centrica

Annual Report and Accounts
2007

energy expertise

we **source** it
we **generate** it
we **process** it
we **store** it
we **trade** it
we **save** it
we **supply** it
we **service** it

Our vision

Our vision is to be a leading integrated energy company in our chosen markets.

We are energy experts. We source, generate, process, store, trade, save and supply energy and provide a range of related services.

We have strong brands and distinctive skills which we use to achieve success in our chosen markets of the UK, North America and Europe, and for the benefit of our employees, our customers and our shareholders.

To view our Annual Report online
go to: **www.centrica.com/reports2007**

Disclaimers
This Report does not constitute an invitation to underwrite, subscribe for, or otherwise acquire or dispose of any Centrica shares. This Report contains certain forward-looking statements with respect to the financial condition, results, operations and businesses of Centrica plc. These statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that will occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements or forecasts. Past performance is no guide to future performance and persons needing advice should consult an independent financial adviser.

At a glance

Our businesses

Centrica's main operations are in the UK, North America and Europe. We have two types of business – downstream and upstream.

Our downstream business delivered 88% of our Group revenue^, 51% of our operating profit^*, and employed 95% of our workforce in 2007. It:

- supplies energy to homes and to businesses; and
- provides home and energy services.

Downstream businesses include:

- British Gas;
- Direct Energy in North America; and
- retail operations in Europe.

Our upstream business delivered 12% of our Group revenue^, 49% of our operating profit^*, and employed 5% of our workforce in 2007. It:

- generates electricity and produces gas; and
- buys, stores and sells energy internationally.

Upstream businesses include:

- Centrica Energy in the UK, Norway, Nigeria and Trinidad;
- Centrica Storage in the UK;
- Direct Energy in North America; and
- assets and trading operations in Europe.

British Gas Residential

We are the biggest energy supplier in Britain's domestic market. Operating under our British Gas brand (Scottish Gas in Scotland), we had 16 million gas and electricity customer accounts at the end of 2007.

£6.5bn
Revenue^

9,200
Employees

£571m
Operating profit^*

16m
Customer accounts

www.britishgas.co.uk

British Gas

British Gas Services

We are Britain's largest operator in the installation and maintenance of domestic central heating and gas appliances employing more than 9,000 engineers. We also provide comprehensive maintenance and breakdown services for electrical white goods, home wiring and, through our Dyno brand, drains, plumbing and home security services.

£1.3bn
Revenue^

15,200
Employees

£151m
Operating profit^*

7.6m
Customer accounts

www.britishgas.co.uk

DYNO Part of British Gas

British Gas

British Gas Business

We are Britain's leading supplier of energy to businesses, dedicated to the needs of small to medium-sized customers through to large industrial and commercial users. We offer a range of options from open tariffs to fixed price contracts.

£2.4bn
Revenue^

2,000
Employees

£120m
Operating profit^*

954,000
Customer supply points

www.britishgasbusiness.co.uk

British Gas Business

British Gas New Energy

We launched British Gas New Energy as a separate business in April 2007 to supply the growing UK market for low-carbon and energy efficient products and services. Already we have launched two industry-leading green energy tariffs and begun to supply and install a range of microgeneration technologies including solar thermal, wind turbines and ground source heat pumps. We remain the largest provider of energy efficiency products, such as loft and cavity wall insulation, in the UK.

We work with other parts of British Gas utilising their skills and resources to help deliver our business objectives.

34
Employees

17.3m
Energy efficiency products provided to UK households

www.britishgas.co.uk

British Gas

Our markets and proportion of Group revenue

The map illustrates how much revenue each of the regions contributed to the Group's 2007 total. The UK, our home market, continues to contribute the majority. North American revenues are growing every year (in local currency) and we expect our operations here to become even more significant in the future. Our businesses in Europe remain small but we expect to see growth once the markets they are in open fully to competition.

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

Centrica Energy

We source gas and electricity from our own production and from third parties, mainly to supply British Gas Residential. Our Morecambe gas fields can supply around 6% of the UK's peak day gas demand; we produce approximately 67% of our peak domestic demand for our electricity customers from our seven gas-fired power stations and major contracts; and we are expecting to invest up to £1.5 billion in renewable assets over the next few years.

£1.5bn
Revenue^

1,100
Employees

£663m
Operating profit^*

4.5GW
UK electricity generation capacity

www.centricaenergy.com

centrica energy

Centrica Storage

Our Rough storage facility is the largest in the UK. It consists of a partially depleted gas field under the North Sea, supported by a gas processing terminal at Easington, which we also manage. In October 2006 Centrica Storage began operating an adjacent terminal receiving Norwegian gas from the world's longest underwater pipeline.

£340m
Revenue^

190
Employees

£240m
Operating profit^*

70%
UK gas storage capacity

www.centrica-sl.co.uk

centrica storage

Direct Energy

We provide energy and energy-related services to residential and business customers in Texas and the north and east of the United States, as well as across Canada. We own and operate approximately 3,000 natural gas wells in Alberta while in Texas, we own three gas-fired power plants and have power purchase agreements totalling 813MW of wind power.

£4bn
Revenue^

4,800
Employees

£187m
Operating profit^*

5m
Customer accounts

www.directenergy.com

Direct Energy

European Energy

We are involved in power generation, energy management and retail energy supply in Europe, with operations in Belgium, Germany, the Netherlands and Spain.

£392m
Revenue^

200
Employees

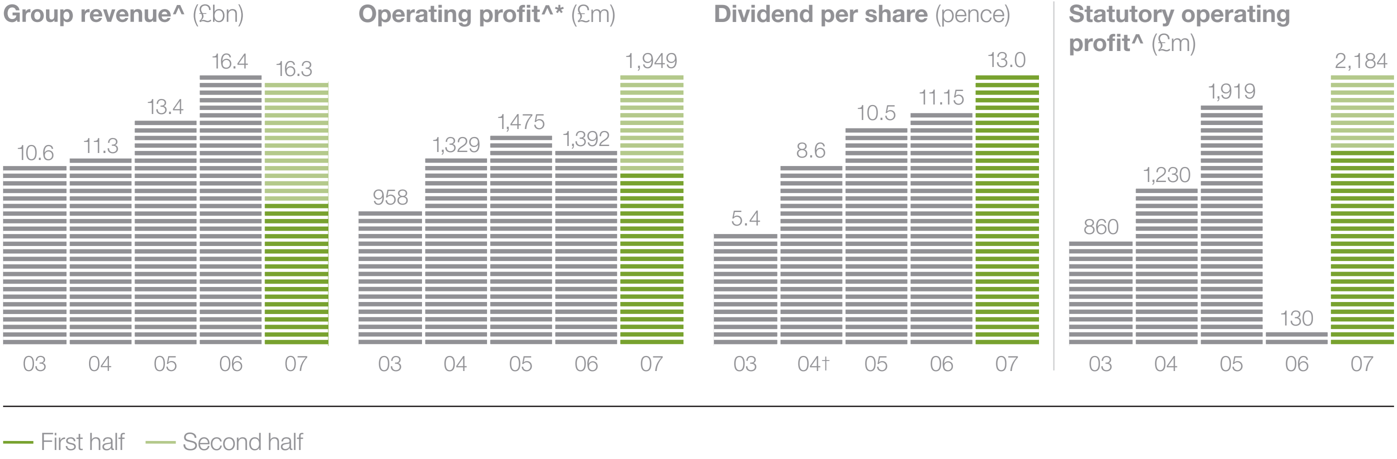
£17m
Operating profit^*

www.oxxio.nl
www.luminus.be
www.centricaenergia.es
www.centrica-energie.de

oxxio
luminus
centrica energia

Financial Highlights

Our performance



12 months ended 31 December	2007	2006
Financial highlights		
Group revenue^	**£16.3bn**	£16.4bn
Operating profit^*	**£1,949m**	£1,392m
Adjusted basic earnings* per share	**30.6p**	19.4p
Ordinary dividend per share	**13.0p**	11.15p
Statutory results		
Group revenue^	**£16.3bn**	£16.4bn
Operating profit^	**£2,184m**	£130m
Basic earnings/(loss) per share	**41.0p**	(4.3p)

^ from continuing operations
* including joint ventures and associates, stated net of interest and taxation, and before exceptional items and certain re-measurements
† excludes special dividend of 25p

Earnings and operating profit numbers are stated, throughout the commentary, before exceptional items and certain re-measurements where applicable – see note 2 for definitions. The Directors believe this measure assists with a better understanding of the underlying performance of the Group. The equivalent amounts after exceptional items and certain re-measurements are reflected in note 6 and are reconciled at Group level in the Group Income Statement. Certain re-measurements and exceptional items are described in note 8. Adjusted earnings and adjusted basic earnings per share are reconciled to their statutory equivalents in note 13. All current financial results listed are for the 12 months ended 31 December 2007.

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.

All references to 'the prior year', '2006' and 'last year' mean the 12 months ended 31 December 2006 unless otherwise specified.

Throughout this Report references to British Gas include Scottish Gas.

Chairman's Statement

Securing shareholder value

"Centrica delivered very strong financial results during another challenging year for UK energy retailers."

Performance review

Centrica delivered very strong financial results during another challenging year for UK energy retailers.

New pipelines from Norway and the Netherlands, which were underpinned by long-term gas contracts with British Gas, began to bring additional gas to the UK and helped to bring down wholesale gas prices at the start of the year. This allowed us to show leadership in the market by passing reductions in the wholesale price on to our customers by reducing our retail prices in March and April. Unfortunately the spectre of high wholesale energy prices appeared again in the second half of the year as global oil prices reached record highs and this has continued into the start of 2008. As a result it was necessary for us to raise customer tariffs in January.

The management team worked diligently through 2007 to minimise the impact of rising wholesale energy prices, making substantial inroads into the operating cost base of British Gas and extracting efficiencies where possible. At the same time we must continue to invest in high quality energy assets to serve our UK and international customers and this reinvestment in our business can only be funded through the consistent delivery of reasonable and sustainable profits.

In February 2007 Sam Laidlaw clearly set out four priorities for Centrica and I believe that management has made some real progress against these objectives. Sam reports on this progress in detail in his review of the year.

British Gas delivered strong financial returns in a year when it also reversed the decline in the size of its customer base. This was achieved not only through lower commodity costs in the first half but also through lower pricing, the continued removal of excess costs, the launch of more innovative propositions and a dedication to improving customer service. During the year Centrica Energy completed a gas acquisition in the North Sea and acquired additional gas exploration acreage with strong future potential. We continue to look for opportunities to acquire more substantial gas assets.

Our growth businesses performed very strongly in 2007. British Gas Business and British Gas Services delivered record results, underpinned by ongoing growth in customer numbers. In North America, Direct Energy also delivered record profits against the backdrop of a weakening housing market, early signs of an economic downturn in the United States and adverse exchange rate movements. It was also another year of record profits in Centrica Storage. In Europe however, while the Commission remains supportive of real network unbundling, meaningful progress on market deregulation was limited.

Dividend

The Board is proposing a final dividend of 9.65 pence (2006: 8.0 pence) for payment in June 2008 bringing our full-year dividend to 13.0 pence (2006: 11.15 pence). This represents a 17% year-on-year increase, in line with our policy and commitment to sustained real growth in the ordinary dividend.

07

Chairman's Statement continued

Securing shareholder value

> "Wholesale energy prices remain extremely volatile and the high gas price at the start of 2008 has squeezed retail supply margins in the UK."

Board changes

Early in the year we changed the structure of our executive management team, with Phil Bentley assuming the role of Managing Director of British Gas, Jake Ulrich adding Europe to his responsibilities as Managing Director of our upstream activities and Nick Luff joining Centrica from P&O as Group Finance Director. I believe that under the leadership of Sam Laidlaw the team has already begun to make a real difference to both the short-term performance and the long-term prospects of Centrica.

Our employees

In a business such as Centrica, people are central to the delivery of better service and improving financial results. Our employees have worked hard to support the change in systems, working practices, organisation structure and management within the Company. I thank them all for their loyalty, hard work and dedication. It is a credit to them that British Gas Business and British Gas Services were both recognised in the Financial Times Top 50 'Best Workplaces for 2007'.

The future

Wholesale energy prices remain extremely volatile and the high gas price at the start of 2008 has squeezed retail supply margins in the UK. In these circumstances retail price increases have been necessary in order to restore reasonable margins.

We will, however, continue to take all possible actions to minimise the impact to our customers whilst delivering the level of profitability required to underpin the investments necessary to secure additional high quality upstream assets.

We have set out a clear agenda for Centrica in the form of four strategic priorities and we will continue to focus on these as we move forward. In doing this we will seek to strike the appropriate balance between driving increased efficiencies in the current core UK energy business, providing growth across the Group and evaluating and securing additional quality upstream assets to reduce exposure to short-term commodity price movements. Only by delivering against our priorities will we be able to satisfy our customers and reward our employees while maximising returns for our shareholders.

Roger Carr
Chairman
21 February 2008

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Our electronic communication service provides fast, easy access to shareholder information.
www.centrica.com/reports2007

Chief Executive's Review

Delivering our strategy

"2007 was a year of substantial achievement for Centrica during which we made further progress on addressing the key priorities for the business."

Centrica delivered a very strong set of financial results during this, my first full year as Chief Executive. We moved the structure and operational performance of the business forwards, but we still have some way to go.

2007 was a year of two very different halves. In the first half, wholesale energy prices in the UK were low as a result of increased supply (through new gas pipelines and liquefied natural gas (LNG) facilities) and reduced demand due to warm weather. Over two-thirds of our earnings were delivered in this period.

During the second six months, the day ahead wholesale gas price was, on average, 56% higher than during the first half. This significantly reduced margins in our UK residential business. And, unfortunately, these relatively high wholesale prices have persisted in the first few months of 2008, necessitating a retail price increase.

Centrica operates in a complex, global and constantly changing industry that is facing some profound long-term challenges. Environmental issues will increasingly influence the shape of the industry. Tougher targets on reducing energy consumption and cutting greenhouse gases are likely to be implemented worldwide, and these will push up the price of energy.

The cost of developing new upstream resources in the UK has risen by 80% since 2000, and growth in demand for fossil fuels from countries such as China and India is also driving a long-term structural movement towards higher prices. We estimate that by 2015 around 75% of the UK's total annual gas demand could be being met by imports, compared to about 20% in 2007. Increasing reliance on imports means that the UK, and Centrica, will not be cushioned from the impact of global market movements, either in terms of price fluctuation or security of supply.

Against this background, our strategy is to create an integrated energy company, operating upstream by developing new sources of gas and power, and downstream with our strong brands and innovative propositions, to succeed in our chosen markets.

Downstream

The UK gas market is the biggest in Europe. We are the largest energy supplier in the UK and at the end of 2007 British Gas Residential once again supplied 16 million customers. British Gas Services is the largest central heating and gas appliance installation and maintenance company in the UK, directly employing more than 9,000 engineers. British Gas is the country's best-recognised energy brand. It is also one of the greenest, according to WWF and has the lowest carbon intensity* of all major suppliers. We are one of the UK's largest producers and suppliers of wind energy and in April we set up British Gas New Energy to expand our offer in low-carbon products and services.

In our North American markets, we had over 5 million customers at the end of 2007. The combined volume of demand for our gas in Canada, the US and Europe will help us to do deals with large-scale suppliers of LNG worldwide.

Our experience of deregulated markets in the UK and North America will also stand us in good stead when European energy markets finally open up to competition. The European Commission published proposals in September for the unbundling of electricity and gas generation and transmission networks across the European Union. When implemented, these should increase competition in Europe. But it hasn't happened yet.

Upstream

Upstream, we have a strong and increasingly diverse portfolio of long-term contracts for gas supplies to the UK from the North Sea, Norway and the Netherlands, as well as our own production. These include our Morecambe gas fields, and interests in over 20 southern North Sea gas fields, including those acquired from Newfield UK Holdings Limited in October.

From October 2008, we will have LNG import capacity at the Isle of Grain which will be able to supply about 6% of Centrica's annual gas demand. We are building our eighth gas-fired power station (in Devon) and two wind farms off the Lincolnshire coast which will have a combined capacity of 180MW. We have interests in three operational wind farms which provide access to 188MW of renewable electricity and we are seeking consent for a further 250MW farm.

Internationally, offices are now established in Nigeria and Norway following the award of exploration and production licence blocks. In 2007 we also acquired further exploration blocks in Norway and Trinidad. Direct Energy bid for Rockyview Energy Inc, an Alberta-based oil and gas company, completing the deal in early 2008.

Centrica has four strategic priorities that underpin how we run the business. Over the next four pages I will explain what these mean and how we have performed against them this year.

*carbon intensity is the amount of carbon dioxide emitted per unit of electricity produced

Transform British Gas

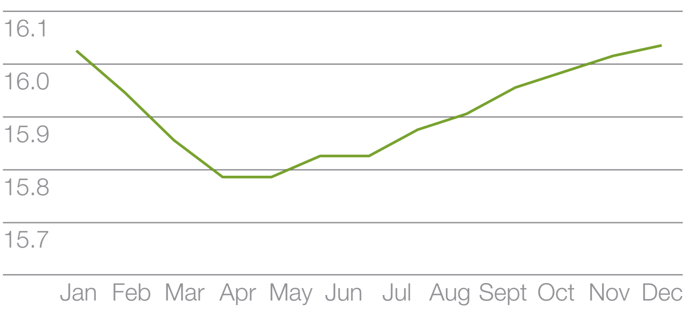
- **We led the industry in reducing prices in 2007**
- **We significantly improved our service levels**
- **We reduced our operating costs by £139 million**

Lower prices and better service led to an increase in the number of customers. This, combined with a fall in commodity prices in the first six months, meant we delivered an excellent financial result.

16m

British Gas Residential customer accounts

British Gas Residential customer accounts in 2007 (m)



Transforming British Gas is a priority because profitability and service levels at British Gas Residential, which is the core of our business, have historically been low and variable.

The transformation aims to:

- improve our price competitiveness, service levels and product offer in order to reverse the decline in customer numbers;
- reduce our costs through 'best-in-class' efficiency and productivity while ensuring that we remain a great place to work; and
- achieve long-term margins of 6-7%.

Progress

We led the industry in reducing prices, cutting them twice during 2007. In March and April our tariffs were cut by a total of 17% in electricity and by 20% in gas. We also provided the lowest dual fuel tariff through our online Click Energy offer. However, because of sharply rising wholesale energy prices during the second half of 2007 and continuing into 2008, we were left with no alternative but to increase retail tariffs in January 2008. Although this was disappointing, retail prices were still lower when compared to January 2007. The 15% increase will help us to re-establish the profit margin we need to invest in the core energy assets that will provide sustainable long-term earnings.

Having completed the migration of all our customers to our new billing system by March, we concentrated on improving the service that had suffered during the migration process. Service levels improved significantly. For example, our speed to answer the telephone improved by almost 75% from the highest point in April and we eliminated the entire correspondence backlog.

As a result, we saw fewer complaints and customer losses. By December 2007, complaints to energywatch had fallen by 80% since April and contacts to energywatch are now at their lowest level since January 2006 when we began to move our customers to a new billing system. Customer churn has also fallen sharply, and the number of energy accounts grew by around 15,000 during the year.

We continued to reduce operating costs within British Gas compared to 2006. This, combined with a fall in commodity prices in the first six months, meant we delivered an excellent operating profit* for the year.

