue to grow our electricity and gas sales to business customers in Canada, Northern US and Texas, and in Ontario the re-opened residential electricity market offers good growth potential. Upstream we will expand our coal bed methane operations in Alberta and integrate our third Texas power station, which was acquired early in 2006. We will work to minimise any impact of the transition out of the Price-to-Beat (PtB) mechanism in Texas at the end of 2006. This will include the re-shaping of our organisation to reduce the overall cost base and lay foundations for further growth.

Europe
Further expansion in Europe remains high on our management agenda. We will continue to lobby heavily for increased transparency and open access to the wholesale markets and faster progress towards real competition in the retail markets, building on our successes to date. We intend to investigate all opportunities to grow in areas close to our current retail positions although it is not yet clear whether deregulation will occur rapidly enough to present meaningful opportunities in 2006.

Summary
In summary the year ahead will be difficult but we have laid firm foundations. The inroads we have already made into the cost base of our business, the clear roadmap to a lower-cost environment, the systems solutions we are successfully putting in place, the continued growth in services and internationally and the progress in our upstream business, all give us reason to be positive about the future of Centrica. Market conditions are volatile but our priorities remain unchanged. In this challenging environment we will search out opportunities to advance our wider strategic aims while we continue to drive through operational improvements which will enhance service, reduce costs and aid customer retention. Centrica may face further turbulence in the commodity markets, but the results of 2005 clearly show a strong underlying business.

Sir Roy Gardner, Chief Executive
23 February 2006

Operating and Financial Review

The needs of our customers lie at the heart of everything we do, from sourcing and securing energy to providing a broad range of distinctive services to homes and businesses.

Our main activities

Sourcing energy
We source energy by exploring for and producing gas; by trading on the energy markets; and through the generation of electricity from our gas-fired power stations and from wind farms.

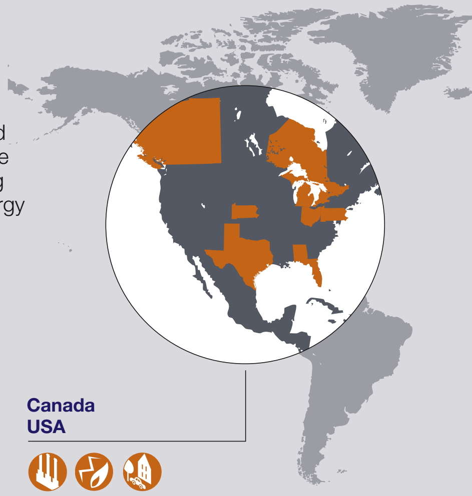
Home services
We offer a range of services to residential customers. These include the installation and servicing of home heating and security systems and the care of electrical wiring, kitchen appliances and plumbing and drains.

Gas and electricity supply
We supply gas and electricity to residential and business customers through our highly customer focused brands.

Gas storage
We store gas under the North Sea for producers and suppliers including our own businesses.

Our key markets

Our key markets
We have established and continue to invest in a successful energy and related home services business in the UK. Overseas we are building businesses in liberalising energy markets where we see good growth opportunities.



British Gas Residential Energy

Turnover^
£6,032m
2004 £5,901m

Operating profit*
£90m
2004 £242m

We supply gas and electricity to residential customers throughout Britain – under the British Gas name in England, as Nwy Prydain and British Gas in Wales, and as Scottish Gas in Scotland. We are the first choice gas supplier for millions of people and, since the market opened for competition in 1998, we have become the country's largest supplier of electricity to residential customers.

> www.house.co.uk

British Gas Services

Turnover^
£1,024m
2004 £943m

Operating profit*
£111m
2004 £72m

We are Britain's largest domestic central heating and gas appliance installation and maintenance company, providing services under our HomeCare range, which also covers plumbing and drains, home electrics, kitchen appliances and monitored home security systems. We directly employ more than 8,300 engineers and also offer services through British Gas-owned Dyno-Rod franchises.

> www.house.co.uk

British Gas Business

Turnover^
£1,510m
2004 £1,200m

Operating profit*
£77m
2004 £68m

We market gas and electricity to businesses, from the largest commercial operations to small and medium-sized enterprises, under the British Gas Business brand, offering the flexibility of an open tariff or the security of fixed contracts. We remain the number one supplier of energy to the commercial sector in Britain (measured by supply points). We also provide heating care for businesses.

> www.britishgasbusiness.co.uk

Centrica Energy

Turnover^#
£1,011m
2004 £931m

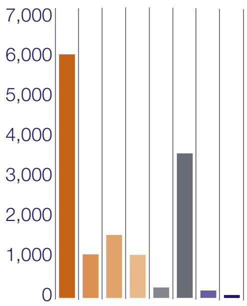
Operating profit*
£903m
2004 £773m

This consists of our upstream gas production, electricity generation, wholesale and industrial gas sales and our energy trading and optimisation unit. We have gas reserves in Morecambe Bay, supplemented by interests in several North Sea fields. To help us meet our customers' electricity demands we have seven gas-fired power stations and are investing in renewable generation through offshore and onshore wind farms.

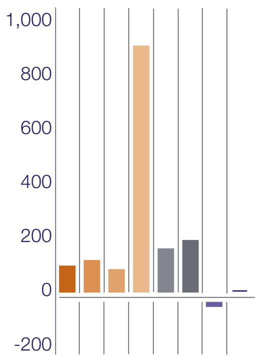
> www.centrica.com

^ from continuing operations
* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.
# excludes revenue from other Centrica businesses

Group turnover^ by business 2005 £million



Group operating profit* by business 2005 £million



- British Gas Residential Energy
- British Gas Services
- British Gas Business
- Centrica Energy
- Centrica Storage
- North America
- Europe
- Other

Centrica Storage

Turnover^#

£195m

2004 £133m

Operating profit*

£154m

2004 £69m

We operate the Rough gas storage facility, a partially depleted gas field 18 miles off the Yorkshire coast in the southern North Sea, supported by a gas processing terminal at Easington. We provide storage services for a range of customers, including businesses within Centrica. Rough can store over 100 billion cubic feet of gas and is the largest storage facility in the UK. For regulatory reasons, Centrica Storage operates separately from the rest of the Group.

> www.centrica-sl.co.uk

Centrica North America

Turnover^

£3,552m

2004 £2,242m

Operating profit*

£185m

2004 £132m

Direct Energy is North America's largest competitive energy solutions provider. In Canada, we serve customers in Ontario, Manitoba and Alberta. In the US we have customers in 10 states in the regions of New England, the North East and the Mid-Atlantic (including through our subsidiaries CPL Retail Energy and WTU Retail Energy in Texas). Direct Energy Business Services supplies energy solutions to businesses throughout Canada and in the US.

> www.directenergy.com
> www.cplretailenergy.com
> www.wturetailenergy.com

Europe

Turnover^†

£427m

2004 £286m

Operating profit (loss)*

£(9)m

2004 £5m

We have acquired a 25.5% stake in the generator SPE into which we rolled our Luminus energy retailing operation. SPE is now the number two competitor in the Belgian market. We have also extended our presence into The Netherlands where we bought the fourth largest energy supplier, Oxxio. In Spain, where competition in the electricity market is restricted, Luseo Energía is focusing on selling energy management products and services.

> www.luminus.be
> www.oxxio.nl
> www.luseoenergia.com

Investing in our business

United Kingdom

- North Sea oil and gas fields: acquired shares in three fields for £268m
- Horne and Wren gas fields: £35m development completed and first gas delivered
- Humber power station: increased interest from 60% to 100% in Humber Power Limited
- Aberdeenshire wind farm: £31m investment to build our first wind farm
- Barrow offshore wind farm: invested over £50m
- Canvey Island LNG: acquired at least 20% interest in proposed LNG reception facility
- Isle of Grain LNG: acquired import capacity for 20 years
- International Power: agreed first coal-indexed power purchase
- Exploration: investment to widen our search for supplies
- British Gas: £386m capitalised investment to date on improved customer service systems

Europe

- Norway: £4bn long-term import deal delivered its first gas supplies
- Belgium: acquired a 25.5% stake in Belgian generator SPE SA
- The Netherlands: acquired Dutch energy supplier Oxxio BV for £95m

> www.centrica.com

^ from continuing operations
* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.
# excludes revenue from other Centrica businesses
† 2005: £119m excluding joint ventures. 2004: £8m excluding joint ventures.

British Gas Residential Energy

- 1.25 million accounts moved to new billing system
- Cost reductions continued
- One million accounts on price protection
- Electricity accounts grew by 66,000 in second half

British Gas

2005 was another very challenging year for the industry with the demand-weighted month-ahead market price of gas for 2005 at 40.15p/therm, 43% up on the prior year and electricity at £35.82/MWh, 47% higher than 2004. These increases in turn forced all suppliers, including British Gas, to announce customer tariff rises. The pilot of our billing system which began in August was completed in November and towards the end of December we successfully completed the first large-scale migration of 1.25 million customer accounts to the new system. The total invested in the transformation programme to the end of the year was £386 million, with £25 million spent during the year of which £8 million was expensed.

Turnover rose by 2.2% to £6.0 billion (2004: £5.9 billion) with the price increase in September 2005 and the full-year effect of the prior-year price increase almost entirely offset by lower customer numbers and lower average consumption levels. Following the price increase in September 2005, the level of customer losses was minimised by a high-profile marketing campaign and a suite of new propositions, including an innovative price protection product which offered customers the opportunity to fix their energy costs until 2010. Within five months we had sold over one million of this product. Reduction in churn and average gross account sales levels of around 60,000 per week resulted in heavily-reduced customer losses in the second half of the year; only 165,000 accounts were lost during this time. Total customer account numbers for the year were down by 670,000, although electricity account numbers were broadly flat and actually grew by 66,000 in the second half.

Gross margin fell by £266 million compared to the prior year. The effect of the price rises and the fall in transportation and distribution charges were more than offset by the rise in the cost of goods, lower customer numbers and the fall in average consumption caused by warmer weather during the critical decision periods for switching off and on central heating systems. The weighted average cost of gas (WACOG) rose by 33% to 35.04 p/therm, slightly below the market increases, reflecting the benefits of the legacy gas purchase contracts and the procurement and optimisation skills of Centrica Energy. The weighted average cost of electricity (WACOE) was £37.7/MWh, 30% above last year, reflecting the higher price of the fuel gas for the power station portfolio required to meet the peak power requirements and generally higher market electricity costs. In order to maximise long-term value we chose not to pass through the entire increase in commodity costs during the year. WACOG and WACOE for 2005 contain a charge of £85 million for the excess cost of energy which the system operator deemed us to have used.

Operating profit* for the year fell by 63% to £90 million (2004: £242 million) with a second half operating loss* of £75 million. The year-on-year reduction in the operating cost base of £138 million was partially offset by an increase in the obligatory investment in energy savings measures for customers, Energy Efficiency Commitment (EEC), which rose by £24 million to £112 million (2004: £88 million).

In December we announced our intention to deliver an operating cost base in 2007 which is £180 million lower in absolute terms than the 2004 baseline. As part of the ongoing transformation of the cost base of the business and enabled by the new systems infrastructure, in July we announced our intention to outsource certain elements of our support functions to India. The outsourced activity did not include any customer-facing staff and is now operational.

Following a strategic review of the business we sold British Gas Connections Limited in May realising an exceptional profit on disposal of £47 million. We retained the siteworks business which manages the relationships required to support the sale of energy and related services to housing developers and new homeowners.

Residential Energy key performance indicators

For the period ended 31 December	2005	2004	Δ%
Customer numbers (period end) (000)			
Residential gas	**11,131**	11,771	(5)
Residential electricity	**5,920**	5,950	(0.5)
Estimated market share (%)			
Residential gas	**54**	57	(3 ppts)
Residential electricity	**23**	23	–
Average consumption			
Residential gas (therms)	**597**	637	(6)
Residential electricity (kWh)	**4,146**	4,186	(1.0)
Weighted average sales price			
Residential gas (p/therm)	**61.16**	53.16	15
Residential electricity (p/kWh)	**7.54**	6.76	12
Weighted average unit costs			
Residential gas (WACOG, p/therm)	**35.04**	26.32	33
Residential electricity (WACOE, p/kWh)	**3.77**	2.90	30
Transportation & distribution costs (£m)			
Residential gas	**1,146**	1,256	(9)
Residential electricity	**493**	489	0.8
Total	**1,639**	1,745	(6)
Operating costs (£m)			
Residential energy	**974**	1,088	(10)
Turnover (£m)			
Residential gas	**4,196**	4,170	0.6
Residential electricity	**1,836**	1,731	6
Total	**6,032**	5,901	2.2
Operating profit (£m)*			
Residential energy	**90**	242	(63)
Operating margin (%)			
Residential energy	**1.5**	4.1	(2.6 ppts)
British Gas product holding**			
Average British Gas products per customer (period end)	**1.67**	1.66	0.6

Δ% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

** British Gas brand

British Gas Services

- Now a £1 billion business
- Strong growth in newer products
- Broader access to key central heating markets
- Roll-out of engineer deployment system completed

During the year direct management responsibility for British Gas Services was split from British Gas Residential Energy, recognising the different challenges and opportunities that each business faces. It continues to have a strong link with the energy business to maximise growth potential and brand synergies.

British Gas Services continued to grow both its top and bottom line. Turnover was up by 9% at £1,024 million (2004: £943 million) as the total number of product relationships increased by 6% to just under 7 million. Operating profit* rose by 54% to £111 million (2004: £72 million), with strong growth in the newer products of plumbing and drains care, home electrical care and kitchen appliance care. There were also one-off positives in the year of £9 million relating to training academy grants and the release of restructuring provisions. The operating margin, excluding these one-offs, widened to 10% (2004: 8%).

Turnover in the central heating installations business is broadly in line with 2004. During the year we released new products in our central heating installation business giving us greater access to the mid-range market.

We completed the roll-out of the engineer deployment system which provides a robust platform for growth and additional flexibility. By the end of the year all of our 6,550 Central Heating Care engineers were using the system.

British Gas Services key performance indicators

For the period ended 31 December	2005	2004	△%
Customer product holdings (period end) (000)			
Central heating service contracts	**3,476**	3,363	3.4
Other central heating service contracts	**861**	843	2.1
Kitchen appliances care (no. of customers)	**365**	331	10
Plumbing and drains care	**1,307**	1,199	9
Home electrical care	**860**	740	16
Home security	**25**	26	(3.8)
Total holdings	**6,894**	6,502	6
Central heating installations	**92**	92	0
Turnover (£m)			
Central heating service contracts	**478**	436	10
Central heating installations	**251**	244	2.9
Other	**295**	263	12
Total	**1,024**	943	9
Engineering staff employed	**8,348**	8,033	3.9
Operating profit (£m)*	**111**	72	54
Operating margin (%)	**11**	8	3 ppts

△% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

British Gas Business

- Still the number one commercial supplier
- Record SME contract renewals of over 90%
- Financial Times Great Places to Work listing recognised empowered employees

In a difficult year for energy suppliers British Gas Business maintained its position as number one supplier (measured by number of supply points) to the commercial sector in Britain. The year was dominated by rising wholesale energy costs which were reflected in increased weighted average input costs for gas and electricity of 49% and 33% respectively. This in turn led to increases in customer prices. Despite this, total supply points rose by 2.9% to 909,000 and gross churn rates fell in both fuels, driven particularly by record SME contract renewal levels of well over 90%.

The combination of price rises, higher customer numbers and higher average consumption after winning electricity contracts for several large corporate accounts increased turnover by 26% to £1.5 billion (2004: £1.2 billion). Operating profit* rose by 13% to £77 million (2004: £68 million).

During the year we maintained our focus on controllable costs, resulting in a 9% reduction in our total operating expenses. We made further progress on our customer service

British Gas Business key performance indicators

For the period ended 31 December	2005	2004	△%
Customer supply points (period end) (000)			
Gas	**394**	368	7
Electricity	**515**	515	0
Total	**909**	883	2.9
Average consumption			
Gas (therms)	**3,492**	3,420	2.1
Electricity (kWh)	**27,512**	24,752	11
Weighted average sales price			
Gas (p/therm)	**51.87**	41.21	26
Electricity (p/kWh)	**5.79**	5.08	14
Weighted average unit costs			
Gas (WACOG, p/therm)	**36.63**	24.51	49
Electricity (WACOE, p/kWh)	**3.25**	2.45	33
Transportation and distribution (£m)			
Gas	**124**	122	1.6
Electricity	**217**	210	3.3
Total	**341**	332	2.7
Turnover (£m)			
Gas	**692**	523	32
Electricity	**818**	675	21
Other	**–**	2	n/m
Total	**1,510**	1,200	26
Operating profit (£m)*	**77**	68	13
Operating margin (%)	**5.1**	5.7	(0.6 ppts)

△% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

initiative and the deployment of new technology and processes which will rationalise our invoicing and collection systems. Total spend in the year was £22 million, of which £3 million was expensed.

Centrica Energy

- **Generated first green power**
- **Stakes acquired in three North Sea fields**
- **Secured capacity at Isle of Grain LNG terminal**
- **Won two gas exploration blocks in Nigeria**

Gas production

Once again we witnessed sharp increases in the wholesale price of gas with the residential demand-weighted month-ahead market price of gas for 2005 at 40.15p/therm, 43% above 2004. In this environment operating profit* rose by 31% to £1,020 million (2004: £779 million) as the average sales price to the downstream business increased. This was partially offset by the 29% reduction in gas production levels at Morecambe. Our decision to switch off the field for a period in the summer and autumn in response to low intraday prices was responsible for approximately one third of this reduction. Under IFRS, petroleum revenue tax is no longer shown as a cost of goods under gas production but is now shown as a tax in the corporate results for 2004 and 2005.

We made good progress on increasing our gas reserves and production levels from fields outside the Morecambe Bay area. In October we acquired equity in three North Sea gas and oil fields for £268 million. This brought us a further 1.1 billion therms (bnth) of gas and 8 million barrels of oil. The development of the Horne and Wren fields, in which we acquired a 50% share in 2004, was completed with first gas being delivered in June. The fields produced over 132 million therms (mmth), reaching a flow rate of 1.1mmth per day (mmth/d). In February, the partners in the Statfjord field approved a programme of depressurisation to increase the level of recoverable gas reserves and extend field life. Approval from the UK and Norwegian governments was given in June. Centrica's share of any capital expenditure is expected to be around £50 million. This is estimated to add at least 500mmth of gas, one million barrels of oil and three million barrels of condensate to the portfolio.

In March we successfully bid for import capacity in the expansion of the Isle of Grain liquefied natural gas (LNG) terminal. From 2008 we will have access to regasification capacity of 3.4mmth/d, equivalent to 3.4 billion cubic metres (BCM) per annum. In July we announced our involvement in a partnership to construct a modern LNG reception facility at Canvey Island, with an annual import capacity of around 5.4BCM. In early 2006 the partnership lodged a planning application with the local authority.

During 2005 we continued to expand our range of potential sources of gas. In August, during the 2005 licensing round, we gained two licence blocks in Nigeria and have developed a relationship with local partners to assist in the surveying and potential future development of these sites. 2005 also saw the start of a focused gas exploration programme in the UK.

Centrica Energy key performance indicators

For the period ended 31 December	2005	2004	Δ%
Gas production			
Production volumes (mmth)			
Morecambe	**2,445**	3,444	(29)
Other	**612**	494	24
Total	**3,057**	3,938	(22)
Average sales price (p/therm)	**39.4**	26.4	49
Turnover (£m)	**1,365**	1,150	19
External turnover (£m)	**183**	109	68
Operating costs (£m)			
Volume related production costs	**215**	240	(10)
Other production costs	**130**	131	(0.8)
Total	**345**	371	(7)
Operating profit (£m)*	**1,020**	779	31
Power stations			
Power generated (GWh)	**11,641**	11,554	0.8
Industrial & wholesale			
External sales volumes (mmth)	**3,081**	3,601	(14)
Average sales price (p/therm)	**24.8**	22.0	13
Turnover (£m)	**786**	805	(2.4)
Operating (loss) (£m)*	**(156)**	(20)	(680)
Accord			
Margin (£m)	**42**	17	147
Operating profit (£m)*	**39**	14	179
Centrica Energy operating profit (£m)*	**903**	773	17

Δ% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

Industrial sales and wholesaling

The industrial sales and wholesaling segment made an operating loss* of £156 million (2004: £20 million loss*). This was mainly due to the sales contracts which posted an operating loss* of £173 million (2004: £42 million loss*). A 38% rise in the average input gas price for these contracts was only partially offset by a 13% year-on-year rise in the average selling price and a 14% decrease in delivered volumes. The balance of the segment includes certain operating costs of the Centrica Energy business unit which were more than offset by other credits. These credits were the results of the Humber power station joint venture, net of interest and tax, until the full acquisition in September and, under IFRS, the element of the tolling fees for the Humber and Spalding power stations which is classified as an interest payment on finance leases rather than an operating cost and recovered from the downstream businesses.

Electricity generation

In September 2005 we acquired the remaining 40% of the Humber power station, taking our total number of owned stations to seven and our total installed technical capacity to 3.4GW. We generated 11,641GWh of power from our owned stations in the year, marginally higher than 2004 (11,554GWh) due to the full year impact of Killingholme and the 40% Humber acquisition being largely offset by a significant King's Lynn outage and lower running due to negative spark spreads. Total fleet load factor was 49% (2004: 58%) reflecting generally lower spark spreads. During the year the UK government confirmed that new build stations will receive carbon emission allowances; the exact level is still to be clarified. In the last quarter we received tenders which are currently being evaluated for the engineering, procurement and construction (EPC) contract on the gas-fired power station option at Langage in Devon.

Renewables

In May we produced our first green power from our 26MW onshore wind farm at Glens of Foudland, Aberdeenshire. We also made good progress with the construction phase at our 90MW joint venture Barrow offshore wind farm and expect first power in the first half of 2006. The award of construction contracts for the wind farms at Inner Dowsing and Lynn has been delayed with Centrica intending to manage several contracts rather than a single EPC contract. First power from the project is now expected to be delivered in 2008. For the supply year April 2004 to March 2005, Centrica fulfilled its obligation to source sufficient renewable obligation certificates (ROCs) to cover 4.9% (1.87TWh) of all electricity supplied.

Energy procurement

In February 2005 we agreed an innovative coal-linked power purchase agreement with International Power for the supply of 250MW of peak power over a three-year period with the power price indexed to international traded coal prices.

In October we started receiving gas under the Statoil contract signed in June 2002. Centrica will receive up to 5BCM of gas every year. In December we entered into a further contract with Statoil for the delivery of 550mmth of 2006/07 winter gas. Both of these contracts use prices linked to the UK market gas price.

Accord energy trading

Under IFRS the reported Accord turnover is now the gross margin for the year and the results for 2005 reflect the adoption of IAS 39 from 1 January 2005. Operating profit* was up by 179% at £39 million (2004: £14 million) while maintaining historical value at risk limits. The profit uplift was primarily due to the volatile conditions in the energy markets, particularly towards the end of the year.

Centrica Storage

- **Profit surged by 123%**
- **41% increase in price of storage**
- **Field reached almost 100% reliability**

Operating profit* at the Rough gas storage operator, Centrica Storage, increased by 123% to £154 million (2004: £69 million). This strong performance was due to the combination of the increase in the market price of storage capacity, reflecting widening summer/winter gas price differentials, excellent levels of operational reliability and the first benefits of Centrica's investment in enhancing Rough's capacity.

The average price of standard bundled units (SBUs) for the 2005/06 storage year rose by 33% to 37.8 pence (2004/05: 28.5 pence), and the average SBU price for the calendar year by 41% to 34.8 pence (2004: 24.6 pence).

As a result of improved operational performance, customers enjoyed almost 100% reliability in both withdrawal and injection. An early start to the injection season and improved injection performance enabled the sale of 170mmth of additional space for the 2005/06 storage year at high market prices, compared to 147mmth in the prior storage year. The extra volume and higher average prices produced revenue from additional space sales for the year of £19 million (2004: £8 million). The field achieved a record daily delivery rate of 492GWh, 8% above the historic capacity of 455GWh. The enhanced deliverability allowed 30mmth of native Rough gas to be sold, along with the associated incremental delivery capacity, generating a one-off operating profit of £20 million in the year.

Further project investment in the year of £23 million, of which £7 million was expensed, brought total investment in the plant since acquisition in 2002 to £45 million. The work completed to date has allowed this investment to be increasingly focused on enhancing the capacity of the facility rather than solely maintenance and renewal.

Centrica Storage key performance indicators

For the period ended 31 December	2005	2004	Δ%
Average SBU price (calendar year) (p)	**34.8**	24.6	41
Turnover (£m)			
Standard SBUs (£m)	**159**	113	41
Extra space (£m)	**19**	8	138
Native gas sales (£m)	**20**	0	–
Gas sales (£m)	**30**	21	43
Other (£m)	**25**	22	14
Total	**253**	164	54
External turnover (£m)	**195**	133	47
Cost of gas (£m)	**35**	33	6
Operating profit (£m)*	**154**	69	123

Δ% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

Centrica North America

- Moved into new US markets
- Business markets turnover up 135%
- Continued growth in Texas customer base

In a challenging year of extreme weather events and volatile wholesale energy markets, we once again delivered strong year-on-year growth. Turnover grew by 58% to £3,552 million (2004: £2,242 million). The positive full-year effect of the 2004 acquisitions of ATCO Retail and Residential Services Group (RSG) (£742 million) was complemented by growth in our business markets revenues and in the Texas customer base. Operating profit* grew by 40% to £185 million (2004: £132 million) with an improvement in the Canadian residential and small commercial energy business due to the higher price environment and the absence of the one-off reconciliation of 2003 data in Texas which reduced the 2004 result.

Canada residential and small commercial energy

Turnover increased by 87% to £1,533 million (2004: £819 million) due to the full-year effect of ATCO Retail acquired in May 2004 and further sales and renewals being made at higher prices. Operating profit* grew by 62% to £47 million (2004: £29 million) as percentage operating margins were maintained in the higher price environment and the upstream gas asset contribution increased.

The regulatory environment in Ontario improved during the year. In gas we held the customer base flat during the second half of the year with higher sales levels and lower customer churn. In electricity the market re-opened fully to competition giving us the opportunity to restart our selling programme. Initially we sold contracts mainly to higher demand customers but have now also begun to move back into the residential space.

The competitive market in Alberta proved increasingly difficult in 2005 with regulatory and pricing regimes conspiring against the selling of competitive tariffs. At the end of December we had sold 59,000 unregulated contracts, primarily on a dual-fuel basis.

Texas residential and small commercial energy

Turnover grew by 28% to £953 million (2004: £744 million). This was driven by customer growth of 8% and higher prices following upwards Price-to-Beat (PtB) filings late in 2004 and in the second and fourth quarters of 2005. Operating profit* was up by 20% at £72 million (2004: £60 million) with the positive year-on-year effect of the tariff refilings, increased customer numbers, the prior-year market reconciliation and a successful procurement and hedging policy partially offset by higher commodity prices and the up-front customer acquisition costs.

Despite the requirement for two PtB refilings during the year, we still reduced customer churn in our incumbent territories, particularly during the second half of the year, and continued to grow our organic base steadily. We now have over 300,000 customers on deregulated tariffs outside our original territories.

Other USA residential and small commercial energy

Turnover grew by 9% to £208 million (2004: £190 million) driven by the higher retail price environment and growth in customer numbers in part through our activity in the aggregation market, partially offset by our withdrawal from Georgia in 2004. Operating profit* was up by £13 million to £16 million as a result of higher margins and the benefits from improved portfolio management and procurement processes which led to a one-off gain of around £5 million.

Home services

Turnover increased by 95% to £360 million (2004: £185 million) mainly due to the acquisition of RSG in October 2004 and growth in the core protection plan business in Ontario. Operating profit* was 42% higher at £51 million (2004: £36 million). Integration of RSG is now complete and trading results are meeting expectations. With the successful launch of services in Alberta and Manitoba and continued

Centrica North America key performance indicators

For the period ended 31 December	2005	2004	△%
Customer numbers (period end) (000)			
Canada energy	**2,130**	2,129	–
Texas energy	**898**	829	8
Other USA energy	**335**	305	10
Home services	**1,885**	1,800	4.7
Volumes			
Gas production (mmth)	**308**	334	(8)
Electricity generation (GWh)	**3,212**	1,176	173
Turnover (£m)			
Canada residential and small commercial energy	**1,533**	819	87
Texas residential and small commercial energy	**953**	744	28
Other USA residential and small commercial energy	**208**	190	9
Home services	**360**	185	95
Business markets	**481**	205	135
Energy trading & wholesale	**17**	99	(83)
Total	**3,552**	2,242	58
Operating profit/(loss) (£m)*			
Canada residential and small commercial energy	**47**	29	62
Texas residential and small commercial energy	**72**	60	20
Other USA residential and small commercial energy	**16**	3	433
Home services	**51**	36	42
Business markets	**(8)**	1	n/m
Energy trading & wholesale	**7**	3	133
Total	**185**	132	40
Operating margin (%)*			
Total North America	**5.2**	5.9	(0.7 ppts)

△% has been used to express 'percentage change'

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

growth in Ontario, we now have more than half a million protection plan policy holders across Canada and a business model which is capable of supporting significant further growth. Overall customer numbers rose by 5% to almost 1.9 million, with more than half of this due to underlying organic growth.

Business markets

Turnover grew by 135% to £481 million (2004: £205 million) with rapid growth in gas volumes in Ontario, Alberta and British Columbia and power volumes in Ontario, Alberta and Texas. We also now account for our large commercial customers within this segment. In the United States we entered the Connecticut, Massachusetts, Rhode Island and Illinois gas markets as well as the Maryland and New Jersey electricity markets. In the year we delivered volumes of 504mmth and 4.9TWh, up on 2004 by 101% and 81% respectively. We also commenced roll-out of our services and technology offer in Texas. The business made an operating loss* of £8 million in the year (2004: operating profit* of £1 million) reflecting the expensed start-up and acquisition costs associated with such rapid growth.

Energy trading & wholesale

Our focus on trading and wholesale business to support our downstream positions, with less emphasis on proprietary trading activities, was the primary driver in turnover falling by 83% to £17 million (2004: £99 million). The business registered an operating profit* of £7 million in the year (2004: £3 million).

Europe

- **Acquisitions boosted European footprint**
- **Clear number two in Belgian market**
- **600,000 customer relationships in Holland**

In the European competitive market, we strengthened our position in continental Europe with acquisitions in Belgium and Holland.

In September we acquired, in partnership with Gaz de France, a 51% controlling stake in SPE SA, a Belgian generator. After rolling the Luminus business into the entity we have a 25.5% share in around 1.6GW of electricity generation capacity and 850,000 energy accounts, with default supplier rights to a further 550,000 when the market opens fully in 2007. SPE is now the credible number two competitor in the Belgian market.

In July we acquired Oxxio BV, the fourth largest energy retailer in Holland, which now has 600,000 relationships across gas and electricity. As well as the growth opportunities, this also provides an opportunity for knowledge sharing across the Group as Oxxio operates a low-cost supply model.

In Spain, the electricity supply market is effectively closed to competition with the regulated tariff retail price set by the Spanish government lower than the wholesale commodity market price. Luseo continues to be active in energy management and related business but currently cannot compete profitably in the supply market. We are therefore reviewing our continued presence in the supply market. Live supply points peaked at 6,200 but by December this had fallen to 5,300.

For the full year our European business made an operating loss* of £9 million, including £14 million of amortisation charges on the fair value of in-the-money contracts recognised as intangible assets on the acquisitions of Oxxio and SPE.

Discontinued business – Onetel

- **Onetel sold to Carphone Warehouse**

In December we completed the sale of the Onetel business to Carphone Warehouse for a consideration of up to £154 million, of which £22 million will be contingent on certain sales criteria being met in the ongoing commercial relationship between Carphone Warehouse and British Gas. Of the total consideration, £130 million of cash was received before the end of the year. This resulted in a loss on disposal of £5 million.

We built Onetel into a strong business that is a serious competitor to BT. However in the past two years we have increasingly moved towards an absolute focus on energy and related services and successfully divested both Goldfish and the AA. Whilst telecoms remains an important part of our overall product offering, we no longer needed to own the business in order to provide the product to our energy customers. Having reviewed our options we concluded that our capital and resources are better deployed in pursuit of our focused strategic aims.

In the year the business made an operating profit* of £12 million on turnover of £342 million.

* including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements.

We were pleased that Centrica continued to be included in the Dow Jones Sustainability World and European Indexes and the FTSE4Good Indices.

We engage with a wide range of stakeholders so that we can more effectively manage the social, ethical and environmental (SEE) impact of our business activities. We thereby seek to minimise risk, create sustainable value for our shareholders and contribute positively to wider economic development in the regions in which we operate.

This section of the report highlights our key corporate responsibility (CR) issues and what we are doing to manage them. Further information will be provided in April in our 2005 CR Report at www.centrica.com/responsibility.

CR governance

The Board reviews our CR strategy and performance annually and is kept informed of progress in managing key issues as well as new developments that may affect its duties.

Our CR strategy is led by a sub-committee of the Executive Committee – the Corporate Responsibility Committee (CRC) – which is chaired by our General Counsel & Company Secretary and is responsible for ensuring that SEE risks are identified and managed in line with our business principles and that key stakeholders are consulted.

Stakeholder engagement

Structured engagement with our stakeholders is fundamental to delivering our business objectives. We manage this process by building strong two-way relationships with employees, customers, investors, regulators, suppliers, opinion-formers and communities.

In 2005 we consulted with our stakeholders to find out their views on CR, their interpretation of Centrica's responsibilities and whether our activities and level of disclosure are fulfilling their expectations. The research identified environmental issues as the most important for stakeholders and indicated that, although we had highlighted our main impacts, more tailored communication was needed.

Corporate responsibility performance indicators

	2005	2004	Δ%
Climate change			
Customer energy efficiency measures subsidised (million)	**9.0**	6.1	48
Lifetime carbon savings for measures subsidised (million tonnes)*	**1.3**	1.0	30
Health and safety			
Lost time injuries/1,000 employees	**13.2**	21.5	39
Lost time injuries/100,000 hours worked	**0.7**	1.1	36
Total injuries/100,000 hours worked	**3.1**	5.1	39
Vulnerable customers – 'here to HELP'			
Homes signed up	**116,823**	78,019	n/a
Homes completed (measures installed)	**28,212**	48,232	n/a
Value of unclaimed benefits identified (£m)	**2.6**	3.8	n/a
Average benefit gain per household (£)	**1,542**	1,197	n/a
Employees			
Human capital return on investment	**2.1**	1.9	11
Employee engagement score	**3.78**	3.73	1.3
Employees from ethnic minority groups (%)	**17.2**	16.6	4
Female/male employees (%)	**30.9/69.1**	33.2/66.8	n/a
Employees with a disability (%)	**2.5**	2.4	4
Communities			
Total community contribution (£m)	**8.2**	7.4	11

Δ% has been used to express 'percentage change'.
* Source: http://www.nef.org.uk/energyadvice/co2calculator.htm

Climate change

British Gas subsidised more than nine million energy efficiency measures in 2005

As a major producer and supplier of energy, Centrica has a responsibility to take measures to tackle the impact of climate change. We seek to contribute to the creation of a sustainable, low-carbon future, while ensuring the security of energy supplies.

Renewable energy

During the year, we made good progress with our £750 million investment in wind farm developments. In May we generated the first electricity from our 26MW Glens of Foudland onshore wind farm in Aberdeenshire. Construction of our Barrow offshore wind farm, a joint venture with Danish energy group DONG, continued through 2005 and the wind farm is on track to begin commercial generation in the first half of 2006.

Carbon emissions trading

Centrica has been actively participating in the EU Emissions Trading market for almost two years. In 2005 we traded 15% of the EU Allowances across Europe. To date, Centrica has delivered two significant deals, totalling in excess of one million Certified Emission Reductions.

Energy Efficiency Commitment

In 2005 British Gas installed more than nine million energy efficiency measures, such as loft and cavity wall insulation and low energy light bulbs, with an equivalent carbon saving of 1.3 million tonnes, benefiting more than 1.1 million households.

Carbon-saving products

British Gas announced the trial of two exciting new products to help customers reduce their carbon footprint. In partnership with Windsave, we are piloting household wind turbines which could enable customers to generate their own free supply of electricity. We are also working with Ceres Power to develop the world's first, mass-market, fuel cell-powered household boiler, which has the potential to reduce household energy bills and cut CO_2 emissions.

Vulnerable customers

Direct Energy's $1.5 million support for 'Neighbor-to-Neighbor' project helped thousands of indebted customers

Our aim is to make life safe, warm and comfortable for all of our customers and particularly for people on low incomes, older people and those with a disability. At a time of rising energy costs, our leading edge programmes are delivering practical solutions to help vulnerable customers.

Fuel poverty

The British Gas 'here to HELP' programme is tackling fuel poverty by helping to reduce household poverty and installing free energy-efficient products. To lessen the impact of price increases on vulnerable customers, British Gas also provided £6.7 million in winter fuel rebates.

Debt

We continued to support the work of the British Gas Energy Trust – an independent fund established with an initial £10 million from British Gas. In addition to making grants to indebted individuals, the Trust provides funding to voluntary sector organisations and registered charities, which assist in the prevention and relief of poverty, with particular emphasis on fuel debt.

Employees

- **Graduate programme won the Personnel Today Award for Excellence in Graduate Recruitment in 2005**

The calibre and the conduct of our people are central to building winning relationships with our customers, shareholders, suppliers and the communities we serve.

Engagement

Our annual engagement survey measures the attitudes and opinions of our employees on a range of company issues. In 2005 our overall engagement score increased by 1.3% which, during a very challenging period for the business, demonstrates the commitment of our people.

Diversity

We continued to implement our diversity and inclusion strategy with each business unit delivering tailored action plans. Awareness training continued for employees across the Group through an online learning package and we contributed to a number of policy consultations.

Development

1,200 senior managers took part in our leadership development programme during the year and more than 1,000 trainees went through the British Gas Engineering Academy. The Academy won an award from Women into Science and Engineering for its efforts to attract women.

Reward

We continued to extend our flexible benefits package with 7,712 employees now benefiting from the scheme. Our annual pay audit showed that the gender pay gap in Centrica is much narrower than published national norms. We also introduced a tax-efficient Home Computing Scheme and childcare vouchers for all employees.

Health and safety

- **Lost time injuries per 1,000 employees reduced by 39%**

The health and safety of our employees, customers and others who could be affected by our activities is a top priority for us.

Safety

In 2005 we delivered continual improvement in health and safety performance across almost all of our businesses, particularly in the reduction of workplace injuries. This creditable performance is built on proactive accident prevention and the positive engagement of our workforce.

British Gas leads the way in raising awareness about the risk of carbon monoxide (CO) poisoning and our campaigns in 2005 targeted students' landlords and homeowners. The incidence of CO incidents showed a year-on-year reduction.

Occupational health

Our approach is to take action through practical support and training and by raising awareness to help prevent work-related health issues. In 2005 we established a back-care programme for employees with a history of back problems and those with physically demanding roles. We also put in place a managers' toolkit on mental health issues – an increasing cause of sickness absence for employees.

Communities

- **Contributed £8.2 million to community causes through combination of cash, time and in-kind support**

We aim to play an active role in local communities by tackling issues of wider social concern, and encouraging and enabling our employees to get involved.

British Gas continued to tackle fuel poverty through the 'here to HELP' programme. During the year we were able to connect more than 8,000 people to additional support from our charity partners and identified over £2.6 million of unclaimed benefits.

Employee involvement

In 2005 our 'Helping Children Shine' partnership with NCH in the UK raised more than £250,000. Through employee fundraising and company support we generated more than £200,000 to support victims of the Asian tsunami. Direct Energy employees supported the relief efforts for hurricanes Katrina and Rita, raising more than $100,000.

We encourage and support employees who want to volunteer in their local community. In 2005 our people invested more than 15,000 hours in volunteering activities with a range of charities and community organisations. This in-kind support equates to around £420,000.

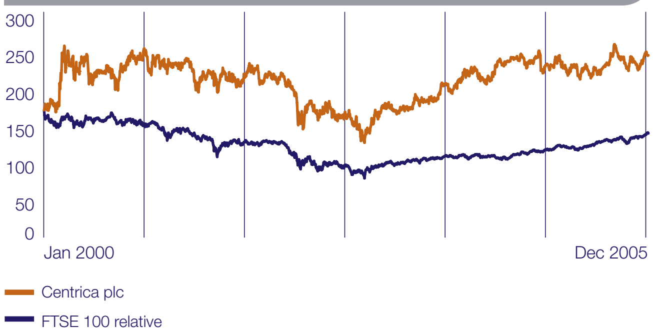
Although 2005 has seen an unprecedented increase in commodity prices, the Group's share price increased by 8% in 2005. Since demerger in 1997 our share price has outperformed the FTSE 100 Index by 261%.

Phil Bentley
Group Finance Director and Managing Director, Europe

Centrica's financial aim is to achieve a total shareholder return (TSR) ranking in the first quartile of UK FTSE 100 Index companies, taking account of share price growth and dividends received and reinvested over a sustained period. Centrica seeks to maximise the return on capital it achieves in excess of its cost of capital, within a prudent risk management framework. The Remuneration Report summarises our TSR performance over recent years against our comparator FTSE 100 Index Group.

The Group's closing share price on 31 December 2005 was 254.75 pence (31 December 2004: 236.25 pence), resulting in a market capitalisation of £9.2 billion (2004: £8.9 billion). This is after returning £385 million to shareholders through the continuation of our share repurchase programme in 2005. The Group's share price increased by 8% in 2005. Since demerger in February 1997, Centrica's share price has outperformed the FTSE 100 Index by 261%.

Centrica share performance
(pence)



Financial statements

Operating profit

Operating profit* increased to £1,513 million from £1,362 million in 2004.

This improvement is driven by increased profits in our gas production, Centrica Storage and North America businesses. Offsetting this are lower profits in our residential energy and industrial sales and wholesaling businesses.

Earnings

Adjusted earnings^ decreased 11% to £672 million (2004: £758 million). This represents a return on capital employed over the year of 28.3% and 7.4% on our average market capitalisation.

Statutory earnings decreased by £579 million to £1,012 million in 2005 (2004: £1,591 million). 2004 earnings included a profit of £911 million recognised on the sale of the AA.

* from continuing operations, including joint ventures and associates, net of interest and taxation, and before exceptional items and certain re-measurements

^ before exceptional items and certain re-measurements

Reference to notes throughout this section refers to the Notes to the Financial Statements on pages 44 to 109

Exceptional items and certain re-measurements

The statutory results benefited from certain re-measurements of £455 million in the year, primarily from marking to market, under the new IFRS rules, some contracts relating to our energy procurement activities. On conversion to IFRS on 1 January 2005, a net out-of-the-money position was charged against reserves. As gas and power were delivered, the related contracts were partially executed and the net positions unwound, generating a credit through the income statement in the period of £140 million. The balance of £315 million reflects the impact of higher future energy prices on the remaining contracts, new contracts signed during the period and proprietary trading positions which contain cross-border capacity. We have reported this separately because we do not believe that it reflects underlying business performance.

Operating exceptional charges of £100 million (2004: £100 million) arose as a result of business restructuring costs. These costs are offset by a £42 million profit arising on renegotiation of a take-or-pay contract and a £47 million profit on the disposal of British Gas Connections Limited.

Exceptional items recognised as discontinued operations in 2005 include £39 million profit on disposal of The AA and £5 million loss on disposal of Onetel. These are more fully explained in note 7.

Net interest

Net interest charged to the profit and loss account was £145 million compared with £104 million in 2004 and was covered 10 times by operating profit* compared with 13 times a year earlier. The increase in interest payable was due to higher average indebtedness mainly as a result of acquisition activity in 2005 and the share repurchase programme.

Taxation

The tax charge of £706 million in 2005 represents an effective rate of 52% on profits before exceptional items and certain re-measurements (2004: £547 million, representing an effective rate of 43%). The overall charge reflects petroleum revenue tax at 50% and corporation tax rates higher than 30% for offshore gas production and North America and deferred tax charges relating to certain re-measurements.

Earnings per share and dividends

Basic earnings per share is down from 38.0 pence to 27.4 pence, while adjusted earnings per share is in line with 2004 at 18.2 pence (2004: 18.1 pence).

Over the last five years the adjusted earnings per share have grown by a compound annual average of over 12%. In addition to the interim dividend previously paid, we are now proposing a final dividend of 7.4 pence giving a total ordinary dividend of 10.5 pence for the year (2004: 8.6 pence).

In addition, we completed our first £500 million share repurchase programme and commenced a second £500 million programme, spending a total of £385 million in 2005 purchasing our own shares. The programme has currently been paused.

Cash flow

Cash flow from continuing operating activities was £1,131 million for 2005 (2004: £1,157 million).

Cash inflow from discontinued operating activities was £13 million, compared to £112 million in 2004.

Net cash outflow from investing activities was £529 million (2004: inflow £497 million) and included the following:

Total net capital expenditure was £704 million this year, up from £397 million in 2004. Acquisition expenditure of £130 million (2004: £590 million), net of cash acquired, included our purchase of Oxxio BV and the remaining 40% interest in Humber Power Limited. Disposal proceeds in 2005 of £184 million include the sale of British Gas Connections Limited and Onetel.

The Group's net cash outflow from financing activities was £335 million (2004: outflow of £1,588 million). As a result of the above cash flow movements the Group's net increase in cash and cash equivalents, net of overdrafts, was £280 million (2004: increase £178 million).

Consolidated balance sheet

The net assets of the Group increased during the year from £2,308 million to £2,442 million.

Non-current assets

2005 closing non-current assets were £6,229 million, up £871 million in the year (2004: £5,358 million).

The 2005 closing value of goodwill arising on acquisitions totalled £1,170 million (2004: £1,049 million). Other intangible assets, mostly relating to internally-generated application software, totalled £569 million (2004: £518 million).

Property, plant and equipment, mainly gas field assets and power stations, had a net book value of £3,670 million (2004: £3,169 million). During the year gas field assets and power station additions and acquisitions totalled £741 million. At the year end, the net proven and probable gas reserves represented by our field interests amounted to 1,989 billion cubic feet (BCF) (2004: 2,136 BCF), which included 304 BCF (2004: 335 BCF) in North America.

The Group's investment in joint ventures and associates was £223 million (2004: £206 million). These investments related principally to the Group's 50% interest in Segebel SA and 50% interest in Barrow Offshore Wind Limited.

Current assets

The Group's current assets at 31 December 2005 were £7,061 million (2004: £4,390 million).