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

Chief Executive's Review continued

Delivering our strategy

Sharpen the organisation and reduce costs

- We have strengthened our executive team
- We have introduced new structures for our businesses in Direct Energy and in British Gas Residential
- We have reduced costs across the Group

Changes to the organisation of the Group have improved accountability and increased business discipline.

£139m

cost savings achieved in BGR in 2007

If we are to compete domestically and internationally in the long term, we need to do what we do better, and at lower cost.

We need to upgrade our skills, increase our business discipline and accountability, and materially reduce costs in each business unit and at the centre.

Progress

Over the past year we have strengthened our executive team with several key appointments, including a new Group Finance Director and a new Managing Director for British Gas, and we have transferred responsibility for our European businesses to the Managing Director of Centrica Energy.

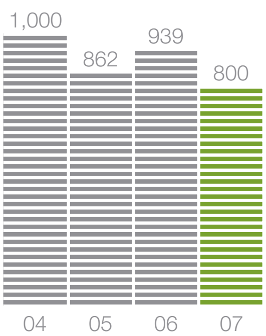
We have also focused on the structure of our operating businesses. Recent initiatives include the separation of power generation in Centrica Energy to form a line of accountability for our UK power segment. In North America we introduced a new structure with the creation of four business units on functional rather than geographic lines.

We have also created three separate profit centres within British Gas Residential (BGR) to better reflect different customer groups. The new units have different objectives and propositions, and a management structure designed to enhance accountability.

Business discipline has been improved through the introduction of systematic quarterly cost reviews of each business unit, a tighter capital allocation framework, and a new three-year planning horizon to focus performance.

And we have reduced costs significantly. For example, the restructuring of British Gas Services has removed £20 million of cost a year, and BGR is on track to deliver its £200 million cost reduction target. Some £139 million of cost savings were achieved in BGR in 2007 with the balance to be achieved in 2008. During the year we moved 2,250 back-office jobs to India and rationalised the corporate centre. This included outsourcing a number of support services including many of the central finance, information system and human resource functions.

British Gas Residential operating expenditure (£m)



Reduce risk through integration

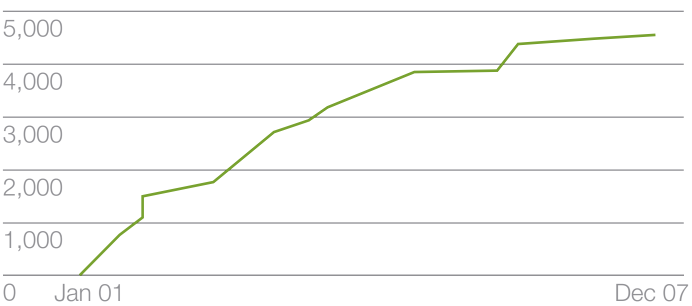
- **We bought Newfield UK Holdings Limited**
- **We acquired exploration opportunities in the UK, Norway and Trinidad**
- **We continued to invest in renewable generation capacity**
- **We are building a new gas-fired power station in Devon**

We made some important progress during the year, though not as much as we had hoped for.

£1bn

planned annual upstream investment 2007 to 2010

Centrica's UK electricity generation (MW)



We want to produce more of the energy that we sell. In the UK we are able to supply around 25% of our gas requirements and around 67% of our peak electricity requirements from our own resources or major contracts. The remainder has to be purchased in notoriously volatile wholesale markets.

We aim to build a profitable UK upstream business to be able to supply 50% of our gas needs. Our target is to have 35% of our retail load supplied from production capacity we own, and 15% from new long-term contracts.

Progress

In October 2007 we bought Newfield UK Holdings Limited for £242 million. This brought us a producing gas field, two development prospects and interests in six licences with the potential to add around 300 billion cubic feet (bcf) of gas reserves in the North Sea. The location of the fields also offers synergies with our retail businesses in western Europe, with gas from one of the fields delivered in the Netherlands. We added a further 43bcf of gas reserves by acquiring Rockyview Energy Inc in Alberta, announced in November and completed in February 2008.

We also acquired interests in licences in Norway and Trinidad bringing our total at the end of the year to 19. From the winter of 2010/11, we will have access to a further 2.4 billion cubic metres (BCM) of LNG import capacity at the Isle of Grain terminal in addition to the 3.4BCM we have available from October 2008.

Construction continues on our 885MW power station at Langage in Devon which will increase our UK generation capacity to over 5GW. It will come online early in 2009. We have also continued to invest in wind generation capacity. We acquired a 50% share in the Braes of Doune wind farm in Stirlingshire in July and concluded a new 170MW power purchase agreement in Texas that brings to 813MW our total power offtake from Texas wind farms. Construction work started on the 180MW Lynn and Inner Dowsing farms off the coast of Lincolnshire. Lynn and Inner Dowsing is currently the world's largest offshore wind construction project and first power is due towards the end of 2008.

Overall we have 430MW of offshore wind projects in construction or early planning stages, which will keep us at the forefront of renewable generation.

Chief Executive's Review continued

Delivering our strategy

Build on our growth platforms

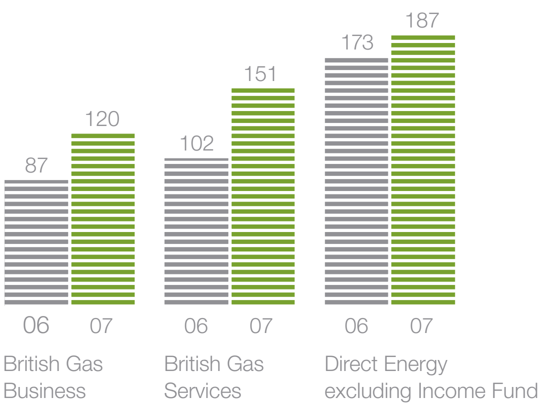
- **We increased profits considerably in all growth businesses**
- **We strengthened our positions in North America and Europe**
- **We launched British Gas New Energy to focus on low-carbon products and services**

We intend to grow businesses organically and through acquisition, driving top and bottom line growth.

500,000

new customer product holdings in British Gas Services

Operating profit^* (£m)



Centrica's growth businesses in the UK, North America and Europe have considerable potential for increasing the Group's profitability, and they made strong progress during 2007. In addition, we are focusing on new opportunities to provide low-carbon products and services to customers concerned about climate change.

Progress

British Gas Business delivered record profitability, a growing customer base and improving levels of customer satisfaction; while in British Gas Services, account numbers grew by 7% and operating profits* by 48% as service levels improved dramatically.

We continued to strengthen our Direct Energy business in North America, which was restructured, delivering the targeted cost reductions. It also grew its operating profit^* by more than 15% before exchange rate movements, despite increased competitive pressures and a weaker US housing market that affected the residential and services businesses. We improved the balance of the business too, with one of its four sectors moving into profit for the first time and another doubling its contribution.

Ahead of the European Union becoming a fully competitive energy market, we are aiming to build a gas and power business in north western Europe. In 2007, our operating profits in Europe more than doubled, we established SPE-Luminus as the undisputed number two player in Belgium in the electricity and gas market, and we added 500,000 customer accounts in the newly liberalised Walloon part of the market.

In April we created a new business unit, British Gas New Energy (BGNE). British Gas is already a noted force in the supply of 'green' electricity and appliances in the UK. BGNE is therefore well placed to operate successfully in the low-carbon market that is expected to grow exponentially in the coming years.

In a related move in North America, we formed a new group in the upstream and wholesale energy business to focus solely on carbon and renewables. Direct Energy also launched its first carbon neutral product as part of its successful market entry into British Columbia. This has since been extended across Canada.

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

During 2008, we will continue to focus our efforts on the four priorities that I set in 2007.

Transforming British Gas

Our critical short-term priority will be continued focus on our service to customers while delivering sustainable returns. Longer term, we believe that for all energy suppliers to substantially improve customer service will require a nationwide investment in smart metering technology.

We will remove an additional £60 million of operating cost and will invest in the British Gas brand to rebuild its relevance to consumers not only as a provider of energy but of energy efficiency advice and services.

Cutting costs

We are making cost reduction central to our business culture.

We will continue to identify and re-engineer outdated processes and procedures with the aim of becoming the most efficient energy supplier with the lowest cost per customer.

We will also introduce new trading and logistic systems into Centrica Energy to better support our asset portfolio and downstream businesses, phased over 2008 and 2009.

Strengthening our asset base

With wholesale energy costs still volatile, the importance of getting more of our gas and power from our own resources cannot be overestimated. Our acquisition of the Newfield gas properties and the investments we are making in both renewables and gas-fired power generation are important steps in the right direction but we need to do more. This will be a key strategic priority in 2008.

We will need to continue pursuing power generation and gas asset opportunities both in the UK and internationally. But we will also assess opportunities in gas storage and develop our gas exploration prospects in the UK, Norway, Nigeria and Trinidad.

We will increase our involvement in LNG, where our aim is to become the downstream partner of choice for the oil companies who own the rights to the vast majority of the world's undeveloped gas resources.

Longer term we will also evaluate carefully the opportunity to participate in the replacement of the UK's fleet of nuclear power stations.

Looking to grow

Our growth businesses are contributing well to the Group, but there are opportunities for them to do even better, and we will continue to drive both top and bottom line improvement in these areas.

In the UK, in British Gas Business we will seek to maintain our current growth trajectory through ongoing development of our routes to market while focusing also on further enhancing the service we deliver.

British Gas Services is developing additional customer propositions to make more rapid progress in the on-demand markets. Improving the links between British Gas Residential, British Gas Services and BGNE will enable us to make better use of our assets and to develop new revenue by offering customers more cross-business packages.

BGNE will become increasingly important in 2008 with growing customer concern about energy efficiency and the positive effect that this can have on climate change. In January we announced a stronger contractual relationship with Ceres Power on the development of a domestic combined heat and power boiler using ground-breaking fuel cell technology, supported by a £20 million equity investment. We will seek to identify more ways of facilitating the move towards a low-carbon society while keeping the British Gas name at the forefront.

In North America there is real potential to grow our business both organically and through acquisition in our existing markets and geographies. Short-term prospects will be affected by the depth and length of any economic downturn but we will seek to minimise the impact through the increasing diversity of our business streams.

Developing our businesses in Europe remains challenging. This year we will concentrate on simplifying the ownership structure of SPE in Belgium as the merger of Suez and Gaz de France proceeds. We will also continue to grow our Belgian, Dutch and Spanish businesses, and to establish ourselves firmly in the industrial and commercial market in Germany.

In summary, we will be following the same path in 2008 as we have in 2007, guided by the same priorities that we have laid down. The UK market faces high wholesale energy prices which appear to be taking their lead from the oil-linked gas markets of continental Europe and our other markets are feeling the effects of weakening economic conditions. In this environment it is important that we remain single-minded in making our operations leaner and more efficient to give us the best chance of success in the UK and internationally.

Centrica is a strong business with a clear sense of direction and the momentum to make the best of its unique strengths. I am confident that we will be able to take significant strides in 2008.

[redacted]

Sam Laidlaw
Chief Executive
21 February 2008

Key Performance Indicators

Measuring our performance

> Our key performance indicators are used by the Board and the Executive Committee to monitor progress against our strategy.

Adjusted basic earnings per share (EPS)
Analysis/comment – We have seen a 58% growth in adjusted EPS during the year.
Target/commitment – To deliver growth in adjusted EPS. This measure is used as one of the performance conditions in the Long Term Incentive Scheme, details of which are on page 44.

Total shareholder return (TSR)
Analysis/comment – We have outperformed the FTSE 100 Index by 27% over a five year period.
Target/commitment – TSR is used as one of the performance conditions in the Long Term Incentive Scheme, details of which are on page 44.

Dividends per share
Analysis/comment – The 2007 dividend shows an increase of 17% on the 2006 dividend.
Target/commitment – To deliver real growth per annum.

Adjusted basic earnings per share

Adjusted basic earnings per share pence

07	30.6
06	19.4
05	18.2

Adjusted EPS is disclosed and reconciled in note 13 on page 87.

This measure of performance is calculated as profit before exceptional items and certain re-measurements for the year, attributable to equity shareholders of the parent company, divided by the weighted average number of shares in issue during the year.

Source: The measure of adjusted EPS is reported on the Group Income Statement, part of the audited Financial Statements.

Total shareholder return

Centrica and FTSE 100 Index

for the five years ended 31 Dec 2007

Total shareholder return measures the return to shareholders in terms of the growth of a £100 investment in the Company's shares, assuming that dividends and returns of capital are reinvested. We compare our TSR with those of the other 99 members of the FTSE 100 at the start of each performance period.

Source: Alithos Ltd.

Dividends per share

Ordinary dividend pence

07	13.0
06	11.15
05	10.5
04†	8.6
03	5.4

†excludes special dividend of 25p.

This is the total dividend per share (excluding special dividends) paid in respect of each financial year.

Source: The dividend is reported as part of the audited Financial Statements.

Key highlights

+58%
Increase in adjusted earnings per share up from 19.4p to 30.6p

27%
Our TSR outperformed the FTSE 100 by 27% over the last five years

13.0p
Dividend per share up by 17% to 13.0p

Customer satisfaction

Analysis/comment – There was a low 2007 NPS score for British Gas Residential, reflecting the 2007 customer service challenges.
Target/commitment – Continued focus on our service to customers will remain a critical short-term priority. We will look to improve on our 2007 scores in both the UK and North America.

Carbon intensity

Analysis/comment – The carbon intensity of the power we generate for our British Gas customers is already significantly lower than the other five major UK suppliers.
Target/commitment – To reduce our UK power generation carbon intensity to 380g* CO_2/kWh by 2012.

Employee engagement

Analysis/comment – Our 2007 engagement score showed a year-on-year increase of 3% with 84% employee participation.
Target/commitment – In 2008 we will change how we measure employee engagement, and begin to measure the percentage of employees who are committed to Centrica.

Customer satisfaction

Net promoter score 2007

3.1%
British Gas

6.1%
Direct Energy

Net promoter score (NPS) is a measure of customer advocacy. It shows the percentage of customers who would recommend us, minus the percentage who would not.

The British Gas and Direct Energy NPS are combined figures for the residential, business and services divisions.

Source: Internal calculations based on NPS performance for 12 months ending 31 December 2007.

Carbon intensity of UK power generation

394g* CO_2/kWh

Carbon intensity measures the volume of carbon dioxide (CO_2) emitted per unit of electricity generated. We are committed to maintaining this leadership position by investing in low-carbon generation such as high-efficiency gas-fired power stations and offshore wind farms.

Source: Based on verified emissions data under the requirements of the EU Emissions Trading Scheme.

*Carbon intensity figures are based on the average annual emissions from all wholly owned UK power generation assets and all other power generation assets from which Centrica is entitled to output under site specific contracts in the UK.

Employee engagement

Engagement score

07	3.96
06	3.84
05	3.78

The Centrica employee survey measures engagement and commitment levels for every team at all levels across the Group. The overall engagement score reflects the attitudes and opinions of our employees and measures, on a scale of one to five, their feelings about working for us.

Source: The survey is managed by an external supplier.

Operating Review

British Gas Residential

British Gas Residential

We reorganised the business to improve accountability and performance

We stabilised customer accounts at 16 million

We increased our operating profit* by £476 million

British Gas Residential has around 16 million customer accounts in the UK, and is the country's largest supplier of both gas and electricity to residential customers. We are also playing a leading role in providing customers with low-carbon products.

British Gas Residential
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Customer numbers (period end)			
Residential gas ('000)	10,018	10,263	(2.4)
Residential electricity ('000)	6,019	5,759	4.5
Total ('000)	16,037	16,022	0.1
Estimated market share (%)			
Residential gas^	46.4	47.9	(1.5)ppts
Residential electricity^	22.4	21.6	0.8ppts
Average consumption			
Residential gas (therms)	541	569	(4.9)
Residential electricity (kWh)	3,945	4,069	(3.0)
Total consumption			
Residential gas (mmth)	5,443	6,120	(11)
Residential electricity (GWh)	23,001	23,842	(3.5)
Transportation & distribution costs (£m)			
Residential gas	1,172	1,110	6
Residential electricity	541	511	6
Total	1,713	1,621	6
Energy Efficiency Commitment (£m)			
EEC	91	90	1.1
Operating costs (£m)			
British Gas Residential	800	939	(15)
Revenue (£m)			
Residential gas	4,296	4,832	(11)
Residential electricity	2,161	2,280	(5)
Total	6,457	7,112	(9)
Operating profit (£m)*			
British Gas Residential	571	95	501
Operating margin (%)			
British Gas Residential	8.8	1.3	7.5ppts

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.
^ Market shares for 2006 are based on a gas market size of 21,403,959 and an electricity market size of 26,695,229, as stated by Ofgem in its Domestic Market Retail Report – March 2006.
Market shares for 2007 are based on a gas market size of 21,567,261 and an electricity market size of 26,917,561, as stated by Ofgem in its Domestic Market Retail Report – June 2007.

Overall 2007 was a strong year for British Gas as we delivered an excellent financial result, with margins above our long-run expectations. We also made considerable progress in improving customer service and stabilising the size of our customer base.

The commodity price environment during the year was extremely volatile, with a fall in wholesale gas prices early in the year leading to a rapid expansion in margins and enabling British Gas to be the first energy supplier to announce reduced prices for customers. In March we lowered prices for credit customers in gas by 17% and in electricity by 11% and followed this up in April with a further 3% reduction in gas prices and 6% in electricity prices. However, wholesale gas and power prices rose through the second half of the year and squeezed margins in this period to just above breakeven.

The quality of our customer service had suffered through 2006 and into the early part of 2007 as we migrated all of our customers to a new billing system. Since completing this migration operational exceptions have been running at a higher level. We have continued to improve the data quality in our systems and have focused on the overall service levels we provide to our customers. In the second half of the year we improved the time taken to answer inbound customer telephone calls by 75% from its highest point in April and we eliminated the entire backlog of customer email and written correspondence. The results of our improving service were reflected in the level of customer complaints to energywatch which had fallen from the high point in April by over 80% by December.

Our more competitive pricing and the improvements we have made to customer service helped us to stabilise our customer base in 2007. From a low point in April of 15.8 million energy accounts we have returned once again to serving just over 16 million accounts.

As part of the transformation of British Gas we have improved accountability for the customer experience and the operating performance by reorganising into three separate lines of business. This resulted in the creation of a dedicated 'pay as you go' business to focus directly on customers who use prepayment meters, where fundamentally different processes are required. We have also split the remaining business between the lower volume customers and those who make up the highest value segment.

Revenue for the year decreased by 9% to £6,457 million (2006: £7,112 million) due to lower average customer numbers across the year and lower average energy consumption levels as a result of unusually warm weather, particularly in the early part of the year.Operating profit* however increased to £571 million (2006: £95 million) with the majority delivered in the first half of the year, £533 million (2006: a loss of £143 million). This was due to lower commodity costs and lower controllable operating costs.

Commodity costs were down by just over £1 billion to £3.2 billion, more than offsetting the revenue reduction. This net benefit was partially offset by the ongoing increases in energy transportation and distribution costs which were up by £92 million over 2006. The cost of delivering our Energy Efficiency Commitment (EEC) in the year was £91 million (2006: £90 million). As EEC is a mandatory cost of supply for all the major UK energy suppliers we now account for this cost within cost of goods rather than operating expenses and have restated the comparable figures for 2006 accordingly.