Included within current assets were inventory and trade and other receivables of £3,617 million (2004: £3,094 million), and derivative financial instruments of £2,159 million (2004: £121 million). The increase in derivative financial instrument balances in 2005 relates to the adoption of IAS 39 and IAS 32 from 1 January 2005. Cash and cash equivalents were £1,239 million, up £273 million in the year (2004: £966 million).

Current liabilities

The Group's current liabilities at 31 December 2005 were £6,395 million (2004: £4,235 million), including derivative financial instrument liabilities totaling £1,787 million (2004: £106 million).

Non-current liabilities

Non-current liabilities have increased in 2005 from £3,205 million to £4,453 million, largely due to increased borrowings, up £822 million at £2,267 million (2004: £1,445 million).

Equity

Total minority interests and shareholders' equity balances at 31 December 2005 of £2,442 million, up £134 million from 2004 (2004: £2,308 million). This movement is explained more fully in notes 25 and 27.

Risk management

Financial risk management
The Board has established objectives and policies for managing financial risks, to enable Centrica to achieve its long-term shareholder value growth targets within a prudent risk management framework. These objectives and policies are regularly reviewed.

Currency, interest rate and liquidity are managed centrally by a treasury team, within parameters set by the Board. This team is also responsible for monitoring the Group's credit ratings and managing the cost of its debt capital. An energy management team manages energy market price and volumetric risks. This team also manages counterparty risks. Where appropriate, financial instruments are used to manage financial risks as explained below and in note 34.

Credit rating
The Group's debt ratings from Moody's Investors Service/Standard & Poor's remain unchanged at A2/A (long-term) and P1/A-1 (short-term) and with a stable outlook.

Liquidity
Cash forecasts identifying the liquidity requirements of the Group are produced frequently. These are reviewed regularly by the Board to ensure that sufficient financial headroom exists for at least a 12-month period. The Group's policy includes maintaining a minimum level of committed facilities and that a proportion of debt should be long-term, spread over a range of maturities. As at 31 December 2005, the Group had undrawn committed facilities of £1 billion, which were used to support the US commercial paper programme.

Currency risk
Through wholly-owned US and Canadian subsidiaries and wholly-owned and partly-owned European entities, the Group has operational exposure in Canadian and US dollars and euros. The Group's policy is to maintain the sterling value of its foreign currency investment through balance sheet hedging instruments. Canadian dollar and euro balance sheet translation exposure is hedged by maintaining a portfolio of foreign currency financial liabilities which approximate to the net asset value of the Canadian and euro based operations. US dollar balance sheet translation exposure has been hedged by borrowing on a short-term basis through a US commercial paper programme.

All debt raised in US dollars through the US commercial paper programme has been used as part of the translation hedging operations described above.

Interest rate risk
The Group's policy is to actively manage interest rate risk on long-term borrowings while ensuring that the exposure to fixed rates remains within a 30% to 70% range. This is achieved by using derivative financial instruments, such as interest rate swaps, to adjust the interest basis of the portfolio of long-term debt. At the year-end, debt has been raised on both a fixed and floating rate basis.

Counterparty risk
The Board's policy is to limit counterparty exposures by setting credit limits for each counterparty, where possible by reference to published credit ratings. Exposures are measured in relation to the nature, market value and maturity of each contract or financial instrument. Surplus cash is invested in short-term financial instruments and only deposited with counterparties with a minimum credit rating of A3/A-/A- or P1/A-1/F1 from any of Moody's Investors Service/Standard & Poor's/Fitch Ratings long-term and short-term ratings respectively. Energy trading activities are undertaken with counterparties for whom specific credit limits are set. All contracted and potential exposures are reported to the Financial Risk Management Committee of the Executive.

Commodity price risk
The key commodity price risks facing the Group are first, natural gas and electricity prices both in the short-term market and in respect of long-term contracts, and secondly, escalation indices on long-term gas contracts, of which the most influential are oil product prices and general price inflation.

The Group's policy is to hedge a proportion of the exposure for a number of years ahead matched to the underlying profiles of our customer energy requirements. The Group aims to manage its risk by using financial instruments such as oil and gas swaps and gas derivatives and bilateral agreements for gas and power, as well as asset ownership.

The Financial Risk Management Committee regularly monitors the extent of the Group's commodity price exposure and the level of hedging taking account of forward prices and market liquidity.

Weather risk
Gas sales volumes, and to a lesser extent electricity volumes, are influenced by temperature and other weather factors.

The weather derivatives market remains relatively immature. We again entered into a number of weather derivative transactions for the winter period October 2005 to March 2006 to hedge part of the Group's weather exposure in the UK.

Accounting policies

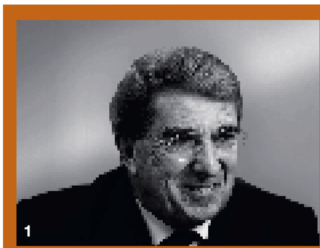
UK listed companies are required to comply with the European regulation to report consolidated financial statements in conformity with International Financial Reporting Standards (IFRS) from 1 January 2005 onwards.

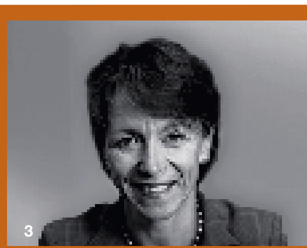
These results for the year ended 2005 are presented on an IFRS basis, and the comparative information for 2004 has been restated accordingly. Note 38 to the Financial Statements summarises the impact of first time adoption of IFRS. The Group has adopted IAS 39 and IAS 32 prospectively from 1 January 2005. A reconciliation of the Group's IFRS balance sheet from 31 December 2004 to 1 January 2005 is included in note 38, and the impact of this change in accounting policy is explained in note 3 to the Financial Statements.

Phil Bentley
Group Finance Director and Managing Director, Europe

Governance

Board of Directors





1. Roger Carr

Chairman (59) N.

Roger Carr joined the Board as a Non-Executive Director in 2001 and was appointed Chairman in May 2004. He is Chairman of Mitchells & Butlers plc, Deputy Chairman of Cadbury Schweppes plc and a senior adviser to Kohlberg Kravis Roberts & Co Ltd.

2. Sir Roy Gardner

Chief Executive (60) D.E.N.

Sir Roy Gardner was appointed Finance Director of British Gas plc in 1994. From 1995, he had responsibility for the business units which subsequently formed Centrica plc. Prior to joining British Gas, he was Managing Director of GEC-Marconi Ltd and a Director of GEC plc. He is President of Carers UK and Chairman of the Apprenticeship Ambassadors' Network. He is the Senior Independent Director and Chairman designate of Compass Group plc.

3. Helen Alexander CBE

Non-Executive Director (49) A.N.R.

Helen Alexander joined the Board in January 2003. She is Chief Executive of The Economist Group, a Trustee of the Tate Gallery and an Honorary Fellow of Hertford College, Oxford. Formerly, she was a Non-Executive Director of BT Group plc and Northern Foods plc.

4. Phil Bentley

Group Finance Director and Managing Director, Europe (47) D.E.

Phil Bentley joined Centrica plc as Group Finance Director in 2000 and was appointed Managing Director, Europe in July 2004. Formerly, he was Finance Director of UDV Guinness from 1999 and Group Treasurer and Director of Risk Management of Diageo plc from 1997. Previously, he spent 15 years with BP plc. He is a Non-Executive Director of Kingfisher plc.

5. Mark Clare

Managing Director, British Gas Residential Energy (48) E.

Mark Clare joined British Gas plc in 1994 as Group Financial Controller and was appointed Finance Director of Centrica plc in 1997. From November 2000 to December 2001, he was responsible for the development of strategy, financial services and e-commerce. He was appointed Managing Director of British Gas in January 2002. He is a Non-Executive Director of BAA plc, The Energy Saving Trust Ltd and The Energy Retail Association Ltd.

6. Mary Francis CBE

Non-Executive Director (57) A.R.

Mary Francis joined the Board in June 2004. She is a Non-Executive Director of the Bank of England, Aviva plc and St. Modwen Properties plc. She is a Director of Fund Distribution Ltd and a Trustee of the Almeida Theatre. She is a former Director General of the Association of British Insurers. She was previously a senior civil servant in the Treasury and the Prime Minister's Office.

7. Andrew Mackenzie

Non-Executive Director (49) A.R.

Andrew Mackenzie joined the Board in September 2005. He is Chief Executive, Industrial Minerals, at Rio Tinto plc. Previously, he spent 22 years with BP plc in a range of senior technical and engineering positions, and ultimately as Group Vice President, BP Petrochemicals.

8. Patricia Mann OBE

Senior Non-Executive Director (68) A.N.R.

Patricia Mann was a Non-Executive Director of British Gas plc from December 1995 until Centrica plc was demerged in February 1997. She was Vice President International of J Walter Thompson Co Ltd and remains a Director of JWT Trustees Ltd. She is on the Board of the UK Centre for Economic and Environmental Development and National Trust Enterprises, and is a Trustee of the AA Motoring Trust.

9. Paul Rayner

Non-Executive Director (51) A.R. Australian citizen

Paul Rayner joined the Board in September 2004. He has been Finance Director of British American Tobacco plc since January 2002. In 1991 he joined Rothmans Holdings Ltd in Australia, holding senior executive appointments, and became Chief Operating Officer of British American Tobacco Australasia Ltd in September 1999.

10. Jake Ulrich

Managing Director, Centrica Energy (53) E. US citizen

Jake Ulrich was appointed to the Board in January 2005. He was appointed Managing Director of Centrica Energy in 1997. Between 1994 and 1997 he was Managing Director of Accord Energy Ltd, a joint venture between Natural Gas Clearinghouse (NGC) and British Gas plc. He previously worked for NGC, Union Carbide Corporation and the OXY/Mid Con/Peoples Energy Group.

11. Paul Walsh

Non-Executive Director (50) A.N.R.

Paul Walsh joined the Board in March 2003. He is Chief Executive of Diageo plc, having previously been its Chief Operating Officer and having served in a variety of finance roles. He is a Non-Executive Director of Federal Express Corporation, a Governor of the Henley Management Centre and Deputy Chairman of the Prince of Wales International Business Leaders Forum.

Key to membership of committees

A Audit Committee
D Disclosure Committee
E Executive Committee
N Nominations Committee
R Remuneration Committee

Directors' Report

The Directors present their reports and the audited financial statements of Centrica plc for the year ended 31 December 2005.

Directors

The Board of Directors section on page 22 gives details of the current Directors. All served throughout the year except for Andrew Mackenzie who was appointed as a Non-Executive Director on 1 September 2005. Jake Ulrich was appointed an Executive Director on 1 January 2005.

In accordance with the Articles of Association, Helen Alexander, Sir Roy Gardner, Patricia Mann, Paul Walsh and Andrew Mackenzie will retire from office at the 2006 Annual General Meeting (AGM). In accordance with the terms of her re-election at the 2005 AGM, Patricia Mann will not be standing for re-election. As previously announced, Sir Roy Gardner will be retiring as Chief Executive in the summer of 2006. As this will be after the AGM, he will stand for re-election in respect of the period up to his retirement. On the recommendation of the Nominations Committee and the Board, Sir Roy Gardner will be proposed for re-election on that basis, Helen Alexander and Paul Walsh will each be proposed for re-election to serve a further three-year term and, it being the first AGM since his appointment, Andrew Mackenzie will be proposed for election to serve an initial three-year term.

The biographical details of those Directors being proposed for election are given in the notice of AGM (full details of Directors' service contracts, emoluments and share interests can be found in the Remuneration Report on pages 28 to 36).

Directors' indemnities

In accordance with the Company's Articles of Association, the Company entered into a deed of indemnity to the extent permitted by law with each of the Directors and the General Counsel & Company Secretary in January 2006.

The Company purchased and maintained directors' and officers' liability insurance throughout 2005, which was renewed for 2006.

Principal activities

The principal activities during the year were:

- the provision of gas, electricity and energy-related products and services in Great Britain, North America and Europe;
- the operation of gas fields and power stations in Great Britain and North America;
- gas storage in Great Britain;
- energy trading in the UK, European and North American markets; and
- the provision of telecommunications services in the UK.

Business review

The Chairman's Statement on pages 2 and 3, the Chief Executive's Review on pages 4 to 6 and the Operating and Financial Review on pages 8 to 20 report on the activities of the Group during the year, recent events and any likely further business developments.

Financial results

The Group Financial Review on pages 18 to 20 reports on the financial results of the Group.

Dividends

An interim dividend for 2005 of 3.1 pence per share was paid on 16 November 2005. The Directors recommend that, subject to approval at the AGM, a final dividend of 7.4 pence per share will be paid on 14 June 2006 to those shareholders registered on 28 April 2006. This would make a total dividend for the year of 10.5 pence per share (2004: 8.6 pence per share and a special dividend of 25 pence per share).

Major acquisitions and disposals

For full details of acquisitions and disposals, see note 17 on pages 68 to 70 and note 29 on pages 81 to 83, the highlights of which are listed below:

Major acquisitions during the year

- 1 July 2005 – Oxxio BV, a Dutch energy supplier, for £95 million.
- 19 September 2005 – the remaining 40% interest in Humber Power Ltd, for £47 million.
- 28 September 2005 – a 50% stake in the holding company Segebel SA, a joint venture with Gaz de France for a cash consideration of £98 million and the Group's interests in Luminus NV. Segebel SA has a controlling 51% stake in SPE SA, a Belgian energy company.

Major disposals during the year

- 20 May 2005 – British Gas Connections Ltd, for a cash consideration of £90 million.
- 30 December 2005 – Onetel for a total consideration of up to £154 million, of which £130 million of cash was received on completion.

Events after the balance sheet date

Events after the balance sheet date are disclosed in note 36 on page 101.

Related party transactions

Related party transactions are set out in note 33 on pages 89 to 90.

Creditor payment policy

It is the Group's policy to:

- agree the terms of payment in advance with the supplier;
- ensure that suppliers are aware of the terms of payment; and
- pay in accordance with contractual and other legal obligations.

The number of days' purchases outstanding as at 31 December 2005 was 34 (2004: 32) for the Group (excluding Accord Energy Ltd) and 36 days (2004: 34 days) for the Company.

Employment policies

During 2005, the Group employed an average of 35,410 people: 29,948 were employed in the UK; 201 in the rest of Europe; and 5,261 in North America.

The Group is committed to pursuing equality and diversity in all its employment activities and continues to support initiatives to provide employment for people from minority groups in the community, including people with disabilities, carers and lone parents. To the extent possible, people with disabilities are offered the same employment training, career development and promotion opportunities as other employees. Centrica is actively working with a number of organisations in the diversity arena including the Employers' Forum on Disability, the Employers' Forum on Age, Race for Opportunity, Carers UK, Opportunity Now, Working Families and Jobcentre Plus.

The Group's business principles and policies set out standards of behaviour expected of its employees in conducting business in an ethical way. Centrica supports the principles of the UN Global Compact on human rights and labour standards. The Group encourages its business partners and suppliers to respect and follow this approach.

Employees are regularly updated on performance against Group strategy. There are regular employee surveys, action planning forums and dialogue with representatives of local employee consultative bodies and recognised trade unions to ensure a comprehensive understanding of employees' views. Further details of the Group's employment policies and employee communications can be found on page 17.

Employee share schemes

The Group encourages employee share ownership by operating tax authority-approved share schemes open to all eligible employees, including Executive Directors.

Each year, Sharesave enables eligible UK employees to acquire shares in the Company at the end of a three- or five-year savings period. A total of 13,138 employees participate in this scheme.

The Company also operates a Share Incentive Plan (SIP), which enables eligible UK employees to buy Centrica shares, subject to monthly limits, out of pre-tax pay. In addition, the Company awards one free matching share for every two shares an employee buys, subject to a monthly limit of 20 free matching shares. A total of 6,047 employees participate in the SIP.

In North America, the Group operates an Employee Share Purchase Plan (ESPP), which enables eligible Canadian and US employees to buy Centrica shares, subject to monthly limits, out of after-tax pay. In addition, after two years, the Company awards one free matching share for every two purchased shares held. A total of 933 employees participate in the ESPP.

Corporate responsibility

Information relating to the Group's impact on society, the economy and the wider environment is given on pages 16 and 17. A separate Corporate Responsibility report will be published in April 2006 on the Company's website at www.centrica.com/crreport.

Charitable and political donations

An outline of the Group's involvement in the community appears on page 17. Cash donations in the UK during the year amounted to £6.7 million (2004: £5.8 million). In line with Group policy, no donations were made for political purposes. The Group, in the normal course of its business, has paid for its management to attend events at which politicians and other opinion-formers have been present, but does not consider these payments to be political donations.

Share capital

The Company's authorised and issued share capital as at 31 December 2005, together with details of shares issued and repurchased during the year, is set out in note 25 on pages 73 and 74.

Authority to purchase shares

The Company was authorised at the 2005 AGM to purchase its own shares, within certain limits and as permitted by the Articles of Association. A renewal of this authority will be proposed at the 2006 AGM.

A share repurchase programme of up to £500 million, announced on 1 July 2004, was completed on 21 September 2005. A further programme of up to £500 million was announced on 24 June 2005.

A total of 164,654,278 shares, each with a nominal value of $6^{14}/_{81}$ pence, were repurchased and cancelled during the year for an aggregate consideration of £385 million. This comprised 4.36% of the issued share capital. Between 1 January 2006 and 21 February 2006, a further 8,950,000 ordinary shares were repurchased and cancelled for an aggregate consideration of £22.4 million.

Shares repurchased under the programme may be cancelled or retained as treasury shares to accommodate requirements for shares under the Group's share incentive schemes.

Material shareholdings

At 21 February 2006, the following material shareholdings were recorded in the register maintained in accordance with the Companies Act 1985:

Legal & General Group	167,726,791	4.64%
Barclays	145,748,793	4.03%
Petronas	145,000,000	4.01%

Auditors

PricewaterhouseCoopers LLP have expressed their willingness to be reappointed as auditors of the Company. Upon the recommendation of the Audit Committee, a resolution to reappoint them as the Company's auditors and authorise the Directors to determine their remuneration will be proposed at the AGM.

Corporate Governance

The Group is committed to the highest standards of corporate governance. Throughout the year, the Company fully complied with the provisions of the Combined Code on Corporate Governance (the 'Code') and applied its principles as set out in this report.

The Board

An effective Board of Directors leads and controls the Group. The Board, which met ten times during the year, has a schedule of matters reserved for its approval. This schedule and the terms of reference for the Executive, Audit, Remuneration, Nominations and Disclosure Committees are available on request and on our website www.centrica.com.

The Board is responsible for:
- the development of strategy and major policies;
- the review of management performance;
- the approval of the annual operating plan, the financial statements and major acquisitions and disposals;
- the system of internal control; and
- corporate governance.

One of its meetings each year is substantially devoted to the development of strategy. Comprehensive briefing papers, including financial information, are circulated to each Director a week prior to Board meetings. A procedure is in place for Directors to obtain independent professional advice in respect of their duties. They also have access to the advice and services of the General Counsel & Company Secretary.

Overall attendance at meetings during 2005 was: 94% for the Board; 81% for the Audit Committee; 90% for the Remuneration Committee; and 90% for the Nominations Committee. The following Directors gave their apologies for absence in respect of one or more meetings: Helen Alexander (two Audit); Andrew Mackenzie (one Board, one Audit); Patricia Mann (one Remuneration); Paul Rayner (one Board); and Paul Walsh (four Board, two Audit, two Nominations, two Remuneration). Non-attendance at meetings was due to prior business or personal commitments and illness. Directors unable to attend Board or Committee meetings reviewed the relevant papers and provided comments to the Chairman or Committee Chairman, as appropriate. Each of the Non-Executive Directors has given an assurance to the Chairman and the Board that they remain committed to their role as a Non-Executive Director of the Company and will ensure that they devote sufficient time to it, including attendance at Board and Committee meetings.

Board membership

The names of the Directors and their details, including the Board Committees on which they serve, appear on page 22. There is a clear division of responsibilities between the Chairman and the Chief Executive, which has been formalised in writing and agreed by the Board; and there is a balance of Executive and independent Non-Executive Directors.

Throughout the year, the Chairman and the other Non-Executive Directors were independent of management. In December 2005, as part of its annual review of corporate governance, the Board considered the independence of the Non-Executive Directors (other than the Chairman) against the criteria in the Code and determined that each was independent. This position was reached in respect of Patricia Mann notwithstanding that she had served a period exceeding nine years. The Board concluded in its deliberations that she continued to perform effectively and demonstrated the necessary objectivity and commitment to the role of independent Non-Executive Director. Patricia Mann was re-elected at the 2005 AGM for a further period of up to one year only and will retire from the Board at the conclusion of the 2006 AGM.

The senior independent Non-Executive Director throughout the year was Patricia Mann. Responsibilities include being available to shareholders if they have concerns that contact through the normal channels has failed to resolve or for which such contact is inappropriate. Throughout the year, all of the independent Non-Executive Directors were members of the Audit and Remuneration Committees, with the exception of Andrew Mackenzie, who was a member of the Audit Committee only from the date of his appointment to the Board. He was appointed as a member of the Remuneration Committee on 21 February 2006. This membership structure gives the Non-Executive Directors detailed insight into the nature of the matters being discussed, brings continuity to membership and avoids undue reliance on particular individuals. Andrew Mackenzie was kept informed of matters discussed at the Remuneration Committee meetings when the Chairman of that Committee reported on its discussions at the subsequent Board meeting.

Throughout the year, the Non-Executive Directors, including the Chairman, met independently of management on a regular basis.

Board appointments, evaluation and training

There is a formal, rigorous and transparent procedure for the appointment of new Directors to the Board. This is described in the section on the Nominations Committee below. All Directors joining the Board are required to submit themselves for election at the AGM following their appointment. Thereafter, they are subject to re-election every third year. The Non-Executive Directors are initially appointed for a three-year term and, subject to review and re-election, can serve up to a maximum of three such terms. The names of the Directors subject to election and re-election appear on page 23.

During the year, the Board conducted, with the assistance of an independent external facilitator, JCA Group, a formal and rigorous evaluation of its own performance and that of its Committees and individual Directors. The Board evaluation built on the positive results and output of the previous year's evaluation and covered a number of topics including the effectiveness of the Chairman and the Board as a whole, the individual contributions of the Non-Executive and Executive Directors, the mix of skills on the Board, strategy development, risk management, Board processes and links between the Board and the businesses.

The process adopted involved the same facilitator interviewing separately each of the Directors and the General Counsel & Company Secretary. In addition, the senior independent Non-Executive Director chaired a meeting of the independent Non-Executive Directors in the absence of the Chairman to appraise the Chairman's performance. The output from those interviews was compiled into a report prepared by the facilitator and this was presented to the Board at its meeting in October 2005, along with a number of recommendations to address the issues raised.

The report concluded that the Board was evolving well as a team and had improved over the last year in terms of membership, organisation and focus on strategy and key operational issues. The appointment of an additional Non-Executive Director with experience and skills in the Group's upstream business was welcomed. The report also concluded that risk management and control had been given the appropriate level of focus at Board and Committee meetings. The Board will continue to review its procedures, its effectiveness and development in the year ahead.

As part of the performance management system that applies to management at all levels across the Group, the Chief Executive's performance is reviewed regularly by the Chairman and that of the Executive Directors by the Chief Executive.

The Directors receive ongoing training including an induction programme tailored to meet the needs of the individual. At Board meetings, the Directors also receive regular updates on changes and developments to the business, legislative and regulatory environments. During the year, the Board was briefed on: the dynamics of the wholesale gas market; commodity risk and pricing; the risks and opportunities of upstream exploration activities; preparation for International Financial Reporting Standards (IFRS); the Market Abuse regime including the new Listing and Disclosure Rules; Directors' duties and responsibilities; Directors' Indemnities; the Company Law Reform Bill; and the new statutory requirements for a business review.

Board committees

The Board has delegated authority to a number of committees to deal with specific aspects of the management and control of the Group. These committees have specific terms of reference (available on www.centrica.com) and meet on a regular basis. The minutes of the meetings of these committees are made available to all the Directors on a timely basis.

Executive Committee

The Executive Committee comprises the Executive Directors, the General Counsel & Company Secretary, the Managing Director, Centrica North America, the Group Human Resources Director, the Director of Corporate Affairs and the Managing Director, British Gas Services. It is chaired by Sir Roy Gardner. It meets weekly to oversee the management of the Group and is the decision-making body for those matters not reserved to the Board and within the limits set out in the Group's delegated authority and expenditure control policy.

During the year, there were four sub-committees of the Executive Committee: the Group Risk Management Committee; the Group Financial Risk Management Committee;

the Corporate Responsibility Committee; and the Health, Safety and Environment Committee. The membership of those committees is drawn from among the Executive Directors and senior management. With effect from 1 March 2006, the Corporate Responsibility Committee will become a formal committee of the Board, chaired by Mary Francis.

Audit Committee

The Audit Committee comprises the Non-Executive Directors, all of whom are independent, and was chaired throughout the year by Paul Rayner. Andrew Mackenzie became a member of the Committee upon his appointment to the Board. Paul Rayner, the finance director of a FTSE 100 company, is identified as having recent and relevant financial experience, as required by the Code.

The Audit Committee, which reports its findings to the Board, is authorised to:

- monitor the integrity of the interim and annual financial statements, including a review of the significant financial reporting judgements contained in them;
- review the Company's internal financial controls and internal control and risk management systems;
- monitor and review the effectiveness of the Company's internal audit function;
- establish and oversee the Company's relationship with the external auditors, including the monitoring of their independence; and
- monitor matters raised pursuant to the Company's whistleblowing arrangements.

In 2005, the Audit Committee met five times and discharged its responsibilities as set out in its terms of reference. It received comprehensive reports from the Director of Business Assurance, other senior management and the external auditors. The Committee commissioned further reports in response to developing issues, as appropriate, and, in respect of all ongoing issues, requested clear objectives, timetables and achievement milestones against which performance could be monitored.

Significant areas of review during the year included debt management, transition reporting under IFRS and specific issues relating to the implementation of IAS 32 and IAS 39, compliance with the undertakings for Centrica Storage and the development and implementation of the British Gas transformation programme. At two of its meetings, the Committee met with the external auditors in the absence of management. The issues discussed by the Committee and the conclusions reached were reported by the Committee Chairman to the following Board meeting.

Note 6 (iii) to the financial statements on page 57 sets out the Group's policy to seek competitive tenders for all major consultancies and advisory projects. The Board has approved policies that restrict the types of non-audit work that can be undertaken by the external auditors and restrict the employment by the Group of former employees of the external audit firms. The award of non-audit work within categories that the external auditors are permitted to carry out under the Board-approved policies is subject to pre-clearance by the Audit Committee if the fee exceeds specified thresholds. All non-audit assignments awarded to the external auditors are reported to the Audit Committee on a quarterly basis, along with a full breakdown of non-audit fees incurred during the year.

As a matter of best practice and in accordance with International Standard on Auditing (UK & Ireland) 260 and Ethical Statement 1 issued by the Accounting Practices Board, the external auditors have held discussions with the Audit Committee on the subject of auditor independence and have confirmed their independence in writing.

Remuneration Committee

During 2005, the Remuneration Committee comprised Helen Alexander, Mary Francis, Patricia Mann, Paul Rayner and Paul Walsh, all of whom are independent Non-Executive Directors. The Committee met six times during the year and was chaired by Patricia Mann until 30 June 2005 when Helen Alexander was appointed Chairman of this Committee. Andrew Mackenzie was appointed a member of the Committee on 21 February 2006. The role of this Committee and details of how the Company applies the principles of the Code in respect of Directors' remuneration are set out on pages 28 to 36.

Nominations Committee

The Nominations Committee comprises Roger Carr (Chairman), Helen Alexander, Sir Roy Gardner, Patricia Mann and Paul Walsh. Throughout the year, a majority of its members were independent Non-Executive Directors.

The Committee makes recommendations to the Board for the appointment of replacement or additional Directors. The Nominations Committee is also responsible for succession planning and Board evaluation.

During the year, the Committee met four times and considered the reappointment of Directors retiring by rotation at the AGM, the Board evaluation process (described above), succession planning and the appointment of additional Executive and Non-Executive Directors.

The Committee reviews the balance of skills, knowledge and experience on the Board against current and future requirements of the Company and, as appropriate, draws up a list of required attributes. In view of the increasing focus on the Group's upstream activities, the Committee sought to further strengthen and complement the Board in that area with the appointment of another Non-Executive Director. External consultants were engaged in the search for an appropriate individual, leading to the appointment of Andrew Mackenzie in September 2005.

The Committee also considered the succession to Sir Roy Gardner as Chief Executive in view of his forthcoming retirement. External consultants were engaged in connection with this search.

Disclosure Committee

The Board established a Disclosure Committee during the year with responsibility for implementing and monitoring systems and controls in respect of the management and disclosure of inside information. The Committee, which met regularly during the year, is chaired by the Chief Executive. The other members are the Group Finance Director and the General Counsel & Company Secretary.

Relations with shareholders

The Company has a programme of communication with its shareholders. As well as share price information, news releases and annual reports, the Centrica website includes speeches from the AGM, presentations to the investment community and a section for shareholder services.

The Board believes that the AGM presents an important opportunity for dialogue with private shareholders, many of whom are also our customers. At the AGM, the Chairman and the Chief Executive present a review of the businesses of the Group. Representatives from across the Group are available to answer questions both before and after the meeting.

All shareholders have the opportunity to cast their votes at the AGM by proxy, by post or via the internet. Shareholders who hold their shares within CREST can cast their votes by proxy using the CREST electronic proxy appointment service. Shareholders can register to receive their communications online, benefiting both themselves and the Company.

The Company also holds regular meetings with its major shareholders. The Chairman attends the meetings at which the annual and interim results are presented to major investors and analysts. During the year, the Chairman met with a number of major institutional shareholders to gain a first-hand understanding of any issues or concerns they may have had. The Chairman reported his findings to the Board on an ongoing basis. This was in addition to the formal independent reports of investor feedback that are included with the papers for each Board meeting. Late in 2004, the Board commissioned an independent survey of shareholder opinion. The results from this survey were presented to the Board early in 2005 and a number of recommendations were adopted. During January and February 2006, major shareholders were consulted on the introduction of proposed new long-term share-based incentives.

Internal control

The Board of Directors is responsible for the Group's system of internal control, which is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Identification, assessment and management of risks

The Company places great importance on internal control and risk management. A risk-aware and control-conscious environment is promoted and encouraged throughout the Group. The Board, either directly or through its committees, sets objectives, performance targets and policies for management of key risks facing the Group. These include: commodity pricing; competitive position; political and regulatory issues; information systems; financial control; mergers and acquisitions; upstream assets; health and safety; and social, environmental and ethical. At each of its five meetings in 2005, the Audit Committee received an internal control report, which allowed it to track a number of issues and monitor performance against objectives. The Chairman of the Audit Committee reported the issues discussed and conclusions reached at the following Board meeting.

Across the Group, each business has a risk management committee that seeks to identify, assess and advise on the management of operational risks. In addition, the Group Risk Management Committee considers the risks that might affect the Company at Group level. The processes of newly-acquired companies are integrated with those of the Group. Centrica Storage, which is subject to undertakings given to the Secretary of State for Trade and Industry, operates separately but to the same standards of internal control and risk management as the rest of the Group.

Assurance

The business assurance function undertakes internal audit reviews according to a plan approved by the Audit Committee. The results of its work are reported to Audit Committee meetings.

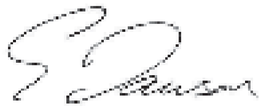
The Board's review of the system of internal control

The Board of Directors, with the advice of the Audit Committee, has reviewed the effectiveness of the system of internal control operated, as described above, throughout the period from 1 January 2005 to the date of this report and is satisfied that the Group complies with the Turnbull Guidance on Internal Control.

Going concern

After making enquiries, the Board has a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. For this reason, we continue to adopt the going concern basis in preparing the financial statements, which are shown on pages 40 to 118.

This Directors' Report has been approved by the Board and signed on its behalf by:



Grant Dawson
General Counsel and Company Secretary
23 February 2006

Registered office:
Millstream
Maidenhead Road
Windsor
Berkshire SL4 5GD
Company registered in England and Wales No. 3033654

Composition and role of the Remuneration Committee

During 2005, the Remuneration Committee comprised Helen Alexander, Mary Francis, Patricia Mann, Paul Rayner and Paul Walsh, all of whom are independent Non-Executive Directors. The Committee met six times during the year and was chaired by Patricia Mann until 30 June 2005 when Helen Alexander was appointed Chairman of the Committee. Andrew Mackenzie was appointed a member of the Committee on 21 February 2006. The Remuneration Committee's terms of reference are available at www.centrica.com.

The Committee makes recommendations to the Board, within formal terms of reference, on the policy and framework of executive remuneration and its cost to the Company. The Committee is also responsible for the implementation of remuneration policy and determining specific remuneration packages for each of the Executive Directors. It has access to the advice and views of the Group Reward Director (Cathy Aldwinckle, who replaced Mike New in July 2005), the Group Human Resources Director (Anne Minto), the General Counsel & Company Secretary (Grant Dawson), the Chief Executive (Sir Roy Gardner) and external consultants.

In 2005, the Committee consulted, but did not formally appoint, Towers Perrin. During the year, the Committee conducted a review of a number of external remuneration consultants. This process resulted in the selection and formal appointment by the Committee in September of Kepler Associates (Kepler) as independent executive remuneration adviser to the Company and the Committee. Both remuneration consultants provided advice on executive compensation to assist in the formulation of the Committee's recommendations.

This report, which will be submitted to the forthcoming AGM for approval, explains how the Company has applied the principles of the Combined Code on Corporate Governance (the 'Code') that relate to Directors' remuneration during the year. No Director is involved in the determination of, or votes on any matter relating to, his or her own remuneration.

Executive Directors' remuneration policy and framework

It is the role of the Committee to ensure that the Group's remuneration policy and framework provides competitive reward for its Executive Directors and other senior executives, taking into account the Company's performance, the markets in which it operates and pay and conditions elsewhere in the Group.

In constructing the remuneration packages, the Committee aims to achieve an appropriate balance between fixed and variable compensation for each executive. Accordingly, a significant proportion of the remuneration package depends on the attainment of demanding performance objectives, both short- and long-term. The annual bonus scheme is designed to incentivise and reward the achievement of demanding financial and non-financial corporate and individual objectives. Long-term share-based incentives are designed to align the interests of Executive Directors and other senior executives with the longer-term interests of shareholders by rewarding them for delivering sustained increased shareholder value.

In agreeing the level of base salaries and the performance-related elements of the remuneration package, the Committee considers the potential maximum remuneration that executives could receive. The Committee reviews the packages and varies individual elements when appropriate from year to year.

The Group's current remuneration policy and framework for Executive Directors and other senior executives, which has been in place since it was approved by shareholders at the 2001 AGM, comprises base salary, annual performance bonus and participation in the Executive Share Option Scheme (ESOS) and Long Term Incentive Scheme (LTIS).

In the second half of 2005, assisted by Kepler and the internal advisers named above, the Committee conducted a thorough review of the Group's executive incentive arrangements to ensure that they: provide a strong alignment with the delivery of value to shareholders; reflect current best practice, while meeting the Group's particular business needs; and enable the Group to continue to attract, retain and motivate high-calibre management in a highly-challenging business environment.

Following this review, the Committee has proposed changes to the future policy and framework of annual and long-term incentive arrangements. The aim of the proposals is to re-balance total remuneration by strengthening the performance-related elements and encouraging executives to invest some of their bonuses in direct shareholdings in the Company. The Committee has consulted with the ABI[1], the RREV[2] and the Company's major shareholders on these proposals.

Subject to shareholder approval at the 2006 AGM of new long-term share-based incentives (full details of which are included in the Notice of Meeting for the 2006 AGM) the Committee has agreed that, in the future, executive remuneration should comprise base salary, annual performance bonus, a new LTIS and a new Deferred and Matching Share Scheme (DMSS). The performance targets, in respect of each of the new schemes (details of which are included in 'Components of remuneration' below) reflect present trading conditions, existing market expectations and current inflation rates. In a period of considerable uncertainty in the global energy markets, the Committee believes that these new targets are stretching, but will review the targets at the beginning of each performance period to ensure they remain so. Performance targets will not be materially adjusted without prior consultation with major shareholders and will be published in the Annual Report. In line with current policy, none of the new schemes will allow the retesting of performance targets.

As a result of these changes, the Committee expects that total remuneration for median performance will remain unchanged, but that total remuneration for upper quartile performance will be increased in line with market practice.

Pursuant to this new policy, it is proposed that awards under the new LTIS commence in 2006 and that the DMSS is operated from 2007 (to replace ESOS), based on the annual performance bonus payable in respect of 2006. From 2006, the maximum payment under the annual performance bonus scheme will be increased by 25% to reflect the proportion of bonus that will be automatically invested in the DMSS.

A grant of options under ESOS will be made in April 2006 in accordance with the 2001 policy, following which, if the new LTIS and the DMSS are approved by shareholders, no further ESOS grants will be made on a regular basis. However, the Committee will retain a general discretion to make grants under ESOS in the future if there are exceptional circumstances in which it considers it appropriate to do so.

As a matter of policy, all Executive Directors and those senior executives immediately below Board level are expected to retain a minimum shareholding in the Company at least equal in value to the executive's base salary. Under the new policy the minimum shareholding requirement will increase to two times base salary for the Chief Executive and 1.25 times base salary for the other Executive Directors. The requirement remains unchanged for senior executives immediately below Board level.

[1] ABI = the Association of British Insurers

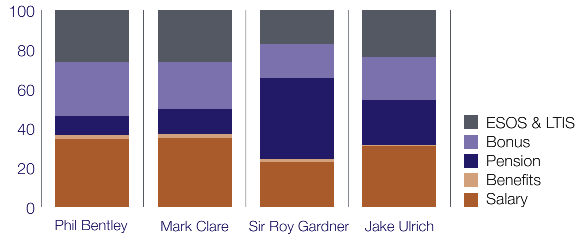
[2] RREV = Research, Recommendations, Electronic Voting – a joint venture between the National Association of Pension Funds and Institutional Shareholder Services

Executive Directors also participate in a contributory, final salary pension scheme (details of which are given on page 36).

The Committee believes that these arrangements, which are further explained below, are important in providing a potential remuneration package that will attract, retain and continue to motivate Executive Directors and other senior executives in a marketplace that is challenging and competitive in both commercial and human resource terms. It is intended that this new remuneration policy and framework, which is fully endorsed by the Board, will continue for 2006 and succeeding years.

In 2005, the total emoluments of the Executive Directors, detailed on page 32, consisted of components in the following proportions:

Relative proportions of the components of each Executive Director's remuneration: 2005



Note: Salary and benefits are the actual amounts received during 2005; pension is the increase in actual transfer value for 2005 over the notional transfer value for 2004 less the Director's contributions during 2005; performance bonus is that payable in respect of 2005; and ESOS and LTIS are the estimated value, based on a Black-Scholes model, of the awards made in 2005, provided that all performance conditions are met in full at the end of the relevant performance periods.

The total emoluments of the Executive Directors are disclosed on page 32. The total emoluments of the four senior executives immediately below Board level for 2005, calculated on the same basis as those of the Executive Directors, fell into the following bands:

Bands £000	No. of senior executives
700-800	1
600-700	–
500-600	2
400-500	–
300-400	–
200-300	1

Note: One senior executive served for only six months of the year and accordingly only the amount received by the individual in respect of that period is shown above.

Components of remuneration

Base salary

The Committee seeks to establish a base salary for each Executive Director and other senior executives, determined by individual performance and having regard to market salary levels for similar positions in comparable companies derived from independent sources. Base salaries are reviewed annually. Base salary is the only element of remuneration that is pensionable.

Annual performance bonus

At the beginning of each year, the Committee reviews the annual performance bonus scheme to ensure that it remains competitive in the marketplace, continues to incentivise the Executive Directors and other senior executives and aligns their interests with those of shareholders. For 2005, the maximum bonus payable to Executive Directors, should every single element of every objective be achieved in full, was 100% of base salary. In 2005, 65% of the maximum bonus achievable related to financial performance targets, 25% to customer and employee satisfaction levels and 10% to personal performance. For Executive Directors with specific business responsibilities, the scheme is structured to reflect the performance of their business as well as that of the Group. The maximum bonus payable to other senior executives immediately below Board level, assuming all objectives are achieved in full, ranges between 80% and 100%, with the three performance categories in the same proportions as those for the Executive Directors.

Pursuant to the new policy (described on pages 28 and 29) and commencing in respect of 2006, the Committee has agreed to increase the maximum amount of annual bonus payable to Executive Directors, upon the attainment in full of challenging targets, from 100% of base salary to 125% of base salary. Similarly, the maximum bonus payable to other senior executives will increase from a range of between 80% and 100% to a range of between 100% and 125% of base salary. 20% of any annual bonus paid (representing the increased portion of the annual bonus) will be invested automatically in the DMSS. The Committee has also changed the bonus structure for Executive Directors and executives immediately below Board level. The maximum achievable bonus will relate to financial performance targets and business-related targets split, 65% and 35% respectively for Executive Directors and 60% and 40% respectively for executives immediately below Board level. In line with current policy, a bonus will be forfeited if overall performance is deemed to be unsatisfactory.

Following the adoption of IFRS in 2005, the Committee agreed, having taken advice from Kepler and having consulted with the ABI and the RREV, to continue with the financial target of economic profit calculated in accordance with IFRS adjusted for exceptional items and certain re-measurements arising on the application of IAS 32 and IAS 39 (see the footnote to the Group Income Statement on page 40, note 3 on pages 51 and 52 and note 7 on pages 57 and 58) excluded on the grounds that such standards do not represent the underlying performance of the business.

Deferred and Matching Share Scheme (DMSS)

Subject to shareholder approval at the 2006 AGM, it is proposed to introduce a DMSS pursuant to which 20% of the annual bonus paid to Executive Directors and other senior executives will be deferred automatically for a period of three years and invested in Centrica shares (deferred shares), during which time they cannot normally be withdrawn. Participants may elect to invest an additional amount in the DMSS to be contributed from actual bonus paid or shares released from the LTIS only, which when added to the value of the deferred shares, will bring the total amount invested up to 50% of the individual's maximum bonus entitlement in respect of the preceding year. Deferred and invested shares will be matched with conditional shares, which will be released to the extent that demanding Group economic profit performance targets are achieved over a three-year period. The number of matching shares that would vest will be determined on a straight-line basis from a zero match for no growth in economic profit to a two-times match for growth of 25% or above. To provide a closer alignment with the interests of shareholders, the number of conditional matched shares that are released following the satisfaction of the performance condition will be increased to reflect the dividends that would have been paid during the three-year performance period.

It is proposed that the DMSS will operate in 2007, based on the annual performance bonus paid in respect of 2006.

Executive Share Option Scheme (ESOS)

In accordance with the remuneration policy adopted in 2001, grants of options have been made annually to Executive Directors and other senior executives under ESOS. If, and to the extent that, performance conditions are satisfied, options normally become exercisable three years after the date of grant and remain so until the tenth anniversary of grant. Performance conditions are based on the extent to which growth in the Company's earnings per share (EPS growth) exceeds growth in the Retail Prices Index (RPI growth) over a three-year performance period.

Following the adoption of IFRS in 2005, the Committee agreed that EPS remains an appropriate, objective, independent and verifiable measure of the Company's performance. However, having taken advice from Kepler and having consulted with the ABI and the RREV, the Committee agreed that EPS should be calculated as fully-diluted earnings per share, adjusted for exceptional items and certain re-measurements arising on the application of IAS 32 and IAS 39 (see the footnote to the Group Income Statement on page 40, note 3 on pages 51 and 52, note 7 on pages 57 and 58 and note 12 on pages 61 and 62) excluded on the grounds that such standards do not represent the underlying performance of the business.

In respect of each grant of options, the Committee has determined that, for the option to be exercisable in full, EPS growth must exceed RPI growth by 18 percentage points or more over the three-year performance period. No part of the option grant will be exercisable if EPS growth fails to exceed RPI growth by at least 9 percentage points over the performance period. The proportion of the option grant exercisable by the executive will increase on a sliding scale between 40% and 100% if EPS growth exceeds RPI growth by between 9 and 18 percentage points over the performance period.

Options granted from 2001 to March 2004 under the ESOS permitted the Company's EPS to be measured annually for a further two years from the date of grant of the options, with the performance conditions increasing proportionately. Having reviewed market practice regarding the retesting of performance measures, the Committee removed this element in respect of all option grants from September 2004. The Committee continues to believe that, in relation to the ESOS, EPS growth in excess of RPI growth is the most appropriate measure for determining the increase in value delivered to shareholders by the Company's Executive Directors and other senior executives. The Committee reviews the appropriateness of the performance measure and the specific targets set when considering each new grant of options.

In April 2005, options were granted to each Executive Director equal to 200% of base salary and, at the same or lower rates, to certain other senior executives. Details of options granted to Executive Directors are shown on page 35.

As reported in the section on policy and framework above, it is not intended to make further grants under this scheme after April 2006, other than in exceptional circumstances.

Long Term Incentive Scheme (LTIS)

In accordance with the remuneration policy adopted in 2001, allocations of shares have been made annually to Executive Directors and other senior executives under the LTIS. These awards are subject to challenging performance conditions based on the Company's total shareholder return (TSR) relative to the returns of a comparator group over a three-year period. Accordingly, executives are not rewarded unless the Company has outperformed its peers in respect of share price movements and dividend payments. The Committee has determined that, for the purpose of the LTIS, the most appropriate comparator group for the Company is the companies comprising the FTSE 100 at the start of the relevant performance period (the LTIS comparator group). The Committee reviews the appropriateness of the performance measure and the specific target set when considering each new allocation of shares under the LTIS.

Allocations made prior to May 2001 were subject to a performance period of either three or four years (at the participant's choice), followed by a retention period of two years. Changes to these arrangements were approved at the 2001 AGM. Allocations made from May 2001 are released to the participant under normal circumstances after the three-year performance period, provided, and to the extent that, the performance conditions have been met. However, prior to the release of share allocations, the Committee reviews whether the extent to which the performance condition has been achieved is a genuine reflection of the Company's financial performance. In assessing the extent of satisfaction of the performance condition, the Committee uses data provided by Alithos Ltd.