British Gas Business
British Gas Services

Operating costs decreased by £139 million to £800 million (2006: £939 million). While we continued our drive to reduce costs there was a delay in this reduction in 2007 as we placed an even greater priority on the improvement in customer service. We expect to remove an additional £60 million of operating costs in 2008, achieving the full £200 million of targeted savings against the 2006 baseline.

British Gas Business

We continued to have high contract renewal rates

We increased the number of customer supply points by more than 2%

We increased our operating margins

British Gas Business sells gas, electricity and energy-related services – including carbon-offsetting – to small, medium and large corporate businesses. The introduction of our dedicated account managers has helped to improve levels of customer service.

British Gas Business performed well during the year. Against a backdrop of volatility in commodity markets we delivered a record financial result and grew our customer base while continuing to improve our customer satisfaction measures.

Revenue increased by 6% to £2,431 million (2006: £2,303 million) due to the net positive impact of price changes during 2006 and 2007, higher customer numbers in both fuels and higher average consumption in electricity driven by the increase in the number of large corporate customers. This was only partially offset by the lower average consumption in gas which resulted from warm weather primarily in the first half of the year. Customer supply point numbers increased by 2% to 954,000 (2006: 932,000) on strong sales performance and the maintenance of high contract renewal rates particularly in our SME business.

Operating profit* was up 38% to £120 million (2006: £87 million). This included a contribution of £38 million (2006: £29 million) from a favourable historic electricity procurement contract. This contract will also provide a small benefit in 2008 before it expires. The primary drivers of the year-on-year uplift were the widening of margins during the contract renewal process and the positive effect of the lower commodity prices on the tariff book. These positive impacts on gross margin enabled us to lift operating margins in the year to 4.9% (2006: 3.8%).

In customer service we are beginning to see positive results from our implementation of a differentiated service model based on dedicated account managers. During the year, while migrating the majority of our gas customer accounts to our new gas billing system, we improved the level of customer satisfaction across the business.

British Gas Business
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Customer supply points (period end)			
Gas ('000)	412	400	3.0
Electricity ('000)	542	532	1.9
Total ('000)	954	932	2.4
Average consumption			
Gas (therms)	3,729	4,015	(7)
Electricity (kWh)	32,644	30,464	7
Total consumption			
Gas (mmth)	1,524	1,597	(4.6)
Electricity (GWh)	17,356	15,864	9
Transportation & distribution costs (£m)			
Gas	174	149	17
Electricity	298	261	14
Total	472	410	15
Revenue (£m)			
Gas	1,037	1,115	(7)
Electricity	1,394	1,188	17
Total	2,431	2,303	6
Operating profit (£m)*			
British Gas Business	120	87	38
Operating margin (%)			
British Gas Business	4.9	3.8	1.1ppts

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.

British Gas Services

We increased our operating profit* by 48%

We delivered improved levels of customer service

British Gas Services is the largest domestic central heating and gas appliance installation and maintenance company in the UK. We directly employ more than 9,000 engineers who also provide comprehensive maintenance and breakdown services for electrical white goods and home wiring. Our Dyno brand provides plumbing, drains and home security services across the UK.

British Gas Services performed strongly in 2007 both financially and operationally. This was supported by the improvements made to customer service, engineer deployment and system stability, which provide us with a strong platform for continued growth.

Operating Review
continued

British Gas Services
Centrica Energy

British Gas Services
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Customer product holdings (period end)			
Central heating service contracts ('000)	4,525	4,392	3.0
Kitchen appliances care (no. of customers) ('000)	414	387	7
Plumbing and drains care ('000)	1,536	1,384	11
Home electrical care ('000)	1,173	986	19
Total holdings ('000)	7,648	7,149	7
Central heating installations ('000)	113	91	24
Revenue (£m)			
Central heating service contracts	688	614	12
Central heating installations	348	264	32
Other	243	226	8
Total	1,279	1,104	16
Engineering staff employed	9,209	8,676	6
Operating profit (£m)*			
British Gas Services	151	102	48
Operating margin (%)			
British Gas Services	11.8	9.2	2.6ppts

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.

Revenue was up by 16% at £1,279 million (2006: £1,104 million) as the total number of customer product relationships increased by 7% to 7.6 million (2006: 7.1 million). During the year we increased the number of customers who take our Homecare Flexi product, which provides the customer with a lower price entry point to our services, we enhanced our online offerings and continued to promote our wider product range through cross-selling. We also strengthened our presence in the on-demand market through our central heating repair service for non-contract customers, with our number of repairs increasing by 19% to 414,000 (2006: 347,000).

Operating profit* increased by 48% to £151 million (2006: £102 million), ahead of revenue growth, due to the strong growth in higher margin care products outside the core central heating range, combined with the continued focus on cost control and overhead savings. In addition, profitability in the central heating installation business grew as the number of installations, including those for the Scottish Executive, increased by 24% to 113,000 (2006: 91,000).

Centrica Energy

The acquisition of Newfield added 67bcfe to our gas reserves

We generated 36% more electricity

Centrica Energy sources the gas and electricity we supply to our residential and business customers in the UK and Europe. This comes from our own upstream gas production, electricity generation and renewable energy operations, and through the management of our gas and electricity purchase contracts and wholesale energy trading.

Centrica Energy performed well during a difficult year for our upstream business when the day ahead wholesale gas price in the UK fluctuated between a low of 13 pence per therm (p/th) in April to a high of 59p/th in December. The operating profitability of Centrica Energy was adversely affected by the low wholesale gas prices in the first quarter of the year which reduced the gas production results. This was partially offset by improved profitability in the legacy industrial and commercial contracts resulting in overall operating profit* being down just 3% to £663 million (2006: £686 million).

The segmental reporting disclosure for Centrica Energy now includes the results from our UK power generation assets as a separate segment, with sales from this segment to the downstream business based on market prices for power. The operating costs of Centrica Energy that were previously held within the industrial sales and wholesaling segment have been allocated across the appropriate business areas. As the power stations were managed on a different basis in 2006, prior period figures have not been restated and no result is reported for the power generation segment for 2006.

Gas production and development
Gas production and development includes all of the activities relating to producing gas, oil and condensates and the related exploration and development activities. It contains both our fully owned assets and our share of joint venture assets.

Operating profit* for gas production and development was down by 50% to £429 million (2006: £864 million). The total hydrocarbon volume produced during the year was up 17% on the previous year after a difficult first half, with a recovery of production levels in the second half of the year as the wholesale price rose and the newly acquired Grove field came onstream. The low wholesale gas price which affected the first half production levels brought down the average price achieved for the gas produced by 43% at 30.4p/th (2006: 53.1p/th). Oil and condensate production volumes were in line with 2006 at 5.6 million barrels of oil equivalent (Mboe).

The rate of variable operating costs per Mboe produced decreased year-on-year by 5% due to proportionately higher production levels from Morecambe. Other production costs increased due to the inclusion in the 2006 result of profits on disposal and the underlying cost inflation across the industry which particularly affected our joint venture operations.

Centrica Energy
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Gas production			
Gas production volumes (mmth)			
Morecambe	1,574	1,207	30
Other	686	709	(3.2)
Total	2,260	1,916	18
Average gas sales price (p/th)	30.4	53.1	(43)
Oil and condensate production volumes (Mboe)	5.6	5.6	–
Average oil and condensate sales price (£/boe)	33.3	33.8	(1.5)
Revenue (£m)	923	1,291	(29)
External revenue (£m)	299	323	(7)
Operating costs (£m)			
Volume related production costs	291	262	11
Other production costs	203	165	23
Total	494	427	16
Operating profit (£m)*	429	864	(50)
Power generation			
Power generated (GWh)	19,845	14,567	36
Operating profit (£m)*	46	n/a	–
Industrial and commercial			
External sales volumes (mmth)	2,260	2,667	(15)
Average sales price (p/th)	35.7	31.3	14
Revenue (£m)	838	n/a	–
Operating profit (£m)*	179	n/a	–
Industrial sales and wholesale			
Operating profit/(loss) (£m)*	n/a	(210)	–
Accord			
Operating profit (£m)*	9	32	(72)
Centrica Energy operating profit (£m)*	663	686	(3.4)

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.

During the year we added an additional 114 billion cubic feet equivalent (bcfe) to our proven and probable gas and liquids reserve base, of which 67bcfe came from the acquisition of Newfield UK Holdings Limited in October. We also invested £154 million in developing our current portfolio of upstream assets, primarily on the development of the Maria field, which is currently being commissioned, and on the depressurisation of the Statfjord field to bring forward gas recovery.

Following additional capital spend we expect to realise a further 238bcfe from the Newfield acquisition. During the year we also acquired seven licence interests in Norway and one in Trinidad to add to our existing acreage in the UK, Egypt and Nigeria. In November we signed a memorandum of understanding with Statoil and Consolidated Contractors Company to assess the feasibility of developing LNG projects with our joint Nigerian assets and we commenced seismic activities on one of these assets.

Industrial and commercial
The industrial and commercial segment contains the results from the long-term legacy gas sales contracts. These delivered a profit* of £179 million in the year, of which £148 million was in the first half, primarily due to the fall in gas prices in the early part of the year and the rising average selling price. The volume of gas delivered reduced by 15% as three contracts ended in September 2006.

Power generation
This segment contains the results from all of the generation assets including the Spalding power station which is recognised on the Group Balance Sheet. Total operating profit* for the year was £46 million. All of the profit was delivered in the first half of the year when the low gas prices pushed up spark spreads, making it profitable to run some of our gas-fired stations at baseload and displacing competitors' coal stations in the merit order.

In the year we generated 19.8TWh (2006: 14.6TWh) from our 4.3GW fleet of gas-fired power stations and our 107MW of wind assets, up by 36% as the overall load factor in the conventional fleet increased to 55% (2006: 40%). The average load factor for the fleet was lower in the second half of the year due to planned and unplanned outages which also coincided with periods of high spark spreads.

In July, we acquired a 50% ownership in the 72MW Braes of Doune wind farm from Airtricity for £42 million. We spent £104 million in the ongoing development of the two 90MW wind farms at Lynn and Inner Dowsing, currently the world's largest offshore wind construction project. The onshore cabling and the turbine foundations are in place and we expect to generate the first power from these assets in the third quarter of 2008. In January 2007 we also submitted a planning application for the 250MW Round Two Lincs offshore wind farm.

We made good progress with our 885MW gas-fired plant at Langage in Devon. This year we spent £143 million of the anticipated £400 million budget and expect to commence operations in the first quarter of 2009. We continued our feasibility study at Eston Grange on Teesside for the potential development of an Integrated Gasification Combined Cycle (IGCC) power station with the ability to sequestrate carbon. However the government's decision to provide economic support for only a post-combustion technology station has made further material investment here less likely.

Energy procurement
In May we secured further gas import capacity at the Isle of Grain allowing us to import an additional 2.4 billion cubic metres (BCM) per annum for 19 years from 2010/11. This increases our total capacity at the Isle of Grain terminal to 5.8BCM per year. Late in the year, due to continued planning delays, we announced our withdrawal from the consortium planning to construct an LNG terminal at Canvey Island.

Accord trading
Accord delivered a reduced profit in the year, down 72% at £9 million (2006: £32 million) as a result of volatile trading conditions during the second half.

Operating Review continued

Centrica Storage Direct Energy

Centrica Storage

We delivered strong financial results

We launched a new virtual storage product

Centrica Storage owns and operates the UK's largest gas storage facility. We sell gas storage and other services to a wide range of gas market participants including Centrica Energy.

Centrica Storage
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Average SBU price (calendar year) (pence)	57.4	56.5	1.6
Revenue (£m)			
Standard SBUs	261	254	2.8
Extra space	28	30	(7)
Gas sales	77	58	33
Other	37	16	131
Total	403	358	13
External turnover (£m)	340	294	16
Cost of gas (£m)	87	58	50
Operating profit (£m)*	240	228	5

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.

Centrica Storage delivered a strong financial and operational result, reporting a record operating profit* of £240 million (2006: £228 million). This improvement reflects both the increase in the average Standard Bundled Unit (SBU) price for the year, up 1.6% to 57.4 pence (2006: 56.5 pence) driven by a wider spread between summer and winter forward gas prices, and the continued growth in non-SBU revenue. A subsequent narrowing of the summer/winter gas price spread reduced the average SBU price for the 2007/08 storage year to 53.4 pence (2006/07: 65.6 pence).

Ongoing investment in Rough to improve its injection and withdrawal capabilities enabled us both to continue to sell significant volumes of additional space, 172 million therms (mmth) in 2007 (2006: 157mmth), and generate additional revenue, particularly from the new virtual storage product, V Store. Launched in May 2007 this product has the equivalent rights to an SBU but delivery of gas is guaranteed to the National Balancing Point. This guarantee meant that this product sold at a substantial premium to the price of an SBU.

Operationally the Rough field performed well, delivering injection and production availability of more than 98%. This was achieved whilst also securing and improving our health and safety performance. A recent review undertaken by the Health and Safety Executive, into systems to ensure asset integrity, placed Rough in the top quartile of all North Sea installations surveyed.

Direct Energy

We delivered another successive year of profit growth*

We made continued progress on diversification of the business

Our Direct Energy brand is one of North America's largest energy and energy service providers, with over 5 million residential and business customers in Canada and the US. We own and operate gas reserves in Canada, and electricity generation capacity in Texas.

Direct Energy performed well during a year in which we continued to develop our activities beyond the mass markets energy supply operations. We also restructured the business into four pan-North American lines of business. This enables greater focus on key groups of customers to drive growth and efficiencies of scale through shared operations.

Due to changes during the year in the relationship with The Consumers' Waterheater Income Fund, which are explained in more detail under Discontinued Operations on page 22, the decision was taken to deconsolidate the Fund's results with effect from 1 December 2007. This commentary covers the results of the remaining Direct Energy operations.

Excluding the negative impact of exchange rate movements, Direct Energy delivered top and bottom line underlying growth. The reported results were adversely impacted by the weakness of the US dollar against sterling through the year and, to a lesser extent, the Canadian dollar in the first half of the year. Whilst reported revenue^ was down 1.4% at £3.99 billion (2006: £4.05 billion), underlying revenue^ was up 4.9%. This was driven by strong growth both in commercial and industrial energy and in upstream and wholesale energy, which offset lower revenues in mass markets energy and in home and business services.

Reported operating profit*^ was up 8% at £187 million (2006: £173 million), with underlying profit* before exchange rate movements up more than 15%. The significant fall in profits* in mass markets energy was more than offset by improvements in other areas of the business.

Direct Energy
Performance indicators

For the period ended 31 December	2007	2006	Δ%
Customer numbers (period end)			
Mass markets energy ('000)	3,005	3,386	(11)
Home and business services ('000)	2,033	1,964	3.5
Volumes			
C&I gas sales (mmth)	627	557	13
C&I electricity sales (GWh)	13,925	11,221	24
Gas production (mmth)	297	304	(2.3)
Electricity generation (GWh)	5,053	4,450	14
Revenue^ (£m)			
Mass markets energy	2,437	2,765	(12)
Commercial and industrial energy	978	847	15
Home and business services	351	378	(7)
Upstream and wholesale energy	226	60	277
Total	3,992	4,050	(1.4)
Operating profit/(loss) (£m)*			
Mass markets energy	123	157	(22)
Commercial and industrial energy	1	(12)	n/m
Home and business services	17	9	89
Upstream and wholesale energy	46	19	142
Total excluding Income Fund	187	173	8
The Consumers' Waterheater Income Fund†	39	50	(22)
Operating margin (%)*			
Total Direct Energy	4.7	4.3	0.4ppts

Δ% has been used to express 'percentage change'.
* including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements.
^ from continuing operations.
† including consolidation entries and £7m 2006 H1 gain on sell-down.

Mass markets energy
Mass markets energy comprises natural gas and electricity sales to residential and small commercial customers across North America.

Mass markets energy experienced difficult trading conditions during the year, particularly the second half, following the expiry of five-year electricity contracts in Ontario, signed at market opening in 2002, combined with the expected competitive pressures in our Texas business following the expiry of Price to Beat regulation and the impact on margins of the takeover of TXU. These factors resulted in a fall in customer numbers. However by the year end this position had stabilised and we were once again growing the overall customer base in the last two months of the year.

Reported revenue was down 12% to £2,437 million (2006: £2,765 million) and reported operating profit* was down 22% at £123 million (2006: £157 million). Before the impact of exchange rate movements underlying revenue was down 6% with operating profit* down 15%.

Commercial and industrial energy
Commercial and industrial energy comprises natural gas and electricity sales to medium and large-sized businesses, public institutions and government.

Rapid growth in this segment continued during the year with volumes up 13% and 24% in gas and electricity respectively. Reported revenue was up 15% to £978 million (2006: £847 million), with underlying revenues up 24%. The business moved into profit during the second half as volumes grew and it recorded a £1 million profit* for the full year (2006: loss* of £12 million) with profits* in the more mature Canadian and Texas businesses offset by the costs of continued rapid growth in the north eastern US.

Home and business services
This line of business comprises home and business services across North America.

Services had a good year despite challenging market conditions, with continued deepening of the housing recession in the US. During the year we grew our customer numbers by 3.5% to over 2 million for the first time. In the US, our mainly residential new construction business weathered the housing market downturn well, gained market share in a shrinking market and expanded its consumer service business. The acquisition in January of MABE, a service provider for white goods, enabled us to launch an appliance protection and repair business across Canada.

Reported revenue^ was down 7% to £351 million (2006: £378 million), although it remained flat on an underlying basis. Following the restructuring of the business services operation and the increased focus on cost control to improve competitiveness, this has resulted in a near doubling of operating profit*^ to £17 million (2006: £9 million).

Upstream and wholesale energy
This business unit comprises our upstream and midstream activities which include upstream gas, power generation, gas storage and transportation leases, wholesale power and gas transactions, wind power purchase agreements and proprietary trading.

We delivered operating profit* of £46 million, up 142% on the prior year (2006: £19 million) with strong contributions from our power stations, wind power contracts as 433MW of new capacity came onstream, wholesale energy auctions and proprietary trading. Power generated increased by 14% to 5.1TWh, whilst gas production was broadly unchanged at 297 million therms. During the year, through our ongoing drilling programme, we replaced 117% of the gas we produced.

In November we announced an agreed offer to acquire Rockyview Energy Inc for around £57 million including debt. On successful completion in February 2008, this added 2,700boe per day to our hydrocarbon production, largely as natural gas. This acquisition is in line with our strategy of increasing the overall level of vertical integration and further developing this revenue stream.

Operating Review
continued

European Energy

European Energy

We increased our customer base in Belgium

We re-entered the Spanish electricity market

We agreed a 20-year tolling contract for a new gas-fired power station in the Netherlands

We are involved in power generation, energy management and retail energy supply, particularly in the increasingly interconnected energy markets of north western Europe.

Our European Energy business performed well in 2007, more than doubling its operating profit* to £17 million (2006: £7 million).

In Belgium in January 2007 we completed the transfer of around 500,000 Wallonian residential customer accounts to our SPE-Luminus business, increasing our total energy customer base to 1.4 million. As part of the remedies required to enable the merger of Gaz de France (GdF) and Suez, GdF must dispose of their 25.5% holding in SPE. Centrica has pre-emption rights over this stake.