The actual number of shares released to the participant depends on the Company's TSR over the performance period relative to the LTIS comparator group. The maximum annual allocation of shares only vests and is released to the executive if the Company's TSR over the performance period is ranked in 25th position or above relative to the 99 other companies in the LTIS comparator group. No shares vest if the TSR over the performance period is ranked below 50th position in the LTIS comparator group. Between 25th and 50th position, shares vest on a sliding scale from 100% to 40%.

In April 2005, LTIS allocations equal to 75% of base salary were awarded to Executive Directors and, at the same or lower rates, to certain other senior executives. The maximum number of shares that could be transferred to each Executive Director upon satisfaction of the performance conditions appears on page 34.

Subject to shareholder approval at the 2006 AGM, it is proposed to introduce a new LTIS pursuant to which conditional allocations of shares up to a maximum of 200% of base salary may be made to Executive Directors and other senior executives. However, the maximum award in 2006 will be limited to 150%.

The release of allocations made under the new LTIS will be subject to performance over a three-year period:

- half of the shares in each allocation will be subject to a performance condition based on the Company's growth in EPS relative to the growth in RPI. To vest in full, EPS growth must exceed RPI growth by 30 percentage points or more over the performance period. No part of the award will vest if EPS growth fails to exceed RPI growth by at least 9 percentage points over the performance period. The proportion of the award that will vest will increase on a straight-line basis between 25% and 100% if EPS growth exceeds RPI growth by between 9 and 30 percentage points over the performance period; and
- the other half of the shares in each allocation will be subject to a performance condition based on the Company's TSR performance relative to the other 99 companies in the FTSE 100 on the date of award with vesting reducing on a straight-line basis from 100% for upper quintile ranking to 25% for median-ranking performance.

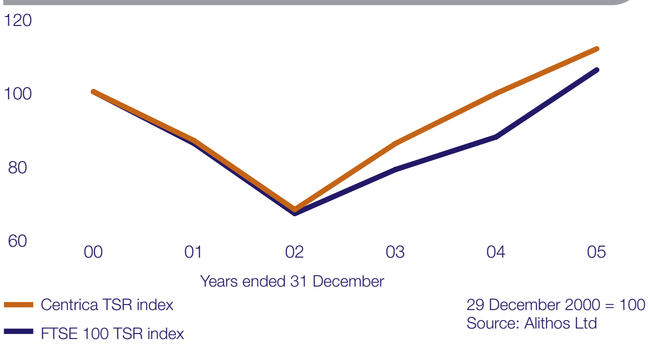
In order to create a closer alignment with the interests of shareholders, the number of shares that are released following the satisfaction of the performance conditions will be increased to reflect the dividends that would have been paid during the three-year performance period.

Funding of share schemes

In order to satisfy the release of shares under the LTIS in 2005, the trustee of the scheme used shares that had been acquired in the market, both prior to and during the year. Newly-issued shares were used throughout the year to meet the requirements of the ESOS.

It is the Company's current intention to satisfy the share requirements of the above schemes by either acquiring shares in the market or, subject to institutional guidelines, using shares held in treasury. However, new shares may be used, subject to institutional guidelines, if it is in the interests of the Company to do so.

Total return indices – Centrica and FTSE 100



The above graph compares the Company's TSR performance with that of the FTSE 100 Index for the five years ended 31 December 2005.

As required by Schedule 7A of the Companies Act 1985, a rolling definition of the FTSE 100 has been used, whereas the definition used for the purposes of the LTIS is the FTSE 100 as constituted at the beginning of the period. In order to demonstrate the delivery of shareholder value during the relevant performance periods, the TSR graphs for the LTIS awards that vested in April and October 2005 are shown on page 34.

Pension

Executive Directors also participate in a contributory, final salary pension scheme (details of which, including the changes brought about by the Finance Act 2004, are given on page 36).

Other employment benefits

In common with other senior management, Executive Directors are entitled to a range of benefits, including a company car, life assurance, private medical insurance and a financial counselling scheme. They are also eligible to participate in the Company's HMRC-approved Sharesave Scheme and Share Incentive Plan, which are open to all eligible employees on the same basis, providing a long-term savings and investment opportunity.

Service contracts

It is the Company's policy that the notice period in Executive Directors' service contracts does not exceed one year. As permitted by the Code, the Committee retains a level of flexibility in order to offer contracts to new Executive Directors that contain an initial notice period in excess of one year, provided that after the first such period the notice period reduces to one year.

The Executive Directors' service contracts have no fixed term but provide that either the Director or the Company may terminate the employment by giving one year's written notice and that the Company may pay compensation in lieu of notice.

The dates of the Executive Directors' service contracts are set out in the table on page 32.

It was announced on 15 September 2005 that Sir Roy Gardner will retire as the Company's Chief Executive in the summer of 2006. In view of his forthcoming retirement, Sir Roy Gardner will not participate in any further awards under the long-term share-based incentive arrangements. Upon retirement, he will be entitled to a pension based on his accrued pension entitlement at that date (see page 36) and, subject to the relevant rules and performance conditions, shares in each of the share incentive arrangements in which he participates (see pages 34 and 35). No other payments will be made to him.

External appointments of Executive Directors

The Board believes that experience of other companies' practices and challenges is valuable both for the personal development of its Executive Directors and for the Company. It is therefore the Company's policy to allow each Executive Director to accept one non-executive directorship of another company, although the Board retains the discretion to vary this policy. Fees received in respect of external appointments are retained by the individual Director.

In 2005, Phil Bentley received £52,000 as a Non-Executive Director of Kingfisher plc, Mark Clare received £58,500 as a Non-Executive Director of BAA plc and Sir Roy Gardner received £66,667 as Chairman of Manchester United plc and £25,000 as a Non-Executive Director of Compass Group plc (a position he accepted after his departure from Manchester United plc).

Non-Executive Directors

Non-Executive Directors including the Chairman do not hold service contracts. Their appointment is subject to the Articles of Association and the dates they joined the Board are shown in the table on page 32. Roger Carr's letter of appointment contains a six-month notice period. The fees of the Non-Executive Directors are approved by the Board, upon the recommendation of the Executive Committee, whose members are: the Executive Directors (Phil Bentley, Mark Clare, Sir Roy Gardner and Jake Ulrich); and four other senior executives (Grant Dawson, General Counsel & Company Secretary, Deryk King, Managing Director, North America, Anne Minto, Group Human Resources Director and Chris Weston, Managing Director, British Gas Services).

Centrica's policy on Non-Executive Directors' fees takes into account not only the need to attract individuals of the right calibre and experience, but also their responsibilities and time commitment, as envisaged in the Code, and the fees paid by other companies.

The current annual fees payable to the Non-Executive Directors are:

Chairman	£250,000
Other Non-Executive Directors:	
Base fee	£50,000
Chairman of Audit Committee	£15,000
Chairman of Remuneration Committee	£10,000

The fees are normally reviewed every two years. The Non-Executive Directors, including the Chairman, do not participate in any of the Company's share schemes, incentive plans or pension schemes.

The Remuneration Report from page 28 to page 31 up to this statement has not been audited. From this point until the end of the report on page 36, the disclosures, with the exception of the graphs on page 34, have been audited by the Company's auditors, PricewaterhouseCoopers LLP.

Directors' emoluments

		Base salary/fees £000	Annual performance bonus £000	Benefits (i) £000	**Total emoluments (ii) 2005 £000**	Total emoluments (ii) 2004 £000
Executive Directors	Date of service contract					
Phil Bentley	13 September 2000	500	401	31	**932**	931
Mark Clare	21 March 2001	498	337	33	**868**	870
Sir Roy Gardner	21 March 2001	884	668	64	**1,616**	1,623
Jake Ulrich	1 January 2005	511	363	7	**881**	–
		2,393	1,769	135	**4,297**	3,424
Non-Executive Directors	Date of appointment					
Helen Alexander	1 January 2003	55	–	–	**55**	39
Roger Carr	1 January 2001	250	–	–	**250**	173
Mary Francis	22 June 2004	50	–	–	**50**	22
Andrew Mackenzie	1 September 2005	17	–	–	**17**	–
Patricia Mann	4 December 1996	55	–	–	**55**	41
Paul Rayner (iii)	23 September 2004	65	–	–	**65**	17
Paul Walsh	1 March 2003	50	–	–	**50**	39
		542	–	–	**542**	331
Directors who stood down in 2004						
Sir Michael Perry		–	–	–	**–**	72
Robert Tobin		–	–	–	**–**	26
Roger Wood		–	–	–	**–**	750
		–	–	–	**–**	848
Total emoluments		2,935	1,769	135	**4,839**	4,603

(i) Benefits include all taxable benefits arising from employment by the Company, including the provision of a car, financial counselling, medical insurance and life assurance premiums.

(ii) The following are excluded from the table above:
- (a) pensions – see page 36;
- (b) share options – see page 35. The aggregate of the amount of gains made by Executive Directors on the exercise of share options was £nil (2004: £258,854); and
- (c) Long Term Incentive Scheme (LTIS) – see pages 33 and 34. The aggregate value of shares vested to Executive Directors under the LTIS was £2,906,606 (2004: £1,862,490).

(iii) Paul Rayner's fees were paid to his employer, British American Tobacco plc.

Directors' interests in shares

The following table and the tables on pages 34 and 35 show the beneficial interests of the Directors who held office at the end of the year in the ordinary shares of the Company and the interests of the Executive Directors who served during the year in the Company's share schemes:

Directors as at 31 December 2005	**Shareholdings as at 31 December 2005**	Shareholdings as at 1 January 2005 or on appointment (i)	**LTIS total allocations as at 31 December 2005**	LTIS total allocations as at 1 January 2005
Executive Directors				
Phil Bentley (ii)	**342,789**	188,454	**556,106**	663,501
Mark Clare (ii)	**804,138**	641,118	**558,338**	702,190
Sir Roy Gardner (ii)	**2,175,892**	2,175,014	**981,655**	1,157,644
Jake Ulrich (ii)	**693,871**	527,936	**574,213**	718,696
Non-Executive Directors				
Helen Alexander	**2,520**	2,520	**–**	–
Roger Carr	**19,230**	19,230	**–**	–
Mary Francis	**981**	981	**–**	–
Andrew Mackenzie	**21,000**	–	**–**	–
Patricia Mann	**1,927**	1,927	**–**	–
Paul Rayner	**5,000**	–	**–**	–
Paul Walsh	**4,500**	4,500	**–**	–

(i) Shareholdings are shown as at 1 January 2005 or, in the case of Andrew Mackenzie, 1 September 2005, being his date of appointment.

(ii) As at 23 February 2006, the beneficial shareholdings of Phil Bentley, Mark Clare, Sir Roy Gardner and Jake Ulrich had each increased by 130 shares acquired through the Share Incentive Plan.

(iii) As at 31 December 2005, nil shares and 2,591 shares (1 January 2005: 6,370,264 and 2,548) were held by the respective Trustees of employee share trusts for the purposes of the LTIS and the Share Incentive Plan. As with other employees, the Executive Directors are deemed to have a potential interest in those shares, being beneficiaries under the trust. As at 21 February 2006, 863 shares were held by the trustee of the Share Incentive Plan.

(iv) From 1 January 2005 to 23 February 2006, none of the Directors had any beneficial interests in the Company's securities other than ordinary shares, nor any non-beneficial interests in any of the Company's securities, nor in those of its subsidiary or associated undertakings.

The following table gives details of the LTIS allocations held by Executive Directors who served during the year:

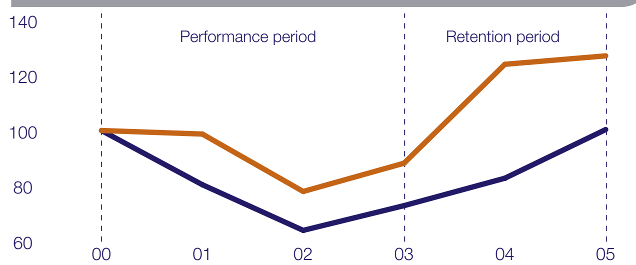
	Vested during 2005		In performance period		
Date of allocation	2 October 2000 (i), (iii)	2 April 2002 (ii), (iii)	1 April 2003 (iv)	1 April 2004 (iv)	1 April 2005 (iv)
Phil Bentley	136,253	104,916	228,891	161,569	165,646
Mark Clare	166,066	108,754	231,434	162,898	164,006
Sir Roy Gardner	234,707	179,125	401,831	287,566	292,258
Jake Ulrich	168,280	111,313	239,064	166,223	168,926
Market price at allocation date	220.50p	227.00p	148.00p	232.00p	228.00p
End of performance period (iv)	1 Oct 03	1 Apr 05	31 Mar 06	31 Mar 07	31 Mar 08
Market price at vesting date (v)	246.50p	234.75p			

(i) At the end of the performance period to 1 October 2003, the Company ranked fortieth in the relevant comparator group. Accordingly, 75% of the original allocations were released following the expiry of the two-year retention period.
(ii) At the end of the performance period to 1 April 2005, the Company ranked thirty-ninth in the relevant comparator group. Accordingly, 76.7% of the original allocations were released to participants.
(iii) The released shares were subject to income tax at the individual's marginal rate and National Insurance contributions (NICs) at the rate of 1%, based on the market value of the shares at the date of vesting. The income tax and NICs liability was satisfied by the sale of sufficient shares and, accordingly, the Executive Directors only received the net number of shares following disposal, which, to the extent retained, is reflected in the shareholdings as at 31 December 2005 on page 33.
(iv) At the end of the performance period the Company's TSR performance will be assessed against that of the relevant LTIS comparator group. If, and to the extent that, the performance conditions are met, the relevant number of shares will be released to the Directors at the Trustee's discretion as soon as practicable thereafter.
(v) The vesting date was 3 October 2005 in relation to the 2000 allocation and 7 April 2005 in relation to the 2002 allocation.

The following graphs, provided by Alithos Ltd (an independent third party), show the TSR performance of the Company and that of the relevant TSR comparator group. They have not been audited by the Company's auditors, PricewaterhouseCoopers LLP. They relate to the LTIS allocations that vested in 2005 in relation to the 2000 allocation and the 2002 allocation:

TSR indices – Centrica and LTIS comparator group:

October 2000 LTIS allocation



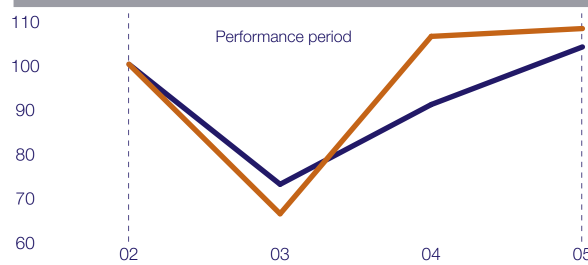
Period from 30 September 2000 to 30 September 2005

Centrica return index

LTIS comparator group (FTSE 100 companies as at 2000)

30 Septmber 2000 = 100
Source: Alithos Ltd

April 2002 LTIS allocation



Period from 1 April 2002 to 1 April 2005

Centrica return index

LTIS comparator group (FTSE 100 companies as at 2002)

1 April 2002 = 100
Source: Alithos Ltd

Directors' interests in share options

Full details of the options over ordinary shares in the Company held by Executive Directors who served during the year, and any movements in those options in the year, are shown below:

	Options held as at 1 January 2005	Options granted during year	Options exercised during year	**Options held as at 31 December 2005**	Exercise price (pence)	Date from which exercisable	Expiry date
Phil Bentley							
ESOS (i)	308,269	–	–	**308,269**	240.05	Jun 2004	May 2011
ESOS (i)	364,768	–	–	**364,768**	224.80	Apr 2005	Apr 2012
ESOS (i)	559,345	–	–	**559,345**	146.60	Mar 2006	Mar 2013
ESOS (i)	401,875	–	–	**401,875**	223.95	Mar 2007	Mar 2014
ESOS (i)	–	441,723	–	**441,723**	228.65	Apr 2008	Apr 2015
Sharesave (ii)	5,161	–	–	**5,161**	182.60	Jun 2007	Nov 2007
	1,639,418	441,723		**2,081,141**			
Mark Clare							
ESOS (i)	329,098	–	–	**329,098**	240.05	Jun 2004	May 2011
ESOS (i)	378,113	–	–	**378,113**	224.80	Apr 2005	Apr 2012
ESOS (i)	579,809	–	–	**579,809**	146.60	Mar 2006	Mar 2013
ESOS (i)	406,340	–	–	**406,340**	223.95	Mar 2007	Mar 2014
ESOS (i)	–	437,349	–	**437,349**	228.65	Apr 2008	Apr 2015
Sharesave (ii)	9,318	–	–	**9,318**	177.60	Jun 2007	Nov 2007
	1,702,678	437,349	–	**2,140,027**			
Sir Roy Gardner							
ESOS (i)	508,227	–	–	**508,227**	240.05	Jun 2004	May 2011
ESOS (i)	622,775	–	–	**622,775**	224.80	Apr 2005	Apr 2012
ESOS (i)	954,979	–	–	**954,979**	146.60	Mar 2006	Mar 2013
ESOS (i)	705,514	–	–	**705,514**	223.95	Mar 2007	Mar 2014
ESOS (i)	–	779,357	–	**779,357**	228.65	Apr 2008	Apr 2015
Sharesave (ii)	9,318	–	–	**9,318**	177.60	Jun 2007	Nov 2007
	2,800,813	779,357	–	**3,580,170**			
Jake Ulrich							
ESOS (i)	337,429	–	–	**337,429**	240.05	Jun 2004	May 2011
ESOS (i)	387,010	–	–	**387,010**	224.80	Apr 2005	Apr 2012
ESOS (i)	593,451	–	–	**593,451**	146.60	Mar 2006	Mar 2013
ESOS (i)	419,736	–	–	**419,736**	223.95	Mar 2007	Mar 2014
ESOS (i)	–	450,470	–	**450,470**	228.65	Apr 2008	Apr 2015
Sharesave (ii)	8,823	–	–	**8,823**	107.10	Jun 2006	Nov 2006
	1,746,449	450,470	–	**2,196,919**			

(i) **Executive Share Option Scheme (ESOS)**
Options were granted to the Executive Directors under the terms of the ESOS on 31 May 2001, 2 April 2002, 24 March 2003, 18 March 2004 and 1 April 2005. Details of the operation of the scheme are provided on page 30.

(ii) **Sharesave Scheme**
The Company operates an HMRC-approved all-employee savings-related share option scheme in the UK. The scheme is designed to provide a long-term savings and investment opportunity for employees and is described on page 24.

The closing price of a Centrica ordinary share on the last trading day of 2005 (30 December) was 254.75 pence. The range during the year was 264.75 pence (high) and 217.5 pence (low).

Directors' pensions

The pension arrangements for the Executive Directors, all of whom are now members of the Centrica Management Pension Scheme, are shown below. The Centrica Management Pension Scheme is a funded, HMRC-approved, final salary, occupational pension scheme. Its rules provide for the following main features:

- normal retirement at age 62;
- right to an immediate, unreduced pension on leaving service after age 60 at own request with employer consent, or on leaving service at the Company's request after age 55;
- life assurance cover of four times pensionable salary for death in service;
- spouse's pension on death in service payable at the rate of 50% of the member's prospective pension and, on death after retirement, half of the accrued pension. Children's pensions are also payable;
- members' contributions payable at the rate of 6% of pensionable earnings;
- pension payable in the event of retirement due to ill health;
- pensions in payment and in deferment guaranteed to increase in line with the increase in the RPI (a maximum of 6% applies to pension accrued after 6 April 2004); and
- no discretionary practices are taken into account in calculating transfer values.

All benefits are subject to HMRC limits and the Centrica Unapproved Pension Scheme (CUPS) provides benefits on the salary in excess of the earnings cap to the level that would otherwise have been paid by the approved scheme. The benefits that arise under this are treated as being subject to the same rules as apply in respect of the approved portion of members' benefits. No individual will receive benefits from Centrica which, when added to their retained benefits elsewhere, exceed two-thirds of their final pensionable earnings. CUPS is unfunded but the benefits are secured by a charge over certain Centrica assets. An appropriate provision in respect of their accrued value has been made in the Company's balance sheet.

Finance Act 2004

As a result of the changes brought about by the Finance Act 2004, Centrica intends to maximise the scope within the new Life Time Allowance (LTA) of £1.5 million, by delivering some of the benefits currently provided via CUPS through the approved arrangement, the Centrica Management Pension Scheme. Centrica will not however transfer any CUPS liabilities in excess of this Allowance which would result in a higher tax rate being paid on the benefits. With effect from 6 April 2006, the contributions made by members of CUPS will not be restricted to the maximum rate of 15% of the earnings cap and from that date their contributions will be based at the rate of 6% of their total pensionable earnings.

Pension benefits earned by Directors (£)

	Accrued pension as at 31 December 2005 (i)	Accrued pension as at 31 December 2004	Increase in accrued pension (ii)	**Transfer value as at 31 December 2005**	Transfer value as at 31 December 2004	**Contributions paid in 2005 (iii)**	Difference in transfer value less contributions	Transfer value of the increase in accrued pension excluding inflation (iv)
Phil Bentley (v)	**85,800**	70,000	13,900	**764,500**	607,700	**15,705**	141,095	88,600
Mark Clare (v)	**138,100**	123,100	11,700	**1,221,100**	1,020,600	**15,705**	184,795	75,900
Sir Roy Gardner (v)	**382,900**	335,800	38,000	**7,740,100**	6,138,200	**15,705**	1,586,195	679,000
Jake Ulrich (v), (vi)	**154,400**	131,400	19,500	**1,735,600**	1,344,300	**15,705**	375,595	181,300

(i) Accrued pension is that which would be paid annually on retirement at age 62, based on eligible service to 31 December 2005.
(ii) The increase in accrued pension has been adjusted to exclude inflation by revaluing the figure in the second column by the rate of inflation (2.7% – see note iv) and deducting this from the figure in the first column.
(iii) Member contributions paid in the year were restricted to the maximum rate of 15% of the earnings 'cap'.
(iv) The rate of inflation used was 2.7%, the annual rate to 30 September 2005, the date used for pension increases under the scheme. The actual transfer value of the increase in accrued pension at 31 December 2005 excludes inflation.
(v) The pension accrual rates applicable in the Centrica Management Pension Scheme for Phil Bentley, Mark Clare, Sir Roy Gardner and Jake Ulrich were, respectively, 2.65%, 2.46%, 4.11% and 3.71% of pensionable earnings for each year of pensionable employment.
(vi) Jake Ulrich was appointed to the Board of Directors with effect from 1 January 2005.

This report on remuneration has been approved by the Board of Directors and signed on its behalf by:

Grant Dawson
General Counsel and Company Secretary
23 February 2006

Statement of Directors' Responsibilities

Company law requires the Directors to prepare Financial Statements for each financial year that give a true and fair view of the state of affairs of the Company and the Group and of the profit or loss of the Group 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; and
- prepare the Financial Statements on the going concern basis, unless it is inappropriate to presume that the Group will continue in business. The Directors confirm that they have complied with the above requirements in preparing the Financial Statements.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and the Group and enable them to ensure that the Financial Statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report to the shareholders of Centrica plc

We have audited the Group Financial Statements of Centrica plc for the year ended 31 December 2005 which comprise the Group Income Statement, the Group Balance Sheet, the Group Cash Flow Statement, the Group Statement of Recognised Income and Expense and the related notes. These Group Financial Statements have been prepared under the accounting policies set out therein.

We have reported separately on the parent Company Financial Statements of Centrica plc for the year ended 31 December 2005 and on the information in the Directors' Remuneration Report that is described as having been audited.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report and the Group Financial Statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the Group Financial Statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's shareholders 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 Group Financial Statements give a true and fair view and whether the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' Report is not consistent with the Group Financial Statements, 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 other transactions is not disclosed.

We review whether the Corporate Governance Statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the Annual Report and consider whether it is consistent with the audited Group Financial Statements. The other information comprises only the Directors' Report, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Chief Executive's Review, the Operating and Financial Review, the Group Financial Review, the Corporate Governance Statement and the Gas and Liquids Reserves. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the Group Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the Group Financial Statements. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the Group Financial Statements, and of whether the accounting policies are appropriate to the Group'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 Group 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 Group Financial Statements.

Opinion

In our opinion:

- the Group Financial Statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the Group's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended; and
- the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation.

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
23 February 2006

Financial Statements

Group Income Statement

Year ended 31 December	Notes	2005 Results for the year before exceptional items and certain re-measurements (i) £m	2005 Exceptional items and certain re-measurements (i) £m	2005 Results for the year £m	2004 Results for the year before exceptional items and certain re-measurements (i) £m	2004 Exceptional items and certain re-measurements (i) £m	2004 Results for the year £m
Continuing operations							
Group revenue	5	**13,448**	**–**	**13,448**	11,361	–	11,361
Cost of sales		**(9,793)**	**–**	**(9,793)**	(7,962)	–	(7,962)
Re-measurement of energy contracts (i)	7	**–**	**456**	**456**	–	–	–
Gross profit		**3,655**	**456**	**4,111**	3,399	–	3,399
Operating costs before exceptional items		**(2,180)**	**–**	**(2,180)**	(2,093)	–	(2,093)
Contract renegotiation	7	**–**	**42**	**42**	–	–	–
Profit on disposal of business	7	**–**	**47**	**47**	–	–	–
Business restructuring costs	7	**–**	**(100)**	**(100)**	–	(100)	(100)
Gas field impairment	7	**–**	**–**	**–**	–	(50)	(50)
Renegotiation provision	7	**–**	**–**	**–**	–	51	51
Operating costs		**(2,180)**	**(11)**	**(2,191)**	(2,093)	(99)	(2,192)
Share of profits in joint ventures and associates, net of interest and taxation		**38**	**(1)**	**37**	56	–	56
Group operating profit	5,6	**1,513**	**444**	**1,957**	1,362	(99)	1,263
Interest income		**102**	**–**	**102**	82	–	82
Interest expense (i)		**(247)**	**–**	**(247)**	(186)	–	(186)
Net interest expense	9	**(145)**	**–**	**(145)**	(104)	–	(104)
Profit from continuing operations before taxation		**1,368**	**444**	**1,812**	1,258	(99)	1,159
Taxation on profit from continuing operations	10	**(706)**	**(138)**	**(844)**	(547)	26	(521)
Profit from continuing operations after taxation		**662**	**306**	**968**	711	(73)	638
Profit from discontinued operations		**11**	**–**	**11**	67	(5)	62
Gain on disposal of discontinued operations	7	**–**	**34**	**34**	–	911	911
Discontinued operations	5	**11**	**34**	**45**	67	906	973
Profit for the year		**673**	**340**	**1,013**	778	833	1,611
Attributable to:							
Equity holders of the parent		**672**	**340**	**1,012**	758	833	1,591
Non-equity minority interests		**–**	**–**	**–**	18	–	18
Minority interests		**1**	**–**	**1**	2	–	2
		673	**340**	**1,013**	778	833	1,611
		Pence		**Pence**	Pence		Pence
Earnings per ordinary share							
From continuing and discontinued operations:							
Basic	12			**27.4**			38.0
Adjusted basic	12	18.2			18.1		
Diluted	12			**27.0**			37.4
From continuing operations:							
Basic	12			**26.2**			14.8
Adjusted basic	12	17.9			16.5		
Diluted	12			**25.8**			14.5

Details of dividends paid and proposed are provided in note 11 to the Financial Statements.

(i) Certain re-measurements included within gross margin comprise re-measurement arising on our energy procurement activities and on proprietary trades in relation to which cross-border transportation or transmission capacity is held (but not on the other activities of our proprietary trading businesses). Certain re-measurements included within interest comprise re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund (£nil at 31 December 2005). All other re-measurement is included within results before exceptional items and certain re-measurements. IAS 39 was adopted from 1 January 2005 and therefore there is no comparative for certain re-measurements for 2004.

The notes on pages 44 to 109 form part of these Financial Statements.

Group Balance Sheet

31 December	Notes	2005 £m	2004 £m
Non-current assets			
Goodwill	13	**1,170**	1,049
Other intangible assets	14	**569**	518
Property, plant and equipment	16	**3,670**	3,169
Interests in joint ventures and associates	17	**223**	206
Deferred tax assets	23	**296**	311
Trade and other receivables	19	**25**	68
Financial assets:			
Derivative financial instruments	34	**231**	–
Other financial assets		**45**	37
		6,229	5,358
Current assets			
Inventories	18	**196**	165
Current tax assets		**–**	5
Trade and other receivables	19	**3,421**	2,929
Financial assets:			
Derivative financial instruments	34	**2,159**	121
Other financial assets		**46**	204
Cash and cash equivalents	20	**1,239**	966
		7,061	4,390
Total assets		**13,290**	9,748
Current liabilities			
Trade and other payables	22	**(3,541)**	(3,186)
Current tax liabilities		**(269)**	(305)
Financial liabilities:			
Derivative financial instruments	34	**(1,787)**	(106)
Bank overdrafts and loans	21	**(655)**	(487)
Provisions	24	**(143)**	(151)
		(6,395)	(4,235)
Net current assets		**666**	155
Non-current liabilities			
Trade and other payables	22	**(102)**	(94)
Financial liabilities:			
Bank loans and other borrowings	21	**(2,267)**	(1,445)
Derivative financial instruments	34	**(52)**	–
Deferred tax liabilities	23	**(743)**	(524)
Retirement benefit obligation	31	**(807)**	(705)
Provisions	24	**(482)**	(437)
		(4,453)	(3,205)
Net assets		**2,442**	2,308
Equity			
Called up share capital	25	**224**	233
Share premium account	27	**595**	575
Merger reserve	27	**467**	467
Capital redemption reserve	27	**15**	5
Other reserves	27	**1,085**	809
Shareholders' equity	27	**2,386**	2,089
Minority interests (2004 including non-equity)	28	**56**	219
Total minority interests and shareholders' equity		**2,442**	2,308

The financial statements on pages 40 to 109 were approved by the Board of Directors on 23 February 2006 and were signed below on its behalf by:

Sir Roy Gardner
Chief Executive

Phil Bentley
Group Finance Director

The notes on pages 44 to 109 form part of these Financial Statements.

Group Statement of Recognised Income and Expense

Year ended 31 December	Notes	2005 £m	2004 £m
Profit for the year		**1,013**	1,611
Gain on revaluation of acquired assets	27	**14**	–
Gains on revaluation of available-for-sale investments	27	**2**	–
Gains on cash flow hedges	27	**408**	–
Exchange differences on translation of foreign operations	27	**13**	–
Actuarial (losses)/gains on defined benefit pension schemes	27	**(126)**	90
Tax on items taken directly to equity	27	**(109)**	(27)
Net income recognised directly in equity		**202**	63
Transferred to income and expense on cash flow hedges	27	**(74)**	–
Tax on items transferred from equity	27	**25**	–
Transfers		**(49)**	–
Total recognised income and expense for the year		**1,166**	1,674
Change in accounting policy – adoption of IAS 32 and IAS 39	3	**(343)**	–
Total recognised income and expense since last report		**823**	1,674
Total income and expense recognised in the year is attributable to:			
Equity holders of the parent		**1,165**	1,654
Non-equity minority interests		**–**	18
Minority interests		**1**	2
		1,166	1,674

The notes on pages 44 to 109 form part of these Financial Statements.

Group Cash Flow Statement

Year ended 31 December	Notes	2005 £m	2004 £m
Cash generated from continuing operations		**1,944**	1,656
Interest received		**16**	32
Interest paid		**(13)**	(26)
Tax paid		**(768)**	(480)
Payments relating to exceptional charges		**(48)**	(25)
Net cash flow from continuing operating activities	30	**1,131**	1,157
Net cash flow from discontinued operating activities		**13**	112
Net cash flow from operating activities	30	**1,144**	1,269
Purchase of interests in subsidiary undertakings and businesses net of cash and cash equivalents acquired	29	**(130)**	(590)
Disposal of interests in subsidiary undertakings and businesses net of cash and cash equivalents disposed		**184**	1,404
Purchase of intangible assets		**(160)**	(182)
Disposal of intangible assets		**36**	41
Purchase of property, plant and equipment		**(593)**	(276)
Disposal of property, plant and equipment		**13**	20
Dividends received from joint ventures and associates		**16**	28
Investments in joint ventures and associates		**(122)**	(25)
Disposal of interests in associates		**11**	–
Interest received		**70**	66
Net sale of other financial assets		**146**	11
Net cash flow from investing activities	30	**(529)**	497
Re-purchase of ordinary share capital		**(388)**	(205)
Issue of ordinary share capital		**17**	24
Interest paid in respect of finance leases		**(95)**	(88)
Other interest paid		**(66)**	(61)
Distribution to unit holders of The Consumers' Waterheater Income Fund		**(20)**	–
Interest paid		**(181)**	(149)
Cash inflow from additional debt		**799**	65
Cash outflow from payment of capital element of finance leases		**(50)**	(33)
Cash outflow from repayment of other debt		**(126)**	(9)
Net cash flow from increase in debt		**623**	23
Realised net foreign exchange (loss)/gain on cash settlement of derivative contracts		**(66)**	51
Equity dividends paid		**(340)**	(1,314)
Distribution to non-equity minority interests		**–**	(18)
Net cash flow from financing activities	30	**(335)**	(1,588)
Net increase in cash and cash equivalents		**280**	178
Cash and cash equivalents at 1 January (i)		**885**	705
Effect of foreign exchange rate changes		**12**	(2)
Cash and cash equivalents at 31 December (i)	20	**1,177**	881

(i) Cash and cash equivalents are stated net of overdrafts of £62 million (2004: £85 million). The value was adjusted by £4 million on 1 January 2005 after the adoption of IAS 39 and IAS 32. The balance at 31 December 2004 does not reflect this re-measurement adjustment.

The notes on pages 44 to 109 form part of these Financial Statements.

1. General information

Centrica plc is a Company incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 27. The nature of the Group's operations and its principal activities are set out in note 5 and in the Operating and Financial Review on pages 8 to 20.

The consolidated Financial Statements of Centrica plc are presented in pounds sterling. Foreign operations are included in accordance with the policies set out in note 2.

At the date of authorisation of these Financial Statements, the following Standards and Interpretations which have not been applied in these Financial Statements were in issue, but not yet effective:

- IFRS 7, Financial instruments: Disclosures, and the related amendment to IAS 1 on capital disclosures;
- IFRIC 8, Scope of IFRS 2;
- IFRIC 7, Applying the restatement approach under IAS 29 reporting in hyperinflationary economies;
- IFRIC 6, Liabilities arising from participating in a specific market – Waste electrical and electronic equipment;
- IFRIC 5, Rights to interests arising from decommissioning, restoration and environmental rehabilitation funds.

The Directors anticipate the adoption of these Standards and Interpretations in future periods will have no material impact on the Financial Statements of the Group except for additional disclosures on capital and financial instruments when the relevant standards come into effect for periods commencing on or after 1 January 2007.

2. Summary of significant accounting policies

Basis of preparation

The consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) for the first time. The disclosures required by IFRS 1 concerning the transition from UK GAAP to IFRS are given in note 38. The consolidated Financial Statements have also been prepared in accordance with IFRS as adopted by the European Union and therefore comply with Article 4 of the EU IAS Regulation.

The consolidated Financial Statements have been prepared on the historical cost basis, except for derivative financial instruments and available-for-sale investments that have been measured at fair value. The carrying values of recognised assets and liabilities that are hedged items in fair value hedges, and are otherwise carried at cost, are adjusted to record changes in the fair values attributable to the risks that are being hedged. The principal accounting policies adopted are set out below.

The Group's Income Statement and segmental note separately identifies the effects of re-measurements of certain financial instruments, and items which are 'exceptional', in order to provide readers with a clear and consistent presentation of the Group's underlying performance.

The re-measurement items which are separately identified within gross profit are the re-measurements of contracts related to our energy procurement activities, which are classified as derivatives under IAS 39, Financial instruments: Recognition and measurement, due to the nature of the contractual terms. It also includes re-measurement of proprietary trades in relation to which cross-border transportation or transmission capacity is held. The re-measurement under IAS 39 of the remaining activities of our proprietary trading businesses is included in results for the year before exceptional items and certain re-measurements. Separately identified within interest is the re-measurement under IAS 39 of the publicly traded units of The Consumers' Waterheater Income Fund. Re-measurement movements reflect changes in external market prices and exchange rates. The treatment has no impact on the on-going cash flows of the business and management believes that these unrealised movements are best presented separately from underlying business performance.

In accordance with IAS 1, Presentation of financial statements, certain items which are material to the result for the period and are of a non-recurring nature are presented separately. Items which have been considered material and non-recurring in nature include disposals of businesses, business restructuring and the renegotiation of significant gas contracts. Such a presentation will be followed on a consistent basis in future periods. Items are considered material if their omission or misstatement, could in the opinion of the Directors, individually or collectively, affect the true and fair presentation of the Financial Statements.

Basis of consolidation

The Group Financial Statements consolidate the Financial Statements of the Company and entities controlled by the Company (its subsidiaries) made up to the 31 December each year, and incorporate the results of its share of jointly controlled entities and associates using the equity method of accounting.

Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are consolidated from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary adjustments are made to the Financial Statements of subsidiaries, associates and jointly controlled entities to bring the accounting policies used into line with those used by the Group.

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

Interests in Joint Ventures

A jointly controlled entity is a joint venture which involves the establishment of an entity to engage in economic activity, which the Group jointly controls with its fellow venturers. Under the equity method investments in jointly controlled entities are carried at cost plus post-acquisition changes in the Group's share of net assets of the jointly controlled entity, less any impairment in value in individual investments. The Income Statement reflects the Group's share of the results of operations after tax of the jointly controlled entity (the equity method).

Certain of the Group's exploration and production activity is conducted through joint ventures where the venturers have a direct interest in and jointly control the assets of the venture. The results, assets, liabilities and cash flows of these jointly controlled assets are included in the consolidated Financial Statements in proportion to the Group's interest.

2. Summary of significant accounting policies continued

Interests in associates
An associate is an entity in which the Group has an equity interest and over which it has the ability to exercise significant influence. Under the equity method investments in associates are carried at cost plus post-acquisition changes in the Group's share of the net assets of the associate, less any impairment in value in individual investments. The Income Statement reflects the Group's share of the results of operations after tax of the associate.

Revenue
Revenue is recognised to the extent that it is probable that the economic benefits will flow to the Group and the revenue can be reliably measured. Revenue includes amounts receivable for goods and services provided in the normal course of business, net of trade discounts, VAT and other sales related taxes.

Energy supply: Revenue is recognised on the basis of energy supplied during the period. Revenue for energy supply activities includes an assessment of energy supplied to customers between the date of the last meter reading and the year end (unread). Unread gas and electricity is estimated using historical consumption patterns, taking into account the industry reconciliation process for total gas and total electricity usage by supplier, and is included in accrued energy income within debtors.

Proprietary energy trading: Revenue comprises net gains and losses (both realised/settled and unrealised/fair value changes) from trading in physical and financial energy contracts.

Storage services: Storage capacity revenues are recognised evenly over the contract period, whilst commodity revenues for the injection and withdrawal of gas are recognised at the point of gas flowing into or out of the storage facilities.

Home services and fixed fee service contracts: Where the Group has an ongoing obligation to provide services, revenues are apportioned on a time basis and amounts billed in advance are treated as deferred income and excluded from current revenue. For one-off services, such as installations, revenue is recognised at the date of service provision. Revenue from fixed fee service contracts is recognised on a straight-line basis over the life of the contract, reflecting the benefits receivable by the customer, which span the life of the contract as a result of emergency maintenance being available throughout the contract term.

Gas production: Revenue is recognised on the basis of energy supplied in the period.

Telecommunications: For subscription based services with recurring fees, revenue is recognised on a time basis over the period of service. For usage based services, revenue is recognised on the basis of services provided. Adjustments are made to defer the relevant portion of unearned amounts billed in advance or to accrue amounts unbilled for services provided at the end of each period.

Interest income: Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying value.

Cost of sales
Energy supply includes the cost of gas and electricity produced and purchased during the period taking into account the industry reconciliation process for total gas and total electricity usage by supplier, and related transportation, royalty costs and bought in materials and services.

Home Services' and fixed fee service contracts cost of sales includes direct labour and related overheads on installation work, repairs and service contracts in the period.

Employee share schemes
The Group has a number of employee share schemes, detailed in the Directors' Report on page 24, the Remuneration Report on pages 30 to 31 and in note 26, under which it makes equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant (excluding the effect of non market-based vesting conditions). The fair value determined at the grant date is expensed on a straight line basis together with a corresponding increase in equity over the vesting period, based on the Group's estimate of the number of shares that will vest and adjusted for the effect of non market-based vesting conditions.

Fair value is measured using methods appropriate to each of the different schemes as follows:

LTIS	A Black-Scholes valuation augmented by a Monte Carlo simulation to predict the Total Shareholder Return performance
Sharesave	Black-Scholes
ESOS	Black-Scholes using an adjusted option life assumption to reflect the possibility of early exercise

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 were unvested at 1 January 2005.

Foreign currencies
The consolidated Financial Statements are presented in sterling, which is the functional currency of the Company and the Group's presentational currency. Each entity in the Group determines its own functional currency and items included in the Financial Statements of each entity are measured using that functional currency. Transactions in foreign currencies are initially recorded at the functional currency rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are retranslated at the functional currency rate of exchange ruling at the balance sheet date. All differences are included in the Income Statement for the period with the exception of exchange differences on foreign currency borrowings that provide a hedge against a net investment in a foreign entity. These are taken directly to equity until the disposal of the net investment, at which time they are recognised in the Income Statement. Non-monetary items that are measured in terms of historical cost in a currency other than the functional currency of the entity concerned are translated using the exchange rates as at the dates of the initial transactions.

2. Summary of significant accounting policies continued

For the purpose of presenting consolidated Financial Statements, the assets and liabilities of the Group's foreign subsidiary undertakings, jointly controlled entities and associates are translated into pounds sterling at exchange rates prevailing on the balance sheet date. The results of foreign subsidiary undertakings, jointly controlled entities and associates are translated into pounds sterling at average rates of exchange for the relevant period. Exchange differences arising from the re-translation of the opening net assets and the results are transferred to the Group's foreign currency translation reserve, a separate component of equity, and are reported in the Statement of Total Recognised Income and Expense. In the event of the disposal of an undertaking with assets and liabilities denominated in a foreign currency, the cumulative translation difference arising in the foreign currency translation reserve is charged or credited to the Income Statement on disposal.

Exchange differences on foreign currency borrowings, foreign currency swaps and forward exchange contracts used to hedge foreign currency net investments in foreign subsidiary undertakings, jointly controlled entities and associates are taken directly to reserves and are reported in the Statement of Recognised Income and Expense. All other exchange movements are recognised in the Income Statement for the period.

Business combinations and goodwill

The acquisition of subsidiaries is accounted for using the purchase method. The cost of the acquisition is measured at the aggregate of the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the Group in exchange for control of the acquiree, plus any costs directly attributable to the business combination. The acquiree's identifiable assets, liabilities and contingent liabilities that meet the conditions for recognition under IFRS 3, Business combinations are recognised at their fair value at the acquisition date, except for non-current assets (or disposal Groups) that are classified as held for resale in accordance with IFRS 5, Non-current assets held for sale and discontinued operations, which are recognised and measured at fair value less costs to sell.

Goodwill arising on a business combination represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities of a subsidiary, jointly controlled entity or associate at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. If, after re-assessment, the Group's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities exceeds the cost of the business combination, the excess is recognised immediately in the Income Statement.

The interest of minority shareholders in the acquiree is initially measured at the minority's proportion of the net fair value of the assets, liabilities and contingent liabilities recognised.

Goodwill which is recognised as an asset is reviewed for impairment, annually, or more frequently if events or changes in circumstances indicate that the carrying amount may be impaired. Any impairment is recognised immediately in the Income Statement and is not subsequently reversed.

For the purpose of impairment testing, goodwill is allocated to each of the Group's cash-generating units or groups of cash-generating units that expect to benefit from the synergies of the combination. Cash-generating units to which goodwill has been allocated are tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit or groups of cash-generating units is less than the carrying amount of the unit, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro-rata on the basis of the carrying amount of each asset in the unit.

On disposal of a subsidiary, associate or jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRS has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated.

Other intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. For purchased application software, for example investments in customer relationship management, cost includes contractors' charges, materials, directly attributable labour and directly attributable overheads. Capitalisation begins when expenditures for the asset are being incurred and activities that are necessary to prepare the asset for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to prepare the asset for use are complete. Amortisation commences at the point of commercial deployment over the asset's estimated useful economic life. The cost of intangible assets acquired in a business combination is their fair value as at the date of acquisition. Following initial recognition, intangible assets are carried at cost less any accumulated amortisation and any accumulated impairment losses. The useful lives of intangible assets are assessed to be either finite or indefinite. Intangible assets with finite lives are amortised over the useful economic life and assessed for impairment whenever there is an indication that the intangible asset may be impaired. The amortisation period and the amortisation method for an intangible asset are reviewed at least at each financial year-end. Changes in the expected useful life or the expected pattern of consumption of future economic benefits embodied in the asset are accounted for on a prospective basis by changing the amortisation period or method, as appropriate, and treated as changes in accounting estimates.

Intangible assets with indefinite useful lives are tested for impairment annually either individually or at the cash-generating unit level. Such intangibles are not amortised. The useful life of an intangible asset with an indefinite useful life is reviewed annually to determine whether indefinite life assessment continues to be supportable. If not, the change in the useful life assessment from indefinite to finite is made on a prospective basis.

The amortisation period for the principal categories of intangible assets are as follows:

Application software	up to 10 years
Licences	up to 20 years
Consents	up to 25 years
Contractual customer relationships	up to 10 years
Identifiable acquired brand – Dyno	Indefinite

Property, plant and equipment

Property, plant and equipment is included in the Balance Sheet at cost, less accumulated depreciation and any provisions for impairment.

2. Summary of significant accounting policies continued

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

Freehold and leasehold buildings	up to 50 years
Plant	5 to 20 years
Power stations	up to 30 years
Equipment and vehicles	3 to 10 years
Storage	up to 28 years

Assets held under finance leases are depreciated over their expected useful economic lives on the same basis as for owned assets, or where shorter, the lease term.

The carrying values of property, plant and equipment are reviewed for impairment when events or changes in circumstances indicate that the carrying value may not be recoverable.

Residual values and useful lives are re-assessed annually and if necessary changes are accounted for prospectively.

Exploration, evaluation and production assets

Exploration and evaluation costs are capitalised using the successful efforts method. Acquisition costs related to exploration and evaluation activities are capitalised. Exploration wells are initially capitalised. If the prospects are subsequently determined to be unsuccessful on completion of evaluation, the associated costs are expensed in the period in which that determination is made.