In the Netherlands we continued to grow our customer base through the Oxxio brand and now supply approximately 754,000 customer accounts. During the year we installed around 75,000 smart meters and are working with the regulator to ensure Oxxio's meters are compatible with future industry standards. We also entered into a 20-year tolling contract with Intergen for a 400MW gas-fired power station in Rijnmond, near Rotterdam, which is expected to be commercially operational by summer 2010.

In January 2007 we rebranded our Spanish operation from Luseo to Centrica Energía. As market conditions improved we successfully re-entered the electricity supply market and have already contracted 0.9TWh of annual consumption. We also grew our portfolio of energy managed on behalf of 'special regime' generators to 650MW.

As a result of the positive developments in the legal and regulatory framework for competition within the German energy market we opened an operation in Düsseldorf selling to the commercial supply market through Centrica Energie GmbH.

Discontinued operations

The Consumers' Waterheater Income Fund was deconsolidated on 1 December 2007, the date of an Internalisation Agreement entered into between Direct Energy and the Fund which materially altered the relationship between the two entities. Details of the impact of the deconsolidation are included in note 3 and note 35.

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

Group Financial Review

Increasing returns to shareholders

"2007 was a year of sound growth in earnings*, driven by a turnaround in the profitability of British Gas Residential and record operating profits* in our growth businesses."

Centrica's financial aim is to achieve a total shareholder return (TSR) ranking in the first quartile of UK FTSE 100 Index companies, taking into account 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.

Financial statements

Group revenue

Group revenue from continuing operations remained broadly flat at £16.3 billion (2006: £16.4 billion). Increases in British Gas Services and British Gas Business as well as the first reported revenues from our Power Generation business were offset by the reduction seen in British Gas Residential due to lower gas and power consumption levels.

Group operating profit

Group operating profit* from continuing operations was up 40% to £1,949 million (2006: £1,392 million). The year-on-year movement was primarily due to the turnaround in the profitability of British Gas Residential and the industrial and commercial gas supply contracts due to the reduction in the wholesale gas price in the first half of 2007. Record operating profits* were also made in British Gas Business, British Gas Services, Centrica Storage and Direct Energy.

The statutory profit for the year was £1,505 million (2006: loss of £155 million). The reconciling items between adjusted Group profit* and the statutory profit are exceptional items, certain re-measurements and discontinued operations, which are explained below.

Group earnings

Group earnings* on a continuing basis were up by 60% to £1,121 million (2006: £701 million). This growth in earnings* came from the higher operating profit* combined with a significant change in profit mix towards greater downstream contributions, resulting in a lower effective group tax rate of 40% in the year (2006: 44%). Interest payments were also lower, at £73 million (2006: £141 million), following the favourable cash flow position held for most of the year.

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

The interest charge includes a one-off charge of £40 million relating to the early repayment of the finance lease on the Humber power station, which helps simplify the Group's debt structure.

Earnings per share and dividends

Adjusted earnings per share* improved by 58% to 30.6 pence in 2007, up from 19.4 pence in 2006. The Group reported basic earnings per share of 41.0 pence, up from a basic loss per share of 4.3 pence in 2006, reflecting the post-tax impact of exceptional charges and certain re-measurements which were positive in 2007, having been negative in 2006.

In addition to the interim dividend of 3.35 pence, per share, we propose a final dividend of 9.65 pence, giving a total ordinary dividend of 13.00 pence for the year (2006: 11.15 pence), an increase of 17%.

Cash flow

Group operating cash flow before movements in working capital was up from £1,892 million in 2006 to £2,494 million. After working capital adjustments, operational interest, tax, exceptional charges and discontinued items, this stood at £2,357 million (2006: £737 million). This increase in operating cash flow is primarily due to increased earnings and a decrease in the amount of tax paid. The net cash outflow from investing activities increased to £964 million (2006: £720 million), 34% higher than last year due to the Group's acquisition of Newfield UK Holdings Limited and a 50% share in the Braes of Doune wind farm. The net cash outflow from financing activities increased to £888 million (2006: £597 million), an increase of 49% on 2006, due mainly to the prepayment of the Humber finance lease. This resulted in a net cash outflow of £368 million relating to principal and £54 million relating to interest.

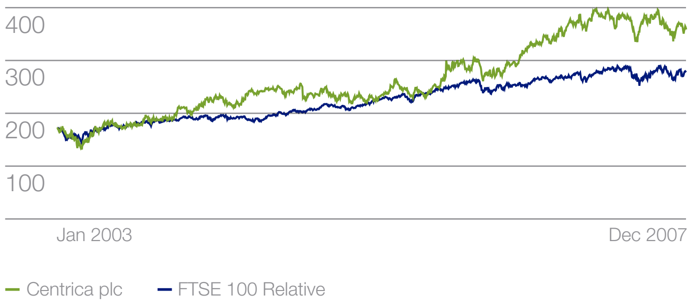
Net debt and interest

The Group's net recourse debt level at 31 December 2007 was £795 million (2006: £1,527 million). This was down from 2006, due primarily to improved operating cash flow. This debt includes £417 million of finance lease commitments on the Spalding power station.

As a result of changes in the relationship with The Consumers' Waterheater Income Fund, with effect from 1 December 2007 we no longer consolidate the period results and the Balance Sheet of the Fund in Centrica's Group accounts. This has reduced the

Group Financial Review continued

Centrica share performance
(pence)



Group's net borrowings by £573 million. These borrowings were previously classified as non-recourse and hence not included in net recourse debt.

Net assets
During the year net assets increased to £3,382 million from £1,642 million as at 31 December 2006. In addition to the retained earnings, net assets were increased by positive movements on the mark-to-market of the Group's financial instruments as detailed below.

Exceptional items
There were no exceptional items reported in continuing operations in 2007 (2006: pre-tax charge of £331 million).

Discontinued operations
The Consumers' Waterheater Income Fund was deconsolidated on 1 December 2007, the closing date of an Internalisation Agreement entered into between Direct Energy and the Fund which materially altered the relationship between the two entities. Details of the impact of the deconsolidation are included in note 3(a) and note 35(ii).

Certain re-measurements
In our business we enter into a portfolio of forward energy contracts which include buying substantial quantities of commodity to meet the future needs of our customers. A number of these arrangements are considered to be derivative financial instruments and are required to be fair-valued under IAS 39.

Fair valuing means that we apply the prevailing forward market prices to these contracts. The Group has shown the fair value adjustments separately as certain re-measurements, as they are unrealised and non-cash in nature. The profits* arising from the physical purchase and sale of commodities during the year, which reflect the prices in the underlying contracts, are not impacted by these re-measurements.

The statutory results include credits to operating profit relating to these re-measurements of £235 million (2006: net charge of £931 million), primarily from marking-to-market some contracts relating to our energy procurement activities. As gas and power were delivered under these contracts, the net out-of-the-money mark-to-market positions were unwound generating a net credit to the Income Statement in the period of £352 million (2006: net charge of £287 million). As the forward prices increased in 2007, the portfolio of contracts fair valued under IAS 39 reported a net charge on revaluation of £104 million (2006: charge of £638 million). The remaining charge of £13 million (2006: charge of £6 million) reflects the proprietary trading positions relating to cross-border capacity and storage contracts.

Acquisition and capital expenditure
During the year the Group acquired Newfield UK Holdings Limited, an exploration and production group with activities focused in the UK Southern Gas Basin, for cash consideration of £242 million, along with a number of smaller acquisitions.

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). The Group's significant accounting policies, including changes of accounting presentation, are explained in note 2 to the Financial Statements. Note 3 to the Financial Statements explains the critical accounting judgements and key sources of estimation uncertainty arising in the preparation of the Financial Statements.

Nick Luff
Group Finance Director

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

Principal Risks and Uncertainties

Managing our risks

> The identification and assessment of risks, together with the implementation of effective mitigating controls, are fundamental to achieving our strategic objectives.

Centrica, like all businesses, faces risks and uncertainties as we conduct our operations and there are a number of risks that could impact the Group's short and long-term performance.

We place great importance on internal control and risk management. A risk-aware and control-conscious environment is promoted and encouraged throughout the Group. We take steps to understand and evaluate risks to support the creation of long-term sustainable returns for shareholders. We have a robust risk management process in place, which is designed to identify, manage and mitigate business risk. This process is described in more detail in the Corporate Governance Report on page 36.

The factors described below highlight the principal risks and uncertainties that affect the Group but are not intended to be an exhaustive analysis of all the risks which may arise in the ordinary course of business or otherwise. Some risks may be unknown to the Group and other risks, currently regarded as immaterial, could turn out to be material.

External market factors

Commodity prices

Our energy requirements to serve our gas and electricity customers are dependent on the wholesale commodity markets for gas, oil, coal, carbon and power prices, all of which have been volatile in recent years. The outlook for 2008 continues to be difficult to predict due in part to the uncertain economic environment and the impact of geopolitical events. The price of gas in the UK market is particularly important for us given the high proportion of the retail gas market we serve and our fleet of gas-fired power stations.

To manage this risk, we optimise our asset and contract portfolio through an approach based on extensive analysis of our supply and demand position and continuous assessment of the commodity markets in which we operate (see note 4 to the Financial Statements on page 69). Our policy is to hedge a proportion of the exposure for a number of years ahead linked to the underlying profiles of our customers' energy requirements through bilateral agreements for gas and power and the use of financial instruments such as oil and gas swaps.

While this hedging strategy has mitigated increases in commodity prices for a period, we had to increase retail energy prices in January 2008. A continuing volatile commodity price environment, particularly with regard to gas costs, may lead to further retail price adjustments. The combination of variable commodity costs and the extent to which these costs are passed through to consumers, will mean that margins will remain volatile, thereby affecting Group earnings. Furthermore, the unpredictability of commodity prices, including carbon (particularly with the uncertainty of the future trading regime), hampers the calculation of reliable forecasts to support investment decisions potentially leading to lower than expected returns.

Consumption

Gas sales volumes, and to a lesser extent electricity sales volumes, are affected by temperature and other weather factors. Customers' demand behaviour will also be influenced by the national economic climate, gas and electricity prices and an increasing awareness of the environmental impact of energy use. The development and application of new technologies, either from the use of domestic energy generating units (such as micro-combined heat and power units), and/or greater use of demand-side management technology (such as smart metering), could also affect demand in the medium term and therefore the Group's earnings. We monitor consumption trends and have developed a portfolio of low-carbon products and services for our customers.

In addition, we use historical consumption patterns to estimate customer usage and therefore the value of the future benefits that will flow to us. Any change in those benefits would change the value of the revenue recognised. For further details see note 3 to Financial Statements on page 67.

Level of competitive activity

The markets in which we operate are highly competitive and subject to customer churn rates that are sensitive to price changes and levels of customer service.

To ensure we retain our competitive position, we need to combine attractive products and propositions with high quality customer service, maintain an efficient cost structure and, for energy supply, procure energy competitively. Accordingly, we actively monitor customer trends and competitor activity to respond to changing circumstances by developing retention campaigns and innovative

Principal Risks and Uncertainties continued

customer offerings. In addition, we retain a strong focus on reducing operating costs, as failure to sustain competitive cost levels will challenge our ability to deliver sustainable operating margins.

Regulatory factors

The energy markets in the UK, North America and Europe are subject to comprehensive operating requirements as defined by the relevant sector regulators and/or government departments. Amendments to the regulatory regime could have an impact on our ability to achieve our financial goals. Furthermore, we are obliged to comply with supply and wholesale industry procedures, amendments to which could have an impact on our operating costs. We are also subject to regulated charges for transportation and distribution of energy. Material increases in these charges will impact our margins, to the extent that any such increases cannot be passed on to our customers.

The UK Energy Bill has had little adverse impact on the Group. We continue to monitor drafting amendments and revisions during the passage of the Bill which could introduce new requirements in relation to smart meters (with the potential for additional costs if existing meters become obsolete) and supplier social tariffs.

In Europe, while the European Commission remains supportive of network unbundling, meaningful progress on European market deregulation continues to be limited. The need for effective competition is emphasised by the current level of consolidation activity in Europe, which could not only have an impact on our participation in European energy markets but also the ability to source and transport gas across Europe to the UK.

In North America the risk of political or regulatory intervention in energy markets remains an uncertainty and could have an impact on the projected growth of our operations. While the 2007 session of the Texas legislature concluded without any material changes to the electricity market or competition rules, this issue remains in the political spotlight and could be reviewed during the next legislative session which begins in early 2009. Specific reviews regarding electricity deregulation are ongoing in a limited number of jurisdictions but energy policy, particularly electricity, remains a highly politicised topic throughout North America.

In order to mitigate these risks, we continue to monitor political and regulatory developments and engage with the relevant stakeholders through targeted contact programmes with regulators, government ministers and senior officials.

Operational factors

Climate change

With the increasing recognition of the impact of climate change on our environment, we believe we can make an important contribution to support a low-carbon economy. Our climate change strategy recognises both the risks and opportunities that will shape our future operations and ultimately the longer-term success of our business. Our strategy is designed to address the risks this may present, such as new legislation, changing customer behaviour including growing demand for low-carbon products and services, and the reputational risks of not taking a leadership position.

Further information on our approach to climate change is available in the Corporate Responsibility Review on page 30.

Information systems

Large, effective and secure information systems are critical for the efficient management and accurate billing of our customers and to support our energy trading and optimisation activities. Any significant disruption to these systems could adversely affect our operations and so there are business continuity plans in place. To improve efficiency, we continue to invest in our systems supported by strong project management to minimise the associated implementation risk. In addition, controls to ensure the confidentiality, availability and integrity of customer and Company data remain a core element of system development and continuous improvement.

Security of supply

As UK gas reserves have declined, the UK energy market has become increasingly reliant on pipelines from Norway and mainland Europe together with liquefied natural gas supplies from other parts of the world. Accordingly, a key element of security of supply is access to these reserves and the reliability of the pipeline and gas processing infrastructure operated by Centrica and third parties both in the UK and abroad. Any break in this supply chain could jeopardise the supply to customers and impact our earnings.

To respond to this changing environment, we have supported new infrastructure development to bring gas to the UK, such as the Langeled pipeline. In addition, we continue to acquire assets, such as Newfield UK Holdings Limited, and sign long-term supply contracts to replace declining gas reserves. We will continue to seek opportunities to secure and develop gas and power assets in the UK and overseas, and continually review our security arrangements to protect those assets.

Health and safety

We manage significant health and safety risks associated with the operation of our onshore and offshore gas production, gas storage and power generation assets. In addition, our service engineers in the UK and North America complete more than 8 million home visits each year to carry out essential work on gas and electrical installations, appliance maintenance and plumbing and drain services. We are committed to maintaining high standards of health and safety and our risk management and governance processes meet internationally recognised standards of good practice. Significant health and safety events could have an adverse impact on personal safety, gas and/or power production or our reputation. Although the likelihood of such events is low, we continue to target risk reduction in our operations to minimise the possibility of incidents occurring.

Further information on our approach is available in the Corporate Responsibility Review on page 31.

UK customer service

The delivery of good quality customer service is central to our business strategy. The implementation of a new billing system for our UK residential energy customers led to levels of customer service that were lower than we aspire to. Through continued focus in this area during 2007 we are now seeing improved levels of customer service and reduced customer complaints. We carefully monitor these service levels and performance throughout our retail operations, to ensure continual improvement.

Outsourcing and offshoring

We have entered into a number of outsourcing contracts, some of which are offshore, in respect of certain support functions for our businesses in the UK and North America. As with any contractual relationship, there are inherent risks to be considered and mitigated.

We have worked closely with our chosen suppliers to ensure the delivery of benefits with strong focus by management in the retained organisation playing an important part in the successful transition and implementation. The Centrica Executive Committee regularly reviews progress and, in addition, a centre of expertise has been developed to capture and share best practice.

Brand and reputation

Our business principles, which apply to all employees and business partners, set out our commitment to operate professionally, fairly and with integrity wherever we work in the world. Failure to follow these principles could harm our reputation, damage our brand and affect our operational performance and financial position. A combination of awareness training and targeted controls (including fraud and data protection) is in place to encourage and monitor adherence to these principles.

As part of the demerger in 1997, Centrica was assigned ownership of the British Gas trademark and related logos for use in the UK. BG Group plc has the right to call for a reassignment of this intellectual property if control of Centrica is acquired by a third party. If, as a result of a change of control, we are unable to continue to use the British Gas trademark and logos, this could adversely affect our competitive position.

Financial factors

Liquidity

Cash forecasts identifying the liquidity requirements for the Group are produced frequently. These are stress-tested for different scenarios and are reviewed regularly by the Board to ensure that sufficient headroom exists for at least a 12-month period. Any failure to maintain sufficient headroom could have an impact on our operations. Our policy is to maintain a minimum level of committed facilities and ensure that a proportion of debt should be long-term and spread over a range of maturities.

Currency

Through wholly-owned US and Canadian subsidiaries and wholly-owned and partly-owned European entities, the Group has operational exposure in US and Canadian dollars and euros. Our policy is to maintain the sterling book value of our foreign currency investment through balance sheet hedging instruments. US dollar, Canadian dollar and euro balance sheet translation exposure is hedged by maintaining foreign currency borrowings and/or derivative financial liabilities which approximate to the net asset value of the foreign operations.

Other material foreign currency cash flow exposures are hedged where there is sufficient certainty that the cash flows will occur. Where there is significant uncertainty over the potential timing of material currency exposures the senior treasury and finance management decide on the appropriate hedging activity required on a case-by-case basis.

Interest rate

Our policy is to 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.

Counterparty

Our 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 minimum long-term and short-term credit ratings of A3/A-/A-or P1/A1/F1 from any of Moody's, S&P or Fitch Ratings. Energy trading activities are undertaken with counterparties for whom specific credit limits are set. Exposures are reviewed by the Financial Risk Management Committee.

Credit rating

The current strong credit rating of the Group (long-term debt: A3 stable outlook (Moody's), A negative outlook (S&P); short-term debt: P-2 stable outlook (Moody's), A-1 negative outlook (S&P)), means that it benefits from high levels of credit for its existing counterparty relationships. Any material deterioration of this rating would mean that we would need to increase our levels of security for existing energy procurement and hedging contracts, which may have a material effect on our cash position or limit our ability to trade in commodity markets. As described above, sufficient liquidity headroom is maintained to limit the immediate financial impact of a reduction in the credit rating. Further details on these financial risks can be found in notes 4 and 5 to the Financial Statements on pages 69 and 74.

Pensions

We maintain a variety of pension schemes including defined benefit schemes. The pension fund liabilities are partially matched with a portfolio of assets, which leaves potential risk around the mortality rate, wage inflation and returns on assets. The scheme contains a high proportion of equity assets that are expected to provide a better return in the long term than alternative investments such as bonds. However, in the short term, the difference between the value of liabilities and assets may vary significantly, potentially resulting in a large deficit having to be recognised on the Group's balance sheet.

In addition, actions by the pension regulators or the trustees and/or any material revisions to the existing pension legislation could require increased contributions by the Group to the pension fund. The risks associated with the pension schemes are regularly reviewed and, in combination with expert external advice, any appropriate action is identified and acted upon accordingly. For further details see note 34 to the Financial Statement on page 126.

Corporate Responsibility Review

Managing our business impact

> We are securing sustainable energy supplies while demonstrating leadership on climate change and social programmes.

Mary Francis CBE
Senior Independent Director and Chairman, Corporate Responsibility Committee

Introduction

We operate in a society which puts an increasingly high value on sustaining the physical environment and nurturing people and communities. For any organisation, this shift in values raises issues of judgement between short-term gain and longer-term sustainability. We must therefore devote time and energy to understand and manage effectively the social, environmental and economic impact of our operations. If we do so successfully, we can win business advantage and deliver value to our shareholders. If we fail, we face reputational and financial risks.

Governance and management

The Corporate Responsibility Committee oversees Centrica's corporate responsibility (CR) strategy and activities on behalf of the Board. Since its formation in January 2006, our objectives have been to increase the time devoted to these matters by the Board and senior management; to ensure that the Group has clear policies on managing its key environmental and social impacts; and to monitor the implementation of our policies through clear targets and performance indicators. Above all, the Committee's role is to ensure that our day-to-day business operations respond to the opportunities, and avoid the risks, posed by CR issues.

I am pleased that both the Board and the senior management team have given strong leadership to the Group's CR work during the year. In September 2007, I made recommendations to the Board with regard to the Committee's ongoing effectiveness and as a result Andrew Mackenzie, Non-Executive Director, and Sam Laidlaw, Chief Executive, joined the Committee and we revised the terms of reference. The reconstituted Committee met for the first time in December 2007 and will provide strong governance in the future.

In 2007 the Committee reviewed our strategy for managing key risks and opportunities including climate change, supporting vulnerable customers, health and safety and the way we operate in developing countries. We also strengthened the Group's risk management and internal audit processes for CR, received regular reports on the views of external stakeholder groups and contributed to the development of CR communications and reporting.

The following sections highlight the challenges we face, the actions we are taking, our performance during the year and our future commitments and targets. While we cover a broad range of issues, our most material CR impact areas continue to be climate change and the environment; vulnerable customers; and health and safety.

Business conduct

Our Group-wide business principles create a framework to help us make decisions in line with a consistent set of operating behaviours based on trust, integrity and openness.

In 2007 Sam Laidlaw demonstrated his personal commitment by leading a programme to update and communicate our principles. This ongoing campaign will help our employees, business partners and external audiences understand the standards we expect. For example, our managers received a guide called 'Building a better business' and were each required to complete an online learning programme.

In addition, we began working with our most senior leaders to create a common set of management behaviours which will help us to build a stronger culture in the business. These will be developed further in 2008 and will help us to increase our leadership capability and develop our next generation of leaders.

We also introduced a new responsible procurement policy to extend our business principles into our supply chain activities. In 2008 we will work with our business partners and suppliers to increase their awareness of our policy and our expectations in relation to its implementation.

Go online

More detailed information will be published in our 2007 Corporate Responsibility Report in May 2008.
www.centrica.com/responsibility

Key highlights

CARBON DISCLOSURE PROJECT

We were recognised as a sector leader by the Carbon Disclosure Project in 2007

sam 2008 gold class

Our sustainability performance was recognised as Gold Class by Sustainable Asset Management in 2007

ACCA

Our online CR report was commended by the Association of Chartered and Certified Accountants in 2007

Listening to stakeholders

It is essential that we are alert to evolving trends and opinions – among employees, customers, policy-makers, investors and wider stakeholders – so that we can fully understand our impact on society and the environment and contribute our expertise and experience to public debate.

Helping shape the policy environment

We are committed to playing a full and active role in the political process to support the creation of competitive energy markets that deliver consumer choice, support vulnerable customers, promote security of supply and facilitate the move towards a low-carbon society.

Competitive markets

In 2007 we continued to support the creation of a truly competitive European energy market. We welcomed the European Commission's proposals for the unbundling of electricity and gas transmission networks and will support their implementation. In addition, Direct Energy continued to advocate market change across North America to improve energy market competitiveness and consumer choice.

Reducing carbon emissions

We played an active part in the debate on reducing carbon emissions, including the development of EU emissions reduction targets and phase three of the EU Emissions Trading Scheme (ETS). In North America, we continued to engage with federal, state and provincial policy-makers as well as industry groups to inform thinking on carbon legislation. The price of carbon is a significant factor in our investment decisions and we believe that effective cap and trade systems such as the ETS will provide long-term visibility.

Talking to investors

In 2007 we hosted our fourth annual CR investor roadshow to brief analysts on our CR strategy and performance on key areas of impact. We continued to be included in the Dow Jones Sustainability Index and FTSE4Good indices during the year. We were recognised as a sector leader by the Carbon Disclosure Project and ranked first in an assessment of UK energy suppliers' action on climate change, undertaken by Innovest on behalf of WWF. Our online CR report was ranked third best in Europe by internet consultancy Jungle Rating.

Corporate Responsibility
Performance indicators

	2007	2006	Δ%
Climate change			
Carbon intensity of UK power generation (g CO_2/kWh)*	394	412	(4)
UK household energy efficiency products provided (million)[1]	17.3	13.5	28
Lifetime carbon savings for UK household energy efficiency products provided (million tonnes)[2]	1.2	1.0	20
Social programmes for vulnerable customers			
Customers on British Gas 'Essentials' social energy tariff	340,000	–	–
Health and safety			
Lost-time injuries/1,000 employees	18.7	14.3	31
Lost-time injuries/100,000 hours worked	1.03	0.80	29
Total accidents/100,000 hours worked[3]	5.7	3.9	46
Total number of fatalities	0	7[4]	–
Local impact			
Total community contributions (£m)[5 6]	5.2	7.4	(30)
Voluntary social contributions (£m)[7]	25	–	–
Mandatory social contributions (£m)[8]	51	–	–
Employees			
Employee engagement score	3.96	3.84	3
Human capital ROI ratio[9]	2.5	2.1	19
Employees from ethnic minority groups (%)[10]	15.2	15.9	(4)
Employee gender (female/male %)	30.2/69.8	29.9/70.1	–
Employees with a disability (%)	3.2	2.7	19

Δ% has been used to express 'percentage change'.
1 UK Energy Efficiency Commitment.
2 Source: www.nef.org.uk/greencompany/co2calculator.htm.
3 We stated total injuries/100,000 hours worked in our 2006 Annual Report.
4 Morecambe Bay helicopter accident: four employees and three contractors.
5 Calculated using London Benchmarking Group methodology.
6 Cash donations in the UK during the year amounted to £4.1 million (2006: £6.1 million). This included a donation of £1.1 million to the British Gas Energy Trust, which supports vulnerable customers. 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.
7 Cost of voluntary programmes to support vulnerable customers in the UK.
8 Cost of mandatory programmes to support vulnerable customers in the UK.
9 PwC Saratoga – a measurement of financial return for investment in employee remuneration, benefits and training.
10 2,007 employees in the UK have not disclosed their ethnic profile.

Corporate Responsibility Review continued

Key highlights

17m[1]

Energy efficient
UK household energy efficiency products provided

380g[†]

2012 target
To reduce our UK power generation carbon intensity to 380g CO_2/kWh[†]

10%

Office energy target
We achieved our target to reduce UK office energy use by 10% in 2007; we are aiming for a further 5% reduction in 2008

Tackling climate change

Reducing carbon emissions while securing future energy supplies for our customers is a very significant challenge. But climate change science makes unequivocal the case for a low-carbon future and we have an important role to play in making it happen. Our strategy is to lead the market in responding to growing consumer demand for low-carbon products and services; to maintain our low-carbon position on power generation; and to work with our employees and suppliers to reduce the environmental impact of our operations.

Commercial opportunities
In 2007 we launched a new business unit – British Gas New Energy – to lead our low-carbon strategy in the UK. In North America, we formed a cross-business team to co-ordinate Direct Energy's climate change activities within each business unit. On both sides of the Atlantic, our increased focus on developing innovative low-carbon products and services for our customers is an important growth opportunity.

Low-carbon products
British Gas launched 'Zero Carbon'[11], our greenest tariff available to domestic customers, and introduced a scheme offering a council tax rebate of £500 to customers installing solar panels. Direct Energy extended its carbon neutral gas programme to Ontario, Alberta and Manitoba after a successful launch in British Columbia. It provides customers with the ability to reduce their carbon footprint by offsetting the greenhouse gases they produce in their homes with carbon credits that fund clean energy projects around the world.

Energy efficiency
British Gas remained the largest provider of household energy efficiency products in the UK, providing more than 17 million products in 2007. Our Green Streets campaign, which links 64 households in eight cities across the UK, aims to highlight the positive impact simple energy efficiency products and behaviours can have.

Low-carbon power generation
The carbon intensity of the power we generate for our British Gas customers is already significantly lower than the other five major UK suppliers. In 2007, 394 grams of carbon dioxide were emitted for every kilowatt hour (g CO_2/kWh) of power we generated*.

To ensure we maintain this leadership position, we have set a target to reduce our UK power generation carbon intensity to 380g CO_2/kWh by 2012 and aim to go even further by cutting our intensity to 350g CO_2/kWh by 2020.[†]

This is a significant challenge, but we believe that our focus on relative, rather than absolute, targets will enable us to reduce CO_2 emissions and continue to provide secure energy supplies for our customers. Our strategy to invest in low-carbon generation such as high-efficiency gas-fired power stations and offshore wind farms will not only enable us to meet our own targets but enable Centrica to play a key role in meeting broader UK and European emissions reduction targets.

Investing in renewables
During the year we acquired 50% ownership of the 72MW Braes of Doune onshore wind farm in Stirlingshire, Scotland. We made good progress with our Lynn and Inner Dowsing development and submitted a planning application for the construction of the Lincs offshore wind farm. Together with other wind farms in development, our UK generation capacity in the next few years is expected to reach more than 1.6GW. In Texas Direct Energy signed a seven-year deal to buy the output of AES Corporation's 170MW Buffalo Gap Wind Farm 3, bringing our total wind power offtake commitment in North America to 813MW.

Reducing our operational footprint
We introduced a new Group-wide environment policy to provide clear direction for our programmes and developed a Group Environmental Management System ready for implementation, commencing with British Gas in 2008. We launched a new company car policy to remove the most polluting vehicles, enabling all eligible employees to select from cars emitting less than 200g of CO_2 per km. Green parking spaces were also created for cars with emissions below 120g of CO_2 per km and for those car-sharing. We initiated a 'Being Green' campaign across the Company to encourage employees to help reduce our operational footprint.

11 Zero Carbon is the name of the tariff. We offset the CO_2 emissions from the gas and electricity customers consume using carbon offsets certified by the United Nations.
* Based on verified emissions data under the requirements of the EU Emissions Trading Scheme.
† Carbon intensity figures are based on the average annual emissions from all wholly-owned UK power generation assets and all other power generation assets from which Centrica is entitled to output under site-specific contracts in the UK.

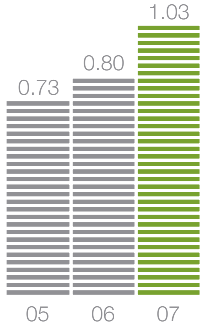
£21m

We have committed more than £21 million to the British Gas Energy Trust since 2004

C$0.5m

Direct Energy's support for the 'Neighbor-to-Neighbor' programme is helping low-income families

Lost-time injuries/100,000 hours worked



Serving our customers

As a multinational energy company providing essential services to millions of customers every day, understanding their evolving needs is very important. Being responsible and responsive in how we manage relationships with our customers is central to our business strategy.

Delivering value

Our priority is to provide our customers with the best value in the marketplace by delivering good quality customer service and being competitive on price. In March 2007 British Gas was the first UK supplier to announce a reduction in its retail prices when wholesale energy costs began to fall and we reduced prices again in April.

Although this helped us retain customers, our quality of service remained lower than the standards we expect. We invested £60 million to help restore service standards in 2007, benefited from the recruitment of 800 new customer service agents and made an extensive commitment to training. As a result, complaints to energywatch fell by 80% during the year and our average time to answer calls reduced by 75%. Further improving levels of customer service is a key priority in 2008.

In response to a significant increase in wholesale energy costs over the winter period, British Gas was forced to increase retail prices in January 2008. However, we protected 340,000 of our most vulnerable customers from this increase until 1 March 2008.

Supporting vulnerable customers

Although UK retail energy prices were lower in 2007 than in the previous 12 months, fuel poverty continued to be an issue. It is our priority to identify and support these households with a tailored range of services including energy efficiency, debt alleviation, priority service, financial assistance and support from partner organisations.

In March 2007 British Gas received widespread recognition from government and industry groups following the launch of 'Essentials', the UK's largest social tariff on the energy market. This £32 million commitment guarantees that up to 750,000 eligible vulnerable customers can receive our lowest cost offline tariff.

Our new 'Winter Warmer' initiative offers sustainable support to 25,000 of the UK's most vulnerable elderly households including free insulation and a winter credit of up to £90 for eligible customers. We are also investing £3.3 million a year in a further four-year commitment to the British Gas Energy Trust, an independent body which helps customers who have the greatest difficulty paying their household bills. Including these commitments, British Gas will be responsible for around 70p of every £1 spent by UK suppliers on fuel poverty initiatives.

Direct Energy's Texas operation expanded its support for the 'Neighbor-to-Neighbor' programme to include Dallas and Houston and now serves 32 agencies across Texas. Our contribution of C$500,000 (£255,000) supplements existing energy-assistance programmes for families experiencing financial emergencies.

Focusing on health and safety

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

During 2007 we conducted a detailed internal review of our management systems. This included consideration of the Baker Report into BP's 'Texas Refinery Incident' and a strong focus on process safety. We identified opportunities to reinforce our approach and implemented an action plan with oversight from the Centrica Executive Committee. A progress report on those actions was presented to the Board at its meeting in December.

Although our proactive improvement programmes helped our business units to achieve their performance targets overall, the Group experienced an increase in accident incidence rates.

This increase can be linked to a concerted campaign over the last 12-18 months to improve incident reporting in our main UK downstream businesses. We will continue to target a year-on-year 4% reduction in time lost from injuries and to support those businesses that have consistently reduced or achieved low injury incidence rates.

To build on our strong performance, we have developed a programme called 'Performance Plus' to heighten our performance expectations and provide greater resilience in our risk management systems through proactive leadership, behavioural change and continual challenge and review at all levels.

Corporate Responsibility Review continued

Valuing our people

The calibre and the conduct of our people are central to building successful relationships with our customers, shareholders, business partners and the communities in which we operate.

During the year we employed an average of 33,908 people: 28,829 in the UK; 4,839 in North America; and 240 in the rest of the world.

Employee engagement

Employees are regularly updated on our performance against our strategy. We want Centrica to be a great place to work and our engagement survey helps us to measure the attitudes and opinions of our employees. In 2007 more than 84% of employees responded and our overall engagement score increased by 3%, demonstrating a high level of commitment from our people. We maintain regular dialogue with representatives of local employee consultative bodies and recognised trade unions to ensure we fully understand employees' views.

Diversity and inclusion

We are committed to pursuing equality and diversity in all our activities and we continue to support initiatives to provide employment opportunities for people from minority groups in the community, including people with a disability, carers and lone parents. For example, we pledged our support to the Local Employment Partnerships scheme, which aims to help 250,000 disadvantaged people in the UK get back into work.

Following the introduction of the Employment Equality (Age) Regulations 2006, we delivered an awareness and training programme to enable employees to understand the new legislation, for which we won an award from the Employers' Forum on Age.

Canada's Association for the Fifty Plus recognised Direct Energy for the opportunities we have created for older employees. In addition, we received the Alfred P Sloan Award for business excellence in workplace flexibility for our programmes in Texas and the Stevie Award for the 'Best Multinational Company' in North America.

In the UK we were recognised as an 'exemplar employer' by Opportunity Now for our flexible working initiatives and our diversity recruitment strategy for engineers.

Training and development

Our British Gas Engineering Academy achieved 'grade one' performance in an Ofsted inspection. Ofsted commended our efforts to recruit from underrepresented groups, with female trainees accounting for almost 13% of all those recruited in 2007. We also introduced a General Management Development Programme. It is an integral part of our talent strategy, which aims to build our senior management capability and develop successors for key roles.

Reward

In 2007 we conducted a fifth comparative review of the levels of pay for male and female employees. The results showed that the gender pay gap in Centrica is much narrower than published national norms. We were the first organisation to enable UK employees to make a direct contribution to fighting climate change via their flexible benefits allowance which offers a personal carbon offset in partnership with Pure, the Clean Planet Trust.

We encourage our employees to own shares in the company by operating a number of all-employee share schemes. In the UK 12,186 employees participated in Sharesave and 5,873 participated in our Share Incentive Plan. In North America 1,100 employees participated in our Employee Share Purchase Plan.

We also operate a Share Award Scheme and a Restricted Share Scheme. Participation in these share schemes is on a highly selective basis at the discretion of the Chief Executive and Group Director, Human Resources. Neither the Executive Directors nor the next tier of executive management is eligible to participate. Further information on these schemes is given in note 33 to the Financial Statements on page 118.

Investing in communities

By understanding our impact on the communities in which we work, we can develop successful partnerships of mutual benefit. We aim to deepen our understanding of social and environmental issues and contribute to action that addresses them. We do this by supporting outside agencies and encouraging our own employees to get involved.

In 2007 we contributed £5.2 million[6] to community causes through a combination of cash, time and in-kind support[5]. Across the Company, our people invested more than 18,000 hours in volunteering activities, which equates to more than £260,000 of in-kind support.

In June a memorial service was held for those who lost their lives in the Morecambe Bay helicopter tragedy on 27 December 2006. The first donation from the fund, set up in memory of those who died, was made to North West Air Ambulance and a memorial stone was unveiled outside our Heysham base.

Direct Energy completed its three-year support of 'Youthworks', an initiative tackling homelessness among young people, run by Canadian charity Raising The Roof. In Canada, we supported Habitat for Humanity's first EnergyStar® building project with a financial donation and products including high-efficiency furnaces.

In addition, British Gas launched the third phase of 'Help Yourselves' in partnership with Save the Children. The scheme provides grants to young people to tackle issues of social exclusion in their local communities – www.helpyourselves.org.uk.

Governance

Board of Directors and Executive team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Board of Directors

1. Roger Carr

Chairman (61) * †

Roger Carr joined the Board as a Non-Executive Director in January 2001. He was appointed Chairman of the Board in May 2004 and is Chairman of the Nominations Committee. He is Chairman of Mitchells & Butlers plc, Deputy Chairman of Cadbury Schweppes plc and a senior adviser to Kohlberg Kravis Roberts & Co Ltd. In June 2007, he was appointed Non-Executive Director of the Court of the Bank of England.

2. Sam Laidlaw

Chief Executive (52) ■ ● ◆ *

Sam Laidlaw joined Centrica plc as Chief Executive in July 2006. He is Chairman of the Executive Committee and the Disclosure Committee. He was previously Executive Vice President of the Chevron Corporation, Chief Executive Officer at Enterprise Oil and President and Chief Operating Officer at Amerada Hess. In January 2008 he was appointed a Non-Executive Director of HSBC Holdings plc. Until August 2007 he was a Non-Executive Director of Hanson plc. He is Trustee of the medical charity RAFT and a Director of the Business Council for International Understanding.