All field development costs are capitalised as property, plant and equipment. Such costs relate to the acquisition and installation of production facilities and include development drilling costs, project-related engineering and other technical services costs. Property, plant and equipment, including rights and concessions related to production activities, are depreciated from the commencement of production in the fields concerned, using the unit of production method, based on all of the proven and probable reserves of those fields. Changes in these estimates are dealt with prospectively. The net carrying value of fields in production and development is compared on a field-by-field basis with the likely discounted future net revenues to be derived from the remaining commercial reserves. An impairment loss is recognised where it is considered that recorded amounts are unlikely to be fully recovered from the net present value of future net revenues. Exploration and production assets are reviewed annually for indicators of impairment.

Decommissioning costs

Provision is made for the net present value of the estimated cost of decommissioning gas production facilities at the end of the producing lives of fields, and storage facilities and power stations at the end of the useful life of the facilities, based on price levels and technology at the balance sheet date.

Changes in these estimates and changes to the discount rates are dealt with prospectively. When this provision gives access to future economic benefits, a decommissioning asset is recognised and included within property, plant and equipment. For gas production facilities and off-shore storage facilities the decommissioning asset is amortised using the unit of production method, based on proven and probable reserves. For power stations the decommissioning asset is amortised on a straight-line basis over the useful life of the facility. The unwinding of the discount on the provision is included in the Income Statement within interest expense.

Leases

The determination of whether an arrangement is, or contains a lease, is based on the substance of the arrangement and requires an assessment of whether the fulfilment of the arrangement is dependent on the use of a specific asset or assets and the arrangement conveys a right to use the asset. Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases. Assets held under finance leases are capitalised and included in property, plant and equipment at their fair value, or if lower, at the present value of the minimum lease payments, each determined at the inception of the lease. The obligations relating to finance leases, net of finance charges in respect of future periods, are included within bank loans and other borrowings, with the amount payable within 12 months included in bank overdrafts and loans within short-term liabilities. Lease payments are apportioned between finance charges and reduction of the finance lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly against income.

Rentals under operating leases are charged to the Income Statement on a straight-line basis over the term of the relevant lease.

Emissions trading scheme and renewable obligations certificates

Granted CO_2 emissions allowances received in a period are initially recognised at nominal value (nil value). Purchased CO_2 emissions allowances are initially recognised at cost (purchase price) within intangible assets. A liability is recognised when the level of emissions exceed the level of allowances granted. The liability is measured at the cost of purchased allowances up to the level of purchased allowances held, and then at the market price of allowances ruling at the balance sheet date, with movements in the liability recognised in operating profit. Forward contracts for the purchase or sale of CO_2 emissions allowances are measured at fair value with gains and losses arising from changes in fair value recognised in the Income Statement. The intangible asset is surrendered at the end of the compliance period reflecting the consumption of economic benefit. As a result no amortisation is recorded during the period.

Purchased renewable obligation certificates are initially recognised at cost within intangible assets. A liability for the renewables obligation is recognised based on the level of electricity supplied to customers, and is calculated in accordance with percentages set by the UK government and the renewable obligation certificate buyout price for that period. The intangible asset is surrendered at the end of the compliance period reflecting the consumption of economic benefit. As a result no amortisation is recorded during the period.

2. Summary of significant accounting policies continued

Impairment of tangible and intangible assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its intangible assets and property, plant and equipment to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of any impairment loss. Where the asset does not generate cash flows that are independent from other assets, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. An intangible asset with an indefinite useful life is tested for impairment annually and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are 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 for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

An impairment loss is reversed only if there has been a change in the estimate used to determine the asset's recoverable amount since the last impairment loss was recognised. Where an impairment loss subsequently reverses, the carrying amount of the asset (cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognised for the asset (cash-generating unit) in prior years. A reversal of an impairment loss is recognised as income immediately. After such a reversal the depreciation/amortisation charge, where relevant, is adjusted in future periods to allocate the asset's revised carrying amount, less any residual value, on a systematic basis over its remaining useful life.

Non-current assets held for sale and discontinued operations

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of carrying amount and fair value less costs to sell. No depreciation is charged in respect of non-current assets classified as held for sale.

Non-current assets and disposal groups are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset (or disposal group) is available for immediate sale in its present condition. Management must be committed to the sale which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

Inventories

Inventories, excluding inventories of gas and oil, are valued on a first-in, first-out basis, at the lower of cost or estimated net realisable value after allowance for redundant and slow moving items. Inventories of gas and oil are valued on a weighted average basis, at the lower of cost, or estimated net realisable value, after allowance for redundant and slow moving items.

Take-or-pay contracts

Where payments are made to external suppliers under take-or-pay obligations for gas not taken, they are treated as prepayments and included within other receivables, as they generate future economic benefits.

Pensions and other post-retirement benefits

The Group operates a number of defined benefit pension schemes. The cost of providing benefits under the defined benefit schemes is determined separately for each scheme using the projected unit credit actuarial valuation method. Actuarial gains and losses are recognised in full in the period in which they occur. They are recognised outside the Income Statement and presented in the Statement of Recognised Income and Expense.

The cost of providing retirement pensions and other benefits is charged to the Income Statement over the periods benefiting from employees' service. Past service cost is recognised immediately to the extent that the benefits are already vested, and otherwise is amortised on a straight-line basis over the average period until the benefits become vested.

The retirement benefit obligation recognised in the Balance Sheet represents the present value of the defined benefit obligation of the schemes as adjusted for unrecognised past service cost, and as reduced by the fair value of the schemes' assets.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, that can be reliably measured, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material. Where discounting is used, the increase in the provision due to the passage of time is recognised in the Income Statement included within interest expense.

Taxation

Current tax, including UK corporation tax, UK petroleum revenue tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted, or substantially enacted, by the balance sheet date.

Deferred tax is recognised in respect of all temporary differences identified at the balance sheet date, except to the extent that the deferred tax arises from the initial recognition of goodwill (if amortisation of goodwill is not deductible for tax purposes) or the initial recognition of an asset or liability in a transaction which is not a business combination and at the time of the transaction affects neither accounting profit nor taxable profit and loss. Temporary differences are differences between the carrying amount of the Group's assets and liabilities and their tax base.

Deferred tax liabilities may be offset against deferred tax assets within the same taxable entity or qualifying local tax group. Any remaining deferred tax asset is recognised only when, on the basis of all available evidence, it can be regarded as probable that there will be suitable taxable profits, within the same jurisdiction, in the foreseeable future against which the deductible temporary difference can be utilised.

2. Summary of significant accounting policies continued

Deferred tax is provided on temporary differences arising on 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.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the asset is realised or liability settled, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date. Measurement of deferred tax liabilities and assets reflects the tax consequences expected to fall from the manner in which the asset or liability is recovered or settled.

Financial instruments

The Group adopted IAS 32, Financial instruments: Disclosure and presentation, and IAS 39, Financial instruments: Recognition and measurement from 1 January 2005. In accordance with the transition provisions of IFRS 1, the Group has taken the exemption from restating comparative information for the effects of IAS 32 and IAS 39. The comparative information has been presented in accordance with UK GAAP and the applicable accounting policies for the comparative period are noted below. The restatement of the Balance Sheet at 1 January 2005 to comply with the requirements of IAS 32 and IAS 39 has been treated as a change in accounting policy as detailed in note 3.

Accounting policies under IAS 32 and IAS 39

Financial assets and financial liabilities are recognised in the Group's Balance Sheet when the Group becomes a party to the contractual provisions of the instrument. Financial assets are de-recognised when the Group no longer has the rights to cash flows, the risks and rewards of ownership or control of the asset. Financial liabilities are de-recognised when the obligation under the liability is discharged, cancelled or expires.

a) Trade receivables

Trade receivables are recognised and carried at original invoice amount less an allowance for any uncollectible amounts. Provision is made when there is objective evidence that the Group will not be able to collect the debts. Bad debts are written off when identified.

b) Share capital

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction from the proceeds received. Own equity instruments that are reacquired (treasury shares) are deducted from equity. No gain or loss is recognised in the Income Statement on the purchase, sale, issue or cancellation of the Group's own equity instruments.

c) Cash and cash equivalents

Cash and cash equivalents comprise cash in hand and current balances with banks and similar institutions, which are readily convertible to known amounts of cash and which are subject to insignificant risk of changes in value and have an original maturity of three months or less.

For the purpose of the consolidated Cash Flow Statement, cash and cash equivalents consist of cash and cash equivalents as defined above, net of outstanding bank overdrafts.

d) Interest bearing loans and borrowings

All interest-bearing loans and borrowings are initially recognised at fair value plus directly attributable transaction costs.

After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method, except when they are the hedged item in an effective fair value hedge relationship where the carrying value is adjusted to reflect the fair value movements associated with the hedged risks and the fair value movements are recognised in the Income Statement. Amortised cost is calculated by taking into account any issue costs, and any discount or premium.

e) Units issued by The Consumers' Waterheater Income Fund

Units issued by The Consumers' Waterheater Income Fund which contain redemption rights providing unit holders with the right to redeem units back to the Fund for cash or another financial asset are treated as a financial liability and recorded at the present value of the redemption amount. Gains and losses related to changes in the carrying value of the financial liability are recognised in the Income Statement as interest income or interest expense.

f) Other financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale, and are initially recognised at fair value, and are included within other financial assets within the Balance Sheet. Available-for-sale financial assets are subsequently recognised at fair value with gains and losses arising from changes in fair value recognised directly in equity and presented in the Statement of Recognised Income and Expense, until the asset is disposed of or is determined to be impaired, at which time the cumulative gain or loss previously recognised in equity is included in the Income Statement for the period. Impairment losses recognised in the Income Statement for equity investments classified as available-for-sale are not subsequently reversed through the Income Statement. Impairment losses recognised in the Income Statement for debt instruments classified as available-for-sale are subsequently reversed if an increase in the fair value of the instrument can be objectively related to an event occurring after the recognition of the impairment loss.

g) Derivative financial instruments and hedge accounting

The Group routinely enters into sale and purchase transactions for physical gas, power and oil. 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 physical position in accordance with the Group's expected sale, purchase or usage requirements, and are not within the scope of IAS 39.

Certain physical gas, power and oil purchase and sales contracts are within the scope of IAS 39 because they net settle or contain written options. Such contracts are accounted for as derivatives under IAS 39 and are recognised in the Balance Sheet at fair value. Gains and losses arising from changes in fair value on derivatives that do not qualify for hedge accounting are taken directly to the Income Statement for the year.

2. Summary of significant accounting policies continued

The Group uses a range of derivatives for both trading and to hedge exposures to financial risks, such as interest rate, foreign exchange and energy price risks, arising in the normal course of business. The use of derivative financial instruments is governed by the Group's policies approved by the Board of Directors. Further detail on the Group's risk management policies is included within the Group Financial Review on page 20 and in note 34 to the Financial Statements.

The accounting treatment for derivatives is dependent on whether they are entered into for trading or hedging purposes. A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies and is in accordance with established guidelines, which require that the hedging relationship is documented at its inception, ensure that the derivative is highly effective in achieving its objective, and require that its effectiveness can be reliably measured. The Group also holds derivatives which are not designated as hedges and derivatives that are held for trading.

All derivatives are recognised at fair value on the date on which the derivative is entered into and are re-measured to fair value each reporting period. Derivatives are carried as assets when the fair value is positive and as liabilities when the fair value is negative. Derivative assets and derivative liabilities are offset and presented on a net basis only when both a legal right of set-off exists and the intention to net settle the derivative contracts is present. Recognition of the gain or loss that results from changes in fair value depends on the purpose for issuing or holding the derivative. For derivatives that do not qualify for hedge accounting, any gains or losses arising from changes in fair value are taken directly to the Income Statement and are included within gross profit or interest income and interest expense. Gains and losses arising on derivatives entered into for speculative energy trading purposes are presented on a net basis within revenue.

For the purpose of hedge accounting, hedges are classified as either fair value hedges, cash flow hedges or hedges of net investments in foreign operations.

Fair value hedges: A derivative is classified as a fair value hedge when it hedges the exposure to changes in the fair value of a recognised asset or liability. Any gain or loss from re-measuring the hedging instrument at fair value is recognised immediately in the Income Statement. Any gain or loss on the hedged item attributable to the hedged risk is adjusted against the carrying amount of the hedged item and recognised in the Income Statement. The Group discontinues fair value hedge accounting if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer qualifies for hedge accounting or the Group revokes the designation. Any adjustment to the carrying amount of a hedged financial instrument for which the effective interest method is used is amortised to the Income Statement. Amortisation may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged.

Cash flow hedges: A derivative is classified as a cash flow hedge when it hedges exposures to variability in cash flows that is attributable to a particular risk either associated with a recognised asset, liability or a highly probable forecast transaction. The portion of the gain or loss on the hedging instrument, which is effective is recognised directly in equity while any ineffectiveness is recognised in the Income Statement.

The gains or losses that are recognised directly in equity are transferred to the Income Statement in the same period in which the highly probable forecast transaction affects income, for example when the future sale of physical gas or physical power actually occurs. Where the hedged item is the cost of a non-financial asset or liability, the amounts taken to equity are transferred to the initial carrying amount of the non-financial asset or liability. Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated or exercised without replacement or rollover, no longer qualifies for hedge accounting, or the Group revokes the designation.

At that point in time, any cumulative gain or loss on the hedging instrument recognised in equity remains in equity until the highly probable forecast transaction occurs. If the transaction is no longer expected to occur, the cumulative gain or loss recognised in equity is recognised in the Income Statement.

Net investment hedges: Hedges of net investments in foreign operations are accounted for similarly to cash flow hedges. Any gain or loss on the effective portion of the hedge is recognised in equity, any gain or loss on the ineffective portion of the hedge is recognised in the Income Statement. On disposal of the foreign operation, the cumulative value of any gains or losses recognised directly in equity is transferred to the Income Statement.

Embedded derivatives: Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of host contracts and the host contracts are not carried at fair value, with gains or loss reported in the Income Statement.

Financial instruments – accounting policies to 31 December 2004

The following are the key accounting policies for financial instruments under UK GAAP for the comparative period.

a) Interest bearing loans, other financial assets and borrowings

All interest-bearing loans, other financial assets and borrowings are initially recognised at cost, being the fair value of the proceeds paid, or for borrowings received, net of issue costs associated with the borrowing. After initial recognition, interest-bearing loans and borrowings are subsequently measured at amortised cost using the effective interest method. Amortised cost is calculated by taking into account any issue costs, and any discount or premium on settlement. Other financial assets are recognised at the lower of cost and net realisable value.

b) Derivative financial instruments

The Group uses a range of derivative instruments for both trading and to manage (hedge) exposures to financial risks, such as interest rate, foreign exchange and energy price risks arising in the normal course of business. The accounting treatment for these instruments is dependant on whether they are entered into for trading or non-trading (hedging) purposes. A derivative instrument is considered to be used for hedging purposes when it alters the risk profile of an underlying exposure of the Group in line with the Group's risk management policies. In addition, there must be a demonstrable link to an underlying transaction, pool of transactions, or specified future transaction or transactions. Specified future transactions must be reasonably certain to arise for the derivative to be accounted for as a hedge.

2. Summary of significant accounting policies continued

The fair value of energy derivatives accounted for as cash flow hedges have been classified as falling due within one year and falling due after one year by reference to the maturity of the contract. Derivative instruments are accounted for as follows:

Energy trading activities: The Group engages in swaps, futures, forwards and options in gas, electricity and weather for trading purposes. Financial and physical positions are marked-to-market using externally derived market prices. Marked-to-market gains and losses are recognised immediately in the Income Statement within revenue. The corresponding fair value debtors or creditors are included within the Balance Sheet.

Energy hedging activities: The Group engages in gas, electricity, oil and weather derivatives to hedge against price exposures arising within the energy procurement, supply and retail operations. The derivatives are matched to the specific exposures which they are designed to reduce, with gains and losses recognised in the Income Statement in the same period as the income and expenses of the underlying hedged transactions.

Treasury hedging activities: The Group uses interest rate swaps, forward rate agreements, foreign currency swaps and forward exchange contracts to manage the exposures to interest rates arising on underlying debt and cash positions, or probable future commitments and foreign exchange risks arising on foreign currency assets and borrowings, foreign currency forecasted transactions and the retranslation of overseas net investments. All instruments are used for hedging purposes in line with the Group's risk management policies.

Amounts payable or receivable in respect of interest rate swaps and forward rate agreements are recognised as adjustments to the net interest charge over the term of the contracts.

Currency swap agreements and forward exchange contracts are retranslated at the rates ruling in the agreements and contracts. Resulting gains or losses are offset against foreign exchange gains or losses on the related borrowings or, where the instrument is used to hedge a committed future transaction, are deferred until the transaction occurs. Where used to hedge overseas net investments, gains or losses are recorded in the Statement of Total Recognised Income and Expense, with interest recorded in the Income Statement.

Where derivatives used to manage interest rate risk or to hedge other anticipated cash flows are terminated before the underlying debt matures or the hedged transaction occurs, the resulting gain or loss is recognised on a basis that matches the timing and accounting treatment of the underlying debt or hedged transaction. When an anticipated transaction is no longer likely to occur or finance debt is terminated before maturity, any deferred gain or loss that has arisen on the related derivative is recognised in the Income Statement, together with any gain or loss on the terminated item.

3. Changes in accounting policy

The Group adopted IAS 32 and IAS 39 from 1 January 2005. The main adjustments arising are as follows.

The Consumers' Waterheater Income Fund

Centrica holds a 19.9% interest in The Consumers' Waterheater Income Fund. The Fund's units are traded on the Toronto Stock Exchange. The Fund is fully consolidated under both UK GAAP and IFRS to reflect our partnership agreements. The minority interest of 80.1% was accounted for as non-equity minority interests under UK GAAP. Units of the Fund held by third parties contain redemption rights, which provide the holder of the units with the right to put the units back to the Fund. These are a common feature of such funds in Canada. There have been no redemptions of units to date and future redemption is considered very unlikely because the terms and conditions of redemption are unfavourable. IAS 32 requires units with such redemption rights to be recorded as a financial liability and that the amount recorded reflects the value of the redemption obligation. The redemption obligation value is based on the price at which these units trade on the Toronto Stock Exchange. At 1 January 2005 the value of the financial liability is £244 million. The impact of implementing IAS 32 at this date was a reclassification of the non-equity minority interest of £164 million to financial liabilities and a charge to the profit and loss reserve at 1 January 2005 of £80 million. Future changes in the financial liability will be charged or credited to interest in the Income Statement.

Derivative contracts and Centrica's business model

IAS 39 covers the treatment of financial instruments, which includes most energy and commodity contracts. The first time application of IAS 39 is complex. IAS 39 requires fair value accounting with limited exceptions, most notably in respect of contracts which are entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with an entity's expected purchase, sale or usage requirements, referred to as 'own use'. Own use contracts are outside the scope of IAS 39 and are recognised under the accrual method of accounting. IAS 39 contains restrictions on contracts achieving own use treatment. Where energy and commodity contracts do not meet the own use criteria, it is likely that under IAS 39 they are treated as derivative contracts.

IAS 39 requires all derivatives to be recognised at fair value with gains and losses arising from changes in fair value recognised in the Income Statement, unless the derivatives have been designated into effective cash flow hedge accounting relationships. Where contracts are designated into such hedging relationships, the portion of the gain or loss on the hedging instrument, which is effective, is recognised directly in equity in a hedging reserve, while any ineffectiveness is recognised in the Income Statement. The gains or losses recognised directly in reserves are transferred to the Income Statement in the same period in which the highly probable forecast transaction, which is being hedged, affects the Income Statement.

Excluding our trading entities, which fair value their trading positions with movements in fair value reflected in the Income Statement, our business model is to buy gas and power to meet the demand of our customers, or to meet demand in our equity power stations. Due to the unpredictability of demand and a limit to the flexibility

3. Changes in accounting policies continued

inherent in our long-term contract portfolio, we use the wholesale market to optimise our portfolio on a daily basis.

Many of our physical energy and commodity contracts meet the criteria for treatment as own use and will continue to be accrual accounted for under IFRS as they were under UK GAAP. However, circumstances set out in IAS 39 where own use treatment is not permitted include, most notably:

- Contracts where we use inherent optionality to take advantage of pricing opportunities, for example the ability to take volume under a contract in excess of variable demand and sell it into the wholesale trading market. This is known as net settling and IAS 39 requires such contracts to be accounted for as derivatives;
- Variable volume contracts where our customers receive gas at a hub from which they themselves can subsequently trade. These contracts are deemed to contain written options and IAS 39 requires such contracts to be accounted for as derivatives.

In addition, IAS 39 requires contracts with similar terms to be treated consistently. It is therefore not permitted under IAS 39 to treat contracts that are similar to net settled contracts, for example because they have standardised, exchange-accepted terms, as own use. However, such derivative contracts can be designated into hedging relationships for instance to hedge against price risk on highly probable forecasted purchases of gas or power to satisfy customer demand.

IAS 39 requires derivative contracts to be recognised at their fair value. The fair value unwinds over time through the Income Statement. As a consequence, over the lifetime of a contract, the net charge or credit to the Income Statement will be the same as under UK GAAP, but the timing of charges and credits to the Income Statement will be different, which results in volatility in earnings.

The overall financial impact of adopting IAS 39 has been to reduce opening net assets at 1 January 2005 by £99 million, comprising £167 million charge to the profit and loss reserve and £68 million credited to the hedging reserve.

The combined impact of adopting IAS 32 and IAS 39 on the Balance Sheet at 1 January 2005 was a £343 million reduction to opening net assets, the movement of which has been recognised in the Statement of Recognised Income and Expense, and is presented in detail in note 38 (b).

4. Critical accounting judgements and key sources of estimation uncertainty

Critical judgements in applying the Group's accounting policies

In the process of applying the Group's accounting policies as described in note 2, management has made the following judgements that have the most significant effect on the amounts recognised in the Financial Statements (apart from those involving estimations which are dealt with below).

Finance lease – Third-party power station tolling arrangement

The Group has entered into a long-term tolling arrangement with the Spalding power station and has determined that, based on the substance of the contractual terms, the arrangement is a finance lease.

Subsidiary – The Consumers' Waterheater Income Fund

The Group holds a 19.9% interest (2004: 19.9%) in The Consumers' Waterheater Income Fund (the Fund), through its wholly owned subsidiary, Direct Energy Marketing Limited. The Fund's units are traded on the Toronto Stock Exchange. The Group has determined that the Fund is a subsidiary and has included the Fund on a consolidated basis within the Group's Financial Statements. Units in the Fund held by third parties contain redemption rights providing the holder of such units with the rights to put the units back to the Fund for cash or another financial asset. The Group has determined that units issued by the Fund, which contain such redemption rights are financial liabilities.

Financial liability – third party limited partnership interest

The Group formed The Centrica Gas Production LP, a limited partnership, during the year. Certain Morecambe gas field assets have been contributed to the partnership by Hydrocarbon Resources Limited, a wholly owned subsidiary of the Group. On 2 December 2005 a bank became a limited partner in this partnership. The Centrica Group retains full control of the Morecambe gas fields as Hydrocarbon Resources Limited retains legal ownership of the Morecambe licences and is also the general partner and asset manager of the partnership. The partnership is included on a consolidated basis within the Group's Financial Statements. The bank is one of the limited partners and is entitled to a specified share of the pre-tax partnership profits arising from South Morecambe after taking account of associated petroleum revenue tax and any losses. The Group has also entered into a Put and Call option arrangement with the bank over the bank's limited partnership interest. Any exercise of the option is contingent upon the occurrence of certain events up to 2 December 2012, and thereafter may occur at any time. The Group has determined that the bank's limited partnership interest should be accounted for as a financial liability recognised initially at fair value and subsequently carried at amortised cost, consistent with treatment as an interest-bearing borrowing.

Emissions trading scheme

The Group has been subject to the European Emissions Trading Scheme (EU ETS) since 1 January 2005. IFRIC 3, Emission rights was withdrawn by the IASB in June 2005, and has not yet been replaced by definitive guidance. The Group has adopted an accounting policy, which recognises CO_2 emissions liabilities when the level of emissions exceeds the level of allowances granted by the Government in the period. The liability is measured at the cost of purchased allowances up to the level of purchased allowances held, and then at market price of allowances ruling at the balance sheet date. Movements in the liability are reflected within operating profit. Forward contracts for sales and purchases of allowances are measured at fair value.

Petroleum revenue tax (PRT)

The definitions of an income tax in IAS 12, Income taxes, have led management to judge that PRT should be treated consistently with other taxes. The charge for the year, is presented within taxation on profit from continuing operations in the Income Statement. Deferred amounts are included within deferred tax assets and liabilities in the Balance Sheet.

4. Critical accounting judgements and key sources of estimation uncertainty
continued

Key sources of estimation uncertainty
The key assumptions concerning the future, and other key sources of estimation uncertainty at the balance sheet date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year, are discussed below.

Impairment of goodwill and indefinite lived intangible assets
The Group determines whether goodwill and indefinite lived intangible assets are impaired at least on an annual basis. This requires an estimation of the value in use of the cash-generating units to which goodwill and indefinite lived intangibles are allocated. Estimating the value-in-use requires the Group to make an estimate of the expected future cash flows from the cash-generating unit and also to choose a suitable discount rate in order to calculate the present value of those cash flows. Further detail on the assumptions used in determining value-in-use calculations is provided in note 15.

Revenue recognition – unread gas and electricity meters
Revenue for energy supply activities includes an assessment of energy supplied to customers between the date of the last meter reading and the year end (unread). Unread gas and electricity is estimated using historical consumption patterns taking into account the industry reconciliation process for total gas and total electricity usage by supplier. The industry reconciliation process is required as differences arise between the estimated quantity of gas and electricity the Group deems to have supplied and billed customers, and the estimated quantity the industry system operator deems the individual suppliers, including the Group, to have supplied to customers.

The reconciliation process can result in either a higher or lower value of industry deemed supply than has been billed to customers, but in practice tends to result in a higher value of deemed supply. Management estimate the level of recovery which will be achieved either through subsequent customer billing or through the developing industry settlement process.

Determination of fair values – energy derivatives
Derivative contracts are carried in the Balance Sheet at fair value, with changes in fair value recorded in the Income Statement. Fair values of energy derivatives are estimated by reference in part to published price quotations in active markets and in part by using valuation techniques. More detail on the assumptions used in determining fair valuations is provided in note 34 (b).

Renegotiation provision
In 1997 Centrica renegotiated certain long term take-or-pay gas contracts, which would have resulted in commitments to pay for gas that would be excess to requirements and/or at prices above likely market rates. Provision has been made covering the net present cost of estimated payments to be made resulting from the renegotiations including one due for settlement in 2008 based on published estimates of reserves in a group of third-party fields. It is reasonably possible, based on existing knowledge, that published estimates of reserves within the next financial year that are different from existing reserve estimates could require a material adjustment to the carrying value of the provision. Further detail of the provision is provided in note 24.

Pensions and other post-retirement benefits
The Group operates a number of defined benefit pension schemes. The cost of providing benefits under the defined benefit schemes is determined separately for each scheme under the projected unit credit actuarial valuation method. Actuarial gains and losses are recognised in full in the period in which they occur. The key assumptions used for the actuarial valuation are based on the Group's best estimate of the variables that will determine the ultimate cost of providing post-employment benefits, on which further detail is provided in note 31.

5. Segmental analysis

Primary reporting format – business segments
The Group's business segments are distinguished on the basis of the internal management reporting system, and reflect the day-to-day management of the business. The products and services included within each segment are described in the Operating and Financial Review, on pages 8 to 20.

The Group previously classified the British Gas communications business within the British Gas Services segment. The results of the business have been reclassified within the Onetel segment for 2005 and the comparatives restated accordingly. The Group disposed of the Onetel group of companies on 30 December 2005 as detailed in note 29. The results of the segment have been treated as discontinued and comparative information for 2004 in the Income Statement and related notes has been restated accordingly.

			2005			2004
a) Revenue	**Gross segment revenue £m**	**Less inter-segment revenue (i), (ii) £m**	**Group revenue £m**	Gross segment revenue £m	Less inter-segment revenue (i), (ii) £m	Group revenue £m
Continuing operations:						
British Gas Residential Energy	**6,032**	**–**	**6,032**	5,901	–	5,901
British Gas Services	**1,024**	**–**	**1,024**	943	–	943
British Gas Residential	**7,056**	**–**	**7,056**	6,844	–	6,844
British Gas Business	**1,510**	**–**	**1,510**	1,200	–	1,200
Industrial sales and wholesaling	**1,460**	**(674)**	**786**	1,961	(1,156)	805
Gas production	**1,365**	**(1,182)**	**183**	1,150	(1,041)	109
Accord energy trading	**42**	**–**	**42**	17	–	17
Centrica Energy	**2,867**	**(1,856)**	**1,011**	3,128	(2,197)	931
Centrica Storage	**253**	**(58)**	**195**	164	(31)	133
North American Energy and Related Services	**3,552**	**–**	**3,552**	2,242	–	2,242
European Energy	**119**	**–**	**119**	10	(2)	8
Other operations	**5**	**–**	**5**	3	–	3
	15,362	**(1,914)**	**13,448**	13,591	(2,230)	11,361
Discontinued operations:						
The AA	**–**	**–**	**–**	637	–	637
Onetel	**344**	**(2)**	**342**	283	(3)	280
	344	**(2)**	**342**	920	(3)	917

(i) Inter-segment revenue is derived from recharges of energy procurement costs between Centrica Energy and other Group segments. Gas purchase costs are appropriately allocated to the revenue generating streams using a method which best reflects the consumption of gas within the Group. Electricity costs are recharged using a method which reflects the actual cost within the Group.

(ii) Inter-segment revenue arising within Centrica Storage represents the provision of storage facilities to other Group companies, provided on an arm's length basis.

Group revenue is derived from the following activities:

	2005 £m	2004 £m
Sales of goods	**11,996**	10,180
Rendering of services	**1,452**	1,181
Group revenue	**13,448**	11,361

5. Segmental analysis continued

b) Operating profit	Operating profit/(loss) before exceptional items and certain re-measurements year ended 31 December		Exceptional items and certain re-measurements year ended 31 December		Operating profit/(loss) after exceptional items and certain re-measurements year ended 31 December		Share of result of joint ventures and associates included within operating profit year ended 31 December	
	2005 £m	2004 £m	**2005 £m**	2004 £m	**2005 £m**	2004 £m	**2005 £m**	2004 £m
Continuing operations:								
British Gas Residential Energy	**90**	242	**570**	(6)	**660**	236	**2**	3
British Gas Services	**111**	72	**(15)**	–	**96**	72	**–**	–
British Gas Residential	**201**	314	**555**	(6)	**756**	308	**2**	3
British Gas Business	**77**	68	**166**	–	**243**	68	**–**	–
Industrial sales and wholesaling	**(156)**	(20)	**(382)**	–	**(538)**	(20)	**29**	48
Gas production	**1,020**	779	**(28)**	(51)	**992**	728	**–**	–
Accord energy trading	**39**	14	**17**	–	**56**	14	**–**	–
Centrica Energy	**903**	773	**(393)**	(51)	**510**	722	**29**	48
Centrica Storage	**154**	69	**1**	–	**155**	69	**–**	–
North American Energy and Related Services	**185**	132	**138**	–	**323**	132	**–**	–
European Energy	**(9)**	5	**–**	–	**(9)**	5	**6**	5
Other operations	**2**	1	**(23)**	(42)	**(21)**	(41)	**–**	–
	1,513	1,362	**444**	(99)	**1,957**	1,263	**37**	56
Discontinued operations:								
The AA	**–**	80	**39**	911	**39**	991	**–**	12
Onetel	**12**	3	**(5)**	(5)	**7**	(2)	**–**	–
	12	83	**34**	906	**46**	989	**–**	12

c) Other non-cash expenses	Depreciation of property, plant and equipment year ended 31 December		Amortisation of intangibles year ended 31 December	
	2005 £m	2004 £m	**2005 £m**	2004 £m
Continuing operations:				
British Gas Residential Energy	**16**	68	**48**	20
British Gas Services	**16**	15	**4**	1
British Gas Residential	**32**	83	**52**	21
British Gas Business	**5**	5	**1**	2
Industrial sales and wholesaling	**81**	44	**–**	1
Gas production	**193**	284	**–**	–
Accord energy trading	**–**	–	**–**	–
Centrica Energy	**274**	328	**–**	1
Centrica Storage	**19**	18	**1**	–
North American Energy and Related Services	**76**	56	**13**	13
European Energy	**–**	–	**9**	–
Other operations	**–**	–	**–**	–
	406	490	**76**	37
Discontinued operations:				
The AA	**–**	2	**–**	2
Onetel	**6**	6	**1**	1
	6	8	**1**	3

The results of discontinued operations before (losses)/profits on disposal of the businesses included costs of £330 million (2004: £922 million) and a tax charge of £1 million (2004: £9 million).

5. Segmental analysis continued

d) Assets and liabilities	Segment assets including share of joint ventures (i) 31 December 2005 £m	2004 £m	Segment liabilities (ii) 31 December 2005 £m	2004 £m	Capital expenditure on property, plant and equipment (note 16) year ended 31 December 2005 £m	2004 £m	Capital expenditure on other intangible assets (note 14) year ended 31 December 2005 £m	2004 £m
Continuing operations:								
British Gas Residential Energy	**1,948**	1,346	**(621)**	(1,208)	**14**	25	**58**	39
British Gas Services	**466**	258	**(191)**	(197)	**10**	31	**19**	18
British Gas Residential	**2,414**	1,604	**(812)**	(1,405)	**24**	56	**77**	57
British Gas Business	**981**	476	**(141)**	(259)	**7**	10	**16**	4
Industrial sales and wholesaling	**5,459**	3,078	**(3,797)**	(502)	**77**	482	**62**	107
Gas production	**1,052**	818	**(1,556)**	(1,207)	**391**	48	**1**	–
Accord energy trading	**1,533**	914	**(1,831)**	(992)	**–**	–	**–**	–
Centrica Energy	**8,044**	4,810	**(7,184)**	(2,701)	**468**	530	**63**	107
Centrica Storage	**451**	436	**(93)**	(80)	**17**	8	**–**	–
North American Energy and Related Services	**3,046**	2,074	**(941)**	(615)	**109**	55	**6**	11
European Energy	**67**	69	**(59)**	(3)	**–**	–	**2**	–
Corporate and unallocated assets/(liabilities)	**2,543**	3,089	**(5,874)**	(5,285)	**18**	32	**10**	–
Total continuing operations	**17,546**	12,558	**(15,104)**	(10,348)	**643**	691	**174**	179
Discontinued operations:								
The AA	**–**	–	**–**	–	**–**	7	**–**	2
Onetel	**–**	159	**–**	(61)	**7**	3	**–**	–
Total discontinued operations	**–**	159	**–**	(61)	**7**	10	**–**	2
Less inter-segment (receivables)/payables	**(4,256)**	(2,969)	**4,256**	2,969				
	13,290	9,748	**(10,848)**	(7,440)	**650**	701	**174**	181

(i) Segment assets consist primarily of property, plant, equipment, goodwill, other intangible assets, investments in joint ventures and associates, inventories, derivatives, receivables and operating cash. Unallocated assets comprise deferred tax attached to unallocable assets and liabilities, investments and derivatives designated as hedges of borrowings. The aggregate investment in each joint venture for each segment is analysed in note 17.

(ii) Segment liabilities comprise operating liabilities. Unallocated liabilities comprise items such as taxation, corporate borrowings, the Group pension deficit (which is not allocable between segments on a reasonable basis) and deferred tax attached to unallocable assets and liabilities.

Corporate overheads are allocated to reportable segments for Group reporting purposes based on annual revenues and operating expenditure.

Secondary reporting format – geographical segments

The Group operates in three main geographical areas:

	Revenue year ended 31 December 2005 £m	2004 £m	Total assets (based on location of assets) 31 December 2005 £m	2004 £m	Capital expenditure on property, plant and equipment (note 16) (based on location of assets) year ended 31 December 2005 £m	2004 £m	Capital expenditure on other intangible assets (note 14) (based on location of assets) year ended 31 December 2005 £m	2004 £m
Continuing operations:								
UK	**9,643**	9,009	**9,866**	7,423	**534**	636	**166**	168
Rest of Europe	**253**	110	**242**	69	**–**	–	**2**	–
North America	**3,552**	2,242	**3,182**	2,092	**109**	55	**6**	11
	13,448	11,361	**13,290**	9,584	**643**	691	**174**	179
Discontinued operations:								
UK	**342**	917	**–**	164	**7**	10	**–**	2

6. Costs of continuing operations

	2005 £m	2004 £m
Revenue	**13,448**	11,361
Certain re-measurements (note 7)	**456**	–
Exceptional items (note 7)	**(11)**	(99)
Transportation and distribution costs	**(2,541)**	(2,472)
Engineer costs	**(550)**	(529)
Other costs relating to energy consumption and provision of services	**(6,387)**	(4,684)
Depreciation and amortisation (note 5)	**(482)**	(527)
Staff costs (note 8)	**(1,235)**	(1,131)
Profit/(loss) on disposal of property, plant and equipment	**13**	(1)
Profit on disposal of other intangible assets	**4**	15
Write-down of inventory	**(3)**	(1)
Impairment of trade receivables (i)	**(84)**	(147)
Foreign exchange gains	**3**	–
Other operating costs	**(711)**	(578)
Share of profits in joint ventures and associates, net of interest and taxation (note 5)	**37**	56
Operating profit from continuing operations	**1,957**	1,263
Auditors' remuneration (ii) (iii)		
Audit services		
Statutory audit		
Company	**0.2**	0.2
Subsidiary undertakings	**2.4**	2.3
Audit-related regulatory reporting (iv)	**1.6**	1.5
Further assurance services	**1.6**	0.9
Tax services		
Tax compliance services	**–**	0.1
Tax advisory services	**–**	0.2
Other services	**0.1**	0.1
	5.9	5.3

Included in cost of sales are transportation and distribution costs, engineer costs, depreciation costs of £256 million (2004: £256 million) and staff costs of £59 million (2004: £21 million). Operating costs consist entirely of administration expenses.

(i) Impairment of trade receivables relates to bad debt write offs, and excludes any recovery or related administrative costs.

(ii) Included in auditors' remuneration, excluding the statutory audit, were non-audit fees payable arising in the UK of £3.2 million (2004: £2.6 million). In addition, the Group's auditors acted as auditors to the Group's pension schemes. The appointment of auditors to the Group's pension schemes and the fees paid in respect of these audits are agreed by the trustees of each scheme, who act independently from the management of the Group.

(iii) It is the Group's policy to seek competitive tenders for all major consultancy and advisory projects. Appointments are made taking into account other factors including expertise and experience. In addition, the Board has approved a detailed policy defining the types of work for which the auditors can tender and the approvals required. The auditors have been engaged on assignments additional to their statutory audit duties where their expertise and experience with the Group are particularly important, including tax advice and due diligence reporting on acquisitions.

(iv) Substantially in respect of the implementation of International Financial Reporting Standards.

7. Exceptional items and certain re-measurements

	2005 £m	2004 £m
a) Exceptional items recognised in continuing operations		
Contract renegotiation (i)	**42**	–
Profit on disposal of business (ii)	**47**	–
Business restructuring costs (iii)	**(100)**	(100)
Gas field impairment (iv)	**–**	(50)
Renegotiation provision (v)	**–**	51
Total exceptional items recognised in continuing operations	**(11)**	(99)
b) Exceptional items recognised in discontinued operations		
Business restructuring costs (iii)	**–**	(5)
Profit on disposal of the AA (vi)	**39**	911
Loss on disposal of Onetel (vii)	**(5)**	–
Total exceptional items recognised in discontinued operations	**34**	906

7. Exceptional items and certain re-measurements continued

	2005 £m	2004 £m
c) Certain re-measurements recognised in continuing operations (viii)		
Net gains arising on delivery of contracts	**140**	–
Net gains arising on market price movements and new contracts	**299**	–
Net gains arising on proprietary trades in relation to which cross-border transportation or transmission capacity is held (ix)	**17**	–
Total certain re-measurements recognised in continuing operations	**456**	–

(i) The profit in 2005 arises on the renegotiation of certain long-term take-or-pay contracts during the period. A benefit of £42 million has been recognised. A deferred tax charge of £12 million has been recognised in respect of the gain.

(ii) The profit in 2005 arises on the disposal of British Gas Connections Limited on 20 May 2005 for which cash consideration of £90 million was received, resulting in a pre-tax operating profit of £47 million (note 29). The disposal of shares qualifies for substantial shareholdings exemption and consequently no tax charge has arisen in relation to the profit.

(iii) Business restructuring costs in 2005 comprise £100 million resulting from staff reductions at the corporate centre (£23 million), British Gas Residential Energy (£43 million), British Gas Services (£15 million), British Gas Business (£1 million) and changes to the property portfolio (£18 million). A tax credit of £23 million has been recognised in respect of these costs. Business restructuring costs in 2004 comprise £105 million resulting from staff reductions at the corporate centre (£23 million), Onetel (£5 million) and Centrica Energy (£1 million), changes to the property portfolio (£19 million) as well as the acceleration of elements of the British Gas transformation programme (£57 million). A tax credit of £26 million was recognised in connection with these costs and those discussed in (iv) and (v) below.

(iv) In 2004 unforeseen water break-through into the Rose well resulted in the well being shut in. A work over of the well to isolate the water producing zone was successful. Due to water ingress it was anticipated that the maximum recoverable volume is 25bcf. This resulted in an impairment charge of £50 million.

(v) The provision reduction in 2004 related to certain long-term take-or-pay contracts renegotiated in 1997 by Centrica, which would have resulted in commitments to pay for gas that would be excess to requirements and/or at prices above likely market rates. A provision was made covering the net present cost of estimated further payments resulting from those renegotiations including one due for future settlement in 2008 based on the reserves in a group of third-party fields. Published estimates of these reserves during 2004 indicated a reduction from the 1997 forecast level of reserves. The provision was reduced by £51 million based on a conservative view of the revised reserve levels.

(vi) Adjustments to finalise the consideration received by the Group on the disposal of the AA have led to the recognition of a further £39 million profit in 2005, net of a tax charge of £11 million. The profit on disposal of discontinued operations in 2004 relates to the disposal of 100% of the share capital of the AA, net of a £13 million tax credit, which arose on certain costs qualifying for tax relief.

(vii) The Group disposed of its 100% shareholding in Centrica Telecommunications Limited, Onetel Limited, Telco Holdings Limited and Awardmodel Limited and their subsidiaries (Onetel), on 30 December 2005 realising a loss of £5 million (note 29 (ii) (b)). No tax has arisen in relation to the loss.

(viii) Certain re-measurements included within gross margin comprise re-measurement arising on our energy procurement activities and on proprietary trades in relation to which cross-border transportation or transmission capacity is held (but not on the other activities of our proprietary trading businesses). IAS 39 was adopted from 1 January 2005 and therefore there is no comparative for certain re-measurements for 2004.

(ix) Under IAS 39, cross-border trades are marked to prices in the local market as opposed to prices in the most favourable market which could be accessed through the cross-border transmission and transportation capacity held against such trades. The associated capacity has not been marked-to-market.

8. Directors and employees

a) Employee costs	2005 £m	2004 £m
Wages and salaries	**1,031**	1,093
Social security costs	**83**	107
Other pension and retirement benefits costs (note 31)	**136**	168
Executive Share Option Scheme	**3**	2
Long Term Incentive Scheme	**7**	7
Sharesave Scheme	**10**	8
Share Incentive Plan	**2**	2
	1,272	1,387

Details of Directors' remuneration, share options, Long Term Incentive Scheme interests and pension entitlements in the Remuneration Report on pages 28 to 36 form part of these Financial Statements. Details of employee share schemes are given on pages 24, 30, and 31 and in note 26. Details of the remuneration of key management personnel are given in note 33.

8. Directors and employees continued

Wages and salaries exclude redundancy costs of £68 million (2004: £69 million) which have been classified as restructuring costs included within exceptional items.

b) Average number of employees during the year	2005 Number	2004 Number
British Gas Residential	**24,947**	24,098
British Gas Business	**1,438**	1,369
Centrica Energy	**884**	816
Centrica Storage	**182**	163
North American Energy and Related Services	**5,261**	3,187
Other operations	**1,781**	1,881
The AA (to disposal on 30 September 2004)	**–**	10,683
Onetel (to disposal on 30 December 2005)	**917**	897
	35,410	43,094
UK	**29,948**	39,522
Rest of Europe	**201**	385
North America	**5,261**	3,187
	35,410	43,094

9. Net interest

	2005			2004		
	Interest expense £m	Interest income £m	Total £m	Interest expense £m	Interest income £m	Total £m
Cost of servicing net debt (excluding non-recourse debt)						
Interest income	**–**	**60**	**60**	–	67	67
Interest expense on bank loans and overdrafts (i)	**(87)**	**–**	**(87)**	(56)	–	(56)
Interest expense on finance leases (including tolling agreements)	**(97)**	**–**	**(97)**	(88)	–	(88)
Fair value (losses)/gains on hedges (ii)	**(5)**	**5**	**–**	–	–	–
Fair value (losses)/gains on other derivatives	**(11)**	**25**	**14**	–	–	–
	(200)	**90**	**(110)**	(144)	67	(77)
Interest arising on non-recourse debt						
Interest expense on non-recourse debt	**(11)**	**–**	**(11)**	(10)	–	(10)
Distributions to unit holders of The Consumers' Waterheater Income Fund (iii)	**(20)**	**–**	**(20)**	–	–	–
	(31)	**–**	**(31)**	(10)	–	(10)
Other interest						
Notional interest arising on discounted items	**(14)**	**–**	**(14)**	(28)	–	(28)
Interest on supplier early payment arrangements (iv)	**–**	**12**	**12**	–	15	15
Interest on customer finance arrangements (v)	**(2)**	**–**	**(2)**	(4)	–	(4)
	(16)	**12**	**(4)**	(32)	15	(17)
Interest (expense)/income	**(247)**	**102**	**(145)**	(186)	82	(104)

(i) Includes £19 million (2004: £nil) interest payable on borrowings related to South Morecambe production as detailed in note 34 (c) (iv).
(ii) Includes fair value (losses)/gains on both derivatives designated into fair value hedging relationships and bonds designated as the hedged item.
(iii) Distributions to unit holders of The Consumers' Waterheater Income Fund were treated as distributions to non-equity minority interests prior to the adoption of IAS 32 and IAS 39 on 1 January 2005 (note 3).
(iv) Interest on supplier early payment arrangements arose on the prepayment of gas transportation charges.
(v) The interest cost relates to subsidised credit arrangements provided to customers purchasing central heating installation.