3. Helen Alexander CBE

Non-Executive Director (51) ▲ * †

Helen Alexander joined the Board in January 2003 and is Chairman of the Remuneration Committee. She is Chief Executive of The Economist Group, a Trustee of the Tate Gallery and an Honorary Fellow of Hertford College, Oxford. In September 2007 she was appointed a Non-Executive Director of Rolls-Royce plc. Formerly, she was a Non-Executive Director of BT Group plc and Northern Foods plc.

4. Phil Bentley

Managing Director, British Gas (49) ■ ◆

Phil Bentley joined Centrica plc as Group Finance Director in November 2000, a position he held until the end of February 2007 when he was appointed Managing Director, British Gas. He was also Managing Director, Europe between July 2004 and September 2006. 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 in various international oil and gas exploration roles. He is also a Non-Executive Director and the Chairman of the Audit Committee of Kingfisher plc.

5. Mary Francis CBE

Senior Independent Director (59) ▲ ■ * †

Mary Francis joined the Board in June 2004 and is Senior Independent Director and Chairman of the Corporate Responsibility Committee. She is a Non-Executive Director of Aviva plc, St. Modwen Properties plc and Alliance & Leicester plc, and a Director of the Almeida Theatre. She is a former Director General of the Association of British Insurers, a former Non-Executive Director of the Court of the Bank of England and was a senior civil servant in the Treasury and the Prime Minister's Office.

6. Nick Luff

Group Finance Director (40) ● ◆

Nick Luff joined Centrica plc as Group Finance Director in March 2007. He was previously Chief Financial Officer of The Peninsular & Oriental Steam Navigation Company (P&O) and has held a number of other senior financial roles at P&O having qualified as a chartered accountant at KPMG. He is a Non-Executive Director of QinetiQ Group plc.

7. Andrew Mackenzie

Non-Executive Director (51) ▲ ■ * †

Andrew Mackenzie joined the Board in September 2005. In November 2007 he was appointed Group Executive and Chief Executive Non Ferrous at BHP Billiton, a position he will take up during 2008. From 2004 he was with Rio Tinto plc, latterly as Chief Executive Diamonds and Minerals. 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. From 2005 to 2007 he was Chairman of the Board of Trustees of the think tank, Demos, and he remains a Trustee.

8. Paul Rayner
Non-Executive Director (53) ▲ * †
Australian citizen
Paul Rayner joined the Board in September 2004 and is Chairman of the Audit Committee. 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.

9. Jake Ulrich
Managing Director, Centrica Energy (55) ◆
Jake Ulrich was appointed to the Board in January 2005. He was appointed Managing Director, Centrica Energy in 1997. He assumed responsibility for the Group's activities in continental Europe in September 2006. 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.

10. Paul Walsh
Non-Executive Director (52) ▲ * †
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 management 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
▲ Audit Committee
■ Corporate Responsibility Committee
● Disclosure Committee
◆ Executive Committee
* Nominations Committee
† Remuneration Committee

Executive team

11. Grant Dawson
General Counsel and Company Secretary (48) ● ◆
Grant Dawson has been General Counsel and Company Secretary of Centrica since the demerger from British Gas plc in February 1997, having joined British Gas in October 1996.

12. Deryk King
Managing Director, Centrica North America (60) ■ ◆
Deryk King is responsible for all of Centrica's activities in North America. He joined Centrica in September 2000, having previously been Group Managing Director of Powergen plc.

13. Catherine May
Group Director, Corporate Affairs (43) ■ ◆
Catherine May joined Centrica as Group Director, Corporate Affairs in September 2006, having previously been Group Director of Corporate Relations for Reed Elsevier.

14. Anne Minto OBE
Group Director, Human Resources (54) ◆
Anne Minto was appointed Group Director, Human Resources in October 2002. Prior to that she was Director, Human Resources for Smiths Group plc, a position which she held since early 1998.

15. Chris Weston
Managing Director, British Gas Services (44) ◆
Chris Weston was appointed Managing Director, British Gas Services in June 2005. Prior to this he was Managing Director, British Gas Business from January 2002.

Corporate Governance Report

The Board of Directors of Centrica plc is committed to the highest standards of corporate governance. Throughout the year ended 31 December 2007, the Company fully complied with the provisions set out in Section 1 of the Combined Code on Corporate Governance (the 'Code'). The Company applied the relevant principles of the Code as set out in this report.

Board of Directors

An effective Board of Directors leads and controls the Group, and has a schedule of matters reserved for its approval. This schedule and the terms of reference for the Executive, Audit, Remuneration, Nominations, Corporate Responsibility and Disclosure Committees are available on request and on the Company's website at **www.centrica.com**.

The powers of the Directors are set out in the Company's Articles of Association, which are also available on the Company's website.

The Board is specifically 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 Group's corporate responsibility arrangements including health, safety and environment matters;
- the Group's system of internal control; and
- corporate governance.

One of the Board's meetings is specifically devoted to the development of the Group's strategic direction. This is continually monitored and a half-year review is presented to and discussed by the Board.

Guidelines are in place concerning the content and presentation of Board briefing papers. Comprehensive papers are provided to Directors one week ahead of each Board meeting.

A procedure is in place for the Directors to seek independent professional advice in respect of their duties at the cost of the Company. The Directors also have access to the advice and services of the General Counsel and Company Secretary.

Board meetings and attendance

The Board has regular scheduled meetings throughout the year and supplementary meetings are held as and when necessary. The Board had 9 scheduled and 4 unscheduled supplementary meetings during the year. A table detailing individual Director attendance at Board and committee meetings during 2007 is set out below.

Non-attendance at meetings was due to prior business or personal commitments and illness. All Directors who were unable to attend specific Board or Committee meetings reviewed the relevant briefing papers and provided their comments to the Chairman of the Board or committee, as appropriate.

The Chairman and each Non-Executive Director has provided assurance to the Board that they remain fully committed to their respective roles and can dedicate sufficient time to meet what is expected of them.

2007 Board and Committee attendance	Board Scheduled	Board Supplementary	Audit Committee	Remuneration Committee	Nominations Committee	Corporate Responsibility Committee
Number of meetings	**9**	**4**	**4**	**5**	**2**	**4**
Roger Carr	9	4		5	2	
Sam Laidlaw (i)	9	4			2	1
Phil Bentley (ii)	9	3				4
Nick Luff (iii)	8	4				
Jake Ulrich (iv)	9	4				2
Helen Alexander	9	2	3	5	2	
Mary Francis	9	3	4	5	2	4
Andrew Mackenzie (v)	9	2	4	4	2	1
Paul Rayner	7	3	4	3	2	
Paul Walsh	6	1	3	3	2	

(i) Sam Laidlaw became a member of the Corporate Responsibility Committee on 11 December 2007.
(ii) Phil Bentley became a member of the Corporate Responsibility Committee on 1 March 2007.
(iii) Nick Luff joined the Board on 1 March 2007.
(iv) Jake Ulrich ceased to be a member of the Corporate Responsibility Committee on 11 December 2007.
(v) Andrew Mackenzie became a member of the Corporate Responsibility Committee on 11 December 2007.

Board membership and appointments

The roles of Chairman and Chief Executive are separate and their responsibilities are clearly established, formalised in writing and agreed by the Board. There is also a balance of Executive and independent Non-Executive Directors. The Board of Directors' biographies including their Board committee membership are set out on pages 34 and 35.

Nick Luff was appointed to the Board as Group Finance Director on 1 March 2007 and was subsequently elected by shareholders at the 2007 Annual General Meeting (AGM). Nick Luff replaced Phil Bentley, who became Managing Director of British Gas on 1 March 2007.

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 specified in the Code and determined that each remained independent.

Mary Francis, the Senior Independent Director, is available to shareholders if they have concerns that contact through the normal channels has either failed to resolve or is inappropriate.

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

Full details of Directors' service contracts, emoluments and share interests are set out in the Remuneration Report on pages 42 to 51.

There is a formal, rigorous and transparent process in place for the appointment of new Directors to the Board. This process is described in the section on the Nominations Committee on page 39.

In accordance with the Code and the Company's Articles of Association, all Directors are subject to election by shareholders at the first AGM following their appointment to the Board and thereafter are subject to re-election every third year. Non-Executive Directors are initially appointed for a three-year term and, subject to rigorous review and re-election, can serve up to a maximum of three such terms. Upon the recommendation of the Nominations Committee, Jake Ulrich, Mary Francis and Paul Rayner will be proposed for re-election at the 2008 AGM, each to serve a further three-year term.

Directors' insurance and indemnities

In accordance with the Company's Articles of Association, the Company has granted a deed of indemnity, to the extent permitted by law, to each of the Directors and the General Counsel and Company Secretary. The Company also maintains directors' and officers' liability insurance for its Directors and officers.

Board evaluation

During the year the Board conducted a formal and rigorous performance evaluation of its own performance and that of its committees and individual Directors, with the assistance of an independent external facilitator, Egon Zehnder International.

The 2007 Board evaluation built upon the positive results and output of such previous exercises and focused on a number of key topics including:

- Board structure and composition;
- Board dynamics and relationships;
- Board meetings;
- information flows and decision-making processes;
- committees;
- people and succession planning; and
- reporting to shareholders.

The evaluation process was carried out with one-to-one interviews between the facilitator and each of the Directors and the General Counsel and Company Secretary. In addition, the Senior Independent 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 December 2007, along with a number of recommendations to address the issues raised.

The evaluation report concluded that the Board and its committees continue to operate effectively and build upon the progress of previous years. A small number of actions and improvements was identified from the evaluation and these will be incorporated into the future Board programme. The report also highlighted the importance of maintaining a focus on key subjects from the Board Planning Conference at future Board meetings.

The Board will continue to review its procedures, its effectiveness and development throughout the year ahead.

As part of the Company's 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 other Executive Directors by the Chief Executive. The Remuneration Committee also assesses the performance of the Executive Directors in connection with its determination of remuneration levels as explained in the Remuneration Report on pages 42 to 51.

Board training

An induction programme tailored to meet the needs of individual Directors is provided for each new Director. Directors also receive training throughout the year.

At Board meetings and, where appropriate, committee meetings, the Directors receive regular updates and presentations on changes and developments to the business, and to the legislative and regulatory environments. During 2007 the Board was briefed on a variety of issues including:

- commodity risk and hedging strategy;
- the risks and opportunities of upstream exploration activities;
- climate change strategy;
- improvements to customer service;
- Health & Safety – Baker Report review; and
- changes introduced by the Companies Act 2006, including the codification of Directors' duties.

Corporate Governance Report continued

Board committees

The Board has delegated authority to its committees on specific aspects of management and control of the Group. Written terms of reference for each of the Board committees have been approved by the Board and published on the Company's website.

Minutes of committee meetings are made available to all Directors on a timely basis.

All of the independent Non-Executive Directors are members of the Audit, Remuneration and Nominations Committees. This membership structure gives the Non-Executive Directors insight into the nature of the matters being discussed, brings continuity to membership and avoids undue reliance on particular members. The full membership of each committee is detailed within the following committee reports:

Executive Committee

During 2007 the Executive Committee comprised the Executive Directors and those key senior managers whose biographical details are set out on pages 34 and 35. Sam Laidlaw is Chairman of the Committee.

The Committee oversees the management of the Group and is the decision-making body for those matters not specifically reserved to the Board and within the limits set out in the Group's delegated authority and expenditure control policy.

Following a review of decision-making arrangements during the year, the Committee moved from weekly to monthly meetings from November 2007. At this time, the Committee established a separate Investment Sub-Committee to consider and approve proposed investment opportunities. The core members of the Investment Sub-Committee are Sam Laidlaw, Nick Luff and Grant Dawson with other members of the Executive Committee attending, as appropriate. The Investment Sub-Committee meets on a regular basis as business dictates, and the papers and minutes are made available to all members of the Executive Committee.

The following are also sub-committees of the Executive Committee, with membership drawn from among the Executive Committee members and appropriate senior management:

- the Group Risk Management Committee;
- the Group Financial Risk Management Committee; and
- the Health, Safety and Environment Committee.

Audit Committee

During 2007 the Audit Committee comprised Paul Rayner (Chairman), Helen Alexander, Mary Francis, Andrew Mackenzie and Paul Walsh. Paul Rayner, the finance director of a FTSE100 company, is identified as having recent and relevant financial experience, as required by the Code. The Board has determined that the members of the Committee are independent and that the membership meets the requirements of the Code.

In accordance with its terms of reference, the 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, 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.

During 2007 the Audit Committee met four times and received comprehensive reports from the Director of Business Assurance, senior management and the external auditors, PricewaterhouseCoopers LLP. The Committee also 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 measured. The output from each of these meetings was reported by the Committee Chairman to the next Board meeting.

At each of its scheduled meetings, the Committee met privately with the external auditors, and separately with the Head of Business Assurance.

Significant areas of review by the Committee during the year included:

- the new British Gas billing system;
- information technology general controls;
- risk profile of the Group's business model and risk mitigation;
- the internal financial control improvement programme;
- electricity prepayment debt and industry reconciliation process; and
- ongoing compliance with the undertakings in respect of Centrica Storage Ltd.

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 auditors. 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. The Group's policy to seek competitive tenders for all major consultancies and advisory projects is set out in note 7 to the Financial Statements on page 81. In addition, the Committee was provided with reports of all non-audit assignments awarded to the external auditors and, on a quarterly basis, a full breakdown of non-audit fees incurred during the year.

In accordance with International Standard on Auditing (UK & Ireland) 260 and Ethical Statement 1 issued by the Accounting Practices Board and as a matter of best practice, the external auditors have confirmed their independence as auditors of the Company in a letter addressed to the Directors.

Remuneration Committee

A report detailing the composition, responsibilities and work carried out by the Remuneration Committee during the year, including an explanation of how it applies the principles of the Code in setting Executive Directors' remuneration, is included within the Remuneration Report on pages 42 to 51.

Nominations Committee

During 2007 the Nominations Committee comprised Roger Carr (Chairman), Helen Alexander, Mary Francis, Sam Laidlaw, Andrew Mackenzie, Paul Rayner and Paul Walsh. Throughout the year a majority of the Committee's members were independent Non-Executive Directors.

The Committee is responsible for making appropriate recommendations to the Board for the appointment of replacement or additional Directors. It is also responsible for succession planning and Board evaluation. In making its recommendations, 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.

The Committee met twice during the year and considered the proposed appointment of a new Group Finance Director, Nick Luff, as replacement for Phil Bentley. The Committee also considered:

- the reappointment of Directors retiring by rotation at the 2007 AGM;
- senior management succession planning; and
- talent management.

Corporate Responsibility Committee

During 2007 the Corporate Responsibility Committee comprised Mary Francis (Chairman), Phil Bentley (from 1 March 2007), Deryk King, Sam Laidlaw (from 11 December 2007), Andrew Mackenzie (from 11 December 2007) and Catherine May. Ian Peters and John Way ceased to be members of the Committee on 1 March 2007 and 31 July 2007 respectively. Mark Crosbie, Grant Dawson, Anne Minto, Jake Ulrich and Chris Weston ceased to be members of the Committee on 11 December 2007. A report detailing the work carried out by the Corporate Responsibility Committee during the year is included within the Corporate Responsibility section on pages 28 to 32.

At its November meeting, the Board approved the Committee's revised terms of reference and membership.

Disclosure Committee

The Disclosure Committee, which met on a number of occasions throughout the year, comprised Sam Laidlaw, Nick Luff (from 1 March 2007) and Grant Dawson. Phil Bentley was a member of the Committee until 28 February 2007. The Committee is responsible for implementing and monitoring systems and controls in respect of the management and disclosure of inside information.

Relations with shareholders

The Board recognises the importance of maintaining an effective investor relations and communication programme as part of its ongoing relationship with the Company's shareholders.

Centrica's website contains a wealth of up-to-date information for shareholders including share price information, news releases, annual reports, speeches from the AGM, presentations to the investment community and a section on shareholder services.

At its 2007 AGM, the Company passed a resolution allowing the website to be used as the primary means of communication with its shareholders. This facility provides significant benefits for shareholders and the Company. Shareholders can still opt to receive their communications in a paper format.

The AGM provides all shareholders with the opportunity to develop their understanding of the Company and ask questions of the Board on the matters put to the meeting, including this Annual Report and Accounts. At the AGM, the Chairman and the Chief Executive present a review of the Group's business. All shareholders also have the opportunity to cast their votes in respect of proposed AGM resolutions by proxy, either electronically or by post, at least 48 hours before the start of the meeting.

The Chief Executive and Group Finance Director hold regular meetings with the Company's major shareholders. The Chairman and the Senior Independent Director attend the meetings at which the annual and interim results are presented to major investors and analysts. The Chairman also met a number of major institutional shareholders during the year to gain a first-hand understanding of any issues or concerns they may have had.

Formal reports of investor feedback are included in the papers for each Board meeting. The Board also commissioned an external survey of investors in order to assist in developing an understanding of the views of major shareholders. The results of this survey were circulated to the Directors.

Risk management and internal control

The Board regards the identification and assessment of risks, together with the mitigating internal controls, to be fundamental to achieving the Group's strategic objectives. It either directly or through its committees, sets objectives, performance targets and policies for management of key risks facing the Group. The Board has overall responsibility for the Group's system of internal control and risk management, which is designed to manage rather than eliminate the risk of failure to achieve the objectives and can provide only reasonable, and not absolute, assurance against material misstatement or loss.

Across the Group, each business has a Risk Management Committee that seeks to identify, assess and advise on the management of risks. These assessments are reported to the Group Risk Management Committee to develop the Company's overall risk profile including those risks that might affect the Company at a Group level. Where significant risks have been identified, a control infrastructure has been established to ensure day-to-day monitoring and management of risks. Centrica Storage Ltd, which is subject to undertakings given to the

Corporate Governance Report continued

Secretary of State for Business, Enterprise and Regulatory Reform, operates separately but to the same standards of internal control and risk management as the rest of the Group. The processes of newly acquired companies are integrated with those of the Group.

At each of its four meetings in 2007, the Audit Committee received a Group Risk Report providing an assessment of the key risks facing the Company including the adequacy of the associated controls. Details of the principal risks and uncertainties are set out on pages 25 to 27 of this report. In addition, the Audit Committee is provided with the results of internal audit reviews conducted by the Business Assurance function according to a plan approved by the Committee. These reports, supplemented by management presentations, enable the Audit Committee to track a number of issues, monitor performance against objectives and ensure that necessary actions were taken to remedy any significant failings or weaknesses identified from those reports. The Chairman of the Audit Committee reported the issues discussed and conclusions reached at the following Board meeting.

The Board's review of the system of internal control
A process of hierarchical self-certification has been established throughout the Group whereby the effectiveness of internal controls and compliance with Group business principles and policies is assessed. The results of this certification process, together with the conclusions of the internal reviews by business assurance, informs the annual assessment performed by the Audit Committee.

The Board, with the advice of the Audit Committee, has reviewed the effectiveness of the system of internal control, for the period from 1 January 2007 to the date of this report, and is satisfied that the Group complies with the Turnbull Guidance. The Board will continue to routinely challenge management to ensure the system of internal control is constantly improving.

Going concern
After making enquiries, the Board has a reasonable expectation that the parent Company and the Group as a whole 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 54 to 148.

Directors' responsibility statement

The Directors are responsible for preparing, in respect of each financial year, the Annual Report and Group Financial Statements. They are also responsible for ensuring that the Financial Statements give a true and fair view and that they have been properly prepared in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the European Union.

The Group Financial Statements have been prepared in accordance with the Companies Act 1985 and IFRS pursuant to Article 4 of the IAS Regulations. The Parent Company Financial Statements have been prepared in accordance with the Companies Act 1985 and United Kingdom Generally Accepted Accounting Practice. The Directors' Report and the Remuneration Report have been prepared in accordance with the Companies Act 1985 and the UK Listing Authority Listing Rules.

In preparing the 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.

Disclosure of information to auditors

Each of the Directors who held office at the date of approval of this Directors' Report confirm that: so far as he/she is aware, there is no relevant audit information of which the Company's auditors are unaware; and he/she has taken all steps that he/she ought to have taken as a Director to make him/herself aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

Other Statutory Information

Major acquisitions and disposals
Full details of acquisitions and disposals are disclosed in the Business Review on pages 8 to 22 and note 35 to the Financial Statements on page 130.

Events after the balance sheet date
Events after the balance sheet date are disclosed in note 39 to the Financial Statements on page 137.

Related party transactions
Related party transactions are set out in note 37 to the Financial Statements on pages 134 and 135.

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 2007 was 37 (2006: 32) for the Group (excluding Accord Energy Ltd) and 28 (2006: 32) for the Company.

Share capital
The Company's authorised and issued share capital as at 31 December 2007, together with details of shares issued during the year, is set out in note 29 to the Financial Statements on page 112. Each ordinary share of the Company carries one vote.

Authority to purchase shares
The Company was authorised at the 2007 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 2008 AGM. Shares repurchased may be cancelled or retained as treasury shares to accommodate requirements for shares under the Group's share incentive schemes. No shares were purchased under this authority during 2007.

Material shareholdings
At 20 February 2008, Centrica had received notification of the following material shareholdings pursuant to the Disclosure and Transparency Rules:

	Ordinary shares	% of share capital	Nature of holding
Legal & General Group	194,972,537	5.30	Direct
Legal & General Group	18,637,022	0.51	Indirect
Petronas	145,000,000	3.94	Direct

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

This Directors' Report comprising pages 8 to 41 has been approved by the Board and signed on its behalf by:

G Dawson

Grant Dawson
General Counsel and Company Secretary
21 February 2008
Registered office:
Millstream
Maidenhead Road
Windsor
Berkshire SL4 5GD
Company registered in England and Wales
No. 3033654

Remuneration Report

Composition and role of the Remuneration Committee

Throughout 2007, the Remuneration Committee comprised Helen Alexander (Chairman), Roger Carr, Mary Francis, Andrew Mackenzie, Paul Rayner and Paul Walsh. The Committee met five times during the year. Its 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), the Group Human Resources Director (Anne Minto), the General Counsel and Company Secretary (Grant Dawson), the Chief Executive (Sam Laidlaw) and external consultants.

At its meetings in 2007, the Committee considered, amongst other things, the following:

- the 2006 Remuneration Report;
- the achievement of the performance targets in respect of the 2006 AIS and the vesting of existing awards made under the long-term share-based incentive arrangements;
- levels of base salary;
- the setting of levels of award and performance targets in respect of the 2007 AIS and awards made under the long-term share-based incentive arrangements;
- the proposed terms of appointment of the new Group Finance Director; and
- the effectiveness of the annual incentive scheme (AIS).

During the year, Kepler Associates (Kepler) acted as independent executive remuneration adviser to the Committee, having been formally appointed in 2005. Kepler provided advice on executive compensation to assist in the formulation of the Committee's recommendations. The Committee also consulted, but did not formally appoint, Towers Perrin.

This report, which will be submitted to the forthcoming Annual General Meeting (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 AIS is designed to incentivise and reward the achievement of demanding financial and business-related 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.

The Committee reviews the packages and varies individual elements when appropriate from year to year. Those reviews are conducted with the assistance of Kepler and the internal advisers named above to ensure that the remuneration arrangements continue to provide a strong alignment with the achievement of strategic objectives and 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 and retain high calibre management in a highly challenging business environment. 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.

Having conducted a review against those criteria, the Committee proposed changes in 2006 to the future policy and framework of executive remuneration arrangements, which were endorsed by shareholders upon the approval of the Remuneration Report and new share-based incentive schemes at the 2006 AGM. These new arrangements were fully implemented in 2007 and are described in this report.

In 2007, the Committee conducted a review of the overall effectiveness of the AIS including: the appropriateness of the architecture to ensure that the targets set in the future would satisfy the criteria described above; the robustness of the targets and their evaluation; the target and maximum levels as a proportion of total reward and the degree of stretch in the targets compared with other FTSE 50 companies. Following that review, the Committee approved a number of changes to the AIS architecture and target setting for future years. It was agreed in respect of the Executive Directors that consideration should be given to increasing the target and maximum AIS levels, with some of the increase being linked to individual performance as measured by robust, stretching personal objectives. It was also agreed to introduce a differential in the maximum bonus opportunity between the Chief Executive and the other Executive Directors.

In 2007, executive remuneration comprised base salary, AIS, an allocation of shares under the Long Term Incentive Scheme (LTIS), and an allocation of shares under the new Deferred and Matching Share Scheme (DMSS). No Executive Share Option Scheme (ESOS) grants were made during the year, although the Committee retains the discretion to make grants under the ESOS in the future if there are exceptional circumstances in which it considers it is appropriate to do so.

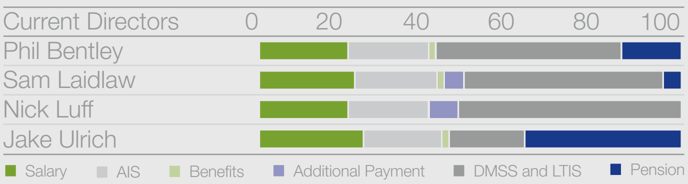
A minimum shareholding policy requires the retention of a value of shares as follows: the Chief Executive – twice his base salary; all other Executive Directors – 1.25 times their base salary; and executives immediately below Board level – base salary. Achievement against this requirement for Executive Directors is set out in the table on page 48.

The Centrica Management Pension Scheme (CMPS) (a contributory final salary arrangement) was closed to new employees on 30 June 2003. Executive Directors in office prior to this date participated in that scheme during 2007. Alternative arrangements are made for new employees, including Executive Directors, after that date. Full disclosure of the pension arrangements for the Executive Directors is given on page 51.

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 currently intended that this remuneration policy and framework, which is fully endorsed by the Board, will continue for 2008 and thereafter.

In 2007, the total emoluments of the Executive Directors, detailed on page 47, consisted of components in the following proportions:

Relative proportions of the components of each Executive Director's remuneration (%): 2007



Note: Salary and benefits are the actual amounts received during 2007; other payments include a salary supplement in lieu of pension paid to Sam Laidlaw and Nick Luff – see page 51; pension, for those Directors in the Centrica Management Pension Scheme, is the increase in actual transfer value for 2007 over the notional transfer value for 2006 less the Director's contributions during 2007; pension for Sam Laidlaw is the actual amount of the contribution made by the Company to his personal pension; AIS is that payable in respect of 2007 as reflected in the emoluments table on page 47; and DMSS and LTIS are the estimated value in accordance with note 2 to the Financial Statements on page 61, of the awards made in 2007, provided that all performance conditions are met in full at the end of the relevant performance periods.

The total emoluments of the five senior executives immediately below Board level for 2007, calculated on the same basis as the emoluments of the Executive Directors detailed on page 47, fell into the following bands:

Bands £000	No. of senior executives
900–1,000	1
800–900	–
700–800	1
600–700	2
500–600	1

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. For members of the CMPS, base salary is the only element of remuneration that is pensionable.

Annual Incentive Scheme (AIS)

At the beginning of each year, the Committee reviews the AIS to ensure that it remains competitive in the marketplace, continues to incentivise the Executive Directors and other executives and aligns their interests with those of shareholders. For 2007, the maximum bonus payable to Executive Directors, should every element of every objective be achieved in full, was 125% of base salary. The maximum bonus payable to executives immediately below Board level, assuming all objectives are achieved in full, ranges between 100% and 125%. In 2007, the maximum achievable bonus related to financial performance targets and business-related targets, split 64% and 36% respectively for Executive Directors and 60% and 40% respectively for executives immediately below Board level. From 2007 20% of any annual bonus paid is deferred automatically and invested in the DMSS (see below). In line with current policy, a bonus will be forfeited if overall performance is deemed to be unsatisfactory. The Committee will also take into consideration performance in relation to corporate responsibility including health, safety and environmental matters when determining the level of bonuses to be paid.

In 2008, the maximum bonus opportunity will be 180% of base salary for the Chief Executive and 150% of base salary for the other Executive Directors.

Deferred and Matching Share Scheme (DMSS)

Following approval at the 2006 AGM, an initial award under the DMSS was made in 2007 to Executive Directors and other senior executives. 20% of the annual bonus payable was deferred automatically for a period of three years and invested in Centrica shares (deferred shares), during which time they cannot be withdrawn. Participants were given the opportunity to invest an additional amount in Centrica shares (investment shares) to be funded from the actual bonus payable which, when added to the value of the deferred shares, would bring the total amount invested up to 50% of the individual's maximum bonus entitlement in respect of 2006. The Remuneration Committee approved certain initial arrangements in respect of Sam Laidlaw (who joined the Company on 1 July 2006 and whose bonus was paid in respect of a half-year only) and Nick Luff (who joined the Company on 1 March 2007 and therefore was not entitled to a bonus in respect of 2006) to ensure that they were incentivised on the same basis as the other Executive Directors. These arrangements, which are explained in detail in the footnotes to the table on page 49, involved those participants investing their own funds into the scheme as investment shares up to an amount equal to 50% of the maximum bonus opportunity that they would have been entitled to had they been employed throughout 2006. Deferred and investment shares were matched with conditional shares (matching shares), which will be released upon the achievement of a performance target (see table on page 44). For the purposes of matching, the investment shares are grossed up for income tax and National Insurance contributions. To provide a closer alignment with the interests of shareholders, the number of matching 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. In the event of a change of control the number of matching shares that vest will be subject to time-apportionment in line with best practice.

Remuneration Report continued

Long Term Incentive Scheme (LTIS)

Conditional allocations of shares up to a maximum of 200% of base salary may be made to Executive Directors and other senior executives under the LTIS approved by shareholders at the 2006 AGM.

In 2007, LTIS allocations equal to 200% of base salary were awarded to Executive Directors and, at lower rates, to other senior executives. Before approving the maximum permitted allocation of LTIS for the Executive Directors, the Remuneration Committee carefully considered the adjusted earnings per share (EPS) performance condition attaching to the award to ensure it was sufficiently stretching. Having reviewed the challenging growth and cost reduction targets inherent in the strategic plan, the Committee concluded that the proposed EPS growth target (to exceed the Retail Prices Index (RPI) by 30% or more over the performance period for full vesting) was sufficiently stretching, but nevertheless agreed that a proportion of the increased award should be subject to an even more demanding performance condition as summarised below. The maximum number of shares that could be transferred to each Executive Director upon satisfaction of the performance conditions in full appears on page 49. The release of allocations will be subject to the performance conditions set out in the table below.

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. In the event of a change of control the number of shares that vest will be subject to time-apportionment in line with best practice.

Performance Condition Summary

Deferred and Matching Share Scheme

Award Year	Vesting Criteria	Performance Condition over three-year period
2007	100% of matching shares on three-year cumulative group economic performance profit (EP) performance targets	2:1 match will be achieved for cumulative EP growth of 25% or more. Zero matching for no cumulative EP growth. Vesting of matching shares will increase on a straight-line basis between points.

Long Term Incentive Scheme

Award Year	Vesting Criteria	Performance Condition over three-year period
2007	50% on EPS† growth against RPI growth	37.5%; full vesting for EPS† growth exceeding RPI growth by 30%. Zero vesting if EPS† growth fails to exceed RPI growth by 9%. Vesting will increase on a straight-line basis between 25% and 100% if EPS† growth exceeds RPI growth by between 9% and 30%.
		12.5%; full vesting for EPS† growth exceeding RPI growth by 40%. Zero vesting if EPS† growth fails to exceed RPI growth by 20%. Vesting will increase on a straight-line basis between 25% and 100% if EPS† growth exceeds RPI growth by between 20% and 40%.
	50% on TSR against FTSE 100*	Full vesting for upper quintile ranking. Zero vesting for sub-median ranking. Vesting will increase on a straight-line basis for ranking between median and upper quintile.
2006	50% on EPS† growth against RPI growth	Full vesting for EPS† growth exceeding RPI growth by 30%. Zero vesting if EPS† growth fails to exceed RPI growth by 9%. Vesting will increase on a straight-line basis between 25% and 100% if EPS† growth exceeds RPI growth by between 9% and 30%.
	50% on TSR against FTSE 100*	Full vesting for upper quintile ranking. Zero vesting for sub-median ranking. Vesting will increase on a straight-line basis for ranking between median and upper quintile.
2004–2005	100% on TSR against FTSE 100*	Full vesting for upper quartile ranking. Zero vesting for sub-median ranking. Vesting will increase on a sliding-scale basis for ranking between median and upper quartile.

Executive Share Option Scheme

Award Year	Vesting Criteria	Performance Condition over three-year period
2001–2006	100% of options based on EPS† growth against RPI growth. Retesting for further two years for options granted up to and including April 2004.	Full vesting for EPS† growth exceeding RPI growth by 18%. Zero vesting if EPS† growth fails to exceed RPI growth by 9%. Vesting will increase on a straight-line basis between 40% and 100% if EPS† growth exceeds RPI growth by between 9% and 18%.

* The Committee has determined that, for the pre 2006 LTIS and for that part of the new LTIS subject to the comparative TSR performance conditions, 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).

† EPS represents the Group's adjusted earnings per share.

Prior to 2006, allocations of shares were made annually to Executive Directors and other senior executives under the old LTIS, in accordance with the remuneration policy adopted in 2001. Such allocations were subject to a performance condition as set out in the table below.

Prior to the release of share allocations under both the old and new LTIS arrangements, the Committee reviews whether the extent to which the performance conditions have been achieved is a genuine reflection of the Company's financial performance. In assessing the extent of satisfaction of the performance conditions, the Committee uses data provided by Alithos Ltd (an independent third party) in respect of comparative TSR and audited figures in respect of EPS.

Executive Share Option Scheme (ESOS)

No grants of options were made during 2007. Details of options granted prior to 2007 and still held by Executive Directors are shown on page 50.

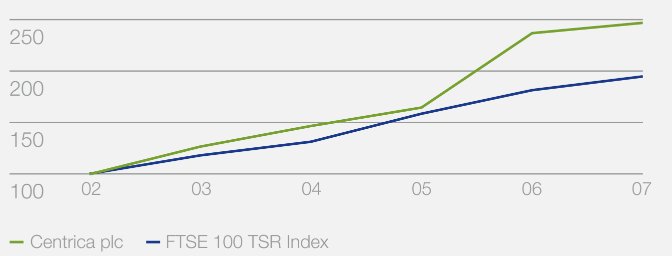
If, and to the extent that, performance conditions are satisfied, options normally become exercisable three years after the date of grant and remain so until the tenth anniversary of grant.

The EPS performance conditions in respect of options granted from 2001 to March 2004 under the ESOS (as set out in the table on page 44) can 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, the Committee removed the provision for retesting of performance measures in respect of all option grants from September 2004.

Performance conditions under IFRS

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 in respect of the AIS and new DMSS; and EPS in respect of the ESOS and the new LTIS, both subject to certain adjustments to the figures calculated in accordance with IFRS. It was agreed that for the purposes of determining performance in respect of those schemes, the relevant figures produced under IFRS should be adjusted for exceptional items and certain re-measurements arising on the application of IAS 32 and IAS 39.

Total Shareholder Return Indices – Centrica and FTSE 100 Index for the five years ended 31 December 2007



Source: Alithos Ltd
31 December 2002 = 100

The graph below compares the Company's TSR performance with that of the FTSE 100 Index for the five years ended 31 December 2007.

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 period, the TSR graph for the LTIS award that vested in April 2007 is shown on page 50.

Funding of share schemes

It is the Company's current intention to satisfy the requirements of its share schemes, in a method best suited to the interests of the Company, either by acquiring shares in the market or, subject to institutional guidelines, issuing new shares or using shares held in treasury. To satisfy the release of shares under the LTIS and meet the requirements of the ESOS in 2007, newly-issued shares were used.

Pension

The pension arrangements of the Executive Directors are fully disclosed on page 51.

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. Sam Laidlaw and Jake Ulrich were also provided with a driver for limited personal mileage. Such benefits are subject to financial limits as set out in appropriate policies. 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. 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.

In the case of new external appointments to the Board, the Committee retains a level of flexibility, as permitted by the Code, in order to attract and retain suitable candidates. It therefore reserves the right to offer contracts which contain an initial notice period in excess of one year, provided that at the end of the first such period the notice reduces to one year. The Committee exercised this discretion in respect of the appointment of Sam Laidlaw on 1 July 2006 and Nick Luff on 1 March 2007. Each has a service contract that contains a notice period of two years, which will reduce to one year on the second anniversary of their respective date of appointment.

The dates of the Executive Directors' service contracts are set out in the table on page 47.

Remuneration Report continued

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 2007, Phil Bentley received £65,625 as a Non-Executive Director of Kingfisher plc, Sam Laidlaw received £37,556 as a Non-Executive Director of Hanson plc and, in respect of the period he was a Director of the Company, Nick Luff received £35,083 as a Non-Executive Director of QinetiQ Group 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 47. 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 (Sam Laidlaw, Phil Bentley, Nick Luff and Jake Ulrich) and five other senior executives (Grant Dawson, Deryk King, Catherine May, Anne Minto and Chris Weston) whose biographies are included on pages 34 and 35.

Centrica's policy on Non-Executive Directors' fees takes into account the need to attract individuals of the right calibre and experience, 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	£450,000
Other Non-Executive Directors	£60,000
Additional fees:	
Chairman of Audit Committee	£18,000
Chairman of Remuneration Committee	£12,000
Chairman of Corporate Responsibility Committee	£12,000
Senior Independent Director	£20,000

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 42 to page 46 up to this statement has not been audited. From this point until the end of the report on page 51, the disclosures, with the exception of the graph on page 50, have been audited by the Company's auditors, PricewaterhouseCoopers LLP.