10. Tax

a) Analysis of tax charge for the year

	2005 £m	2004 £m
The tax charge comprises:		
Current tax		
UK corporation tax	**368**	280
UK petroleum revenue tax	**400**	328
Tax on exceptional items (i), (ii)	**(23)**	(17)
Foreign tax	**22**	22
Adjustments in respect of prior years	**(62)**	(44)
Total current tax	**705**	569
Deferred tax		
Current year	**10**	(16)
Prior year	**(22)**	27
Tax on exceptional items and certain re-measurements (ii), (iii), (iv)	**161**	(9)
UK petroleum revenue tax	**(27)**	(36)
Foreign deferred tax	**17**	(14)
Total deferred tax	**139**	(48)
Total tax on profit from continuing operations	**844**	521

(i) The tax credit arising on the business restructuring costs in 2005 recognised in continuing operations was £23 million (note 7 (iii)).
(ii) The tax credit arising on the exceptional items in 2004 recognised in continuing operations was £26 million (note 7 (iii)).
(iii) The tax charge arising on the re-measurement of energy contracts was £149 million (note 7 (viii)).
(iv) The tax charge arising on contract renegotiation in 2005 was £12 million (note 7 (i)).
(v) Tax on items taken directly to equity is disclosed in note 27.

Corporation tax is charged at 30% (2004: 30%) of the estimated assessable profit for the year. The Group earns its profits primarily in the UK, therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 30%. A supplementary charge of 10% is also currently applicable on the Group's UK upstream profits. Taxation for other jurisdictions is calculated at the rates prevailing in the respective jurisdictions.

In December 2005, the UK government announced an increase in the supplementary charge levied on upstream profits from 10% to 20%, effective from 1 January 2006. At 31 December 2005 the tax rate change was not substantively enacted. The deferred tax expense would have increased by approximately £8 million and the overall tax rate by 0.4%, had the change of tax rate been substantively enacted at the balance sheet date.

b) Factors affecting the tax charge for the year

The differences between the total tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	2005 £m	2004 £m
Profit from continuing operations before tax	**1,812**	1,159
Less: share of profits less losses in joint ventures and associates, net of interest and taxation	**(37)**	(56)
Group profit from continuing operations before tax	**1,775**	1,103
Tax on profit from continuing operations at standard UK corporation tax rate of 30% (2004: 30%)	**533**	331
Effects of:		
Expenses not deductible for tax purposes	**9**	12
Adjustments in respect of prior years	**(84)**	(17)
Movement in unrecognised deferred tax assets	**63**	(39)
UK petroleum revenue tax rates	**261**	175
Overseas tax rates	**15**	4
Supplementary charge applicable to upstream profits	**61**	55
Exceptional profit on disposal of British Gas Connections Limited	**(14)**	–
Group tax charge on profit from continuing operations	**844**	521

11. Dividends

	2005 £m	2004 £m
Prior year final dividend of 6.1p (2004: 3.7p) per ordinary share	**220**	230
Interim dividend of 3.1p (2004: 2.5p) per ordinary share	**120**	105
Special dividend of 25.0p per ordinary share	**–**	1,051
	340	1,386

The prior year final dividend was paid on 15 June 2005 and the 2005 interim dividend was paid on 16 November 2005. The special dividend was paid on 17 November 2004.

The Directors propose a final dividend of 7.4 pence per share (totalling £268 million) for the year ended 31 December 2005. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 19 May 2006. These Financial Statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2006.

12. Earnings per ordinary share

Basic earnings per ordinary share has been calculated by dividing the earnings attributable to equity holders of the parent Company for the year of £1,012 million (2004: £1,591 million) by the weighted average number of ordinary shares in issue during the year of 3,688 million (2004: 4,184 million). The number of shares excluded 3 million ordinary shares (2004: 18 million), being the weighted average number of the Company's own shares held in the employee share trust which are treated as treasury shares.

There was a share repurchase programme in operation during the year as described in note 25.

The Directors believe that the presentation of an adjusted basic earnings per ordinary share, being the basic earnings per ordinary share adjusted for certain re-measurements and exceptional items assists with understanding the underlying performance of the Group. The reconciliation of basic to adjusted basic earnings per ordinary share is as follows:

	2005		2004	
a) Continuing and discontinued operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings – basic	**1,012**	**27.4**	1,591	38.0
Net exceptional items after tax (note 7)	**(34)**	**(0.9)**	(833)	(19.9)
Certain re-measurement gains and losses after tax (note 7)	**(306)**	**(8.3)**	–	–
Earnings – adjusted basic	**672**	**18.2**	758	18.1
Earnings – diluted	**1,012**	**27.0**	1,591	37.4

	2005		2004	
b) Continuing operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings – basic	**967**	**26.2**	618	14.8
Net exceptional items after tax (note 7)	**–**	**–**	73	1.7
Certain re-measurement gains and losses after tax (note 7)	**(306)**	**(8.3)**	–	–
Earnings – adjusted basic	**661**	**17.9**	691	16.5
Earnings – diluted	**967**	**25.8**	618	14.5

	2005		2004	
c) Discontinued operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings – basic	**45**	**1.2**	973	23.3
Earnings – diluted	**45**	**1.2**	973	22.9

12. Earnings per ordinary share continued

Certain re-measurements within gross margin comprise re-measurement arising on our energy procurement activities and proprietary trades in relation to which cross-border transportation or transmission capacity is held (but not on the other activities of our proprietary trading businesses). Certain re-measurements included within interest comprise re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund. All other re-measurement is included within results before exceptional items and certain re-measurement.

In addition to basic and adjusted earnings per ordinary share, information is presented for diluted earnings per ordinary share. Under this presentation, no adjustments are made to the reported earnings for either 2005 or 2004, but the weighted average number of shares used as the denominator is adjusted. The adjustments relate to notional share awards made to employees under the Long Term Incentive Scheme. The share options granted to employees under the share schemes were as follows:

	2005 million shares	2004 million shares
Weighted average number of shares used in calculation of basic earnings per ordinary share	**3,688**	4,184
Estimated vesting of Long Term Incentive Scheme shares	**24**	26
Dilutive effect of shares to be issued at a discount to market value under the Sharesave Schemes	**34**	37
Potentially dilutive shares issuable under the Executive Share Option Scheme	**5**	4
Weighted average number of shares used in the calculation of diluted earnings per ordinary share	**3,751**	4,251

13. Goodwill

	£m
Cost	
1 January 2005	**1,230**
Acquisitions (i)	**109**
Disposals (ii) (note 29)	**(110)**
Exchange adjustments	**130**
31 December 2005	**1,359**
Aggregate amortisation and impairment	
1 January 2005	**181**
Disposals (ii) (note 29)	**(13)**
Exchange adjustments	**21**
31 December 2005	**189**
Net book value	
31 December 2005	**1,170**

(i) Goodwill arising of £109 million, comprises £101 million relating to acquisitions detailed in note 29 (i), and £8 million relating to adjustments to deferred consideration on prior year acquisitions.
(ii) Goodwill disposed of (net book value of £97 million) relates to the disposal of Onetel, as detailed in note 29 (ii) b, and comprises the goodwill relating to the acquisitions in prior years of Onetel and Telco Global, and of Rednet during 2005 (note 29 (i) c).

	£m
Cost	
1 January 2004	2,004
Acquisitions	229
Disposals	(991)
Exchange adjustments	(12)
31 December 2004	1,230
Aggregate amortisation and impairment	
1 January 2004	390
Impairment losses for the year	4
Disposals	(211)
Exchange adjustments	(2)
31 December 2004	181
Net book value	
31 December 2004	1,049

13. Goodwill continued

The net book value of goodwill at 31 December related to the following acquisitions:

	2005 £m	2004 £m
Direct Energy	**328**	285
Energy America	**26**	24
Enron Direct/Electricity Direct	**133**	133
Onetel	**–**	45
Telco Global	**–**	48
Enbridge Services	**205**	177
WTU/CPL	**210**	185
ATCO	**46**	40
Dyno-Rod	**17**	17
Residential Services Group	**77**	67
Oxxio	**84**	–
Humber	**14**	–
Other	**30**	28
	1,170	1,049

14. Other intangible assets

	Application software (iii) £m	Renewable obligation certificates £m	Brands (i) £m	Other £m	Total £m
Cost					
1 January 2005	419	71	57	39	**586**
Additions – acquired from a third party	41	55	–	3	**99**
Additions – directly attributable costs	75	–	–	–	**75**
Acquisitions (ii) (note 29)	1	–	–	32	**33**
Disposals	(5)	(78)	–	–	**(83)**
Disposal of subsidiary (note 29)	(3)	–	–	–	**(3)**
Exchange adjustments	7	–	–	1	**8**
31 December 2005	**535**	**48**	**57**	**75**	**715**
Aggregate amortisation and impairment					
1 January 2005	67	–	–	1	**68**
Charge for the year	67	–	–	10	**77**
Disposals	(4)	–	–	–	**(4)**
Disposal of subsidiary (note 29)	(1)	–	–	–	**(1)**
Exchange adjustments	6	–	–	–	**6**
31 December 2005	**135**	**–**	**–**	**11**	**146**
Net book value					
31 December 2005	**400**	**48**	**57**	**64**	**569**

Amortisation arising on application software and other intangible assets is charged to operating costs in the Income Statement.

(i) Included within brands is the Dyno-Rod brand, acquired on the acquisition of the Dyno group of companies during 2004. In accordance with IAS 38 paragraph 88, management has ascribed the brand an indefinite useful life because there is no foreseeable limit to the period over which the Dyno brand is expected to generate net cash inflows. In reaching this determination, management have reviewed potential threats from competition, the risks of technological obsolescence and the expected usage of the brand by management.

(ii) Included within acquisitions of other intangible assets is a reduction of £3 million arising from revisions to the fair values of intangibles acquired with acquisitions in 2004.

(iii) Included within application software is amounts for customer relationship management systems. At 31 December 2005 the net book value of these systems is £323 million (2004: £268 million). The remaining amortisation periods of these systems range from 5 to 10 years.

14. Other intangible assets continued

	Application software £m	Renewable obligation certificates £m	Brands (i) £m	Other £m	Total £m
Cost					
1 January 2004	380	40	–	–	420
Additions – acquired from a third party	4	106	–	–	110
Additions – directly attributable costs	71	–	–	–	71
Acquisitions	6	–	57	38	101
Disposals	(5)	(75)	–	–	(80)
Disposal of subsidiary	(39)	–	–	–	(39)
Exchange adjustments	1	–	–	–	1
31 December 2004	418	71	57	38	584
Aggregate amortisation and impairment					
1 January 2004	32	–	–	–	32
Charge for the year	40	–	–	–	40
Disposal of subsidiary	(6)	–	–	–	(6)
31 December 2004	66	–	–	–	66
Net book value					
31 December 2004	352	71	57	38	518

15. Impairment testing of goodwill and intangibles with indefinite useful lives

Goodwill acquired through business combinations and indefinite lived intangibles have been allocated to cash-generating units as follows:

		2005			2004		
Cash-generating unit	**Acquisition to which goodwill relates**	**Carrying amount of goodwill £m**	**Carrying amount of indefinite lived brand £m**	**Total £m**	Carrying amount of goodwill £m	Carrying amount of indefinite lived brand £m	Total £m
British Gas Business	Enron Direct/Electricity Direct	**133**	**–**	**133**	133	–	133
British Gas Services – Dyno-Rod	Dyno-Rod	**17**	**57**	**74**	17	57	74
Texas residential energy – CPL/WTU	CPL/WTU	**210**	**–**	**210**	185	–	185
Canada residential energy – east	Direct Energy	**328**	**–**	**328**	285	–	285
Canada residential energy – west	ATCO	**46**	**–**	**46**	40	–	40
Canada home services	Enbridge Services	**205**	**–**	**205**	177	–	177
US home services	RSG	**77**	**–**	**77**	67	–	67
Europe – Oxxio	Oxxio	**84**	**–**	**84**	–	–	–
Onetel (i)	Onetel/Telco Global	**–**	**–**	**–**	93	–	93
Other (ii)	Various	**70**	**–**	**70**	52	–	52
		1,170	**57**	**1,227**	1,049	57	1,106
Europe – SPE (iii)	SPE/Luminus	**49**	**–**	**49**	51	–	51

(i) The Group disposed of the Onetel group on 30 December 2005, as detailed in note 29 (ii) (b).
(ii) Goodwill balances allocated across multiple cash-generating units. The amount of goodwill allocated to each cash-generating unit is not significant compared to the aggregate carrying value of goodwill reported within the Group.
(iii) Includes goodwill relating to interests in joint ventures detailed in note 17.

15. Impairment testing of goodwill and intangibles with indefinite useful lives continued

Goodwill and indefinite lived intangibles are tested for impairment annually, or more frequently if there are indications that amounts might be impaired. The impairment test involves determining the recoverable amount of the cash-generating units, which corresponds to the fair value less costs to sell or the value in use. Value in use calculations have been used to determine recoverable amounts for the cash-generating units noted above. These are determined using cash flow budgets, which are based on business plans for a period of five years. These business plans have been approved by the executive boards and are valid when the impairment test is performed. The plans are based on past experience as well as future expected market trends. Cash flows beyond the five year plan period used in the value in use calculations are increased in line with historic long-term growth rates in the UK, or where applicable the US, Canada and the Netherlands. Discount rates applied to the cash flow forecasts in determining recoverable amounts are derived from the Group's weighted average cost of capital and for North American cash-generating units range from 8.8% to 11.3%, and for UK and Europe cash-generating units range from 8.6% to 11.4%, on a pre-tax basis. Growth rates used to extrapolate cash flow projections beyond the period covered by the most recent forecasts range from 0% to 3%. The key assumptions in the value in use calculations determining recoverable amounts for the specific cash-generating units noted above are:

British Gas Business

Budgeted gross margin – This is based on the average achieved gross margin in the six month period immediately prior to approval of the business plan. Management believe the assumed margins are reasonably achievable. Budgeted market share – This is based on the average market share achieved immediately prior to the approval of the business plan and the growth forecasts based on sales and marketing activity. Management believes the assumed improvements are reasonably achievable.

British Gas Services – Dyno-Rod

Budgeted income – This is based on financial performance in the period prior to the approval of the budget including an encouraging response to recently launched sales initiatives. Income relates to franchise fees budgeted to be received by the Group. Management believe the assumed improvements are reasonably achievable.

Texas residential energy – CPL/WTU

Budgeted gross margin – This is based on the average achieved gross margin in the three year period prior to the approval of the business plan. Management believes that the assumed margins are reasonably achievable. Budgeted customer numbers – This is based on customer numbers prior to the approval of the business plan uplifted for expected improvements due to new product offerings. Management believes that the assumed improvements are reasonably achievable. Budgeted market price – This is based on Centrica's view of forward gas and forward power prices in Texas immediately prior to the approval of the business plan. Budgeted consumption – This is based on the average consumption per customer prior to the approval of the business plan.

Canada residential energy – east

Budgeted gross margin – For existing customers this is based on contracted margins. For new and renewal customers this is based on achieved gross margin in the period immediately prior to the approval of the business plan, uplifted in certain markets for expected improvements. Management believes that the assumed improvements are reasonably achievable. Budgeted market share – This is based on the average market share achieved in the period immediately prior to the approval of the business plan, uplifted in certain markets for a forecast increase based on increased brand awarenesss and expansion of sales capacity. Management believes that the assumed improvements are reasonably achievable. Budgeted market price – This is based on Centrica's view of forward gas and forward power prices in Canada immediately prior to the approval of the business plan. Budgeted consumption – This is based on the average consumption per customer for the two year period prior to the approval of the business plan.

Canada residential energy – west

Budgeted gross margin – For existing customers this is based on contracted margins. For new customers this is based on achieved margins in the period immediately prior to the approval of the business plan, uplifted in certain markets for expected improvements arising from increased market penetration and brand awareness. Management believes that the assumed improvements are reasonably achievable. Budgeted market share – For the regulated business this is based on the market share immediately prior to the approval of the business plan, with adjustments made for the expected growth in the market offset by increased competition. For the other businesses, budgeted market share is based on average market share achieved in the period immediately prior to the approval of the business plan, uplifted for a forecast increase due to expected regional inflation and economic growth. Management believes that the assumed improvements are reasonably achievable. Budgeted market price – This is based on Centrica's view of forward gas and forward power prices in Canada immediately prior to the approval of the business plan.

Canada home services

Budgeted gross margin – This is based on the achieved gross margin in the period immediately prior to the approval of the business plan, uplifted for expected improvements due to arise from additional product offerings. Management believes that the assumed improvements are reasonably achievable. Budgeted revenue growth – This is based on the average achieved revenue growth for the three year period prior to the approval of the business plan, uplifted in certain markets for expected improvements due to arise from additional product offerings. Management believes that the assumed improvements are reasonably achievable.

15. Impairment testing of goodwill and intangibles with indefinite useful lives continued

US home services

Budgeted gross margin – This is based on achieved gross margin in the period immediately prior to the approval of the business plan. Management believes that the assumed margins are reasonably achievable. Budgeted revenue growth – This is based on the average achieved revenue growth for the North American home services operations for the three year period prior to the approval of the business plan, uplifted for growth targets. Management believes that the growth targets are reasonably achievable due to market penetration in certain key US state markets.

Europe – Oxxio

Budgeted gross margin – This is based on the achieved gross margin in the six month period prior to the approval of the budget. Management believes that the assumed margins are reasonably achievable. Budgeted revenue growth – This is based on management's expectations of future requirements provided by customers, growth in customer numbers and reduction in customer churn. The growth is not based on historical revenue growth, which resulted from the significant growth in customer numbers following the opening of the electricity and gas markets in the Netherlands. Management believes that the assumed improvements are reasonably achievable.

Europe – SPE

The assets tested for impairment in respect of SPE comprise goodwill of £49 million in addition to other net assets of £126 million. In accordance with IFRS 3, Business combinations, the net assets of SPE SA were fair valued upon acquisition. The remaining excess consideration after allocating the purchase price to all identifiable assets and liabilities is treated as goodwill. The carrying values recognised upon acquisition have been assessed for impairment against the expected future cash flows of the entity. Management have concluded that the future cash inflows are sufficient to support the carrying value of recognised goodwill and other net assets.

Centrica is of the opinion that, based on current knowledge, expected changes in the aforementioned key assumptions on which the determination of the recoverable amounts are based would not cause the carrying amounts of the cash-generating units to exceed the recoverable amounts.

16. Property, plant and equipment

	Land and buildings (i) £m	Plant, equipment and vehicles (iii), (v) £m	Power generation (v), (vi), (viii), (ix), (xi) £m	Storage, exploration and production (ii), (iv), (vii), (x) £m	**Total £m**
Cost					
1 January 2005	59	648	1,379	4,030	**6,116**
Additions	–	94	100	456	**650**
Acquisitions (note 29)	1	1	181	4	**187**
Transfers from joint ventures	–	–	249	–	**249**
Revaluation	–	–	14	–	**14**
Disposals	(15)	(58)	(315)	(3)	**(391)**
Disposal of subsidiary (note 29)	–	(86)	–	–	**(86)**
Revisions and additions to decommissioning liability	–	–	7	34	**41**
Exchange adjustments	–	47	17	49	**113**
31 December 2005	**45**	**646**	**1,632**	**4,570**	**6,893**
Aggregate depreciation and impairment					
1 January 2005	30	159	112	2,646	**2,947**
Charge for the year	1	84	90	237	**412**
Disposals	(14)	(54)	(60)	(2)	**(130)**
Disposal of subsidiary (note 29)	–	(33)	–	–	**(33)**
Exchange adjustments	–	12	1	14	**27**
31 December 2005	**17**	**168**	**143**	**2,895**	**3,223**
Net book value					
31 December 2005	**28**	**478**	**1,489**	**1,675**	**3,670**

16. Property, plant and equipment continued

	Land and buildings (i) £m	Plant, equipment and vehicles (iii), (v) £m	Power generation (v), (vi), (viii), (ix), (xi) £m	Storage, exploration and production (ii), (iv), (vii), (x) £m	Total £m
Cost					
1 January 2004	119	638	615	3,844	5,216
Additions	–	150	479	72	701
Acquisitions	3	6	298	114	421
Disposals	(11)	(48)	(10)	(3)	(72)
Disposal of subsidiary	(52)	(99)	–	–	(151)
Exchange adjustments	–	1	(3)	3	1
31 December 2004	59	648	1,379	4,030	6,116
Aggregate depreciation and impairment					
1 January 2004	51	125	67	2,324	2,567
Charge for the year	3	121	51	323	498
Disposals	(4)	(38)	(6)	(2)	(50)
Disposal of subsidiary	(20)	(50)	–	–	(70)
Exchange adjustments	–	1	–	1	2
31 December 2004	30	159	112	2,646	2,947
Net book value					
31 December 2004	29	489	1,267	1,384	3,169

(i) The net book value of land and buildings at 31 December 2005 comprised freehold of £10 million (2004: £10 million), long leasehold of £10 million (2004: £11 million) and short leasehold of £8 million (2004: £8 million).

(ii) The net book value of storage, exploration and production assets included decommissioning costs with a net book value of £85 million (2004: £48 million).

(iii) The net book value of the fixed assets of The Consumers' Waterheater Income Fund (the Fund) within plant, equipment and vehicles was £210 million (2004: £184 million). Debt issued by a subsidiary of the Fund, without recourse to the Group, is secured on the assets.

(iv) The net book value of exploration and production fixed assets includes £36 million (2004: £17 million) of exploration and evaluation costs. During the year £36 million (2004: £9 million) of exploration and evaluation costs were capitalised and £2 million of exploration and evaluation costs were transferred to producing assets becoming subject to depreciation (2004: £1 million). £15 million of exploration and evaluation costs were impaired during the year because evaluation revealed that the fields were not commercially viable (2004: £15 million). The impairments occurred within Centrica Energy – gas production, a reportable segment of the Group.

(v) The amounts capitalised in the year in respect of assets in the course of construction within plant, equipment and vehicles was £15 million (2004: £11 million), and within power generation was £16 million (2004: £21 million).

(vi) The Group acquired the remaining 40% stake in Humber Power Limited (Humber) on 19 September 2005 (note 29). The Group's 60% stake in Humber had previously been equity accounted as a joint venture. Power generation includes assets with a fair value of £181 million, which were revalued on the acquisition. The carrying amount which would have been recognised had the assets been carried at cost was £164 million. The assets of the joint venture of £249 million have been transferred from interests in joint ventures and revalued to their fair value at 19 September 2005. In addition to its share in the net assets of the joint venture, the Group previously treated its tolling arrangement with Humber as a finance lease. This asset, with a net book value of £251 million, was de-recognised on 19 September 2005.

(vii) Additions include the purchase of the Brae, Buckland and Skene gas fields from Kerr McGee for £268 million. This transaction was completed on 30 September 2005. The consideration paid was allocated to the assets and liabilities acquired. In addition to assets of £332 million, a £38 million provision for decommissioning, £5 million for working capital and a £31 million financial liability relating to the fair value of contracts acquired was recognised.

(viii) The net book value of power generation assets includes £434 million (2004: £723 million) of assets to which title is restricted for the Spalding finance lease asset (2004 comparative includes the Humber finance lease asset).

(ix) The net book value of power generation assets includes £411 million (2004: £nil) of assets which are pledged as security for liabilities.

(x) Included within acquisitions for storage, exploration and production is a £4 million increase related to the finalisation of fair values of prior year acquisitions.

(xi) Assets held under finance leases are analysed as follows:

16. Property, plant and equipment continued

Assets held under finance leases	2005 £m	2004 £m
Cost at 1 January	**1,200**	732
Additions	**413**	469
Disposals	**(311)**	(1)
Cost at 31 December	**1,302**	1,200
Aggregate depreciation at 1 January	**396**	356
Charge for the year	**54**	41
Disposals	**(60)**	(1)
Aggregate depreciation at 31 December	**390**	396
Net book value at 31 December	**912**	804

The net book value of property, plant and equipment held under finance leases and the depreciation charge for the period is split as follows:

	Net book value £m	Depreciation charge £m
Power generation	**910**	54
Storage, exploration and production	**2**	–
	912	54

17. Interests in joint ventures and associates

	Investments in joint ventures and associates			
	Investments £m	Goodwill £m	Shareholder loans £m	Total £m
Share of net assets/cost				
31 December 2004	131	51	24	**206**
Adoption of IAS 39	(14)	–	–	**(14)**
1 January 2005 as restated	117	51	24	**192**
Additions (i)	114	23	–	**137**
Increase in shareholder loans	–	–	24	**24**
Conversion of shareholder loans to equity shares	36	–	(36)	**–**
Disposals (i), (iii)	(14)	(25)	–	**(39)**
Transfer to subsidiaries (ii)	(112)	–	–	**(112)**
Dividends received	(16)	–	–	**(16)**
Share of profits less losses for the year	37	–	–	**37**
31 December 2005	**162**	**49**	**12**	**223**

17. Interests in joint ventures and associates continued

	Investments in joint ventures and associates			
	Investments £m	Goodwill £m	Shareholder loans £m	Total £m
Share of net assets/cost				
1 January 2004	104	52	–	156
Additions	1	–	–	1
Increase in shareholder loans	–	–	24	24
Disposals (iv)	(15)	–	–	(15)
Dividends received	(28)	–	–	(28)
Share of profits less losses for the year	69	–	–	69
Exchange adjustments	–	(1)	–	(1)
31 December 2004	131	51	24	206

The Group's share of joint ventures' gross assets and gross liabilities at 31 December 2005 principally comprises its interests in Barrow Offshore Wind Limited (renewable power generation) and Segebel SA (energy supply).

(i) On 28 September 2005, the Group entered into a 50/50 joint venture (Segebel SA) with Gaz de France. Segebel SA holds a controlling stake of 51% in SPE SA, a Belgian energy company. At the time of the acquisition SPE SA acquired the Group's 50/50 joint venture energy supply business, Luminus NV for shares. The acquisition of Luminus NV by SPE SA was treated as a partial (24.5%) disposal by the Group resulting in a loss of £1 million.
(ii) On 19 September 2005, the Group acquired the remaining 40% stake in Humber Power Limited, and accordingly Humber Power Limited has been treated as a subsidiary of the Group from that date (note 29). The Group's 60% share of the assets and liabilities of Humber Power Limited have been transferred to the Group at the date of acquisition.
(iii) On 11 October 2005 the Group disposed of its 49% shareholding in AccuRead Limited for cash consideration of £11 million, resulting in a pre-tax profit on disposal of £8 million.
(iv) Disposals in 2004 relate to the disposal of financial services joint ventures, and associates disposed of with the AA.

	2005			2004
	Barrow Offshore Wind Limited £m	**Segebel SA £m**	**Total £m**	Total £m
Interests in joint ventures				
Share of current assets	1	108	**109**	143
Share of non-current assets	54	255	**309**	401
	55	363	**418**	544
Share of current liabilities	(19)	(50)	**(69)**	(54)
Share of non-current liabilities	–	(138)	**(138)**	(311)
	(19)	(188)	**(207)**	(365)
Share of net assets of associates	–	–	**–**	3
Shareholder loans	12	–	**12**	24
Interests in joint ventures and associates	48	175	**223**	206
Net debt included in share of gross liabilities	(12)	(30)	**(42)**	(240)

	2005						2004
	Barrow Offshore Wind Limited £m	**Segebel SA £m**	**Luminus £m**	**Humber £m**	**Other £m**	**Total £m**	Total £m
Share of results of joint ventures							
Income	–	92	216	52	22	**382**	430
Expenses	–	(91)	(210)	(14)	(20)	**(335)**	(350)
	–	1	6	38	2	**47**	80
Tax	–	(1)	–	(8)	(1)	**(10)**	(13)
Share of post-tax results of joint ventures	–	–	6	30		**36**	67
Share of post-tax results of associates					1	**1**	2
Share of post-tax results of joint ventures and associates	–	–	6	30	1	**37**	69

17. Interests in joint ventures and associates continued

The Group's share of the investment in and results of Barrow Offshore Wind Limited is included within the Centrica Energy segment, within the industrial and wholesaling subsegment. The Group's share of the investment in and results of Segebel SA are included within the European Energy segment. Up to the date of acquisition of the Group's remaining stake in Humber Power Limited, the Group's share of the investment in and results of Humber Power Limited were included within the Centrica Energy segment, within the industrial and wholesaling subsegment.

18. Inventories

	2005 £m	2004 £m
Gas in storage and transportation	**108**	97
Other raw materials and consumables	**74**	52
Finished goods and goods for resale	**14**	16
	196	165

Inventories include £77 million which is carried at fair value less cost to sell, being lower than cost (2004: £46 million). The Group consumed £184 million of inventories (2004: £176 million) during the year.

19. Trade and other receivables

	2005		2004	
	Current £m	Non-current £m	Current £m	Non-current £m
Trade receivables, net of provisions for impairment	**944**	**25**	703	43
Accrued energy income	**1,968**	**–**	1,712	–
Other receivables	**244**	**–**	183	1
Prepayments and other accrued income	**265**	**–**	331	24
	3,421	**25**	2,929	68

20. Cash and cash equivalents

	2005 £m	2004 £m
Cash at bank, in transit and in hand	**21**	51
Short-term deposits	**1,218**	915
Cash and cash equivalents	**1,239**	966

Short-term deposits included £30 million (2004: £30 million) held by the Group's insurance subsidiary undertakings and £25 million (2004: £10 million) held by The Consumers' Waterheater Income Fund. These amounts are not readily available to be used for other purposes within the Group. Short-term deposits include £624 million relating to cash collateralised on letters of credit provided by banks on borrowings relating to South Morecambe gas production. The borrowings are described in more detail in note 34 (c) (iv).

21. Bank overdrafts and loans

Amounts falling due:	Within one year 2005 £m	After one year 2005 £m	Within one year 2004 £m	After one year 2004 £m
a) Businesses' recourse borrowings				
Bank loans and overdrafts (i)	**71**	**55**	90	33
Other bank loans (ii)	**188**	**449**	–	–
Sterling bonds (iii)	**–**	**422**	125	410
Commercial paper (iv)	**377**	**–**	220	–
Loan notes	**–**	**–**	2	–
Obligations under finance leases (including power station tolling arrangements) (vii)	**19**	**809**	50	785
	655	**1,735**	487	1,228
b) Businesses' non-recourse borrowings				
Canadian dollar bonds (v)	**–**	**250**	–	217
Units of The Consumers' Waterheater Income Fund (vi)	**–**	**282**	–	–
	655	**2,267**	487	1,445

The Group's management of exposures to financial instruments, and an analysis of effective interest rates is detailed in note 34.

(i) Includes bank overdrafts of £62 million (2004: £85 million) which are repayable on demand. Overdrafts bear interest at floating rates based on bank base rate plus 1% margin. Bank loans repayable after one year comprise £52 million repayable within two to five years, and £3 million repayable after more than five years.

(ii) Other bank loans represent borrowings relating to South Morecambe gas field production as described in more detail in note 34 (c) (iv).

(iii) Sterling bonds were repayable as follows: less than one year £nil (2004: £125 million) and after five years £422 million (2004: £410 million). The bonds bear interest at fixed rates of 5.875% (2004: 5.375% and 5.875%). The bonds have a face value of £415 million (2004: £540 million) and are stated at amortised cost net of £4 million (2004: £5 million) issuance discount, and at fair value where hedged.

(iv) Commercial paper has a face value of £382 million (2004: £221 million).

(v) Canadian dollar bonds have a face value of £250 million (2004: £217 million). This debt is issued by The Consumers' Waterheater Trust, a wholly owned subsidiary of The Consumers' Waterheater Income Fund (the Fund), which is consolidated in the Group Financial Statements. The debt is secured solely on the assets of the Fund and its subsidiaries, without recourse to the Group. These bonds were issued in two series and have a maturity date of greater than five years bearing interest between 4.700% and 5.245% respectively.

(vi) Units of the Fund are traded on the Toronto Stock Exchange and are treated as debt in the Group Financial Statements from the date of adoption of IAS 32 on 1 January 2005. The units were treated as non-equity minority interests of the Group prior to the adoption of IAS 32.

(vii) Future finance lease commitments are as follows:

	Minimum lease payments 2005 £m	Present value of minimum lease payments 2005 £m	Minimum lease payments 2004 £m	Present value of minimum lease payments 2004 £m
Amounts payable:				
Within one year	**49**	**19**	146	50
Between one and five years	**219**	**110**	486	54
After five years	**849**	**699**	1,896	731
	1,117	**828**	2,528	835
Less future finance charges	**(289)**		(1,693)	
Present value of lease obligations	**828**		835	
Interest receivable in the Humber Power Limited joint venture in respect of finance lease charges	**–**		1,491	

In addition to the minimum lease payments, tolling charges are payable, calculated based on effective operating hours of the station. In the year, £20 million of tolling charges were paid in respect of the Humber and Spalding tolling contracts (2004: £12 million).The Group acquired the remaining 40% stake in Humber Power Limited on 19 September 2005 (note 29). Prior to the acquisition, the tolling arrangement with the joint venture was treated as a finance lease in the Group's Financial Statements. On acquisition, this finance lease has been de-recognised. The net assets acquired by the Group, and the net assets transferred from the joint venture at acquisition include a finance lease in respect of the generation assets. The Group has an option to extend the Spalding tolling arrangement. To exercise this option, notice must be given to the operator, prior to 30 September 2020. Should this option be exercised, by serving further notice the Group has an option to purchase the station. At this time, the generator has the option to retain the station and terminate the tolling contract. Valuation of these options will be determined by an expert panel, appointed by both parties. The minimum lease payments and the tolling charges based on equivalent operating hours are subject to escalation based on a market of indices. There are no restrictions under the finance leases in either the current or prior year.

22. Trade and other payables

	2005 Current £m	2005 Non-current £m	2004 Current £m	2004 Non-current £m
Trade payables	**1,400**	**–**	1,429	–
Other payables	**1,134**	**89**	873	70
Accruals				
Transportation	**34**	**–**	18	–
Other accruals	**874**	**–**	797	7
	908	**–**	815	7
Deferred income	**99**	**13**	69	17
	3,541	**102**	3,186	94

23. Deferred corporation tax liabilities and assets

The following are the major deferred tax liabilities and assets recognised by the Group and movements thereon during the current and prior reporting period:

	Accelerated tax depreciation (petroleum revenue tax) £m	Deferred corporation tax effect thereon £m	Decommissioning (petroleum revenue tax) £m	Deferred corporation tax effect thereon £m	Retirement benefit obligation and other provisions £m	Accelerated tax depreciation (corporation tax) £m	Other timing differences including losses carried forward £m	Mark-to-market £m	Total £m
1 January 2004	244	(98)	(41)	16	(326)	394	(103)	–	**86**
Charge to income	(15)	6	(21)	9	–	(9)	(18)	–	**(48)**
Charge to equity	–	–	–	–	27	–	–	–	**27**
Acquisition/disposal of subsidiary	–	–	–	–	87	33	28	–	**148**
31 December 2004	229	(92)	(62)	25	(212)	418	(93)	–	**213**
Adoption of IAS 32 and IAS 39	–	–	–	–	–	–	–	(44)	**(44)**
1 January 2005 as restated	229	(92)	(62)	25	(212)	418	(93)	(44)	**169**
Charge to income	(30)	20	3	(1)	–	(3)	(11)	161	**139**
Charge to equity	–	–	–	–	(37)	–	4	117	**84**
Acquisition/disposal of subsidiary	–	–	–	–	–	54	–	–	**54**
Transfers	(19)	–	–	–	–	–	–	–	**(19)**
Exchange adjustments	–	–	–	–	–	11	–	9	**20**
31 December 2005	**180**	**(72)**	**(59)**	**24**	**(249)**	**480**	**(100)**	**243**	**447**

Certain deferred tax assets and liabilities have been offset. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2005 £m	2004 £m
Deferred tax liabilities	**743**	524
Deferred tax assets	**(296)**	(311)
	447	213

At the balance sheet date the Group had certain deductible temporary differences of £576 million (2004: £329 million) available for utilisation against future profits. No deferred tax asset has been recognised in respect of these temporary differences, due to the unpredictability of future profit streams. These assets may be carried forward indefinitely.

At the balance sheet date temporary differences of £66 million (2004: £69 million) existed in respect of the Group's overseas investments. The deferred tax liability arising on these temporary differences is estimated to be £8 million (2004: £9 million), which has been provided.

At the balance sheet date there were no material current deferred tax assets or liabilities.

24. Provisions

Current provisions for liabilities and charges	1 January 2005 £m	Acquisitions and disposals (v) £m	Charged in the year £m	Unused and reversed in the year £m	Utilised £m	Transfers £m	**31 December 2005 £m**
Restructuring costs (ii)	87	–	107	(27)	(64)	1	**104**
Renegotiation provisions (iii)	–	3	14	(13)	–	–	**4**
Other (iv)	64	(24)	6	(6)	(5)	–	**35**
	151	**(21)**	**127**	**(46)**	**(69)**	**1**	**143**

Non-current provisions for liabilities and charges	31 December 2004 £m	Adoption of IAS 39 (note 38) £m	1 January 2005 £m	Acquisitions and disposals (v) £m	Charged in the year £m	Unused and reversed in the year £m	Revisions and additions £m	Utilised £m	Transfers £m	**31 December 2005 £m**
Decommissioning costs (i)	262	–	262	2	21	–	41	–	–	**326**
Restructuring costs (ii)	8	–	8	–	27	(2)	–	–	(3)	**30**
Renegotiation provisions (iii)	83	–	83	2	12	(6)	–	–	–	**91**
Sales contract loss provision	62	(62)	–	–	–	–	–	–	–	**–**
Other (iv)	22	–	22	17	3	(6)	–	(1)	–	**35**
	437	**(62)**	**375**	**21**	**63**	**(14)**	**41**	**(1)**	**(3)**	**482**

(i) Provision has been made for the estimated net present cost of decommissioning gas production and storage facilities at the end of their useful lives. The estimate has been based on proven and probable reserves, price levels and technology at the balance sheet date. The timing of decommissioning payments are dependent on the lives of the facilities but are anticipated to occur between 2007 and 2042. The charge to income includes £10 million of notional interest (2004: £9 million).

(ii) During the year the Group undertook a significant restructuring programme to achieve its stated cost reduction targets. The restructure involved a reduction in employee numbers of 1,182 and the exit of three properties. The provision represents costs relating to surplus properties, redundancy and other costs relating to reorganisations. The element relating to surplus properties was calculated as the lower of the difference between rental costs and sub-let income over the remainder of the leases and the expected cost to surrender those leases. The charge to income for the year included £100 million (2004: £105 million) for exceptional redundancy and other reorganisation costs (note 7). The exceptional charge comprises staff reduction costs at Corporate Centre (£23 million), British Gas Residential Energy (£43 million), British Gas Services (£15 million), British Gas Business (£1 million) and changes to the property portfolio (£18 million). The majority of these sums are expected to be utilised during 2006. Included within the provision for 2005 are liabilities arising in the Pension Schemes of £13 million in respect of redundancy costs (2004: £14 million).

(iii) In previous years, the Group renegotiated certain long-term take-or-pay contracts which would have resulted in commitments to pay for gas that would be excess to requirements and/or at prices above likely market rates. The provision represents the net present cost of estimated payments due to suppliers as consideration for the renegotiations, which are due for settlement in 2008 based on the reserves in a group of third party fields. The amount arising in the year includes £6 million of notional interest (2004: £10 million).

(iv) Other provisions included, outstanding litigation and provision for National Insurance payable in respect of Long Term Incentive Scheme liabilities. The National Insurance provision was based on a share price of 254.75 pence at 31 December 2005 (2004: 236.25 pence) and is expected to be utilised between 2006 and 2008.

(v) Also included within acquisitions and disposals for other provisions were provisions relating to the costs of disposal of the AA and Onetel. The majority of these amounts are expected to be utilised within one year. Included within acquisitions and disposals for decommissioning provisions are adjustments of £2 million relating to the finalisation of fair values of prior year acquisitions.

25. Called up share capital

	2005 £m	2004 £m
Authorised share capital of the Company		
4,455,000,000 ordinary shares of $6^{14}/_{81}$p each		
(2004: 4,455,000,000 ordinary shares of $6^{14}/_{81}$p each)	**275**	275
100,000 cumulative redeemable preference shares of £1 each	**–**	–
Allotted and fully paid share capital of the Company		
3,623,982,266 ordinary shares of $6^{14}/_{81}$p each		
(2004: 3,775,817,747 ordinary shares of $6^{14}/_{81}$p each)	**224**	233

25. Called up share capital continued

The movement in allotted and fully paid share capital of the Company for the year was as follows:

	2005 Number	2004 Number
1 January	**3,775,817,747**	4,265,901,206
Shares repurchased (i)	**(164,654,278)**	(84,875,000)
Effect of share consolidation (ii)	**–**	(421,793,113)
Shares issued under employee share schemes (iii)	**12,818,797**	16,584,654
31 December	**3,623,982,266**	3,775,817,747

The closing price of a Centrica ordinary share on 31 December 2005 was 254.75 pence (2004: 236.25 pence).

(i) During the year, the Company purchased, and subsequently cancelled, 165 million ordinary shares at prices ranging from 219.89 pence per share to 254.69 pence per share, with an average of 233.84 pence per share. The total cost of the purchases including expenses was £388.5 million which has been charged against distributable reserves, of which £10.2 million related to the nominal value and has been recognised in the capital redemption reserve.

(ii) On 25 October 2004, the ordinary share capital was consolidated on the basis of nine new ordinary shares of $6^{14}/_{81}$ pence each for every ten existing ordinary shares of $5^{5}/_{9}$ pence.

(iii) The Centrica Employees Share Trust was established to acquire ordinary shares in the Company, by subscription or purchase, with funds provided by way of interest-free loans from the Company to satisfy rights to shares on the vesting of allocations made under the Company's long-term incentive arrangements.
On 29 September 2005, 1,279,475 were acquired by the Trust to satisfy the release of the October 2000 LTIS allocations. Movements in the Trust are shown below. Dividends due on shares held in trust are waived in accordance with the trust deed. All administration costs are borne by the Group.

	2005			2004		
	Number of shares million	**Cost £m**	**Market value £m**	Number of shares million	Cost £m	Market value £m
1 January	**6.4**	**15**	**15**	21.2	45	45
Shares purchased	**1.3**	**3**	**3**	–	–	–
Shares released under Long Term Incentive Scheme	**(7.7)**	**(18)**	**(18)**	(13.5)	(30)	(30)
Share consolidation (see above)	**–**	**–**	**–**	(1.3)	–	–
Change in market value	**–**	**–**	**–**	–	–	–
31 December	**–**	**–**	**–**	6.4	15	15
% of ordinary share capital	**–**			0.2%		
Nominal value (£m)	**–**			0.4		

The nominal value of shares purchased by the Trust was £0.01 million (2004: £nil).

Ordinary shares were also allotted and issued to satisfy the exercise of share options and the matching element of the Share Incentive Plan as follows:

	2005	2004
Number	**12,818,797**	16,584,654
Nominal value (£m)	**0.8**	1.0
Consideration (£m) (net of issue costs £nil (2004: £nil)).	**22**	27

26. Share-based payments

Centrica operates five employee share schemes – the Executive Share Option Scheme (ESOS), the Long Term Incentive Scheme (LTIS), Sharesave, the Share Incentive Plan (SIP) and the Employee Share Purchase Plan (ESPP). These are described in the Directors' Report on page 24 and in the Remuneration Report on pages 30 to 31. There were no other share-based payment transactions during the period.

26. Share-based payments continued

ESOS

Under the ESOS the Board may grant options over shares in Centrica plc to employees of the Group. Options are granted with a fixed exercise price equal to the market price of the shares at the date of grant. The contractual life of an option is ten years. Awards under the ESOS are generally reserved for employees at senior management level and above and 83 employees are currently eligible to participate. Options granted under the ESOS will become exercisable on the third anniversary of the date of grant, subject to the growth in earnings per share over that period exceeding RPI growth by more than 18 percentage points. The number of options becoming exercisable is reduced on a sliding scale if EPS growth exceeds RPI growth by between nine and 18 percentage points. Options granted up to March 2004 also permit retesting of EPS growth annually for a further two years. Exercise of options is subject to continued employment within the Group. Options were valued using the Black-Scholes option pricing model. No performance conditions were included in the fair value calculations. Early exercise has been taken into account by estimating the expected life of the options. As allowed by IFRS 2, only options granted since 7 November 2002 which were unvested at 1 January 2005 have been valued. The fair values and the related assumptions used in the calculations are as follows:

Grant date	**23 September 2005**	**1 April 2005**	1 September 2004	18 March 2004	1 September 2003	24 March 2003
Share price at grant date	**£2.46**	**£2.28**	£2.46	£2.28	£1.80	£1.47
Exercise price	**£2.51**	**£2.29**	£2.45	£2.24	£1.78	£1.47
Number of options originally granted	**291,235**	**8,339,818**	195,795	8,815,399	635,599	13,319,276
Vesting period	**3 yrs**	**3 yrs**	3 yrs	3 yrs	3 yrs	3 yrs
Expected volatility (i)	**30%**	**30%**	27%	27%	35%	35%
Contractual option life	**10 yrs**	**10 yrs**	10 yrs	10 yrs	10 yrs	10 yrs
Expected life	**5 yrs**	**5 yrs**	5 yrs	5 yrs	5 yrs	5 yrs
Risk-free rate	**4.80%**	**4.70%**	5.00%	5.01%	4.45%	4.44%
Expected dividend yield	**4.37%**	**4.37%**	4.82%	4.82%	3.09%	3.09%
Expected forfeitures	**25%**	**25%**	25%	25%	25%	25%
Fair value per option	**£0.50**	**£0.49**	£0.47	£0.45	£0.51	£0.41

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the average expected period to exercise. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. A reconciliation of option movements is as follows:

	2005		2004	
	Number	**Weighted average exercise price £**	Number	Weighted average exercise price £
Outstanding at start of period	**28,289,511**	**1.99**	25,490,282	1.87
Granted	**8,631,053**	**2.30**	9,011,194	2.24
Exercised	**(1,807,513)**	**2.23**	(3,947,344)	1.83
Forfeited	**(570,570)**	**2.10**	(2,264,621)	1.96
Outstanding at the end of the period	**34,542,481**	**2.05**	28,289,511	1.99
Exercisable at the end of the period	**8,569,410**	**2.31**	3,813,145	2.40

For options outstanding at the end of the period, the range of exercise prices and average remaining life was as follows:

2005				2004			
Range of exercise prices	**Weighted average exercise price**	**Number of shares**	**Average remaining contractual life Years**	Range of exercise prices	Weighted average exercise price	Number of shares	Average remaining contractual life Years
£1.40 – £1.49	**£1.47**	**9,738,428**	**7.3**	£1.40 – £1.49	£1.47	9,929,912	8.3
£1.70 – £1.79	**£1.78**	**406,061**	**7.7**	£1.70 – £1.79	£1.78	406,061	8.7
£2.20 – £2.29	**£2.26**	**20,320,269**	**8.2**	£2.20 – £2.29	£2.24	13,944,598	8.4
£2.40 – £2.49	**£2.40**	**3,786,488**	**5.6**	£2.40 – £2.49	£2.40	4,008,940	6.6
£2.50 – £2.59	**£2.51**	**291,235**	**9.7**				
	£2.05	**34,542,481**	**7.7**		£1.99	28,289,511	8.0

For options exercised during the period the weighted average share price was £2.39 (2004: £2.42).

26. Share-based payments continued

LTIS

Under the LTIS, allocations of shares in Centrica plc are made to employees of the Group. Awards under the LTIS are generally reserved for employees at senior management level and above and 365 employees are currently eligible to participate. The number of shares that are to be released to participants is calculated subject to the Company's total shareholder return (TSR) during the three years following the grant date, compared to the TSR of other shares in the FTSE 100 Index over the same period. The number of shares released is reduced on a sliding scale if Centrica's TSR is ranked between 50th and 25th. For allocations granted from October 2001 onwards shares are released to participants immediately following the end of the period in which TSR performance is assessed. For awards granted prior to that date allocations are subject to a further two years retention. Release of shares is subject to continued employment within the Group at the date of release. Allocations were valued using the Black-Scholes option pricing model. Performance conditions were included in the fair value calculations, through the use of a Monte Carlo simulation model. As allowed by IFRS 2, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been valued. The fair values and the related assumptions used in the calculations are as follows:

Grant date	**23 September 2005**	**1 April 2005**	1 September 2004	1 April 2004	1 September 2003	1 April 2003
Share price at grant date	**£2.46**	**£2.28**	£2.46	£2.30	£1.80	£1.47
Exercise price	**£nil**	**£nil**	£nil	£nil	£nil	£nil
Number of shares originally granted	**456,421**	**8,408,130**	310,460	9,765,341	665,696	13,573,547
Vesting period	**3 yrs**	**3 yrs**	3 yrs	3 yrs	3 yrs	3 yrs
Expected volatility (i)	**30%**	**30%**	27%	27%	35%	35%
Contractual life	**3 yrs**	**3 yrs**	3 yrs	3 yrs	3 yrs	3 yrs
Expected life	**3 yrs**	**3 yrs**	3 yrs	3 yrs	3 yrs	3 yrs
Risk-free rate	**4.80%**	**4.68%**	5.00%	5.04%	4.31%	3.88%
Expected dividend yield	**4.37%**	**4.37%**	4.82%	4.82%	3.09%	3.09%
Expected forfeitures	**20%**	**20%**	20%	20%	20%	20%
Average volatility of FTSE 100	**30%**	**30%**	30%	30%	30%	30%
Average cross-correlation of FTSE 100	**(ii)**	**(ii)**	30%	30%	30%	30%
Fair value per share allocated	**£1.20**	**£1.03**	£1.25	£1.17	£0.99	£0.89

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the contract life, which is a fixed-term of three years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. A reconciliation of movements in allocations is shown below:

	2005 Number	2004 Number
Outstanding at start of period	**28,002,488**	36,680,531
Granted	**8,864,551**	10,075,801
Exercised	**(7,715,506)**	(13,517,400)
Forfeited – performance related	**(1,223,789)**	(1,795,858)
Forfeited – non-performance related	**(1,493,449)**	(3,440,586)
Outstanding at the end of the period	**26,434,295**	28,002,488
Exercisable at the end of the period	**157,276**	3,845,623

(ii) From 2005, the cross-correlation of the FTSE 100 has been obtained from a model which calculates the correlation between Centrica's historical share price and each of the FTSE 100 over the period from March 2000.

For shares released during the period the weighted average share price was £2.40 (2004: £2.42).

Sharesave

Under Sharesave the Board may grant options over shares in Centrica plc to UK-based employees of the Group. Options are granted with a fixed exercise price equal to 80% of the average market price of the shares for the three days prior to invitation which is three to four weeks prior to the grant date. Employees pay a fixed amount from salary into a savings account each month, and may elect to save over three or five years. At the end of the savings period, employees have six months in which to exercise their options using the funds saved. If employees decide not to exercise their options, they may withdraw the funds saved, and the options expire. Exercise of options is subject to continued employment within the Group. Options were valued using the Black-Scholes option pricing model. As allowed by IFRS 2, only options granted since 7 November 2002, which were unvested at 1 January 2005, have been valued. The fair values and the related assumptions used in the calculations are as follows:

26. Share-based payments continued

Grant date	6 April 2005	6 April 2005	1 April 2004	1 April 2004	8 April 2003	8 April 2003
Share price at grant date	**£2.36**	**£2.36**	£2.30	£2.30	£1.59	£1.59
Exercise price	**£1.88**	**£1.88**	£1.83	£1.83	£1.07	£1.07
Number of options originally granted	**4,329,658**	**5,791,571**	3,854,639	7,407,793	37,280,748	34,151,197
Vesting period	**5 yrs**	**3 yrs**	5 yrs	3 yrs	5 yrs	3 yrs
Expected volatility (i)	**30%**	**30%**	27%	27%	35%	35%
Contractual option life	**5.5 yrs**	**3.5 yrs**	5.5 yrs	3.5 yrs	5.5 yrs	3.5 yrs
Expected life	**5 yrs**	**3 yrs**	5 yrs	3 yrs	5 yrs	3 yrs
Risk-free rate	**4.65%**	**4.64%**	5.13%	5.04%	3.90%	3.90%
Expected dividend yield	**4.37%**	**4.37%**	4.82%	4.82%	3.09%	3.09%
Expected forfeitures	**40%**	**25%**	40%	25%	40%	25%
Fair value per option	**£0.68**	**£0.64**	£0.61	£0.58	£0.64	£0.60

(i) The expected volatility is based on historical volatility over the last three years (except in the case of options granted in 2003, where historical volatility over the preceding three years was 43% and this was felt to be unrepresentative because it included a significant period of exceptionally high volatility in 1999/2000. In this case the volatility was reassessed ignoring this period). The expected life is the contract life, which is a fixed-term of three years. The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life. A reconciliation of movements in allocations is as follows:

	2005		2004	
	Number	**Weighted average exercise price £**	Number	Weighted average exercise price £
Outstanding at start of period	**80,576,125**	**1.24**	84,057,544	1.21
Granted	**10,121,229**	**1.88**	11,262,432	1.83
Exercised	**(7,869,934)**	**1.44**	(5,113,975)	1.72
Lapsed	**(8,981,271)**	**1.33**	(9,629,876)	1.37
Expired	**(97,954)**	**1.78**	–	–
Outstanding at the end of the period	**73,748,195**	**1.30**	80,576,125	1.24
Exercisable at the end of the period	**7,273**	**1.78**	11,151	1.91

For options outstanding at the end of the period, the range of exercise prices and the average remaining life was as follows:

2005				2004			
Range of exercise prices	**Weighted average exercise price**	**Number of shares**	**Average remaining contractual life Years**	Range of exercise prices	Weighted average exercise price	Number of shares	Average remaining contractual life Years
£1.00 – £1.09	**£1.07**	**52,169,512**	**1.8**	£1.00 – £1.09	£1.07	62,027,264	2.8
£1.70 – £1.79	**£1.78**	**2,722,085**	**1.7**	£1.70 – £1.79	£1.78	6,878,105	1.7
£1.80 – £1.89	**£1.86**	**17,176,807**	**3.0**	£1.80 – £1.89	£1.83	9,586,922	3.4
£1.90 – £1.99	**£1.91**	**1,679,791**	**0.7**	£1.90 – £1.99	£1.91	2,083,834	1.7
	£1.30	**73,748,195**	**2.1**		£1.24	80,576,125	2.7

For options exercised during the period the weighted average share price was £2.33 (2004: £2.35).

SIP

Under SIP, employees in the UK may purchase ‘partnership shares’ through monthly salary deductions. The Company then grants one ‘matching share’ for every two purchased, up to a maximum of 20 matching shares per employee per month. Both partnership shares and matching shares are held in a trust initially. Partnership shares may be withdrawn at any time, but matching shares are forfeited if the related partnership shares are withdrawn within three years from the original purchase date. Matching shares vest unconditionally for employees after being held for three years in the trust. Vesting of matching shares is also subject to continued employment within the Group. Matching shares are valued at the market price at the grant date. The average fair value of these awards during the year was £2.36 (2004: £2.74). A reconciliation of matching shares held in trust is as follows:

26. Share-based payments continued

	2005 Number	2004 Number
Unvested at start of period	**1,433,447**	897,497
Granted	**863,516**	843,176
Shares sold and transferred out of the plan	**(138,554)**	(222,629)
Forfeited	**(91,176)**	(84,597)
Unvested at end of period	**2,067,233**	1,433,447

ESPP

Under the ESPP, employees in North America purchase 'partnership shares' through salary deductions. The Company then grants one 'matching share' for every two shares purchased. Partnership shares may be withdrawn at any time, but the entitlement to matching shares is forfeited if the related partnership shares are withdrawn within two years from the original purchase date. Matching shares vest unconditionally for employees after being held for two years. Vesting of matching shares is also subject to continued employment within the Group. Matching shares are valued at the market price at the grant date. The average fair value of these awards during the year was £2.37 (2004: £nil). A reconciliation of matching shares granted is shown below:

	2005 Number	2004 Number
Unvested at start of period	**–**	–
Granted	**223,116**	–
Vested	**(961)**	–
Forfeited	**(13,826)**	–
Unvested at end of period	**208,329**	–

27. Reserves

	Attributable to equity holders of the Company							
	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserves £m	**Total £m**	Minority interest £m	**Total equity £m**
31 December 2004	233	575	467	5	809	**2,089**	219	**2,308**
Adoption of IAS 32 and IAS 39	–	–	–	–	(179)	**(179)**	(164)	**(343)**
1 January 2005 as restated	233	575	467	5	630	**1,910**	55	**1,965**
Exchange differences on translation of foreign operations	–	–	–	–	13	**13**	–	**13**
Actuarial losses on defined benefit pension schemes	–	–	–	–	(126)	**(126)**	–	**(126)**
Gains on revaluation of acquired assets	–	–	–	–	14	**14**	–	**14**
Gains on revaluation of available for sale investments	–	–	–	–	2	**2**	–	**2**
Cash flow hedges								
Net fair value gains	–	–	–	–	408	**408**	–	**408**
Transfers to income statement	–	–	–	–	(74)	**(74)**	–	**(74)**
Tax on items taken directly to equity	–	–	–	–	(84)	**(84)**	–	**(84)**
	233	575	467	5	783	**2,063**	55	**2,118**
Profit for the year	–	–	–	–	1,012	**1,012**	1	**1,013**
Employee share option schemes								
Purchase of treasury shares	–	–	–	–	(3)	**(3)**	–	**(3)**
Share issue	1	20	–	–	–	**21**	–	**21**
Value of services provided	–	–	–	–	21	**21**	–	**21**
Repurchase of shares	(10)	–	–	10	(388)	**(388)**	–	**(388)**
Dividends	–	–	–	–	(340)	**(340)**	–	**(340)**
31 December 2005	**224**	**595**	**467**	**15**	**1,085**	**2,386**	**56**	**2,442**

27. Reserves continued

	Attributable to equity holders of the Company							
	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserves £m	Total £m	Minority interest £m	Total equity £m
1 January 2004	237	549	467	–	657	1,910	217	2,127
Actuarial gain on defined benefit pension schemes	–	–	–	–	90	90	–	90
Tax on items taken directly to equity	–	–	–	–	(27)	(27)	–	(27)
	237	549	467	–	720	1,973	217	2,190
Profit for the year	–	–	–	–	1,591	1,591	20	1,611
Employee share option schemes:								
Share issue	1	26	–	–	–	27	–	27
Value of services provided	–	–	–	–	17	17	–	17
Repurchase of shares	(5)	–	–	5	(205)	(205)	–	(205)
Dividends	–	–	–	–	(1,314)	(1,314)	–	(1,314)
Distributions to non-equity minority interests	–	–	–	–	–	–	(18)	(18)
31 December 2004	233	575	467	5	809	2,089	219	2,308

Other reserves can be further analysed as follows:

	Revaluation reserve £m	Foreign currency translation reserve £m	Cash flow hedging reserve £m	Profit and loss reserve £m	**Total other reserves £m**
31 December 2004	–	–	–	809	**809**
Adoption of IAS 32 and IAS 39	–	–	68	(247)	**(179)**
1 January 2005 as restated	–	–	68	562	**630**
Exchange differences on translation of foreign operations	–	(3)	16	–	**13**
Actuarial losses on defined benefit pension schemes	–	–	–	(126)	**(126)**
Gains on revaluation of acquired assets	14	–	–	–	**14**
Gain on revaluation of available for sale investments	–	–	–	2	**2**
Cash flow hedges:					
Net fair value gains	–	–	408	–	**408**
Transfers to income statement	–	–	(74)	–	**(74)**
Tax on items taken directly to equity	(4)	–	(117)	37	**(84)**
	10	(3)	301	475	**783**
Profit for the year	–	–	–	1,012	**1,012**
Employee share option schemes:					
Purchase of treasury shares	–	–	–	(3)	**(3)**
Value of services provided	–	–	–	21	**21**
Repurchase of shares	–	–	–	(388)	**(388)**
Dividends	–	–	–	(340)	**(340)**
31 December 2005	**10**	**(3)**	**301**	**777**	**1,085**

	Revaluation reserve £m	Foreign currency translation reserve £m	Cash flow hedging reserve £m	Profit and loss reserve £m	**Total other reserves £m**
1 January 2004	–	–	–	657	**657**
Actuarial gains on defined benefit pension schemes	–	–	–	90	**90**
Tax on items taken directly to equity	–	–	–	(27)	**(27)**
	–	–	–	720	**720**
Profit for the year	–	–	–	1,591	**1,591**
Employee share option schemes:					
Value of services provided	–	–	–	17	**17**
Repurchase of shares	–	–	–	(205)	**(205)**
Dividends	–	–	–	(1,314)	**(1,314)**
31 December 2004	–	–	–	809	**809**

27. Reserves continued

The revaluation of the Group's existing interest in Humber Power Limited to fair value, following the acquisition by the Group of the remaining 40% stake, has been recorded as a revaluation reserve adjustment.

Aggregate tax taken directly to the profit and loss reserve amounted to £84 million (2004: £27 million), of which £37 million relates to deferred tax arising on actuarial gains and losses on the Group's defined benefit schemes (2004: £27 million) and £121 million relates to deferred tax arising on gains and losses on available for sale investments and cash flow hedges (2004: £nil).

Cumulative gains of £2 million (2004: £nil) on available for sale investments were included within the profit and loss reserve.

Cumulate actuarial losses arising on defined benefit pension schemes amounted to £36 million (2004: £90 million profit).

Exchange losses of £146 million (2004: £13 million loss) on net investment in overseas undertakings have been offset in full in reserves against exchange gains of £133 million (2004: £13 million gain) on foreign currency borrowings.

Cumulative exchange losses of £1 million were charged to the income statement on the disposal of the Group's share in Luminus NV (note 17).

The repurchase of shares includes transaction costs charged directly to equity of £1 million (2004: £2 million).

The profit and loss reserve can be further analysed as follows:

	Treasury shares £m	Share options reserve £m	Other £m	**Profit and loss reserve £m**
31 December 2004	(15)	24	800	**809**
Adoption of IAS 32 and IAS 39	–	–	(247)	**(247)**
1 January 2005 as restated	(15)	24	553	**562**
Actuarial losses on defined benefit pension schemes	–		(126)	**(126)**
Gains on revaluation of available for sale investments	–	–	2	**2**
Tax on items taken directly to equity	–	–	37	**37**
	(15)	24	466	**475**
Profit for the year	–	–	1,012	**1,012**
Employee share option schemes:				
Purchase of treasury shares	(3)	–	–	**(3)**
Exercise of awards	18	(3)	(15)	**–**
Value of services provided	–	21	–	**21**
Repurchase of shares	–	–	(388)	**(388)**
Dividends	–	–	(340)	**(340)**
31 December 2005	**–**	**42**	**735**	**777**

	Treasury shares £m	Share options reserve £m	Other £m	**Profit and loss reserve £m**
1 January 2004	(45)	11	691	**657**
Actuarial gains on defined benefit pension schemes	–	–	90	**90**
Tax on items taken directly to equity	–	–	(27)	**(27)**
	(45)	11	754	**720**
Profit for the year	–	–	1,591	**1,591**
Employee share option schemes:				
Exercise of awards	30	(4)	(26)	**–**
Value of services provided	–	17	–	**17**
Repurchase of shares	–	–	(205)	**(205)**
Dividends	–	–	(1,314)	**(1,314)**
31 December 2004	(15)	24	800	**809**

28. Minority interests

	Equity £m	Non-equity £m	**Total £m**
31 December 2004	55	164	**219**
Adoption of IAS 32 and IAS 39	–	(164)	**(164)**
1 January 2005	55	–	**55**
Profit on ordinary activities after taxation	1	–	**1**
31 December 2005	**56**	**–**	**56**

Equity minority interests at 31 December 2005 related to a 30% economic interest held by Lloyds TSB Bank plc in the dormant legal entity (formerly Goldfish Holdings Limited) pending winding up of the company and its subsidiary, GF One Limited (formerly Goldfish Bank Limited). Non-equity minority interests at 31 December 2004 related to the 80.1% of units in The Consumers' Waterheater Income Fund listed on the Toronto Stock Exchange. These units have been re-classified as non-recourse debt at 1 January 2005, on adoption of IAS 32 by the Group.

29. Acquisitions and disposals

(i) Acquisitions

During the year the Group acquired 100% of Oxxio BV and 40% of Humber Power Limited. The Group also made a number of smaller acquisitions which are aggregated in section c.

The acquisition method of accounting was adopted in all cases. The analysis of assets and liabilities acquired, and the fair value of these acquisitions were as shown below. All intangible fixed assets were recognised at their respective fair values. The residual excess over the net assets acquired on each acquisition is recognised as goodwill in the financial statements. The fair values stated are provisional because the Directors have not yet reached a final determination on all aspects of the fair value exercise.

a) Oxxio BV	IFRS carrying values pre-acquisition £m	Fair value £m
Other intangible assets	30	25
Property, plant and equipment	1	1
Trade and other receivables – current	22	20
Cash and cash equivalents	15	15
Trade and other payables – current	(40)	(42)
Trade and other payables – non-current	(7)	–
Deferred tax liability	(2)	(6)
Net assets acquired	19	13
Goodwill arising		82
Cash consideration		**95**

The Group acquired 100% of the voting share capital of Oxxio BV, a Dutch energy supplier, on 1st July 2005. Oxxio contributed a loss after tax of £9 million to the Group for the period from 1 July 2005 to 31 December 2005. The book value of assets and liabilities has been adjusted to align with the fair value of assets and liabilities acquired. The principal adjustments to intangible fixed assets have been to recognise contractual customer relationships and commodity contracts at their estimated fair value and reverse goodwill that had previously been acquired by Oxxio. Adjustments have also been made to eliminate a non-current borrowing settled as part of the purchase consideration and to recognise current payables at their fair value. A deferred tax liability has been recognised in relation to the fair value adjustments. Goodwill represents the ongoing commercial activities of the business acquired and the corresponding entry of the recognition of deferred tax on fair value adjustments.

29. Acquisitions and disposals continued

b) Humber Power Limited	IFRS carrying values pre-acquisition £m	Fair value £m
Property, plant and equipment	164	181
Inventories	2	2
Trade and other receivables – current	10	10
Cash and cash equivalents	42	42
Trade and other payables – current	(14)	(12)
Trade and other payables – non-current	(170)	(147)
Deferred tax liabilities	(12)	(19)
Derivative financial instruments	–	(24)
Net assets acquired	22	33
Goodwill arising		14
Cash consideration		**47**

The Group acquired 40% of the voting share capital of Humber Power Limited, which owns the gas-fired South Humber Bank power station, on 19 September 2005. The Group now holds 100% of the voting share capital of Humber Power Limited. The acquired business contributed profit after tax of £5 million to the Group for the period from 19 September 2005 to 31 December 2005. The book value of assets and liabilities has been adjusted to align with the fair value of assets and liabilities acquired. Adjustments have been made to recognise property, plant and equipment at fair value and to recognise trade and other payables in respect of an external finance lease with Lloyds TSB Bank plc, and liabilities in respect of the recognition of four money-market swaps, at their respective fair values. Goodwill has principally arisen in relation to the recognition of deferred tax on fair value adjustments.

c) Other business combinations	IFRS carrying values pre-acquisition £m	Fair value £m
Other intangible assets	–	11
Property, plant and equipment	1	1
Trade and other receivables – current	2	2
Trade and other payables – current	(1)	(1)
Trade and other payables – non-current	(1)	(1)
Deferred tax liability	–	(2)
Provisions	–	(5)
Net assets acquired	1	5
Goodwill arising		5
Cash consideration		**10**

The Group acquired the plumbing-related assets of Belyea Brothers on 3 March 2005 (consideration £0.2 million, goodwill £0.2 million); 100% of the voting share capital of Awardmodel Limited and its subsidiary RedNet Limited, an internet service provider, on 21 April 2005 (consideration £3.8 million, goodwill £4.1 million); the assets of Wendland Air Conditioning and Heating LLC, which sold and installed air conditioning and heating, on 1 June 2005 (consideration £0.4 million, goodwill £0.3 million); a 10% joint working interest in the Canadian Craigmyle gas field on 25 July 2005 (consideration £0.8 million, goodwill £nil); 100% of the voting share capital of James Wall Plumbing Limited, a heating, ventilation, air conditioning and plumbing company, on 1 October 2005 (consideration £0.6 million, goodwill £0.1 million); and 12,826 gas sales and purchase contracts and the related customer relationships from Total Gas and Power Limited on 1 December 2005 (consideration £4.2 million, goodwill £nil). The acquired businesses contributed a loss after tax of £1 million to the Group from their respective dates of acquisition up to 31 December 2005.

The pro-forma consolidated results of the Group, as if the 2005 acquisitions had been made at the beginning of the period include revenues of £13,564 million and profit after tax of £999 million. In preparing the pro-forma results, revenue and costs have been included as if the businesses were acquired on 1 January 2005 and inter company transactions had been eliminated. This information is not necessarily indicative of the results of the combined Group that would have occurred had the purchases actually been made at the beginning of the period presented, or future results of the combined Group.

During 2005 the Group paid £98 million of deferred and contingent consideration in relation to prior year acquisitions. Cash of £63 million has been transferred to the Group on the acquisition by the Group of the remaining 40% stake in Humber Power Limited. The cash relates to the Group's 60% stake in Humber Power Limited which was previously reported within interests in joint ventures.

29. Acquisitions and disposals continued

(ii) Disposals

a) British Gas Connections Limited

The Group disposed of its shareholding in British Gas Connections Limited on 20 May 2005 for cash consideration of £90 million, resulting in a pre-tax operating profit on disposal of £47 million. The analysis of assets and liabilities sold and consideration received is given below:

	£m
Property, plant and equipment	33
Deferred tax liability	(3)
Net assets	30
Pre-tax profit on disposal	47
Deferred consideration (i)	13
Cash consideration	**90**

(i) £13 million of the total cash consideration relates to the future order book of 35,000 connections which will be completed on behalf of the purchaser by British Gas' siteworks business, New Housing Connections. The assets will be constructed over the next five years. £13 million consideration will be deferred and recognised as the assets are constructed and delivered to the purchaser.

b) Onetel

On 30 December 2005 the Group disposed of its shareholding in Centrica Telecommunications Limited, Onetel Limited, Telco Holdings Limited and Awardmodel Limited and their subsidiaries (Onetel), for cash consideration of £130 million, resulting in a discontinued loss on disposal of £5 million. No tax charge has arisen in relation to the disposal. An analysis of the assets and liabilities sold is as follows:

	£m
Other intangible assets	2
Property, plant and equipment	20
Deferred tax assets	1
Trade and other receivables	49
Cash and cash equivalents	26
Trade and other payables	(199)
Provisions	(1)
Net liabilities	(102)
Related goodwill	97
Net liabilities disposed	(5)
Sale proceeds	
Cash consideration received	130
Deferred settlements (i)	39
Write-off of inter company balances (ii)	(150)
Separation costs (iii)	(13)
Professional fees	(3)
Provision for future connection costs (iv)	(13)
Net liabilities disposed	5
Discontinued loss on disposal	**(5)**

(i) Deferred settlements relate to the finalisation of the amounts paid in relation to closing working capital.
(ii) Amounts due to the Group from Onetel have been written off on disposal.
(iii) Included within separation costs of £13 million are £10 million of lease exit costs, £2 million retention bonuses and £1 million other.
(iv) Centrica has agreed to provide 225,000 customer connections each year until 2008. £13 million represents the marginal cost of the connections.

30. Notes to the Group Cash Flow Statement

a) Reconciliation of Group operating profit to net cash flow from operating activities	2005 £m	2004 £m
Continuing operations		
Group operating profit before share of joint ventures and associates	**1,920**	1,207
Add back:		
Amortisation of intangible assets	**76**	37
Depreciation and impairment	**406**	490
Employee share scheme costs	**17**	13
Profit on sale of businesses	**(53)**	–
Profit on sale of property, plant and equipment, and other intangible assets	**(17)**	(13)
Movement in provisions	**42**	(76)
Re-measurement of energy contracts	**(455)**	–
Operating cash flows before movements in working capital	**1,936**	1,658
(Increase)/decrease in inventories	**(22)**	10
Increase in receivables	**(269)**	(356)
Increase in payables	**299**	344
Cash generated by operations	**1,944**	1,656
Income taxes paid	**(320)**	(217)
Petroleum revenue tax paid	**(448)**	(263)
Net interest received	**3**	6
Payments relating to exceptional charges	**(48)**	(25)
Net cash flow from operating activities: continuing operations	**1,131**	1,157

	2005 £m	2004 £m
Discontinued operations		
Operating profit before share of joint ventures and associates	**12**	71
Add back:		
Amortisation of intangible assets	**1**	3
Depreciation and impairment	**6**	8
Employee share scheme costs	**1**	5
Profit on sale of property, plant and equipment, and other intangible assets	**–**	(1)
Movement in provisions	**(4)**	(2)
Operating cash flows before movements in working capital	**16**	84
Decrease in inventories	**–**	1
(Increase)/decrease in receivables	**(3)**	6
Increase in payables	**–**	43
Cash generated by operations	**13**	134
Income taxes paid	**–**	(22)
Net interest received	**–**	–
Payments relating to exceptional charges	**–**	–
Net cash flow from operating activities: discontinued operations	**13**	112
Total cash inflow from operating activities	**1,144**	1,269

b) Net cash flow from investing activities	2005 £m	2004 £m
Continuing operations	**(520)**	497
Discontinued operations	**(9)**	–
Net cash flow from investing activities	**(529)**	497

c) Net cash flow from financing activities	2005 £m	2004 £m
Continuing operations	**(356)**	(1,515)
Discontinued operations	**21**	(73)
Net cash flow from financing activities	**(335)**	(1,588)

There were no additions to property, plant and equipment during the year financed by new finance leases. Cash and cash equivalents (which are presented as a single class of assets on the face of the Balance Sheet) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less.

31. Pensions

Substantially all of the Group's UK employees at 31 December 2005 were members of one of the three main schemes: the Centrica Pension Scheme (formerly the Centrica Staff Pension Scheme), the Centrica Engineers' Pension Scheme and the Centrica Management Pension Scheme (the approved pension schemes). These schemes are defined benefit schemes and are subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employers' contributions which, together with the specified contributions payable by the employees and proceeds from the schemes' assets, are expected to be sufficient to fund the benefits payable under the schemes.

The Centrica Unapproved Pension Scheme is an unfunded arrangement which provides benefits to certain employees whose benefits under the main schemes would otherwise be limited by the earnings cap. The Group also has a commitment to provide certain pension and post retirement benefits to employees of Direct Energy Marketing Limited (Canada).

The latest full actuarial valuations were carried out at the following dates: the approved pension schemes at 31 March 2004, the Unapproved Pension Scheme at 6 April 2005 and the Direct Energy Marketing Limited pension plan at 14 June 2005. These have been updated to 31 December 2005 for the purposes of meeting the requirements of IAS 19. Investments have been valued, for this purpose, at market value.

Major assumptions used for the actuarial valuation	**31 December 2005 %**	31 December 2004 %
Rate of increase in employee earnings	**4.35**	4.30
Rate of increase in pensions in payment and deferred pensions	**2.85**	2.80
Discount rate	**4.85**	5.40
Inflation assumption	**2.85**	2.80

The assumptions relating to longevity underlying the pension liabilities at the balance sheet date are based on standard actuarial mortality tables, and include an allowance for future improvements in longevity. The assumptions are equivalent to future longevity for members in normal health at age 65 approximately are as follows:

	31 December 2005 Years	31 December 2004 Years
Currently aged 65 – range	**18 – 23**	18 – 23
Currently aged 45 – range	**20 – 25**	20 – 25

The market value of the assets in the schemes, the present value of the liabilities in the schemes and the expected rate of return at the balance sheet date were:

31 December	**Expected rate of return per annum 2005 %**	**Valuation 2005 £m**	Expected rate of return per annum 2004 %	Valuation 2004 £m
Equities	**7.9**	**2,023**	8.1	1,590
Bonds	**4.5**	**391**	5.0	336
Property	**6.3**	**83**	6.9	62
Cash and other assets	**3.7**	**73**	3.6	53
Total fair value of plan assets	**7.3**	**2,570**	7.4	2,041
Present value of defined benefit obligation		**(3,390)**		(2,760)
Net liability recognised in the Balance Sheet (i)		**(820)**		(719)
Associated deferred tax asset recognised in the Balance Sheet		**249**		212
Net pension liability		**(571)**		(507)

(i) £13 million of the liability relates to restructuring costs arising in the year and is included within the restructuring provision on the Balance Sheet (2004: £14 million).

31. Pensions continued

The overall expected rate of return on assets is a weighted average based on the actual plan assets held and the respective expected returns on separate asset classes. The return on separate asset classes were derived as follows: the expected rate of return on equities is based on the expected median return over a ten year period, as calculated by the independent company actuary. The median return over a longer period than ten years was not expected to be materially dissimilar. The expected rate of return on bonds was measured directly from actual market yields for UK gilts and corporate bond stocks. The rate above takes into account the actual mixture of UK gilts, UK corporate bonds and overseas bonds held at the balance sheet date. The expected rate of return on property takes into account both capital growth and allowance for expenses, rental growth and depreciation. The expected rate of return on cash is comparable to current bank interest rates.

Included within schemes' liabilities above are £32 million (2004: £26 million) relating to unfunded pension arrangements.

The amounts recognised in the Income Statement and in the Statement of Recognised Income and Expense are set out below:

Analysis of the amount charged to operating profit	2005 £m	2004 £m
Current service cost	122	148
Past service cost	–	4
Loss on curtailment	14	16
Net charge to operating profit	136	168

Analysis of the amount (credited)/charged to interest	2005 £m	2004 £m
Expected return on pension scheme assets	(153)	(173)
Interest on pension scheme liabilities	150	178
Net (credit)/charge to interest	(3)	5

Analysis of the actuarial gain/(loss) recognised in the Statement of Recognised Income and Expense	2005 £m	2004 £m
Actual return less expected return on pension scheme assets	307	64
Experience gains and losses arising on the scheme liabilities	21	134
Changes in assumptions underlying the present value of the schemes' liabilities	(454)	(108)
Actuarial (loss)/gain to be recognised in the Statement of Recognised Income and Expense before adjustment for tax	(126)	90

History of deficit	2005 £m	2004 £m	2003 £m
Plan assets	2,570	2,041	2,353
Defined benefit obligation	(3,390)	(2,760)	(3,491)
Deficit	(820)	(719)	(1,138)

History of experience gains and losses	2005	2004	2003
Difference between the expected and actual return on scheme assets:			
Amount (£m)	307	64	202
Percentage of scheme assets	11.9%	3.1%	8.6%
Experience gains and losses on scheme liabilities:			
Amount (£m)	21	134	(64)
Percentage of the present value of scheme liabilities	0.6%	4.9%	1.8%
Total actuarial (loss)/gain recognised in the Statement of Recognised Income and Expense:			
Amount (£m)	(126)	90	(281)
Percentage of the present value of scheme liabilities	3.7%	3.3%	8.0%

31. Pensions continued

Movement in the defined benefit obligation during the year	2005 £m	2004 £m
1 January	**2,760**	3,491
Movements in the year:		
Current service cost	**119**	146
Past service cost	**–**	4
Loss on curtailment	**14**	17
Interest on scheme liabilities	**150**	178
Plan participants' contributions	**24**	31
Benefits paid	**(48)**	(52)
Disposal of AA pension and post-retirement benefit schemes	**–**	(1,031)
Acquisition of liability in year	**–**	2
Actuarial loss/(gain)	**433**	(26)
Settlements/curtailments paid from fund	**(62)**	–
31 December	**3,390**	2,760

Movement in plan assets during the year	2005 £m	2004 £m
1 January	**2,041**	2,353
Movements in the year:		
Expected return on scheme assets	**153**	173
Actuarial gain	**307**	64
Employer contributions	**155**	238
Plan participants' contributions	**24**	31
Disposal of AA pension and post-retirement benefit schemes	**–**	(766)
Benefits paid	**(48)**	(52)
Settlements/curtailments paid from fund	**(62)**	–
31 December	**2,570**	2,041

Agreed future contribution rates (% of pensionable salary) for the three main defined benefit schemes	2005 %
Centrica Pension Scheme – Final salary section	**19.7**
Centrica Pension Scheme – CRIS section	**8.0**
Centrica Engineers' Pension Scheme	**19.0**
Centrica Management Pension Scheme	**26.2**

The Centrica Pension Scheme (final salary section) and the Centrica Management Pension Scheme were closed to new members from 1 April 2003. Under the projected unit method, used to value pension liabilities under IAS 19 for closed plans, the current service cost is expected to increase over time as members approach retirement.

32. Commitments and contingencies

a) Commitments

At 31 December 2005, the Group had placed contracts for the acquisition of property, plant and equipment amounting to £64 million (2004: £32 million), and for the acquisition of intangible assets of £137 million (2004: £31 million). Commitments in relation to the acquisition of intangible assets include application software £25 million (2004: £31 million) and ROCS £103 million (2004: £nil).

At 31 December 2005 the Group had commitments of £44 million in respect of the acquisition of Braes of Doune Wind Farm.

At 31 December 2005 the Group had commitments in relation to software and maintenance contracts of £13 million (2004: £29 million).

32. Commitments and contigencies continued

b) Decommissioning costs

The Group has provided certain guarantees and indemnities to BG Group plc in respect of the decommissioning costs of the Morecambe gas fields. The Company and its wholly-owned subsidiary, Hydrocarbon Resources Limited, have agreed to provide security, in respect of such guarantees and indemnities, to BG International Limited, which, as original licence holder for the Morecambe gas fields, will have exposure to decommissioning costs relating to the Morecambe gas fields should liabilities not be fully discharged by the Group. The security is to be provided when the estimated future net revenue stream from the Morecambe gas fields falls below 150% of the estimated cost of such decommissioning. The nature of the security may take a number of different forms and will remain in force unless and until the costs of such decommissioning have been irrevocably discharged and the relevant Department of Trade and Industry decommissioning notice in respect of the Morecambe gas fields has been revoked.

c) Operating lease commitments

At 31 December the total of future minimum lease payments under non-cancellable operating leases for each of the following periods were:

	Other	
	2005 £m	2004 £m
Within one year	**73**	67
Between one and five years	**160**	169
After five years	**192**	184
	425	420

	Other	
	2005 £m	2004 £m
The total of future minimum sub-lease payments expected to be received under non-cancellable operating sub-leases at 31 December	**16**	20
Lease and sub-lease payments recognised as an expense in the year were as follows:		
Minimum lease payments	**80**	99
Contingent rents	**1**	–

There are no restrictions imposed by the Group's operating leases, in either the current or prior year.

d) Litigation

The Group has a number of outstanding disputes arising out of its normal activities, for which provisions have been made, where appropriate, in accordance with IAS 37.

e) Guarantees and indemnities

The Company has £1,000 million of bilateral credit facilities (2004: £915 million). Hydrocarbon Resources Limited and British Gas Trading Limited have guaranteed, jointly and severally, to pay on demand any sum which the Company does not pay in accordance with the facility agreements.

In relation to the sale and leaseback of the Morecambe gas field plant, property and equipment recorded in these Financial Statements, the Group has given guarantees amounting to £1 million (2004: £22 million).

The Group has given guarantees in connection with the finance lease obligations referred to in note 16. A fixed collateral payment amounting to £245 million (2004: £225 million) is required in the event of Centrica plc failing to retain at least one credit rating which is not on credit watch above the BBB+/Baa1 level, and further collateral of £245 million (2004: £75 million) is required if the credit rating falls further.

Group companies have given guarantees and indemnities, subject to certain limitations, to various counterparties in relation to wholesale energy trading and procurement activities, and to third parties in respect of gas production and energy transportation liabilities.

In connection with their energy trading, transportation and upstream activities, certain Group companies have entered into contracts under which they may be required to prepay or provide credit support or other collateral in the event of a significant deterioration in credit worthiness. The extent of credit support is contingent upon the balance owing to the third party at the point of deterioration.

Following the closure of the British Gas Energy Centres Limited (Energy Centres) operations in July 1999, guarantees have been signed on certain former Energy Centres' properties as a result of reassignment of leases.

f) Other

The Group's use of financial instruments is explained in the Group Financial Review on page 20 and in note 34.

32. Commitments and contingencies continued

g) Commodity purchase contracts

The Group procures gas and electricity through a mixture of production from owned gas fields and power stations and procurement contracts. Procurement contracts include short-term forward market purchases of gas and electricity at fixed and floating prices. They also include gas contracts indexed to market prices and long-term gas contracts with non-gas indexation. Further information about the Group's procurement strategy is contained in note 34(i).

Commodity purchase commitments are estimated, on an undiscounted basis, as follows:

	2005 £m	2004 £m
Within one year	**8,500**	2,700
Between one and five years	**16,500**	11,800
After five years	**10,600**	8,400
	35,600	22,900

The total volume of gas to be taken under certain long-term structured contracts depends on a number of factors, including the actual reserves of gas that are eventually determined to be extractable on an economic basis. The resulting monetary commitment is based on the minimum quantities of gas that the Group is contracted to pay at estimated future prices.

The estimated commitment to make payments under gas procurement contracts differs in scope and in basis from the principal value of energy derivatives disclosed in note 34(ii). Only certain procurement contracts – and certain sales contracts – are within the scope of IAS 39 and included in note 34. In addition, the volumes used in calculating principal values are estimated using valuation techniques.

Contractual commitments which are subject to fulfilment of conditions precedent are excluded.

At 31 December 2004, the commitment was estimated using the Group's average cost of gas from its contracts with third parties for the year ended 31 December 2004.

The Group purchases electricity from a range of generating sources, including renewables, in respect of which a number of long-term purchase arrangements are in place. The estimated commitment at 31 December 2005 included above in respect of renewables contracts amounted to £37 million within one year, £235 million between one and five years, and £1,254 million after five years, on an undiscounted basis.

33. Related party transactions

During the year, the Group entered into the following transactions with related parties who are not members of the Group:

	Sale of goods 2005 £m	Purchase of goods and services 2005 £m	Other transactions 2005 £m	Sale of goods 2004 £m	Purchase of goods and services 2004 £m	Other transactions 2004 £m
Humber Power Limited (to 19 September 2005)	**3**	**58**	**–**	4	80	–
AccuRead Limited (to 11 October 2005)	**–**	**28**	**–**	–	38	–
Lloyds TSB Bank plc	**–**	**–**	**2**	–	–	1
	3	**86**	**2**	4	118	1

Balances outstanding with related parties at 31 December were as follows:

	Amounts owed from related parties 2005 £m	Amounts owed to related parties 2005 £m	Provision for bad or doubtful debt relating to amounts owed from related parties 2005 £m	Amounts owed from related parties 2004 £m	Amounts owed to related parties 2004 £m	Provision for bad or doubtful debt relating to amounts owed from related parties 2004 £m
Humber Power Limited (to 19 September 2005)	**–**	**–**	**–**	–	13	–
AccuRead Limited (to 11 October 2005)	**–**	**–**	**–**	–	–	–
Barrow Offshore Wind Limited	**12**	**1**	**–**	35	6	–
Lloyds TSB Bank plc	**46**	**–**	**–**	44	–	–
	58	**1**	**–**	79	19	–

33. Related party transactions continued

Humber Power Limited was a joint venture of the Group until the Group's acquisition of the remaining 40% of its share capital on 19 September 2005. Humber Power Limited has been consolidated as a subsidiary of the Group from this date. AccuRead Limited was an associated undertaking of the Group until the Group disposed of its interest on 11 October 2005. Barrow Offshore Wind Limited is a joint venture of the Group. Lloyds TSB Bank plc is a related party of the Group because of its 20% interest in GFOne Limited, a subsidiary of the Group.

Transactions with Humber Power Limited related to the Group's tolling arrangement for the purchase of power from the entity. Transactions with AccuRead Limited related to a contract for the reading of meters on behalf of the Group, entered into at arm's length. Transactions with Barrow Offshore Wind Limited relate to loan facilities. Transactions with Lloyds TSB bank plc relate to a loan facility.

Remuneration of key management personnel	2005 £m	2004 £m
Short-term benefits	**7**	7
Post-employment benefits	**3**	4
Share-based payments	**3**	2
	13	13

Key management personnel comprise members of the Board and Executive Committee, a total of 15 individuals at 31 December 2005 (2004: 14). A relative of a Board member employed by the Group received emoluments of £0.1 million (2004: £0.1 million). Key management personnel and their families purchase gas and electricity from the Group for domestic purposes on an arm's length basis.

34. Financial instruments

The Group adopted IAS 32, Financial Instruments: Disclosure and Presentation and IAS 39, Financial instruments: Recognition and Measurement with effect from 1 January 2005. In accordance with the transition provisions of IFRS 1, First time adoption of International Financial Reporting Standards, no comparative information has been presented for the year ended 31 December 2004. Accordingly the disclosures contained in the Group's Annual Report and Accounts for 2004, prepared in accordance with FRS 13, Derivatives and other financial instruments: disclosures, have been reproduced below.

Exposure to commodity price risk, counterparty credit risk, interest rate risk, currency risk and liquidity risk arises in the normal course of the Group's business. Derivative financial instruments are entered into to reduce exposure to fluctuations in commodity prices, interest rates and foreign exchange rates. Derivative financial instruments are also entered into for trading purposes. The Group also enters into primary financial instruments to finance the Group's operations in the normal course of business. A financial instrument is defined in IAS 32 as any contract which gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity. Further detail on the Group's risk management policies is included within the Group Financial Review on page 20.

(i) Risks

a) Commodity price risk

The most significant financial risk facing the Group relates to commodity prices, in particular for gas and electricity. Commodity price risk arises as a result of contracted or forecast retail sales of gas and electricity not being fully matched by equity production or procurement contracts with equivalent volumes, time periods and pricing. The risk is primarily that market prices for commodities will move adversely between the time that sales prices are fixed or tariffs are set and the time at which the purchase cost is fixed, thereby potentially reducing expected margins.

The Group monitors exposure to commodity price risk using volumetric limits set as a combination of long-standing target ranges and specific shorter-term targets for both gas and electricity. The volumetric limits are supported by the use of Value at Risk (VaR) and Profit at Risk (PaR) methodologies.

In order to reduce commodity price risk, the Group procures gas and electricity through a mixture of production from owned gas fields and power stations, and procurement – and certain sales contracts. This reduces the volume of gas and electricity which remains to be procured at market prices. Procurement contracts include short-term forward market purchases and sales of gas and electricity at fixed prices. They also include long-term gas contracts whose prices are determined based on historic or forward quoted gas prices up to 12 months in advance of the period the gas is delivered – thus stabilising procurement and sales prices and eliminating exposure once the price has been determined. Finally, they include long-term gas contracts with non-gas indexation, which stabilise prices but also result in some exposure to other commodities and indices. These include oil and oil products, coal and general indices such as the Producers Price Index (PPI).The contract prices are determined based on forward quoted prices for the commodities and indices up to 12 months in advance of the period in which the gas is delivered. The volume variability in the contract portfolio is actively managed in order to optimise the use of the contracts.

Certain of these procurement contracts – and certain sales contracts – constitute derivative financial instruments which are within the scope of IAS 39 whose fair value is recorded in the financial statements. The fair values of these contracts are subject to change resulting from changes in commodity prices, except for contracts which are indexed to the market price of the commodity which is the subject of the contract, and for which the price is not fixed in advance of delivery.

Commodity price risk also arises from proprietary trading activity. These exposures are subject to volumetric limits on open exposures and to VaR limits.

34. Financial instruments continued

To reduce the commodity price risk associated with gas and power purchase requirements the Group has entered into physical and financial gas and power purchase contracts, certain of which it has accounted for as cash flow hedges. The hedged item is the forecast future purchase requirement to meet customer demand. The hedging instruments are fixed price forward gas and power purchase contracts. The net fair value of commodity cash flow hedging instruments was a £481 million asset at 31 December 2005. There were no forecasted transactions for which hedge accounting had previously been applied that are no longer expected to occur.

Commodity contracts are subject to legal and contract risk. The fair values of field-specific depletion contracts are by their nature also subject to reserves risk and other operational risks associated with gas production.

b) Credit risk

Counterparty credit risk is the risk that the financial benefits of contracts with a specific counterparty will be lost if a counterparty defaults on their obligations under the contract. This includes any cash amounts owed to the Group by those counterparties, less any amounts owed to the counterparty by the Group where a legal right of set-off exists and also includes the fair values of contracts with individual counterparties which are recorded in the Financial Statements.

Energy wholesale and trading

Counterparty credit exposures are monitored by individual counterparty and by category of credit rating, and are subject to approved limits. The majority of significant exposures are with A-rated counterparties or better. A credit risk adjustment is made to the fair values of financial instruments in accordance with the credit rating of the counterparty. No credit risk adjustment is made to financial instruments under a joint operating agreement where operators are contractually required to fulfill the obligations of any defaulting party.

Downstream businesses

Exposure to credit risk arises in the normal course of operations as a result of the potential for a customer defaulting on their payable balance. In the case of business customers credit risk is managed by checking a company's creditworthiness and financial strength both before commencing to trade and during the business relationship. For residential customers, credit worthiness is ascertained normally before commencing to trade by reviewing an appropriate mix of internal and external information. An ageing of receivables is monitored and used to manage the exposure to credit risk.

Collateral

Centrica employs a variety of other methods to mitigate credit risk including margining, various forms of bank and Parent Company Guarantees and Letters of Credit. In all cases the aim of setting up a credit risk mitigation instrument is to upgrade the credit risk to a better equivalent rating, than the stand-alone rating of the counterparty. At 31 December 2005 Centrica had pledged £41 million of cash collateral and had received £537 million of cash collateral principally under margin calls to cover exposure to mark-to-market positions on derivative contracts. Most collateral paid or received is interest bearing and free of any restrictions over its use.

Centrica had also provided £646 million of cash collateral to banks to reduce the cost of providing Letters of Credit and utilise Centrica's cash deposits in a more efficient way. Amounts include £624 million relating to cash collateralised on Letters of Credit provided by banks on borrowings relating to South Morecambe gas production as described in more detail in note 34 (c) (iv). If a cash collateralised Letter of Credit is called by the beneficiary and Centrica defaults under the counter indemnity, then the bank is entitled to utilise the cash deposit to meet the ensuing liability.

Centrica also uses Master Netting Agreements or netting provisions to reduce credit risk and net settles payments with counterparties where master netting agreements are held.

Credit risk exposures

The maximum exposure to credit risk without taking account of collateral was represented by the balance sheet carrying amount for all financial instruments within the scope of IAS 32 except for £28 million in relation to financial guarantees. Of the total credit risk exposure on energy derivatives of £2,361 million, £1,910 million (81%) related to the UK and Europe, of which £291 million related to a single European energy counterparty with a credit rating of A+ for which cash collateral of £221 milion was held at 31 December 2005, and £451 million (19%) related to North America. Of the total credit risk exposure on trade and other receivables within the scope of IAS 32 and IAS 39 of £3,150 million, £2,357 million (75%) related to the UK and Europe and £793 million (25%) related to North America. There were no other significant concentrations of credit risk at 31 December 2005.

c) Interest rate risk

Interest rate risk is the risk that the Group suffers financial loss due to changes in the value of an asset or liability or in the value of future cash flows due to movements in interest rates. Any financial asset or liability on which interest is paid or received will be subject to interest rate risk. The Group's policy is to actively manage the interest rate risk on long-term recourse borrowings while ensuring that the exposure to fixed interest rates remains within a 30% – 70% range.

Interest rate swaps and cross-currency interest rate swaps are used to hedge interest rate fair value exposures by swapping fixed-rate interest flows into floating rate interest flows. Interest rate swaps are also used to hedge the cash flow risk associated with changes in interest rates resulting from floating interest rates. The net fair value of fair value interest rate hedging instruments was a £3 million asset at 31 December 2005 and the net fair value of cash flow interest rate hedging instruments was a £44 million liability at 31 December 2005.

34. Financial instruments continued

Effective interest rate analysis

In respect of income-earning financial assets and interest-bearing financial liabilities, the following table indicates their effective interest rates at the balance sheet date and the earlier of the periods in which they re-price or mature:

	Effective interest rate %	Total £m	Within 1 year £m	1-2 years £m	2-5 years £m	More than 5 years £m
Available for sale government bonds	**4.3**	**14**	–	–	14	–
Available for sale floating rate note (i)	**3.7**	**5**	–	–	5	–
Loans (i)	**4.7**	**46**	46	–	–	–
Margining collateral included in other receivables (i), (ii)	**4.2**	**39**	39	–	–	–
Cash and cash equivalents (i), (ii)	**4.5**	**1,075**	1,075	–	–	–
Bank loans – fixed	**3.8**	**(63)**	(8)	(24)	(28)	(3)
Effect of interest rate swap on bank loans (iii)	**0.4**	**–**	(6)	–	–	6
Bank loans and overdrafts – floating (i)	**5.5**	**(63)**	(63)	–	–	–
Other bank loans (i), (iv)	**36.0**	**(637)**	(637)	–	–	–
Sterling bonds (v)	**5.9**	**(422)**	–	–	–	(422)
Effect of interest rate swaps on sterling bonds (iii)	**(0.4)**	**–**	(207)	–	–	207
Commercial paper (i)	**4.3**	**(377)**	(377)	–	–	–
Finance lease obligations – fixed	**5.9**	**(451)**	(16)	(18)	(65)	(352)
Finance lease obligations – floating (i)	**4.6**	**(377)**	(377)	–	–	–
Effect of interest rate swap on finance lease obligations (iii)	**2.4**	**–**	240	–	–	(240)
Margining collateral included within other payables (i)	**4.4**	**(537)**	(537)	–	–	–
Non recourse borrowings						
Canadian dollar bonds (vi)	**4.9**	**(250)**	–	–	(250)	–

(i) These assets/liabilities bear interest at a floating rate.
(ii) Excludes non-interest bearing balances.
(iii) Effect of interest rate derivative on swapped portion of financial instrument at 31 December 2005.
(iv) Centrica formed The Centrica Gas Production LP, a limited partnership, during the year. Certain Morecambe gas field assets have been contributed to the partnership by Hydrocarbon Resources Limited, a Centrica Group company. On 2 December 2005 a bank became a limited partner in this partnership. The Centrica Group retains full operational control of the Morecambe gas fields as Hydrocarbon Resources Limited retains legal ownership of the Morecambe licences and is also the general partner and asset manager of the partnership. The partnership is included on a consolidated basis within the accounts of the Centrica Group. The bank is one of the limited partners of the partnership and at the discretion of the asset manager is entitled to a specified share of the pre-tax partnership profits arising from South Morecambe after taking account of petroleum revenue tax and any losses. All the other limited partners are Centrica Group companies. The bank's accession to the partnership has been accounted for as a loan in the Group accounts, repayable out of the partnership distributions made to it. The costs of this loan will accordingly vary, within pre-determined and defined limits, according to levels of field production, operating costs and repayments, wholesale prices and interest rates. Due to the structure of the transaction the costs of the loan reflect the fact that there is a reduced overall tax charge to the Centrica Group. The loan is repayable as follows: less than one year £188 million; one to two years £339 million; two to five years £74 million and greater than five years £36 million.

On 2 December 2005 the Group also entered into a Put and Call Option arrangement with the bank over the bank's partnership interest. Any exercise of the option is contingent upon the occurrence of certain events up to 2 December 2012, and thereafter may occur at any time. The option exercise price is dependent on the quantum of partnership profits generated from the South Morecambe gas field production partnership and distributions made and interest rates.
(v) Sterling bonds are stated at a face value of £415 million. As disclosed in note 21 these bonds are stated in the Group Balance Sheet net of £4 million of issuance discount, and at fair value where hedged.
(vi) The bonds are expected to be repaid between 2008 and 2010 in advance of the maturity dates.

d) Currency risk

Currency risk is the risk that the Group suffers financial loss as a result of changes in the value of an asset or liability or in the value of future cash flows due to movements in foreign currency exchange rates. Through wholly owned US, Canadian and European subsidiaries, the Group has exposures to US dollars, Canadian dollars and euros. The Group's policy is to protect the sterling value of overseas investments by entering into net investment hedges. The Group hedges all exposures to foreign currencies arising from operating activities where practicable. There were no material financial assets or liabilities other than in the Group's functional currencies, except for £92 million of liabilities denominated in euros. The euro liabilities represent short-term cash flow timing differences and the fair value of gas and power commodity contracts.

34. Financial instruments continued

Net investment hedges

Centrica hedges the carrying value of its overseas investments through holding either foreign currency debt or entering into foreign currency derivatives or a mixture of both. Centrica enters into short-term foreign exchange forwards and medium-term cross-currency interest rate swaps to hedge the net investments. Changes in the sterling value of borrowings or derivatives are used to offset changes in the sterling value of the investments. The net fair value of net investment hedging instruments at 31 December 2005 was a £468 million liability, consisting of borrowings of £377 million and derivative financial instruments of £91 million.

Cash flow hedges

Forward foreign exchange contracts are used to hedge the risk that future foreign currency cash flows vary with changes in foreign exchange rates by fixing the sterling value of a specified foreign currency amount on a specified basis. The net fair value of derivative financial instruments designated as currency cash flow hedging instruments at 31 December 2005 was a £8 million liability.

The maturity analysis of amounts included in the cash flow hedging reserve, which includes fair value gains and losses in relation to commodity, interest rate risk and currency hedges is as follows:

	Cash flow hedging reserve £m
Less than one year	282
One to two years	138
Two to five years	43
More than five years	(9)
	454

e) Liquidity risk

Liquidity risk is the risk that the Group will not have sufficient funds to meet liabilities. Cash forecasts identifying the liquidity requirements of the Group are produced frequently. These are reviewed regularly to ensure sufficient financial headroom exists for at least a 12 month period. The Group's policy includes maintaining a minimum level of committed facilities of £800 million less available cash resources and that at least 50% of net debt (excluding non-recourse debt) over £200 million should be long-term, spread over a range of maturities.

Borrowings

At 31 December 2005, the Group had undrawn committed bank borrowing facilities of £1 billion. These facilities mature in 2010. In addition the Group has access to a number of uncommitted facilities. The principal debt facilities in use by the Group at 31 December 2005 consisted of a US commercial paper programme of US$2 billion and a Euro Medium Term Note (EMTN) programme of US$2 billion. At 31 December 2005, US$658 million had been issued under the commercial paper programme and bonds totalling £415 million were outstanding under the EMTN programme. All the commercial paper issued was held in US dollars to hedge the Group's net investments in North America.

(ii) Fair values

The fair values of the Group's financial instruments together with the carrying amounts included in the Consolidated Balance Sheet are analysed below. Balances excluded from the scope of IAS 32 comprise trade and other receivables with a carrying value of £296 million, trade and other payables with a carrying value of £274 million and provisions of £354 million.

	2005	
Primary financial assets	**Carrying value £m**	**Fair value £m**
Loans and receivables:		
Trade and other receivables (i), (ii)	**3,150**	**3,150**
Loans (ii), (iii)	**46**	**46**
Available for sale assets (iii), (iv), (v)	**45**	**45**
Cash and cash equivalents (ii)	**1,239**	**1,239**

34. Financial instruments continued

Primary financial liabilities	Carrying value £m	Fair value £m
	2005	
Financial liabilities measured at amortised cost:		
Trade and other payables (i), (ii)	(3,369)	(3,369)
Provisions (i), (ii)	(271)	(271)
Businesses' recourse borrowings		
Bank loans and overdrafts (vi)	(126)	(118)
Other bank loans (vii)	(637)	(637)
Sterling bonds (iv)	(422)	(425)
Commercial paper (ii)	(377)	(377)
Obligations under finance leases (including power station tolling arrangements) (viii)	(828)	(856)
Businesses' non-recourse borrowings		
Canadian dollar bonds (iv)	(250)	(261)
Units of The Consumers' Waterheater Income Fund (iv)	(282)	(282)

Derivative financial instruments	Carrying value £m	Fair value £m
	2005	
Derivative financial instruments held for trading (ix)		
Energy derivatives – assets (x)	1,873	1,873
Energy derivatives – liabilities (xi)	(1,664)	(1,664)
Interest rate derivatives – assets	18	18
Interest rate derivatives – liabilities	(20)	(20)
Foreign exchange derivatives – assets	4	4
Foreign exchange derivatives – liabilities	(1)	(1)
Net total	**210**	**210**
Derivative financial instruments in hedging relationships (ix)		
Energy derivatives – assets	488	488
Energy derivatives – liabilities	(7)	(7)
Interest rate derivatives – assets	4	4
Interest rate derivatives – liabilities	(45)	(45)
Foreign exchange derivatives – assets	3	3
Foreign exchange derivatives – liabilities	(102)	(102)
Net total	**341**	**341**

(i) Balances which are outside the scope of IAS 32 have been excluded.
(ii) Due to the nature and/or short maturity of these financial instruments, carrying value approximated fair value.
(iii) Included within other financial assets in the consolidated Balance Sheet.
(iv) Fair value determined with reference to closing market prices.
(v) Includes £26 million of equity instruments.
(vi) Fair value of bank overdrafts and current loans is equivalent to carrying value due to the short-term maturity. The fair value of non-current loans is based on future cash flows discounted using discount rates based on the Group's cost of borrowing of 5%.
(vii) Fair value approximates carrying value. As described above the finance costs and repayments vary within pre-determined and defined limits, according to levels of field production, operating costs, wholesale gas prices and interest rates. The loan re-prices within one year.
(viii) Fair values have been determined based on future cash flows, discounted using discount rates based upon the Group's cost of borrowing of 5%.
(ix) Included within derivative financial instruments in the consolidated Balance Sheet. The principal value of energy derivatives at 31 December 2005 was £45,345 million of which £18,150 million had a maturity of less than one year, £19,609 million had maturity between one and five years and £7,586 million had a maturity greater than five years. The principal value of interest rate derivatives was £1,053 million of which £300 million had a maturity of less than one year and £753 million had a maturity of greater than one year. The principal value of foreign exchange derivatives was £1,718 million of which £1,188 million had a maturity of less than one year and £530 million had a maturity of greater than one year. Principal values are undiscounted and are derived from the aggregated volumes, estimated using valuation techniques, of those sales and purchase contracts which are within the scope of IAS 39. The principal value differs in scope and in basis from the estimated commitment to make payments under procurement contracts, disclosed in note 32 (g). The principal value provides an indication of the scope of the use of derivatives but does not reflect the risk the Group is exposed to from entering into derivatives.
(x) Includes £284 million in relation to proprietary trading.
(xi) Includes £272 million in relation to proprietary trading.

34. Financial instruments continued

The major methods and assumptions used in estimating the fair values of derivative financial instruments are as follows:

Energy derivatives

In order to reduce commodity price risk, the Group procures gas and electricity through a mixture of production from owned gas fields and power stations and procurement contracts. Certain of these procurement contracts – and certain sales contracts – constitute derivative financial instruments which are within the scope of IAS 39 and whose fair value is recorded in the Financial Statements. These fair value balances therefore represent only a part of the Group's overall gas procurement activities. The criteria for determining treatment of contracts in accordance with IAS 39 are outlined in note 3.

The fair values represent the unrealised gains and losses from holding commodity contracts at the balance sheet date, for delivery in future periods, that are not indexed to the market price of the commodity which is the subject of the contract or for which the price is fixed in advance of delivery. These fair values are subject to change resulting from changes in commodity prices, and may not be realised. The methods and assumptions applied in determining fair values are described under 'UK markets' and 'North American markets' below. The effect of changes in assumptions, and sensitivities to changes in commodity prices, are set out in 'Effect of changes in assumptions and sensitivities' below.

The net fair value of the contracts included within Energy Derivatives in the table on page 94 is £690 million and consists of the following balances:

	2005 £m
Derivative financial instruments held for trading	
Energy derivatives – assets	1,873
Energy derivatives – liabilities	(1,664)
Derivative financial instruments in hedging relationships	
Energy derivatives – assets	488
Energy derivatives – liabilities	(7)
Net total	**690**

The contracts included within energy derivatives are subject to a wide range of detailed specific terms but comprise the following general components:

	2005 £m
Short-term forward market purchases of gas and electricity	
UK and Europe	873
North America	363
Long-term gas purchase contracts	553
Long-term gas sales contracts	(1,110)
Other	11
Net total	**690**

The aggregated principal value of energy derivatives (sales and purchases), and its range of maturities, which provides an indication of the underlying maturity profile, is contained in footnote (ix) above. The cash flows arising in relation to these contracts will occur either as physical delivery takes place over the life of the individual contracts, or as a result of the contracts being traded or may not be realised depending on market price movements. The Group's strategy for entering into energy derivatives, and a summary of the terms and conditions of these contracts, is outlined on pages 90 and 91.

Certain other commodity contracts are outside the scope of IAS 39 and are not fair valued in the Financial Statements. The disclosures that follow relate only to the fair values of contracts entered into which are within the scope of IAS 39.

UK markets

Fair values of commodity contracts are estimated by reference in part to published price quotations in active markets and in part by using valuation techniques. Management consider the UK markets for gas and electricity to be active for up to two years, with reliable broker quotes and published prices available for this period. In the active period of the market, financial instruments are valued against forward market prices available at 31 December 2005. Outside the active period financial instruments are valued using commodity prices derived using assumptions that are based on market expectations and reasonably reflect all factors that market participants would consider in setting a price. Forecast prices are derived for the commodities which are the subject of the contracts (primarily gas) and for commodities whose indices are incorporated in the price calculation formulae of certain long-term contracts. These include oil and oil products, coal, and general indices such as the Producer Price Index (PPI). Fair values are discounted based on the yields on zero-coupon bonds with differing maturity dates as available in the market, and interpolated to arrive at monthly rates.

The total change in fair value estimated using valuation techniques that was recognised in the Income Statement during the year amounted to a loss of £91 million. The net fair value of commodity contracts recorded in the Financial Statements determined using valuation techniques at 31 December 2005 is a £170 million liability.

34. Financial instruments continued

Assumptions made in determining fair values

The most significant assumptions incorporated in the valuation techniques used to value commodity contracts at 31 December 2005 are as follows:

- New gas infrastructure capacity will strengthen the direct linkage between UK and continental European gas prices in the medium-term.
- A potential oversupply of gas to the UK market will lower prices during this time.
- Interaction between US and European gas prices will occur in certain periods as cargoes of LNG may be directed to either European or US markets.
- Liberalisation of the European gas market will weaken the linkage between oil prices and gas prices in the medium-term.
- Continued increases in gas demand will not be matched by equivalent increases in supply in the long-term causing upward pressure on prices in the long-term.
- Electricity prices are derived from gas prices, carbon prices and the spark spread (the margin between fuel input prices and electricity sales prices). Gas-fired power stations are assumed to determine the long run marginal price of electricity in the UK for the foreseeable future.
- Oil prices are based on the views held by a cross-section of independent external market experts.
- Coal prices are based on the assumption that market prices will be dominated by the cost of imported coal and that the price of coal shows some linkage to the price of oil.
- For contracts with volume optionality it is assumed that counterparties act to maximise the economic value of the contract.
- It is assumed that markets would allow the sale or purchase of each commodity in equivalent volumes to those contracted at the forecast market price.

Effect of changes in assumptions and sensitivities

Either of the following alternative assumptions, or a combination of these alternative assumptions, would significantly increase forecast gas and electricity prices outside the active period of the market:

- higher oil prices and continued strong linkage between oil and gas prices;
- lower supply to the UK gas market, for instance due to insufficient new infrastructure being put in place, or due to higher worldwide competition for gas supplies.

The impact of changing to either of these reasonably possible alternative assumptions, individually or in combination would be to increase the net fair value liabilities for commodity contracts outside the active period of the market at 31 December 2005 by an estimated £35 million.

Management consider it likely that the occurrence of these alternative assumptions would be accompanied by an increase in gas and electricity prices in the active period of the market. An average increase of 20p/th for gas and £15/MWh for electricity is considered reasonably possible at 31 December 2005. The impact of such increases in gas and electricity prices in the active period would be to increase net fair value assets at 31 December 2005 by £686 million.

In combination the increase in gas and electricity prices in the active and inactive periods would increase net fair value assets at 31 December 2005 by an estimated £651 million.

A combination of the following alternative assumptions would significantly decrease forecast gas prices outside the active period of the market:

- lower oil prices and continued linkage between oil and gas prices;
- a discontinuation of the linkage between oil and gas prices in the medium-term;
- liberalisation in the European gas market, if this were to result in increased competition between gas producers;
- a degree of oversupply to the UK gas market resulting from new infrastructure or lower worldwide demand for gas.

The impact of changing to a reasonably possible combination of these alternative assumptions would be to decrease the net fair value liabilities for commodity contracts outside the active period of the market at 31 December 2005 by approximately £20 million.

Management consider it likely that the occurrence of these alternative assumptions would be accompanied by a decrease in gas prices in the active period of the market. An average decrease of 20p/th for gas and £15/MWh for electricity is considered reasonably possible at 31 December 2005. The impact of such decreases in gas and electricity prices in the active period would be to decrease net fair value assets at 31 December 2005 by £681 million.

In combination the decrease in gas and electricity prices in the active and inactive periods would decrease net fair value assets at 31 December 2005 by an estimated £661 million.

The impacts disclosed above result from changing the assumptions used for fair valuing commodity contracts to reasonably possible alternative assumptions at the balance sheet date. These impacts are not necessarily indicative of the changes in fair value that would occur if these events actually take place in the future, as contractual positions change over time. The fair value impacts only concern those contracts entered into which are within the scope of IAS 39 and should not be construed as a measure of the Group's exposure to cash flow risk resulting from changes in commodity prices.

34. Financial instruments continued

North American markets

Management consider the North American markets for gas and electricity to be active for between one and five years and vary depending on delivery point. The fair value of financial instruments recorded in the Financial Statements is primarily based on quoted market prices in active markets.

Management consider an average increase in gas prices of 16 p/th and an average increase in power prices of £10/MWh reasonably possible at 31 December 2005. The impact of such increases in commodity prices would be to increase net fair value assets at 31 December 2005 by £777 million.

Management consider an average decrease in gas prices of 15 p/th and an average decrease in power prices of £9/MWh reasonably possible at 31 December 2005. The impact of such decreases in commodity prices would be to decrease net fair value assets at 31 December 2005 by £704 million.

Foreign exchange derivatives

Fair values are determined by reference to closing exchange rates at 31 December 2005.

Interest rate derivatives

Fair values have been determined with reference to closing interest rates at 31 December 2005.

(iii) Comparatives

The financial instrument comparatives prepared in accordance with FRS 13 are reproduced below as required by IFRS 1. These disclosures are unchanged from those which were included in Centrica's 2004 Annual Report and Accounts prepared under UK Generally Accepted Accounting Principles.

The interest rate risk profile of the Group's financial assets at 31 December was as follows:

a) Interest rate risk profile of financial instruments

Financial assets	2004 US dollar	Canadian dollar	Sterling	Total
Floating interest rate (£m)	3	8	1,172	1,183
Fixed interest rate (£m)	–	43	5	48
No interest receivable (£m) (i)	–	–	20	20
Total financial assets (£m)	3	51	1,197	1,251
Weighted average fixed interest rate (%)	–	13.5	4.2	12.5
Weighted average period for which rate is fixed (months)	–	59	50	58
Weighted average period for which no interest is receivable (months)	–	–	–	–

With the exception of uncleared items, floating rate financial assets attract interest at rates based upon LIBOR for periods of one year or less.

(i) Financial assets on which no interest is paid relate to unit trust investments, for which no maturity date is specified.

After taking into account forward foreign currency swaps, the interest rate profile of the Group's financial liabilities at 31 December was as follows:

b) Financial liabilities	2004 US dollar	Canadian dollar	Sterling	Total
Floating interest rate (£m)	(271)	(12)	(468)	(751)
Fixed interest rate (£m)	–	(256)	(269)	(525)
No interest payable (£m) (i)	–	(164)	(34)	(198)
Total financial liabilities (£m)	(271)	(432)	(771)	(1,474)
Weighted average fixed interest rate (%)	–	4.8	5.8	5.3
Weighted average period for which rate is fixed (months)	–	109	74	91
Weighted average period for which no interest is payable (months)	–	–	47	47

Floating rate financial liabilities bear interest at rates based upon LIBOR for periods of one day to six months.

(i) Financial liabilities on which no interest is paid include £164 million relating to non-equity minority interests. Non-equity minority interests relate to the 80.1% economic interest in The Consumers' Waterheater Income Fund, represented by units listed on the Toronto Stock Exchange, for which no maturity date is specified.

34. Financial instruments continued

c) Currency risk

Sterling, Canadian and US dollars were the functional currencies for all material operations in 2004. There were no material monetary assets and liabilities in currencies other than these functional currencies, except for £7 million of monetary assets denominated in euros. The euro assets represent short-term cash flow timing differences and margin requirements on European gas trading activities.

The maturity profile of the Group's financial liabilities at 31 December was as follows:

Maturity of financial liabilities	Borrowings £m	Other financial liabilities £m	2004 Total financial liabilities £m
In one year or less, or on demand	468	121	589
In more than one year but not more than two years	9	24	33
In more than two years but not more than five years	24	19	43
In more than five years	632	18	650
Non-equity minority interests (i)	–	164	164
	1,133	346	1,479

The maturity profile of borrowings includes £540 million of sterling bonds stated at face value. As disclosed in note 21, these bonds are stated in the Group Balance Sheet net of £5 million of issuance discount.

(i) As noted above, no maturity date is specified for non-equity minority interests.

d) Borrowing facilities

At 31 December 2004, the Group had undrawn committed bank borrowing facilities of £915 million. Of these facilities, 50% mature during 2005, and the remainder in 2006. In addition the Group has access to a number of uncommitted facilities.

The principal debt facilities in use by the Group at 31 December 2004 were uncommitted and consisted of a US commercial paper programme of US$2 billion and a Euro Medium Term Note (EMTN) programme of US$2 billion. At 31 December 2004, US$420 million (£220 million) had been issued under the commercial paper programme and bonds totalling £540 million had been issued under the EMTN programme. All the commercial paper issued was held in US dollars to hedge the Group's net investments in North America. In relation to the bonds, 23% mature in less than one year and 77% mature after five years.

The following table shows the book and fair values of the Group's financial instruments at 31 December:

e) Fair values of financial assets and liabilities	2004 Book value £m	2004 Fair value £m
Primary financial instruments held or issued to finance the Group's operations:		
Cash at bank and in hand and current asset investments (i)	1,207	1,207
Long-term trade debtors (i)	44	44
Other financial assets	–	–
	1,251	1,251
Bank loans and overdrafts (i)	(85)	(85)
Commercial paper (ii)	(220)	(220)
Bonds (v)	(752)	(783)
Finance lease borrowings (iv)	(30)	(30)
Canadian dollar loans (v)	(39)	(35)
Loan notes (i)	(2)	(2)
Other financial liabilities (i)	(182)	(182)
	(1,310)	(1,337)
Non-equity minority interests (v)	(164)	(264)
	(1,474)	(1,601)
Derivative financial instruments held to manage the Group's currency, interest rate profile and energy price exposures:		
Forward foreign currency contracts (ii), interest rate swaps and forward rate agreements (v)	(22)	(27)
Energy derivatives (iii)	11	40
Derivative financial instruments held for trading:		
Energy derivatives (iii)	15	15

34. Financial instruments continued

(i) Due to the nature and/or short maturity of these financial instruments, book values approximated fair values.
(ii) Fair values have been determined by reference to closing exchange rates at 31 December 2004.
(iii) The fair values of energy derivatives are calculated as the product of the volume and the difference between their strike or traded price and the corresponding market prices. The market price is based upon the corresponding closing price of that market. Where there is no organised market and/or the market is illiquid, the market price is based upon management estimates, taking into consideration all relevant current market and economic factors. Energy derivatives held for trading includes both physical and financial energy contracts entered into for trading purposes.
(iv) The fair values of these financial instruments are based upon discounted cash flows, using discount rates based upon the Group's cost of borrowing.
(v) Fair values have been determined by reference to closing prices at 31 December 2004.

f) Gains and losses on financial instruments held for trading

The Group engages in swaps, futures, forwards and options in gas, electricity and weather, for trading purposes. Financial and physical trading positions are marked-to-market using externally derived market prices and any gain or loss arising is recognised in the Income Statement. This is not in accordance with the general provisions of Schedule 4 of the Companies Act 1985, which requires that these contracts be stated at the lower of cost and net realisable value or that, if revalued, any revaluation difference be taken to a revaluation reserve. However, the Directors consider these requirements would fail to provide a true and fair view since the marketability of energy trading contracts enables decisions to be taken continually whether to hold or sell them. Accordingly the measure of profit in any period is properly made by reference to market values. The effect of this departure from the historical cost convention on the Financial Statements for the year is an increase in profit amounting to £12 million and an increase in net assets at 31 December 2004 of £26 million.

Energy derivatives held for trading include both physical and financial energy contracts entered into for trading purposes. The net gain from trading in energy derivatives included in the Income Statement for the year ended 31 December 2004 is £14 million. The fair value of financial assets and financial liabilities held for trading purposes at 31 December 2004 included within other debtors and other creditors amounted to £119 million and £104 million respectively. The average fair value of instruments held during the year ended 31 December 2004 did not materially differ from the year-end position.

g) Gains and losses on hedges

The Group uses financial instruments to hedge its currency, interest, energy price and weather exposures. Changes in the fair value of these derivatives used are not recognised in the financial statements until the hedged position itself is recorded therein. Unrecognised and deferred gains and losses on hedges arose as analysed as follows:

	Unrecognised			Deferred		
	Gains £m	Losses £m	Total net gains/(losses) £m	Gains £m	Losses £m	Total net gains/(losses) £m
At 1 January 2004	144	(85)	59	24	(3)	21
Arising in previous years that were recognised in 2004	(84)	26	(58)	(21)	2	(19)
Arising in previous years that were not recognised in 2004	60	(59)	1	3	(1)	2
Arising in 2004	71	(48)	23	11	1	12
At 31 December 2004	131	(107)	24	14	–	14
Of which:						
Expected to be recognised in 2005	84	(64)	20	6	–	6
Expected to be recognised in 2006 or later	47	(43)	4	8	–	8

35. Fixed fee service contracts

The Group adopted IFRS 4 with effect from 1 January 2005.

Fixed fee service contracts are entered in to with home services customers in the UK and North America (Central Heating Care, Boiler and Controls Care, Gas Appliance Care, Gas Appliance Check, Plumbing and Drains Care, Kitchen Appliance Care and Home Electrical Care in the UK, and Heating Protection, Cooling Protection and Plumbing and Drains Protection in North America). These contracts are of 12 to 24 months duration in the UK and continue in North America until cancelled by either party to the contract. These plans incorporate both an annual service element and a maintenance element.

Fixed fee service contracts protect purchasers of these contracts against the risk of breakdown of electrical, plumbing, heating, cooling and household appliances, resulting in the transfer of an element of risk from contract holders to Centrica. Benefits provided to customers vary in accordance with terms and conditions of the contracts entered in to, however generally include repair and/or replacement of the items affected.

The risk and level of service required within the maintenance element of the contracts is dependent upon the occurrence of uncertain future events, in particular the number of call outs, the cost per call out and the nature of the fault. Accordingly the timing and amount of future cash outflows related to the contracts is uncertain.

The key terms and conditions that impact future cash flows are as follows:

- Provision of labour and parts for repairs, dependent on the agreement and associated level of service;
- One safety and maintenance inspection in every year of the agreement (for Central Heating Care, Boiler and Controls Care, Gas Appliance Care and Gas Appliance Check in the UK, and Heating Protection Plus and Cooling Protection Plus in North America);
- One safety and maintenance inspection in every continuous two year period of the agreement (for Home Electrical Care, Kitchen Appliance Care and Plumbing and Drains Care);
- No limit to the number of call outs to carry out work included within the selected agreement;
- Caps on certain maintenance and repair costs within fixed fee contracts.

Revenue from fixed fee service contracts is recognised on a straight-line basis over the life of the contract, reflecting the benefits receivable by the customer which span the life of the contract as a result of emergency maintenance potentially being required at any point within the contract term.

Cost of sales relates directly to the engineer workforce employed by Centrica within home services, the cost of which is accounted for over a twelve month period with adjustments made to reflect the seasonality of workload over a given year.

The costs of claims under the fixed fee service contracts will be the costs of the engineer workforce employed by Centrica within home services. These costs are accounted for over a twelve month period with adjustments made to reflect the seasonality of workload over a given year. No further claims costs are accrued.

Weather conditions and the seasonality of maintenance can impact the number of call outs, the cost per call out and the nature of the fault. Centrica's obligations under the terms of its home services fixed fee service contracts are based on the following types of uncertain future events taking place within the contract period:

- Boiler, radiator, controls, hot water cylinder and pipe work breakdown;
- Gas fire, water heater, wall heater, and gas cooker breakdown;
- Hot and cold water pipe, overflow, cold tank, toilet siphon and radiator valve breakdown;
- Washing machine, tumble drier, dishwasher, fridge, freezer, cooker, oven, hob and microwave oven breakdown;
- Fixed electrical wiring system, fuse box, light switch, wall socket, circuit breaker and transformer breakdown;
- Ventor motor, circuit board, direct drive motor and flame sensor breakdown;
- Evaporator and condenser fan motor breakdown.

Centrica actively manages the risk exposure of these uncertain events by undertaking the following risk mitigation activities:

- An initial service visit is performed for central heating care. If, at the initial visit, faults that cannot be rectified are identified, the fixed fee service contract will be cancelled and no further cover provided;
- An annual or bi-annual safety and maintenance inspection is performed to ensure all issues are identified prior to them developing into significant maintenance or breakdown issues;
- Caps on certain maintenance and repair work are incorporated into fixed fee service contracts to limit liability in areas considered to be higher risk in terms of prevalence and cost to repair.

35. Fixed fee service contracts continued

The Group considers the adequacy of estimated future cash flows under the contracts to meet expected future costs under the contracts. Any deficiency is charged immediately to the Income Statement.

Service requests are sensitive to the reliability of appliances as well as the impact of weather conditions. Each incremental 1% increase in service requests would impact profit and equity by approximately £4 million. The contracts are neither exposed to any interest rate risk, significant credit risk, nor are there any exposures relating to embedded derivatives.

	2005 £m	2004 £m
Total revenue	**708**	624
Expenses relating to fixed fee service contracts	**602**	566
Deferred income	**50**	50

The claims notified during the year were £231 million (2004: £214 million) and were exactly matched by expenses related to fixed fee service contracts. All claims are settled immediately and in full.

36. Events after the balance sheet date

The Directors propose a final dividend of 7.4 pence per share (totalling £268 million) for the year ended 31 December 2005. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 19 May 2006. These Financial Statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2006.

The second share repurchase programme of up to £500 million, announced on 24 June 2005, commenced on 3 October 2005.

Between 1 January and 21 February 2006, a further 8,950,000 shares of $6^{14}/_{81}$ pence each were repurchased and cancelled for an aggregate consideration of £22.4 million, representing 0.25% of the Company's issued share capital. This makes a total since October 2005 of 45,688,436 shares for an aggregate consideration of £58.4 million. The share repurchase programme has currently been paused.

On 24 January 2006 the Group completed the disposal of its 49% share of the Chiswick field. Cash proceeds of £8 million were received from CH4 resulting in a net profit on the disposal of £4 million.

On 31 January 2006 the Group completed the disposal of its 19% share of the Ensign field. Cash proceeds of £2 million were received from Venture Production resulting in a net profit on disposal of £2 million.

On 1 February 2006 the Group acquired 100% of the partnership interests in Tenaska III Texas Partners (TP) for consideration of US$48 million (£27 million) in cash, and 100% of the equity interests in WillowTex pipeline Co. for consideration of approximately US$8 million (£4 million) cash. Management considers it impracticable to disclose information about the fair value of the net assets acquired since the valuation exercise has not yet been completed.

On 16 February 2006 a fire occurred at the Rough Storage off-shore facility. As a result of this it is anticipated that the facility will not be operational for some time. It is not possible at the present time to estimate the financial effect of this event.

37. Principal undertakings

31 December 2005 (i)	Country of incorporation	% Group holding in ordinary shares and net assets	Principal activity
Subsidiary undertakings			
Accord Energy Limited	England	100	Wholesale energy trading
Accord Energy (Trading) Limited	England	100	Wholesale energy trading
Bastrop Energy Partners LP	USA	100	Power generation
British Gas Services Limited	England	100	Servicing and installation of gas heating systems
British Gas Trading Limited	England	100	Energy supply
Centrica America Limited	England	100	Holding company
Centrica Barry Limited	England	100	Power generation
Centrica Brigg Limited	England	100	Power generation
Centrica Canada Limited	Canada	100	Holding company and gas production
Centrica Energía SL	Spain	100	Energy supply
Centrica Energy Operations Limited	England	100	Power generation
Centrica Gamma Holdings Limited	England	100	Holding company
Centrica KL Limited	England	100	Power generation
Centrica KPS Limited	England	100	Power generation
Centrica Langage Limited	England	100	Power generation
Centrica Overseas Holdings Limited	England	100	Holding company
Centrica PB Limited	England	100	Power generation
Centrica Renewable Energy Limited	England	100	Renewable energy holding company
Centrica Resources Limited	England	100	Gas and oil production
Centrica RPS Limited	England	100	Power generation
Centrica SHB Limited	England	100	Power generation
Centrica Storage Limited	England	100	Gas storage
Centrica US Holdings Inc	USA	100	Holding company
CPL Retail Energy LP	USA	100	Energy supply
DER Development No. 10 Limited	Canada	100	Gas production
Direct Energy LP	USA	100	Energy supply
Direct Energy Marketing Limited	Canada	100	Energy supply and home services
Direct Energy Services LLC	Canada	100	Energy supply and home services
Dyno Holdings Limited	England	100	Home services
Electricity Direct (UK) Limited	England	100	Energy supply
Energy America LLC	USA	100	Energy supply
Frontera Generation LP	USA	100	Power generation
GB Gas Holdings Limited	England	100	Principal holding company
Glens of Foudland Windfarm Limited	England	100	Power generation
Hydrocarbon Resources Limited	England	100	Gas production
Oxxio BV	Netherlands	100	Energy supply
Residential Services Group Inc	USA	100	Holding company
WTU Retail Energy LP	USA	100	Energy supply
Joint ventures			
Barrow Offshore Wind Limited	England	50	Wind farm construction
Segebel SA	Belgium	50	Energy supply
Partnerships			
The Centrica Gas Production LP (ii)	England	–	Gas production

The Consumers' Waterheater Income Fund is also consolidated as part of the Group in accordance with the requirements of IAS 27. The Fund commenced operating on 17 December 2002. At 31 December 2005 Centrica held a 19.9% interest in the Fund (2004: 19.9%) through its wholly-owned subsidiary, Direct Energy Marketing Limited, which holds 100% of the class B exchangeable units in Waterheater Holding Limited Partnership, a subsidiary of the Fund. Class B exchangeable units are exchangeable into units of the Fund and attract comparable voting rights to units of the Fund. Units of the Fund are traded on the Toronto Stock Exchange.

(i) All principal undertakings are indirectly held by the Company, except for GB Gas Holdings Limited, which is a direct subsidiary undertaking. The information is only given for those subsidiaries which in the Directors' opinion principally affect the figures shown in the Financial Statements.

(ii) The Centrica Gas Production LP is a 'qualifying partnership' and is included on a consolidated basis within the Financial Statements of the Group. It has no share capital. Hydrocarbon Resources Limited, a Centrica Group company, exercises management of the partnership as the general partner. Its registered office is Millstream, Maidenhead Road, Windsor SL4 5GD.

38. First-time adoption of IFRS

The Group reported under UK GAAP in its previously published Financial Statements for the year ended 31 December 2004. The analysis below shows a reconciliation of net assets and profit as reported under UK GAAP at 31 December 2004 to the revised net assets and profit under IFRS reported in these Financial Statements. In addition, there is a reconciliation of net assets under UK GAAP to IFRS at the transition date for the Group (1 January 2004). In preparing the restated financial information, the Group has early adopted:

- IFRS 5, Non-current assets held for sale and discontinued operations;
- IFRIC 4, Determining whether an arrangement contains a lease;
- The amendment to IAS 19 Employee benefits – actuarial gains and losses, Group plans and disclosures; and
- IFRS 6, Exploration for and evaluation of mineral resources.

The rules for first-time adoption of IFRS are set out in IFRS 1, First time adoption of International Financial Reporting Standards. IFRS 1 states that a company should use the same accounting policies in its opening IFRS balance sheet and throughout all periods presented in its first IFRS financial statements. The Standard requires these policies to comply with IFRS effective at the reporting date of the first published financial statements (31 December 2005) under IFRS.

IFRS 1 allows exemptions from the application of certain IFRS to assist companies with the transition process. Centrica has taken the following key exemptions:

- Financial instruments: The Group has elected to adopt IAS 32, Financial instruments: Disclosure and presentation and IAS 39, Financial instruments: Recognition and measurement from 1 January 2005 with no restatement of comparative information. As a result, the information related to financial instruments in the comparative information in the Financial Statements is presented on the previous UK GAAP basis;
- Business combinations: The Group has elected not to restate business combinations prior to the transition date;
- Employee benefits: All cumulative actuarial gains and losses have been recognised in reserves at the transition date. This is to maintain consistency with the prospective Group policy, whereby all actuarial gains and losses will be recognised directly in reserves via the Statement of Recognised Income and Expense;
- Cumulative translation differences: The Group has elected to reset the foreign currency translation reserve to zero at the transition date. Any gains and losses on subsequent disposals of foreign operations will exclude translation differences arising prior to the transition date; and
- Share-based payment: The Group has applied IFRS 2: Share-based payment, to all grants of equity instruments after 7 November 2002 that were unvested as of 1 January 2005.

The Group disposed of its interest in the Onetel group of companies on 30 December 2005, and has subsequently re-stated the 2004 result of the segment as discontinued. This restatement is reflected in the Group Income Statement and related Notes to the Financial Statements. It is not reflected in the reconciliations below.

a) Restatement of 2004

Reconciliation of profit before interest	Notes	£m
Profit before interest reported under UK GAAP		1,000
Petroleum revenue tax (PRT)	(i)	209
Leases	(ii)	87
Retirement benefits	(iii)	(50)
Employee share schemes	(iv)	(2)
Goodwill	(vi)	123
Other income taxes	(vii)	(4)
Discontinued operations	(viii)	(76)
Presentational items	(ix)	(26)
Profit before interest reported under IFRS		1,261

Reconciliation of profit for the year	Notes	£m
Profit for the year reported under UK GAAP		675
Petroleum revenue tax	(i)	(48)
Leases	(ii)	4
Retirement benefits	(iii)	(41)
Employee share schemes	(iv)	(1)
Goodwill	(vi)	119
Other income taxes	(vii)	1
Discontinued operations	(viii)	(72)
Profit for the year reported under IFRS		637

38. First-time adoption of IFRS continued

Reconciliation of equity at 1 January 2004 (date of transition to IFRS)	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non-current assets			
Goodwill	1,614	–	1,614
Other intangible assets	–	388	388
Property, plant and equipment	2,730	(81)	2,649
Interests in joint ventures and associates	94	61	155
Deferred tax assets	25	381	406
Trade and other receivables	92	–	92
Derivative financial instruments	–	–	–
Other financial assets	3	22	25
	4,558	771	5,329
Current assets			
Inventories	173	–	173
Current tax assets	31	(31)	–
Trade and other receivables	2,890	(39)	2,851
Derivative financial instruments	–	–	–
Other financial assets	992	(745)	247
Cash and cash equivalents	34	723	757
	4,120	(92)	4,028
Current liabilities			
Trade and other payables	(3,469)	129	(3,340)
Current tax liabilities	(229)	(30)	(259)
Derivative financial instruments	–	–	–
Bank overdrafts and loans	(298)	(3)	(301)
Provisions	–	(23)	(23)
	(3,996)	73	(3,923)
Non-current liabilities			
Trade and other payables	(104)	–	(104)
Bank loans and other borrowings	(781)	(326)	(1,107)
Derivative financial instruments	–	–	–
Deferred tax liabilities	(541)	49	(492)
Retirement benefit obligation	(30)	(1,108)	(1,138)
Provisions	(489)	23	(466)
	(1,945)	(1,362)	(3,307)
Net assets	2,737	(610)	2,127
Equity			
Called up share capital	237	–	237
Share premium account	549	–	549
Merger reserve	467	–	467
Other reserves	1,267	(610)	657
Shareholders' equity	2,520	(610)	1,910
Minority interests (equity and non-equity)	217	–	217
Total minority interests and shareholders' equity	2,737	(610)	2,127

38. First-time adoption of IFRS continued

Reconciliation of equity at 31 December 2004	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Non-current assets			
Goodwill	1,006	43	1,049
Other intangible assets	–	518	518
Property, plant and equipment	2,832	337	3,169
Interests in joint ventures and associates	112	94	206
Deferred tax assets	36	275	311
Trade and other receivables	151	(83)	68
Other financial assets	–	37	37
	4,137	1,221	5,358
Current assets			
Inventories	158	7	165
Current tax assets	21	(16)	5
Trade and other receivables	3,128	(78)	3,050
Other financial assets	1,166	(962)	204
Cash and cash equivalents	41	925	966
	4,514	(124)	4,390
Current liabilities			
Trade and other payables	(3,506)	214	(3,292)
Current tax liabilities	(279)	(26)	(305)
Bank overdrafts and loans	(468)	(19)	(487)
Provisions	–	(151)	(151)
	(4,253)	18	(4,235)
Non-current liabilities			
Trade and other payables	(93)	(1)	(94)
Bank loans and other borrowings	(660)	(785)	(1,445)
Deferred tax liabilities	(486)	(38)	(524)
Retirement benefit obligation	–	(705)	(705)
Provisions	(588)	151	(437)
	(1,827)	(1,378)	(3,205)
Net assets	2,571	(263)	2,308
Equity			
Called up share capital	233	–	233
Share premium account	575	–	575
Merger reserve	467	–	467
Capital redemption reserve	5	–	5
Other reserves	1,072	(263)	809
Shareholders' equity	2,352	(263)	2,089
Minority interests (equity and non-equity)	219	–	219
Total minority interests and shareholders' equity	2,571	(263)	2,308

38. First-time adoption of IFRS continued

Reconciliation of profit for the year ended 31 December 2004	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Continuing operations			
Group revenue	18,303	(6,662)	11,641
Cost of sales	(14,712)	6,605	(8,107)
Gross profit	3,591	(57)	3,534
Goodwill amortisation	(117)	117	–
Exceptional items	(104)	–	(104)
Other operating expenses	(2,432)	207	(2,225)
Share of profits less losses in joint ventures and associates, net of interest and taxation	62	(6)	56
Group operating profit from continuing operations	1,000	261	1,261
Net interest payable	(19)	(85)	(104)
Profit from continuing operations before taxation	981	176	1,157
Taxation	(306)	(214)	(520)
Profit from continuing operations after taxation	675	(38)	637
Discontinued operations	–	63	63
Gain on disposal of discontinued operation	727	184	911
Profit for the year	1,402	209	1,611
Minority interests (equity and non-equity)	(20)	–	(20)
Dividends	(1,387)	73	(1,314)
Transfer (from)/to reserves	(5)	282	277

Reconciliation of cash flows for the year ended 31 December 2004	UK GAAP £m	Effect of transition to IFRS £m	IFRS £m
Net cash flows from operating activities	1,115	154	1,269
Net cash flows from investing activities	298	199	497
Net cash flows from financing activities	(1,438)	(150)	(1,588)
Net increase in cash and cash equivalents	(25)	203	178
Exchange rate translation differences on cash and cash equivalents	(1)	(1)	(2)
Cash and cash equivalents at 1 January 2004	(18)	723	705
Cash and cash equivalents at 31 December 2004	(44)	925	881

Cash and cash equivalents at 31 December 2004 are stated net of overdrafts of £85 million (1 January 2004: £52 million).

(i) Changes to the calculation of the PRT charge under IFRS do not affect the amount of PRT paid for the production of or the timing of cash paid to HM Collector of Taxes. However, the adoption of IFRS does change the calculation of the deferred liability and therefore the timing of charges to the Income Statement. Under UK GAAP there is no definitive guidance on the accounting treatment of PRT. Under UK GAAP the Group accounted for PRT as a cost of sale (within gross margin) calculated on a unit of production basis, spread over the life of the field. IFRS also lacks specific guidance on PRT, although the definitions of an income tax in IAS 12, Income taxes have led management to judge that PRT should be treated consistently with other taxes. This treatment also changes the basis of calculation of the charge on a temporary difference basis. At transition, the impact was to increase net assets by £68 million. The overall PRT charge for the year ended 31 December 2004 increased by £48 million net of deferred corporation tax, and resulted in the re-classification within the Income Statement of £209 million of PRT costs from cost of sales into the tax charge. At 31 December 2004, the impact was to increase net assets by £19 million.

38. First-time adoption of IFRS continued

(ii) IFRS contains specific guidance which sets out whether or not an arrangement contains a lease (IFRIC 4). Adoption of IFRIC 4 is not mandatory until 1 January 2006, but the Group has, as permitted, adopted it at the transition date, in order to aid comparability. Certain third-party power tolling arrangements have been assessed to be leases in line with IFRIC 4. When assessed against the criteria of IAS 17, Leases, certain arrangements have been assessed to be finance leases, due to the contractual terms and operating interests the Group has in the assets. The assets and finance lease creditor balances have been recognised based on the fair values of the lease arrangements as determined at the inception date of the leases. At transition, the effect was to increase net assets by £8 million, comprising additional assets of £334 million and additional liabilities of £326 million. At 31 December 2004 the effect was to increase net assets by £12 million, comprising additional assets of £810 million and additional liabilities of £798 million. In the Income Statement for the year ended 31 December 2004, £82 million previously treated as a cost of sale under UK GAAP has been treated as interest payable, and £21 million has been recognised in operating costs in respect of depreciation of the plant, property and equipment. In the Cash Flow Statement, operating cash flow has increased by £78 million and net cash outflow from financing activities has also increased by £78 million. These arrangements included the Humber tolling arrangement, which was treated as a finance lease prior to the Group's acquisition of the remaining stake in Humber Power Limited on 19 September 2005. Before the transaction, the Group had a 60% equity interest in Humber Power Limited, which was accounted for as a joint venture. IFRS permits a choice in accounting for joint ventures which meet the definition of jointly controlled entities (JCE). This choice is between equity accounting (a single line reflecting the Group's share in each of the Balance Sheet and Income Statement of the JCE, or proportionate consolidation (showing the Group's share of each category of asset and liability, income and expense of the JCE). The Group has adopted equity accounting for jointly controlled entities. The impact on accounting for the Humber JCE after the change in accounting for the inherent leases at 31 December 2004 was to increase profits by £26 million and to increase investments in joint ventures by £88 million.

(iii) In the Financial Statements for the year ended 31 December 2004, the Group measured pension commitments and other related benefits in accordance with SSAP 24, Accounting for pension costs, and provided the additional disclosures required by FRS 17, Retirement benefits. The adoption of IAS 19 requires the pension obligations and assets to be measured in a manner similar to FRS 17, except that assets are valued at bid price rather than a middle market value. IAS 19 requires the deficit to be shown gross under long-term liabilities rather than net of deferred tax. The associated deferred tax asset is recognised but recorded separately within non-current assets. The Group recognises actuarial gains and losses directly through reserves, reported in the Statement of Recognised Income and Expense, as permitted by IAS 19. The impact of adoption of IAS 19 at the transition date was to reduce net assets by £783 million, comprising liabilities of £1,116 million and a deferred tax asset of £333 million. The impact on profit after taxation from continuing operations for the year ended 31 December 2004 was to reduce profit by £41 million. The profit recognised on the disposal of the AA was increased by £202 million as a result of disposing of the associated pension deficit. The impact on the Balance Sheet at 31 December 2004 was to reduce net assets by £559 million, comprising assets of £154 million and liabilities of £713 million.

(iv) IFRS 2, Share-based payments, introduces a number of changes in the way in which share schemes are accounted for. UK GAAP excluded HM Revenue and Customs approved 'save as you earn' schemes from its scope, removing any related charges from the Income Statement. IFRS 2 has no such scope exclusions and requires its application to all grants of equity instruments after 7 November 2002 that were unvested as at 1 January 2005. First-time adopters were not required to apply the standard to grants of equity instruments before 7 November 2002 and Centrica has not done so. The second area of difference relates to the methodology for calculating the charge. Under UK GAAP the charge was based on the difference between the market price of the share on the grant date, and the exercise price to be paid by the employee ('intrinsic value'). IFRS 2 requires the fair value of the award to be calculated and charged. The impact was to increase deferred tax assets on transition and at 31 December 2004 by £6 million.

(v) A wider range of intangible assets are recognised under IFRS, particularly in respect of business combinations. Under both IFRS and UK GAAP, an intangible asset is an identifiable non-monetary asset without physical substance. Under IAS 38, Intangible assets, an asset is identifiable when it is separable (that is, capable of being sold separately from the entity) or arises from contractual or other legal rights (regardless of whether those rights are separable), whilst under UK GAAP (FRS 10) the assets must be capable of separate disposal without disposing of the related business. Where intangibles are identified in business combinations this has the impact of reducing goodwill (which is not amortised under IFRS) and recognising other types of intangible assets, which are amortised over their estimated useful lives. Under IFRS, only computer software that is integral to a related item of hardware should be included as property, plant and equipment. All other computer software should be recorded as an intangible asset. The impact at transition was to reclassify £349 million from property, plant and equipment and £39 million of renewable obligation certificates classified within trade and other debtors under UK GAAP to intangible assets. Furthermore, amounts capitalised under UK GAAP were expensed on transition to IFRS, resulting in a reduction to opening net assets of £5 million. The associated depreciation was reclassified as amortisation of intangibles in the Income Statement but there was no net impact on earnings or operating profit as a result of this reclassification for the year ended 31 December 2004. At 31 December 2004, the Group reclassified £66 million of goodwill, £385 million of property, plant and equipment, and £71 million of renewable obligation certificates as intangible assets.

(vi) IFRS 3, Business combinations prohibits the amortisation of goodwill and instead requires an annual impairment review in accordance with IAS 36 Impairment of assets. Therefore the goodwill amortisation charge under UK GAAP of £123 million for the 12 months ended 31 December 2004 was reversed in the IFRS restated results. Assessments for impairment of goodwill were conducted at the transition date and none were identified. An assessment was also performed during 2004 on an IFRS basis, which led to an impairment of £4 million as a result of the additional goodwill recognised from a deferred tax liability arising on acquisitions during the year.

38. First-time adoption of IFRS continued

(vii) Under UK GAAP, deferred tax is provided on timing differences, whereas IAS 12, Income taxes requires provision to be made for temporary differences between carrying values and the related tax base of assets and liabilities (excluding goodwill), except under certain specific circumstances. As a result deferred tax needs to be recognised under IFRS in a number of areas where no deferred tax was required under UK GAAP. These are as follows:

- Deferred tax is recognised on temporary differences arising on acquisitions of businesses, where the recognition of assets or liabilities acquired at fair value differs to their tax base. The Group recognised an additional deferred tax liability on acquisitions made during 2004 of £33 million, with a corresponding asset recognised within goodwill. Goodwill is tested for impairment annually, and at 31 December 2004, an impairment of £4 million was recognised on goodwill arising in this way (referred to in note (vi) above). Deferred tax arising on acquisitions prior to 1 January 2004 of £54 million was recognised as an adjustment to opening reserves.
- Under UK GAAP a deferred tax provision is made for tax which would arise on the remittance of the retained earnings of overseas subsidiaries, joint ventures and associated undertakings only to the extent that dividends have been accrued as receivable. IAS 12 requires the recognition of deferred tax on the retained earnings of subsidiaries, joint ventures and associates whose distribution is not within the control of the Group and which is likely within the foreseeable future, whether or not dividends have been accrued. The Group recognised a liability of £7 million in the opening balance sheet, and an additional £2 million during the course of 2004.

(viii) The Group has early adopted IFRS 5, Non-current assets and discontinued operations. This required the restatement of the results of the AA to be included, post tax and interest, within discontinued operations, along with the associated profit on disposal.

(ix) The requirements of IAS 1, Presentation of financial statements, differ from UK GAAP. In the Income Statement, the energy trading activities undertaken by our trading arm, Accord, and our North American proprietary trading business are presented on a net basis within revenue under IFRS. Both unrealised gains and losses on net open financial and physical positions and realised gains and losses on liquidated positions are included within revenue. This compares to the previous presentation under UK GAAP whereby liquidated sales were included within turnover, and liquidated purchases along with unrealised gains and losses on net open positions were included within cost of sales. The impact of this presentational change was to reduce Group revenue and decrease Group costs of sales for the 12 months to 31 December 2004 by £6,025 million, with no net impact on earnings or operating profit. In the 31 December 2004 Balance Sheet a number of items were reclassified under IAS 1, most notably the current element of provisions of £151 million presented as a current liability. In the Cash Flow Statement, current asset investments with a maturity of less than three months are reported under IFRS as cash and cash equivalents rather than other financial assets. This had the effect of increasing reported cash and cash equivalents by £723 million at 1 January 2004 and £925 million at 31 December 2004.

38. First-time adoption of IFRS continued

b) Adoption of IAS 32 and IAS 39 at 1 January 2005

IFRS 1, First-time adoption of IFRS, allows exemptions from the application of certain IFRS to assist with the transition process. In accordance with IFRS 1, the Group has elected to adopt IAS 32, Financial instruments, Disclosure and presentation, and IAS 39, Financial instruments, Recognition and measurement, with effect from 1 January 2005, with no restatement of comparative information. The effect of adopting these standards at 1 January 2005 was as follows:

Reconciliation of equity at 31 December 2004	31 December 2004 £m	Effect of change in accounting policy £m	1 January 2005 £m
Non-current assets			
Goodwill	1,049	–	1,049
Other intangible assets	518	–	518
Property, plant and equipment	3,169	–	3,169
Interests in joint ventures and associates	206	(14)	192
Deferred tax assets	311	34	345
Trade and other receivables	68	(24)	44
Derivative financial instruments	–	55	55
Other financial assets	37	1	38
	5,358	52	5,410
Current assets			
Inventories	165	–	165
Current tax assets	5	–	5
Trade and other receivables	2,929	(10)	2,919
Other financial assets	204	–	204
Derivative financial instruments	121	549	670
Cash and cash equivalents	966	3	969
	4,390	542	4,932
Current liabilities			
Trade and other payables	(3,186)	6	(3,180)
Derivative financial instruments	(106)	(761)	(867)
Current tax liabilities	(305)	–	(305)
Bank overdrafts and loans	(487)	(1)	(488)
Provisions	(151)	–	(151)
	(4,235)	(756)	(4,991)
Non-current liabilities			
Trade and other payables	(94)	5	(89)
Derivative financial instruments	–	(6)	(6)
Bank loans and other borrowings	(1,445)	(252)	(1,697)
Deferred tax liabilities	(524)	10	(514)
Retirement benefit obligation	(705)	–	(705)
Provisions	(437)	62	(375)
	(3,205)	(181)	(3,386)
Net assets	2,308	(343)	1,965
Equity			
Called up share capital	233	–	233
Share premium account	575	–	575
Merger reserve	467	–	467
Capital redemption reserve	5	–	5
Other reserves	809	(179)	630
Shareholders' equity	2,089	(179)	1,910
Minority interests (equity and non-equity)	219	(164)	55
Total minority interests and shareholders' equity	2,308	(343)	1,965

Independent auditors' report to the shareholders of Centrica plc

We have audited the parent Company Financial Statements of Centrica plc for the year ended 31 December 2005 which comprise the Balance Sheet and the related notes. These parent Company Financial Statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' Remuneration Report that is described as having been audited.

We have reported separately on the Group Financial Statements of Centrica plc for the year ended 31 December 2005.

Respective responsibilities of Directors and Auditors

The Directors' responsibilities for preparing the Annual Report, the Directors' Remuneration Report and the parent Company Financial Statements in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the Company's shareholders 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 parent Company Financial Statements give a true and fair view and whether the parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited have been 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 parent Company 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 other transactions is not disclosed.

We read other information contained in the Annual Report and consider whether it is consistent with the audited parent Company Financial Statements. The other information comprises only the Directors' Report, the unaudited part of the Directors' Remuneration Report, the Chairman's Statement, the Chief Executive's Review, the Operating and Financial Review, the Group Financial Review, the Corporate Governance Statement and the Gas and Liquids Reserves. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the parent Company Financial Statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the parent Company 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 parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited 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 parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited.

Opinion

In our opinion:

- the parent Company Financial Statements give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the Company's affairs as at 31 December 2005; and
- the parent Company Financial Statements and the part of the Directors' Remuneration Report to be audited have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP

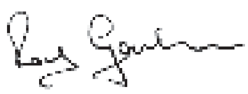
PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
23 February 2006

Company Balance Sheet

31 December	Notes	2005 £m	*2004 £m
Fixed assets			
Tangible assets	ii	**80**	72
Investments in subsidiary undertakings	iii	**2,062**	2,047
		2,142	2,119
Current assets			
Debtors (amounts falling due within one year)	iv	**3,529**	5,234
Debtors (amounts falling due after more than one year)	iv	**–**	40
		3,529	5,274
Current asset investments	v	**1,139**	1,075
Cash at bank and in hand		**5**	28
		4,673	6,377
Creditors (amounts falling due within one year)			
Borrowings	vi	**(443)**	(345)
Other creditors	vii	**(3,773)**	(4,849)
		(4,216)	(5,194)
Net current assets		**457**	1,183
Total assets less current liabilities		**2,599**	3,302
Creditors (amounts falling due after more than one year)			
Borrowings	vi	**(422)**	(410)
Provisions for liabilities and charges	viii	**(43)**	(79)
Net assets		**2,134**	2,813
Capital and reserves – equity interests			
Called up share capital	25	**224**	233
Share premium account	ix	**595**	575
Capital redemption reserve	ix	**15**	5
Other reserves	ix	**1,300**	2,000
Shareholders' funds	x	**2,134**	2,813

* The comparatives have been restated for the adoption of FRS 17, FRS 20 and FRS 21 by the Company (see note xii).

The Financial Statements on pages 111 to 118 were approved by the Board of Directors on 23 February 2006 and were signed on its behalf by:



Sir Roy Gardner
Chief Executive

Phil Bentley
Group Finance Director

The notes on pages 112 to 118 form part of these Financial Statements, along with notes 25 and 26 to the Group Financial Statements.

i. Principal accounting policies of the Company

Accounting principles
The Company Balance Sheet has been prepared in accordance with applicable UK accounting standards and under the historical cost convention and the Companies Act 1985.

The Company has adopted FRS 17, Retirement benefits, FRS 20, Share based payment, FRS 21 (IAS 10), Events after the balance sheet date, FRS 25 (IAS 32), Financial instruments: Disclosure and presentation, and FRS 26 (IAS 39), Financial instruments: Measurement, in these financial statements. The adoption of each of these standards represents a change in accounting policy and accordingly the comparative figures have been restated where required. Details of the effect of the change in policy are given in note xii.

Basis of preparation
No Profit and Loss Account is presented for the Company as permitted by Section 230(3) of the Companies Act 1985.

The accounting policies for financial instruments are consistent with those of the Group, and are disclosed in note 2 to the Group Financial Statements. The financial risk management policies are consistent with those of the Group and are described on page 20 and in note 34 to the Group Financial Statements.

Employee share schemes
The Group has a number of employee share schemes, detailed in the Directors' Report on page 24, the Remuneration Report on pages 30 to 31, and in note 26, under which it makes equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value at the date of grant (excluding the effect of non-market-based vesting conditions). For share-based payments to employees of the Company, the fair value determined at the grant date is expensed on a straight-line basis together with a corresponding increase in equity over the vesting period, based on the Group's estimate of the number of shares that will vest and adjusted for the effect of non market-based vesting conditions. Equity-settled share-based payments which are made available to employees of the Company's subsidiaries are treated as increases in equity over the vesting period of the award, with a corresponding increase in the Company's investments in subsidiaries, based on the Group's estimate of the number of shares that will vest, and adjusted for the effect of non market-based vesting conditions.

Fair value is measured using methods appropriate to each of the different schemes as follows:

LTIS	A Black-Scholes valuation augmented by a Monte Carlo simulation to predict the Total Shareholder Return performance
Sharesave	Black-Scholes
ESOS	Black-Scholes using an adjusted option life assumption to reflect the possibility of early exercise

The Company has taken advantage of the transitional provisions of FRS 20, Share-based payment in respect of equity-settled awards and has applied FRS 20 only to equity-settled awards granted after 7 November 2002 that were unvested at 1 January 2005.

Foreign currencies
Transactions in foreign currencies are translated at the rate of exchange ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies are translated into sterling at closing rates of exchange. Exchange differences on monetary assets and liabilities are taken to the Profit and Loss Account.

Tangible fixed assets
Tangible fixed assets are included in the Balance Sheet at cost, less accumulated depreciation and any provisions for impairment Tangible fixed assets are depreciated on a straight-line basis at rates sufficient to write off the cost, less estimated residual values, of individual assets over their estimated useful lives at periods ranging from five to 20 years.

Leases
Rentals under operating leases are charged to the Profit and Loss Account on a straight-line basis.

Investments
Fixed asset investments are held in the Balance Sheet at cost, less any provision for impairment as necessary. Current asset investments are stated at the lower of cost and net realisable value.

Pensions and other retirement benefits
The Company's employees participate in a number of the Group's defined benefit pension schemes as described in note 31. The Company is unable to identify its share of the underlying assets and liabilities in the schemes on a consistent and reasonable basis and therefore accounts for the schemes as if they were defined contribution schemes. The charge to the Profit and Loss Account is equal to the contributions payable to the schemes in the accounting period. Details of the defined benefit schemes of the Group (accounted for in accordance with the Group's accounting policies detailed in note 2) can be found in note 31.

i. Principal accounting policies of the Company continued

Taxation

Current tax, including UK corporation tax and foreign tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated, but not reversed, at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future, or a right to pay less tax in the future, have occurred at the balance sheet date. Timing differences are differences between the Group's taxable profits and its results as stated in the Financial Statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the Financial Statements.

A deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits in the foreseeable future from which the reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless, by the balance sheet date, there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the Financial Statements. Deferred tax is not recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is recognised in respect of the retained earnings of overseas subsidiaries and associates only to the extent that, at the balance sheet date, dividends have been accrued as receivable or a binding agreement to distribute past earnings in the future has been entered into by the subsidiary or associate.

Deferred tax is measured at the average tax rates that are expected to apply in the periods in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantially enacted by the balance sheet date.

Deferred tax is measured on a non-discounted basis.

ii. Tangible fixed assets

	Plant, equipment and vehicles £m
Cost	
1 January 2005	108
Additions	25
Disposals	(4)
31 December 2005	**129**
Depreciation and amortisation	
1 January 2005	36
Charge for the year	14
Disposals	(1)
31 December 2005	**49**
Net book value	
31 December 2005	**80**
31 December 2004	72

No assets were held under finance leases (2004: £nil).

iii. Investments in subsidiary undertakings

	Investments in subsidiaries' shares £m
Cost	
1 January 2005 as restated (i)	2,047
Additions (ii)	15
31 December 2005	**2,062**

(i) The opening balance has been restated following the adoption of FRS 20 by the Company. Details of the restatement are provided in note xii.
(ii) Additions represent the increase in shares to be issued under employee share schemes in Group undertakings.

iv. Debtors

	2005		2004	
	Within one year £m	**After one year £m**	Within one year £m	After one year £m
Amounts owed by Group undertakings (i), (ii)	**3,467**	**–**	5,206	40
Derivative financial instruments	**53**	**–**	–	–
Other debtors	**3**	**–**	20	–
Prepayments and other accrued income	**6**	**–**	6	–
Corporation tax	**–**	**–**	2	–
	3,529	**–**	5,234	40

The 2004 comparatives have been restated following the adoption by the Company of FRS 17 and FRS 20. Details of the restatement are given in note xii.
(i) Included within amounts owed by Group companies are revolving credit facilities totalling C$2,082 million. Interest is calculated at the Canadian Prime rate on the last day of the preceding quarter. Interest is payable quarterly in arrears. The amount drawn under the facilities at 31 December 2005 is C$1,330 million (2004: C$1,121 million). Principal amounts are repayable on demand.
(ii) Included within amounts owed by Group companies are revolving credit facilities totalling US$855 million. Interest is calculated at the US Prime rate on the last day of the preceding quarter. Interest is payable quarterly in arrears. The amount drawn under the facilities at 31 December 2005 is US$646 million (2004: US$512 million). Principal amounts are repayable on demand.

v. Current asset investments

	2005 £m	2004 £m
Money market investments	**1,139**	1,075

£31 million (2004: £25 million) of money market investments were held by the Law Debenture Trust, on behalf of the Company, as security in respect of the Centrica Unapproved Pension Scheme (note 31).

vi. Borrowings

Amounts falling due	2005 Within one year £m	2005 After one year £m	2004 Within one year £m	2004 After one year £m
Bank loans and overdrafts	**66**	**–**	–	–
Sterling bonds [(i)]	**–**	**422**	125	410
Commercial paper [(ii)]	**377**	**–**	220	–
	443	**422**	345	410

(i) Sterling bonds were repayable as follows: less than one year £nil (2004: £125 million) and after five years £422 million (2004: £410 million). The bonds bear interest at fixed rates of 5.875% (2004: 5.375% and 5.875%). The bonds have a face value of £415 million (2004: £540 million) and are stated at amortised cost net of £4 million (2004: £5 million) issuance discount and at fair value where hedged.

(ii) Commercial paper has a face value of £382 million (2004: £221 million).

vii. Other creditors

Amounts falling due	2005 Within one year £m	2005 After one year £m	2004 Within one year £m	2004 After one year £m
Trade creditors	**12**	**–**	11	–
Amounts owed to Group undertakings	**3,526**	**–**	4,682	–
Derivative financial instruments	**145**	**–**	–	–
Taxation and social security	**3**	**–**	6	–
Accruals and deferred income	**87**	**–**	150	–
	3,773	**–**	4,849	–

The comparatives have been restated following the adoption of FRS 21 by the Company. Details of the restatement are given in note xii.

viii. Provisions for liabilities and charges

	1 January 2005 £m	Profit and loss charge £m	Utilised in the year £m	Unused and released £m	**31 December 2005 £m**
Restructuring and other provisions	79	29	(16)	(49)	**43**

Potential unrecognised deferred corporation tax assets amounted to £26 million (2004: £24 million).

Restructuring and other provisions principally represent estimated liabilities for redundancy costs associated with the restructuring announced in 2004 and 2005, the disposal of the AA, outstanding litigation and National Insurance in respect of Long Term Incentive Scheme liabilities. The National Insurance provision was based on a share price of 254.75 pence at 31 December 2005 (2004: 236.25 pence). The majority of the amounts are expected to be utilised between 2006 and 2008.

ix. Reserves

	Share premium account £m	Capital redemption reserve £m	Cash flow hedging reserve £m	Profit and loss account £m	**Total £m**
31 December 2004 as previously stated	575	5	–	1,809	**2,389**
Prior year adjustment (note xii)	–	–	–	191	**191**
31 December 2004 as restated	575	5	–	2,000	**2,580**
Adoption of FRS 26 (note xii)	–	–	–	2	**2**
1 January 2005 as restated	575	5	–	2,002	**2,582**
Profit for the year (i)	–	–	–	11	**11**
Gains on revaluation of available for sale assets	–	–	–	2	**2**
Losses on revaluation of cash flow hedges (ii)	–	–	(5)	–	**(5)**
Dividends	–	–	–	(340)	**(340)**
Employee share option schemes:					
Purchase of treasury shares	–	–	–	(3)	**(3)**
Value of services provided	–	–	–	21	**21**
Share issue	20	–	–	–	**20**
Repurchase of shares	–	10	–	(388)	**(378)**
31 December 2005	**595**	**15**	**(5)**	**1,305**	**1,910**

(i) As permitted by section 230(3) of the Companies Act 1985, no Profit and Loss Account is presented. The Company's profit for the financial year was £11 million (2004 as restated: £2,564 million) before dividends paid of £340 million (2004: £1,387 million). The Company's profit includes dividends received from subsidiary undertakings of £nil (2004: £2,560 million).

(ii) Arising on revaluation of interest rate derivatives. Further details of the Company's interest rate derivatives are included within the Group financial instrument disclosures in note 34.

The profit and loss account can be further analysed as follows:

	Treasury shares £m	Share options reserve £m	Other £m	**Profit and loss account £m**
1 January 2005 as restated	(15)	24	1,993	**2,002**
Profit for the year (i)	–	–	11	**11**
Gains on revaluation of available for sale assets	–	–	2	**2**
Dividends	–	–	(340)	**(340)**
Employee share option schemes:				
Purchase of treasury shares	(3)	–	–	**(3)**
Exercise of awards	18	(3)	(15)	**–**
Value of services provided	–	21	–	**21**
Repurchase of shares (note 25 (i))	–	–	(388)	**(388)**
31 December 2005	**–**	**42**	**1,263**	**1,305**

(i) Includes a £12 million gain on re-measurement of interest rate derivatives and bonds designated as the hedged item and a £2 million gain on re-measurement of foreign exchange derivatives. Further details of the Company's interest rate and foreign currency derivatives are included within the Group financial instrument disclosures in note 34.

x. Movements in shareholders' funds

	2005 £m	2004 (i) £m
1 January	**2,813**	1,602
Adoption of FRS 26 (2004: adoption of FRS 17, FRS 20 and FRS 21) (i)	**2**	145
1 January as restated	**2,815**	1,747
Profit attributable to the Company (ii)	**11**	2,564
Losses on revaluation of cash flow hedges	**(5)**	–
Gains on revaluation of available for sale assets	**2**	–
Dividends paid to shareholders	**(340)**	(1,314)
Employee share option schemes:		
Purchase of treasury shares	**(3)**	–
Value of services provided	**21**	27
Share issue	**21**	(205)
Repurchase of shares (note 25(i))	**(388)**	(6)
Net movement in shareholders' funds for the financial year	**(681)**	1,066
31 December	**2,134**	2,813

The Directors propose a final dividend of 7.4 pence per share (totalling £268 million) for the year ended 31 December 2005. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 19 May 2006. These Financial Statements do not reflect this dividend payable, which will be accounted for in shareholders' equity as an appropriation of retained earnings in the year ending 31 December 2006.

Details of the Company's share capital are provided in notes 25 and 26 to the Group Financial Statements. The repurchase of shares is stated net of transaction costs of £1 million (2004: £2 million).

The second share repurchase programme of up to £500 million, announced on 24 June 2005, commenced on 3 October.

Between 1 January and 21 February 2006, a further 8,950,000 shares of $6^{14}/_{81}$ pence each were repurchased and cancelled for an aggregate consideration of £22.4 million, representing 0.25% of the Company's issued share capital. This makes a total since October 2005 of 45,688,436 shares for an aggregate consideration of £58.4 million. The share repurchase programme has currently been paused.

(i) The prior year comparatives have been restated following the adoption by the Company of FRS 17, FRS 20 and FRS 21. Details of the restatement are given in note xii.
(ii) Profit attributable to the Company includes dividends received from subsidiary undertakings of £nil (2004: £2,560 million).

xi. Commitments and indemnities

a) Capital expenditure

At 31 December 2005, the Company had placed contracts for capital expenditure amounting to £16 million (2004: £25 million).

b) Lease commitments

At 31 December 2005, there were £1 million of land and building and £5 million of computer lease commitments in relation to non-cancellable operating leases for the Company (2004: £1 million and £5 million respectively). The Company has guaranteed operating commitments of a subsidiary undertaking at 31 December 2005 of £7 million (2004: £9 million) in respect of land and buildings.

c) Guarantees and indemnities

Refer to note 32(e) for details of guarantees and indemnities. The maximum credit risk exposure was represented by the carrying amount for all financial instruments with the exception of financial guarantees issued by the Company to third parties, principally to support its subsidiaries' gas and power procurement and banking activities. At 31 December 2005 the credit risk exposure under financial guarantees issued by Centrica plc was £832 million.

xii. Changes in accounting policy

The Company has adopted the following standards with effect from 1 January 2005; FRS 17, Retirement benefits, FRS 20, Share-based payment, FRS 21 (IAS 10), Events after the balance sheet date, FRS 25, Financial instruments: Disclosure and presentation and FRS 26, Financial instruments: Measurement.

The Company previously accounted for retirement benefits in accordance with SSAP 24. The charge to the Profit and Loss Account comprised the cost of providing retirement pensions and other benefits, spread over the period benefiting the employees' service. The Company recognised a provision or prepayment which represented the difference between charges to the Profit and Loss Account and contributions paid to the pension schemes. Under FRS 17, the Company is unable to identify its share of the underlying assets and liabilities in the schemes on a consistent and reasonable basis. Therefore the Company's charge to the Profit and Loss Account is equal to the contributions payable to the schemes in the accounting period. Details of the defined benefit schemes of the Group (accounted for in accordance with the Group's accounting policies detailed in note 2) can be found in note 31. The implementation of FRS 17 has resulted in a reduction to the Company's previously reported net assets of £25 million at 31 December 2004, and a reduction of £30 million to the Company's previously reported profits for the year then ended.

The Company previously accounted for share-based payments in accordance with UITF 38 and UITF 17 (revised 2003). These abstracts required own shares held under trust to be shown as a deduction from shareholders' funds, while the profit and loss charge was determined as the intrinsic value of the options granted. Under FRS 20, own shares held under trust continue to be presented as a deduction from shareholders' funds, but equity-settled share-based payments are measured at fair value at the date of grant. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the number of instruments that will satisfy non-market vesting conditions. The implementation of FRS 20 has resulted in a reduction of the Company's previously reported net assets of £14 million at 31 December 2004, an increase to the Company's previously reported profits of £26 million, and a debit to the share option reserve of £23 million for the year then ended.

FRS 21, Events after the balance sheet date, requires that dividends declared after the balance sheet date should not be recognised as a liability at the balance sheet date, because the liability does not represent a present obligation. Instead, dividends will be recognised in the period in which they are declared and approved. This has the effect of increasing net assets at 31 December 2004 by £230 million. The retained earnings for 2004 include the 2003 final dividend of £157 million, the 2004 interim dividend of £108 million and the special dividend of £1,050 million. The 2004 final dividend of £230 million is reflected in 2005.

The Company adopted FRS 25 and FRS 26 with effect from 1 January 2005. In accordance with the transitional provisions of those standards, the comparative information for 2004 has not been restated. The accounting policies of the Company for 2004 and 2005 in respect of financial instruments are consistent with those of the Group, and are detailed in note 2. The effect of adopting FRS 26 was to increase net assets at 1 January 2005 by £2 million. In accordance with paragraph 3 (c) of FRS 25, the Company is exempt from the disclosure requirements of paragraphs 51 to 95 of FRS 25. The Company's financial instruments are consolidated with those of the Group and are incorporated into the disclosures in note 34.

The Company was also required to adopt FRS 22 (IAS 33), Earnings per share, FRS 23 (IAS 21), The effects of changes in foreign exchange rates, and FRS 24 (IAS 29), Financial reporting in hyperinflationary economies, none of which are material for the Company.

Comparative figures have been restated in the Company Balance Sheet and notes iii, iv, vii, ix, and x.

Gas and Liquids Reserves (Unaudited)

The Group has estimated proven and probable gas and liquid reserves in the UK and North America. Estimates are made by management.

The principal fields in the UK are South Morecambe, North Morecambe, Statfjord and the Rough field associated with Centrica Storage. The principal fields in North America are Medicine Hat and Entice.

Estimated net proven and probable reserves of gas (billion cubic feet)	UK	North America	**Total**
1 January 2005	1,801	335	**2,136**
Revisions of previous estimates (i)	21	(1)	**20**
Purchases of reserves in place	88	1	**89**
Extensions, discoveries and other additions (ii)	79	–	**79**
Production	(304)	(31)	**(335)**
31 December 2005	**1,685**	**304**	**1,989**

Estimated net proven and probable reserves of liquids (million barrels)	UK	North America	**Total**
1 January 2005	7	3	**10**
Revisions of previous estimates	7	–	**7**
Purchases of reserves in place	9	–	**9**
Extensions, discoveries and other additions (ii)	9	–	**9**
Production	(4)	–	**(4)**
31 December 2005	**28**	**3**	**31**

(i) Includes revised reserves estimate for the Galleon field (51 billion cubic feet reduction).
(ii) Other additions comprise reclassifications from contingent resources to reserves.

Liquid reserves includes oil, condensate and natural gas liquids (NGL).

Five Year Record

Results

Year ended 31 December	As reported under UK GAAP 2001 £m	2002 £m	2003 £m	Restated to IFRS *2004 £m	**2005 £m**
Group revenue from continuing operations	12,611	14,345	17,931	11,361	**13,448**
Operating profit from continuing operations before goodwill amortisation, exceptional charges, and certain re-measurements including share of joint ventures and associates:					
British Gas Residential	(46)	244	206	314	**201**
British Gas Business	44	65	51	68	**77**
Centrica Energy	573	519	561	773	**903**
Centrica Storage		1	40	69	**154**
	571	829	858	1,224	**1,335**
North American Energy and Related Services	68	63	130	132	**185**
Other operations	(4)	5	–	1	**2**
European Energy				5	**(9)**
Onetel (i)	4	2	4	–	**–**
The AA (ii)	72	73	93	–	**–**
Goldfish Bank (iii)	(32)	(40)	(27)	–	**–**
	679	932	1,058	1,362	**1,513**
Operating profit from discontinued operations, net of tax					
Onetel (i)				3	**12**
The AA (ii)				80	**–**
Exceptional items and certain re-measurements (net of tax)	(80)	(35)	(53)	833	**340**
Goodwill amortisation (net of tax credit)	(88)	(123)	(161)		
Profit attributable to the Group	323	478	500	1,591	**1,012**
	Pence	Pence	Pence	Pence	**Pence**
Earnings per ordinary share	8.1	11.4	11.8	38.0	**27.4**
Adjusted earnings per ordinary share (iv)	12.1	15.2	16.8	18.1	**18.2**

Assets and liabilities

At 31 December	As reported under UK GAAP 2001 £m	2002 £m	2003 £m	Restated to IFRS *2004 £m	**2005 £m**
Intangible assets including goodwill	1,524	1,813	1,614	1,567	**1,739**
Other non-current assets	2,225	2,865	2,827	3,791	**4,490**
Net current (liabilities)/assets	(397)	(108)	241	155	**666**
Long-term liabilities and provisions	(1,816)	(2,168)	(1,945)	(3,205)	**(4,453)**
Net assets	1,536	2,402	2,737	2,308	**2,442**
Debt, net of cash and money market investments:					
Net (debt)/cash (excluding Goldfish Bank and non-recourse debt)	(433)	(529)	163	(508)	**(1,060)**
Goldfish Bank working capital facility	(610)	(430)	–	–	**–**
Consumers' Waterheater Income Fund (non-recourse) debt		(196)	(216)	(217)	**(532)**
	(1,043)	(1,155)	(53)	(725)	**(1,592)**

* The 2004 comparatives have been restated on transition to IFRS.

On implementation in 2004 of UITF 38, values for 2003 were restated for the change in accounting policy.

(i) Discontinued in 2005.
(ii) Discontinued in 2004.
(iii) Discontinued in 2003.
(iv) Adjusted earnings per share exclude goodwill amortisation and exceptional charges under UK GAAP, and certain re-measurements and exceptional items under IFRS.

Cash flows

Year ended 31 December	As reported under UK GAAP 2001 £m	2002 £m	2003 £m	Restated to IFRS *2004 £m	**2005 £m**
Cash inflow from operating activities before exceptional payments	869	733	992	1,294	**1,192**
Exceptional payments	(44)	(16)	–	(25)	**(48)**
Net cash flow from investing activities				497	**(529)**
Disposals and acquisitions	(607)	(935)	292		
Cash (outflow)/inflow before financing	(342)	(918)	652	1,766	**615**

Shareholder Information

Financial calendar

Ex-dividend date for 2005 final dividend	26 April 2006
Record date for 2005 final dividend	28 April 2006
Annual General Meeting, Queen Elizabeth II Conference Centre London SW1	19 May 2006
Final dividend payment date	14 June 2006
2006 interim results announced	27 July 2006
Interim dividend payment date	15 November 2006

Centrica shareholder helpline

Centrica's shareholder register is maintained by Lloyds TSB Registrars, which is responsible for making dividend payments and updating the register, including details of changes to shareholders' addresses and purchases or sales of Centrica shares. If you have a question about your shareholding in Centrica, you should contact:

telephone: **0870 600 3985***
text phone: 0870 600 3950*
write to: Lloyds TSB Registrars,
The Causeway, Worthing,
West Sussex BN99 6DA
email: **centrica@lloydstsb-registrars.co.uk**

***** calls charged at national rate

The Centrica website

The Centrica website at www.centrica.com provides news and details of the Company's activities, plus information on the share price and links to our business sites.

The investor information section of the website contains up-to-date information for shareholders including the Company's latest results and key dates such as dividend payment dates. It also holds historical details such as past dividend payment dates and amounts, and a comprehensive share price information section. Visit **www.centrica.com/shareholders**.

Electronic communications

Shareholders who prefer to receive communications from Centrica electronically are encouraged to register their email address via our website at **www.centrica.com/ecomms**.

By registering for this service shareholders can in future:
- help us to reduce print, paper and postage costs and the associated environmental impact of these;
- view the Annual Report on the day it is published;
- receive electronic notification when important shareholder communications are published, such as the annual reports and notices of general meetings;
- cast their AGM vote electronically; and
- access details of their individual shareholding quickly and securely online.

Registration is free and easy to complete. All that is required for registration is the shareholder reference number which is shown on your tax voucher, FlexiShare statement or share certificate. Once you are registered, you may also look up a range of information including the number of Centrica shares you hold, the registered name and address details and information held for dividend payment instructions.

The Centrica FlexiShare service

FlexiShare

By transferring your shares into FlexiShare you will benefit from:
- low-cost share dealing facilities provided by a panel of independent brokers;
- quicker settlement periods;
- no certificates to lose; and
- a dividend reinvestment plan – your cash dividend can be used to buy more Centrica shares (for a small dealing charge) which are then credited to your FlexiShare account.

FlexiShare is a 'corporate nominee', sponsored by Centrica and administered by Lloyds TSB Registrars. It is a convenient way to manage your Centrica shares without the need for a share certificate. Your share account details will be held on a separate register and you will receive an annual confirmation statement. Participants will have the same voting and attendance at general meetings rights as all other shareholders. There is no charge for holding your shares in the service, nor for transferring in or out at any time.

For further details about FlexiShare, please call the Centrica shareholder helpline on 0870 600 3985 or visit www.centrica.com/flexishare.

Direct dividend payments

Dividends can be paid automatically into your bank or building society account. This service has a number of benefits:
- there is no chance of the dividend cheque going missing in the post;
- the dividend payment is received more quickly as the cash is paid directly into the account on the payment date without the need to pay in the cheque and wait for it to clear; and
- a single consolidated tax voucher is issued at the end of each tax year, in March, in time for your self-assessment tax return.

Direct dividend payment also helps Centrica improve its efficiency by reducing postage and cheque clearance costs. To register for this service, please call the Centrica shareholder helpline on 0870 600 3985 to request a direct dividend payment form, or download it from our website at www.centrica.com/shareholders.

Overseas dividend payments

A service has been established to provide shareholders in over 30 countries with the opportunity to receive Centrica dividends in their local currency. For a small fixed fee, shareholders can have their dividends automatically converted from sterling and paid into their bank account, normally within five working days of the dividend payment date. For further details, please contact the Centrica overseas shareholder helpline on +44 121 415 7061.

Frequent shareholder enquiries

If you change your address
Please notify Lloyds TSB Registrars in writing. If shares are held in joint names, the notification must be signed by the first-named shareholder. A form can be downloaded from www.centrica.com/shareholders.

If you change your name
Please notify Lloyds TSB Registrars in writing and enclose a copy of any marriage certificate or change of name deed as evidence.

Lost Centrica share certificate
If your share certificate is lost or stolen, you should call the Centrica shareholder helpline on 0870 600 3985 immediately. A letter of indemnity will be sent to you to sign. Lloyds TSB Registrars will charge you for a replacement certificate.

Duplicate shareholder accounts
If you receive more than one copy of Centrica communications you may have your shares registered inadvertently in at least two accounts. This happens when the registration details of separate transactions differ slightly. If you wish to consolidate such multiple accounts, call the Centrica shareholder helpline on 0870 600 3985 to request an account combination form or download from www.centrica.com/shareholders.

Buying and selling shares in the UK
If you wish to buy or sell certificated Centrica shares, you will need to use a stockbroker or high street bank which trades on the London Stock Exchange. There are many telephone and online services available. If you are selling, you will need to present your share certificate at the time of sale. FlexiShare (details on page 122) offers a year-round, low-cost dealing service to its participants.

Transferring Centrica shares
Transferring shares to someone else requires the completion of a stock transfer form. This form, with details of the procedure you need to follow, is available from the Centrica shareholder helpline on 0870 600 3985. Stamp duty is not normally payable if the transfer is to a relative or if there is no money being paid in exchange for the shares.

Share price information
As well as using the Centrica website to view details of the current and historical Centrica share price, shareholders can find share prices listed in most national newspapers. Ceefax and Teletext pages also display share prices that are updated regularly throughout the trading day. For a real-time buying or selling price, you should contact a stockbroker.

Useful historical information
Demerger
The shares of Centrica plc were traded on the London Stock Exchange for the first time on 17 February 1997, the date of demerger from its then parent company British Gas plc. Shares were acquired in Centrica plc on the basis of one Centrica share for every British Gas share held at demerger. The split between the post-demerger Centrica and BG shares was in the proportion Centrica 27.053% and BG 72.947%.

Shares in Centrica plc acquired on demerger are treated as having a base cost for capital gains tax purposes (calculated in accordance with taxation legislation) of 64.25 pence each.

Share capital consolidations
The share capital of Centrica plc has been consolidated on two occasions.
- On 10 May 1999, the ordinary share capital was consolidated on the basis of nine new ordinary shares of 55/9 pence for every ten ordinary shares of 5 pence held on 7 May 1999. The consolidation was linked to the payment of a special dividend of 12 pence per share on 23 June 1999.
- On 25 October 2004, the ordinary share capital was consolidated on the basis of nine new ordinary shares of 614/81 pence for every ten ordinary shares of 55/9 pence held on 22 October 2004. The consolidation was linked to the payment of a special dividend of 25 pence per share on 17 November 2004.

ShareGift
ShareGift is an independent registered charity (no. 1052686) which provides a free service for shareholders wishing to give small holdings of shares to benefit charitable causes. It may be especially useful for those who wish to dispose of a small parcel of shares which would cost more to sell than they are worth. There are no capital gains tax implications (i.e. no gain or loss) on gifts of shares to charity and it is also possible to obtain income tax relief. Further information can be obtained at www.sharegift.org or from the Centrica shareholder helpline on 0870 600 3985.

American Depositary Receipts
Centrica has an American Depositary Receipt (ADR) programme. The ADRs, each of which is equivalent to ten ordinary Centrica shares, trade under the symbol CPYYY.

For enquiries, please contact:
ADR Depositary
The Bank of New York
Investor Relations
PO Box 11258, Church Street Station
New York NY 10286-1258
email: shareowners@bankofny.com
or via www.stockbny.com
Telephone: 1 888 BNY ADRs in the US
or +1 212 815 3700 from outside the US.
www.adrbny.com

Analysis of shareholders as at 31 December 2005

Distribution of shares by the type of shareholder	Holdings	Shares
Nominees and institutional investors	9,311	3,248,823,297
Individuals (certificated)	885,536	375,158,969
Total	894,847	3,623,982,266

Size of shareholding	Number of holdings	Shares
1 – 500	706,362	163,511,857
501 – 1,000	118,611	83,126,509
1,001 – 5,000	64,139	109,532,046
5,001 – 10,000	3,407	23,155,330
10,001 – 50,000	1,219	23,066,169
50,001 – 100,000	212	15,260,194
100,001 – 1,000,000	543	201,054,271
1,000,001 and above	354	3,005,275,890
Total	894,847	3,623,982,266

As at 31 December 2005 there were 84,208 participants in the Centrica FlexiShare service, with an aggregate shareholding of 92,916,487 shares, registered in the name of Lloyds TSB Registrars Corporate Nominee Limited.

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Six great reasons to visit www.centrica.com

- **Shareholder centre**
  sign up to receive Centrica shareholder communications electronically
- **Current share price**
  daily and historical market data
- **Online presentations and reports**
  the latest Annual and Interim Reports and presentations to analysts
- **Centrica news**
  sign up to receive email alerts whenever a news release is published
- **Investor tools**
  up-to-date Company and industry data
- **Business directory**
  full details of Centrica's main areas of business

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If you would like this Annual Report in a different format, such as large print, Braille, audio or digital (text CD or floppy disk), you can request these in the following ways:

Telephone 0191 438 6063
Text phone 0191 438 1122

Please note that these numbers should be used to order copies of alternative formats only. For general shareholder enquiries please use the shareholder helpline (details on page 122).

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