Directors' emoluments

		Base salary/fees £000	Annual incentive scheme (AIS) £000 (i)	Additional payments £000 (ii)	Benefits £000 (iii)	**Total emoluments 2007 £000 (iv)**	Total emoluments 2006 £000 (iv)
Executive Directors	Date of service contract						
Phil Bentley	13 September 2000	567	516	–	42	**1,125**	1,136
Sam Laidlaw(v)	1 July 2006	873	753	180	64	**1,870**	1,079
Nick Luff	1 March 2007	442	399	145	3	**989**	–
Jake Ulrich (vi)	1 January 2005	567	427	–	39	**1,033**	1,102
		2,449	2,095	325	148	**5,017**	3,317
Non-Executive Directors	Date of appointment						
Helen Alexander	1 January 2003	69	–	–	–	**69**	60
Roger Carr	1 January 2001	413	–	–	–	**413**	344
Mary Francis	22 June 2004	84	–	–	–	**84**	56
Andrew Mackenzie	1 September 2005	58	–	–	–	**58**	50
Paul Rayner	23 September 2004	75	–	–	–	**75**	65
Paul Walsh	1 March 2003	58	–	–	–	**58**	50
		757	–	–	–	**757**	625
Past Directors	Date of cessation						
Mark Clare	30 September 2006	–	–	–	–	**–**	412
Sir Roy Gardner	30 June 2006	–	–	–	–	**–**	784
Patricia Mann	19 May 2006	–	–	–	–	**–**	21
							1,217
Total emoluments		3,206	2,095	325	148	**5,774**	5,159

(i) Of the AIS bonus agreed by the Remuneration Committee, 80% is paid in cash and is included above. 20% of the agreed AIS bonus (25% of the amounts shown under the AIS column above) is deferred automatically and invested as deferred shares in the Deferred and Matching Share Scheme (DMSS) – see pages 48 and 49.

(ii) Sam Laidlaw is contractually entitled to a salary supplement of 40% of base pay in lieu of any pension provision. This amounted to £349,180 in 2007 of which £168,750 was paid directly by the Company into his personal pension plan and is disclosed in the notes on page 51. The balance of £180,430 is included above under the heading 'Additional payments'. Nick Luff is contractually entitled to a salary supplement of 30% of base pay in lieu of any pension provision. This amount is included above under the heading 'Additional payments'. Cash payment in lieu of provision of a company car paid to Nick Luff is also included under the heading 'Additional payments'.

(iii) Benefits include all taxable benefits arising from employment by the Company, including the provision of a car (Sam Laidlaw and Jake Ulrich were also provided with a driver for limited personal mileage), financial counselling, medical insurance and life assurance premiums.

(iv) The following are excluded from the table above:
  (a) pensions – see page 51;
  (b) share options – see page 50. The aggregate of the amount of gains made by Executive Directors on the exercise of share options was £615,839 (2006: £3,462,389); and
  (c) Long Term Incentive Scheme (LTIS) – see pages 48 and 49. The aggregate value of shares vested to Executive Directors under the LTIS was £2,211,361 (2006: £2,352,203).

(v) The 2006 total emoluments figure in respect of Sam Laidlaw is for the six-month period 1 July 2006 (being the date of his appointment to the Board) to 31 December 2006. It includes an additional payment of £255,000 (being the balance of an initial payment to him that was not paid in to his personal pension plan and a salary supplement of 40% of base pay in lieu of any pension provision).

(vi) The 2006 total emoluments figure in respect of Jake Ulrich includes an amount of £22,000 that was paid to him in 2006 in respect of the non-payment of a car allowance for 2005 that he was contractually entitled to.

Remuneration Report continued

Directors' interests in shares

The following table and the tables on pages 49 and 50 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 2007	Shareholdings as at 31 December 2007	Shareholdings as at 1 January 2007 or on appointment (i)	DMSS total matching shares as at 31 December 2007	DMSS total matching shares as at 1 January 2007 or on appointment (i)	LTIS total allocations of shares as at 31 December 2007	LTIS total allocations of shares as at 1 January 2007 or on appointment (i)
Executive Directors						
Phil Bentley (ii) (iii)	**623,718**	460,880	**181,727**	–	**740,346**	606,064
Sam Laidlaw (ii) (iii)	**341,964**	200,106	**272,431**	–	**891,320**	431,837
Nick Luff (i) (ii) (iii)	**200,255**	200,000	**169,871**	–	**276,545**	–
Jake Ulrich (ii) (iii)	**861,229**	719,341	**181,726**	–	**743,626**	613,998
Non-Executive Directors						
Helen Alexander	**2,520**	2,520	**–**	–	**–**	–
Roger Carr	**19,230**	19,230	**–**	–	**–**	–
Mary Francis	**981**	981	**–**	–	**–**	–
Andrew Mackenzie	**21,000**	21,000	**–**	–	**–**	–
Paul Rayner	**5,000**	5,000	**–**	–	**–**	–
Paul Walsh	**4,500**	4,500	**–**	–	**–**	–

(i) Shareholdings and LTIS allocations are shown as at 1 January 2007 or in the case of Nick Luff, 1 March 2007, his date of appointment.
(ii) As at 21 February 2008, the beneficial shareholdings of Phil Bentley and Jake Ulrich had each increased by 113 shares and those of Sam Laidlaw and Nick Luff had increased by 114 shares acquired through the Share Incentive Plan.
(iii) Executive Directors' shareholdings above include those held in the Share Incentive Plan and the deferred and investment shares held in the DMSS. Matching shares held in the DMSS and shares held in the LTIS are provided separately in the table above and in more detail in their respective tables on page 49.

From 1 January 2007 to 21 February 2008, 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.

Executive Directors' Minimum Shareholding Policy

As stated on page 42, the Executive Directors are required to hold shares with a value based on a multiple of their base salary. Under that policy the Executive Directors have a period of five years in which to achieve their minimum shareholding requirement. The table below sets out, in respect of each Executive Director, their requirement and achievement as at 31 December 2007 against that requirement.

Directors as at 31 December 2007	Base salary £000	Value of shareholdings £000 (i)	Minimum shareholding requirement as % of base salary	Actual shareholding as % of base salary	Target to be achieved by
Executive Directors					
Phil Bentley	**567**	**2,238**	**125**	**395**	–
Sam Laidlaw	**881**	**1,227**	**200**	**139**	30 June 2011
Nick Luff	**530**	**718**	**125**	**136**	–
Jake Ulrich	**567**	**3,090**	**125**	**545**	–

(i) The value of shareholdings is based on the closing price of a Centrica ordinary share on the last trading day of 2007 (31 December) of 358.75 pence.

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

	Total number of deferred, investment and transferred shares held in the DMSS at 31 December 2007 (i) (ii) (iii)	Total number of conditional matching shares held in the DMSS at 31 December 2007 (ii) (iii)
Phil Bentley	65,507	181,727
Sam Laidlaw	88,451	272,431
Nick Luff	50,112	169,871
Jake Ulrich	64,368	181,726
Market price at allocation date	391.50p	391.50p
End of performance period	3 Apr 2010	3 Apr 2010

(i) Normally, 20% of gross bonus (before the deduction of income tax and National Insurance contributions) is automatically deferred and invested in Centrica shares (deferred shares).
Participants have the opportunity to make a further investment (investment shares), funded from net annual performance bonus, so that the maximum total investment (on a gross basis) is 50% of the individual's maximum bonus entitlement for the preceding year.
Certain initial arrangements were agreed in respect of Sam Laidlaw and Nick Luff who joined the Board on 1 July 2006 and 1 March 2007 respectively. Sam Laidlaw invested his entire bonus paid in respect of the period 1 July to 31 December 2006. He also transferred shares into the scheme that he already held, such that the total value of the investment as calculated on the basis as set out above was equal to 50% of the maximum bonus opportunity had he been employed for the whole year. Nick Luff transferred shares into the scheme that he already held equal in value to 50% of the maximum bonus opportunity had he been employed for the whole of 2006.

(ii) The calculation of the conditional matching shares is made on a gross basis. Investment shares are grossed up (to reflect the impact of income tax and National Insurance contributions) for the calculation of the matching shares so that the deferred and investment shares are matched on the same basis. The number of matching shares that 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 over a three-year period. The number of matching shares that will be 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. Dividends are paid on the deferred and investment shares to the participants on the normal dividend payment date.

(iii) The scheme commenced in 2007. The purchase of deferred and investment shares, the transfer of shares already held and the conditional award of matching shares were made on 4 April 2007.

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

	Vested during 2007	In performance period			
Date of allocation	1 April 2004 (i)	1 April 2005 (ii)	3 April 2006 (iii)(iv)	4 September 2006 (iii)	4 April 2007 (iii)
Phil Bentley	161,569	165,646	278,849	–	295,851
Sam Laidlaw	–	–	–	431,837	459,483
Nick Luff	–	–	–	–	276,545
Jake Ulrich	166,223	168,926	278,849	–	295,851
Market price at allocation date	232.00p	228.00p	284.00p	302.50p	391.50p
End of performance period	31 Mar 07	31 Mar 08	31 Mar 09	31 Aug 09	31 Mar 10
Market price at vesting date (i)	386.00p				

(i) At the end of the performance period to 31 March 2007, the Company ranked 38th in the relevant comparator group. Accordingly, 78.3% of the original allocations were released to participants on 4 April 2007. 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 2007 on page 48.

(ii) 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.

(iii) The percentage of the allocation eventually to vest is dependent on the satisfaction of performance criteria over a three-year performance period: half of the shares (EPS shares) will be subject to a performance condition based on the Group's adjusted EPS growth relative to the growth in RPI over three financial years. EPS growth will be calculated by comparing the Group's adjusted EPS figure for the financial period preceding the date of allocation with that for the financial period three years later; and half of the shares will be determined by the Company's Total Shareholder Return (TSR) performance relative to the other companies comprising the LTIS comparator group – the FTSE 100 at the start of the three-year performance period (the TSR shares). At the end of the performance period, the TSR performance condition will be measured, the same calculation made for all the other 99 companies in the LTIS comparator group and a ranking list will be compiled.

(iv) The first awards under the new LTIS (approval was sought and given by shareholders at the AGM held on 19 May 2006) were made to participants other than the Executive Directors on 3 April 2006 (on the date that allocations would normally be made under the previous LTIS and within the 42-day period following the release of the Company's annual results). The awards to the Executive Directors then in office could only be made after shareholder approval, but in order to align their awards with those of other participants, their first awards were deemed to have been made on 3 April 2006 for all purposes of the new LTIS, including the calculation of the number of shares, the adjusted EPS and relative TSR performance tests and the three-year vesting period.

Remuneration Report continued

The following graph, provided by Alithos Ltd (an independent third party), shows the TSR performance of the Company and that of the relevant TSR comparator group. It has not been audited by the Company's auditors, PricewaterhouseCoopers LLP. It relates to the 2004 LTIS allocations that vested in 2007.

TSR Indices – Centrica and LTIS comparator group
April 2004 LTIS allocation – period from 1 April 2004 to 31 March 2007

Source: Alithos Ltd
1 April 2004 = 100

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 2007	Options granted during the year	Options exercised during the year	Options lapsed during the year	**Options held as at 31 December 2007**	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	Mar 2015
ESOS (i)	371,799	–	–	–	**371,799**	285.10	Apr 2009	Apr 2016
Sharesave (ii)	5,161	–	5,161	–	**–**	182.60	Jun 2007	Nov 2007
Sharesave (ii)	–	3,244	–	–	**3,244**	291.30	Jun 2010	Nov 2010
	2,452,940	3,244	5,161	–	**2,451,023**			
Sam Laidlaw								
Sharesave (ii)	–	3,244	–	–	**3,244**	291.30	Jun 2010	Nov 2010
	–	3,244	–	–	**3,244**			
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	–	356,145	–	**63,591**	223.95	Mar 2007	Mar 2014
ESOS (i)	450,470	–	–	–	**450,470**	228.65	Apr 2008	Mar 2015
ESOS (i)	371,799	–	–	–	**371,799**	285.10	Apr 2009	Apr 2016
Sharesave (ii)	–	3,244	–	–	**3,244**	291.30	Jun 2010	Nov 2010
	2,559,895	3,244	356,145	–	**2,206,994**			

(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, 1 April 2005 and 3 April 2006. Details of the operation of the scheme are provided on pages 44 and 45.

(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.

The closing price of a Centrica ordinary share on the last trading day of 2007 (31 December) was 358.75 pence. The range during the year was 335.00 pence (low) and 397.00 pence (high).

Directors' pensions

Of the four Executive Directors, Phil Bentley and Jake Ulrich are members of the Centrica Management Pension Scheme (CMPS). Sam Laidlaw and Nick Luff, who joined the Company in recent years, are not members of any of Centrica's pension schemes.

CMPS

The CMPS is a funded, HMRC-registered, 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 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. Contributions made by the Executive Directors who are also members of the Centrica Unapproved Pension Scheme (CUPS) are payable at the rate of 6% of their total pensionable earnings above the scheme earnings cap;
- 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 registered scheme benefits are subject to HMRC limits. Where these limits would restrict the pension promise due, the CUPS provides benefits on the salary in excess of the CMPS earnings cap to the level that would otherwise have been paid by the registered scheme. The benefits that arise under this are treated as being subject to the same rules as apply in respect of the registered 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 the accrued value of these benefits has been made in the Company's balance sheet.

Pension benefits earned by Directors in the CMPS (£)

	Accrued pension as at 31 December 2007 (i)	Accrued pension as at 31 December 2006	Increase in accrued pension less inflation (ii)	**Transfer value as at 31 December 2007**	Transfer value as at 31 December 2006	**Contribution paid in 2007**	Difference in transfer value less contributions	Transfer value of increase in accrued pension excluding inflation
Phil Bentley	**126,900**	107,500	15,208	**1,396,800**	978,700	**34,020**	384,080	124,000
Jake Ulrich	**212,600**	186,800	18,515	**3,200,500**	2,312,600	**34,020**	853,880	217,400

(i) Accrued pension is that which would be paid annually on retirement at age 62, based on eligible service to and pensionable salary at 31 December 2007. The pension accrual rates for 2007 for Phil Bentley and Jake Ulrich were, 2.65% and 3.71% respectively.
(ii) The increase in accrued pension has been adjusted to exclude inflation by revaluing the accrued pension as at 31 December 2006 by the rate of inflation (3.9%) and deducting this from the accrued pension as at 31 December 2007. The rate of inflation used was 3.9%, the annual rate to 30 September 2007, the date used for pension increases under the scheme.

Pay in lieu of pension provision

Under the terms of their contracts of employment, Sam Laidlaw and Nick Luff are entitled to a salary supplement in lieu of pension provision of 40% and 30% of base salary, respectively. With the exception of £168,750 paid directly by the Company into Sam Laidlaw's personal pension plan, these amounts are disclosed in the Directors' emoluments table on page 47.

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
21 February 2008

Independent Auditors' Report to the Members of Centrica plc

Independent Auditors' report to the members of Centrica plc

We have audited the Group Financial Statements of Centrica plc for the year ended 31 December 2007 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 2007 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 members 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 whether, in our opinion the information given in the Directors' Report (comprising the Directors' Report – Business Review and the Directors' Report – Governance) is consistent with the Group Financial Statements.

In addition we report to you if, in our opinion, 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 Report reflects the Company's compliance with the nine provisions of the Combined Code (2006) 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 Chairman's Statement, the Directors' Report, the Gas and Liquids Reserves, Five Year Record and Shareholder Information. 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 2007 and of its profit and cash flows for the year then ended;
- the Group Financial Statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation; and
- the information given in the Directors' Report is consistent with the Group Financial Statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
21 February 2008

Financial Statements

Group Income Statement

Year ended 31 December	Notes	2007 Results for the year before exceptional items and certain re-measurements (i) £m	2007 Exceptional items and certain re-measurements (i) £m	2007 Results for the year £m	2006 (restated) (ii) Results for the year before exceptional items and certain re-measurements (i) £m	2006 (restated) (ii) Exceptional items and certain re-measurements (i) £m	2006 (restated) (ii) Results for the year £m
Continuing operations							
Group revenue	6	**16,342**	**–**	**16,342**	16,403	–	16,403
Cost of sales (ii)	7	**(12,217)**	**–**	**(12,217)**	(12,764)	–	(12,764)
Re-measurement of energy contracts (i)	6,8	**–**	**244**	**244**	–	(916)	(916)
Gross profit		**4,125**	**244**	**4,369**	3,639	(916)	2,723
Operating costs before exceptional items (ii)		**(2,190)**	**–**	**(2,190)**	(2,250)	–	(2,250)
Systems write-down	8	**–**	**–**	**–**	–	(196)	(196)
Business restructuring costs	8	**–**	**–**	**–**	–	(87)	(87)
Rough storage incident	8	**–**	**–**	**–**	–	(48)	(48)
Operating costs (ii)	7	**(2,190)**	**–**	**(2,190)**	(2,250)	(331)	(2,581)
Share of profits/(losses) in joint ventures and associates, net of interest and taxation (i)	8,18	**14**	**(9)**	**5**	3	(15)	(12)
Group operating profit	6	**1,949**	**235**	**2,184**	1,392	(1,262)	130
Interest income	10	**258**	**–**	**258**	105	–	105
Interest expense	10	**(331)**	**–**	**(331)**	(246)	–	(246)
Net interest expense	10	**(73)**	**–**	**(73)**	(141)	–	(141)
Profit/(loss) from continuing operations before taxation		**1,876**	**235**	**2,111**	1,251	(1,262)	(11)
Taxation on profit from continuing operations	11	**(753)**	**(60)**	**(813)**	(549)	363	(186)
Profit/(loss) from continuing operations after taxation		**1,123**	**175**	**1,298**	702	(899)	(197)
Profit/(loss) from discontinued operations (i)	35	**1**	**(19)**	**(18)**	14	37	51
Gain/(loss) on disposal of discontinued operations	35	**–**	**227**	**227**	(8)	–	(8)
Discontinued operations		**1**	**208**	**209**	6	37	43
Profit/(loss) for the year		**1,124**	**383**	**1,507**	708	(862)	(154)
Attributable to:							
Equity holders of the parent		**1,122**	**383**	**1,505**	707	(862)	(155)
Minority interests	31	**2**	**–**	**2**	1	–	1
		1,124	**383**	**1,507**	708	(862)	(154)
		Pence		**Pence**	Pence		Pence
Earnings/(loss) per ordinary share							
From continuing and discontinued operations:							
Basic	13			**41.0**			(4.3)
Adjusted basic	13	30.6			19.4		
Diluted	13			**40.3**			(4.3)
From continuing operations:							
Basic	13			**35.3**			(5.4)
Adjusted basic	13	30.5			19.2		
Diluted	13			**34.7**			(5.4)
Interim dividend paid per share	12			**3.35**			3.15
Final dividend proposed per share	12			**9.65**			8.00

(i) Certain re-measurements (notes 2 and 8) included within operating profit comprise re-measurement arising on our energy procurement activities and re-measurement of proprietary trades in relation to cross-border transportation or capacity contracts. Certain re-measurements included within profit from discontinued operations 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-measurements.

(ii) Restated to present costs incurred under the energy savings programmes in cost of sales and to present The Consumers' Waterheater Income Fund as a discontinued operation. Note 2 details the change of accounting presentation and note 3 details the deconsolidation of The Consumers' Waterheater Income Fund.

The notes on pages 58 to 138 form part of these Financial Statements.

Group Balance Sheet

31 December	Notes	2007 £m	2006 (restated) (i) £m
Non-current assets			
Goodwill	14	**1,074**	1,055
Other intangible assets	15	**465**	446
Property, plant and equipment	17	**3,910**	3,655
Interests in joint ventures and associates	18	**285**	220
Deferred tax assets	26	**27**	226
Trade and other receivables	20	**33**	16
Derivative financial instruments	21	**72**	17
Available-for-sale financial assets	28	**39**	37
Retirement benefit assets	34	**152**	–
		6,057	5,672
Current assets			
Inventories	19	**241**	270
Current tax assets	26	**40**	98
Trade and other receivables	20	**3,423**	3,590
Derivative financial instruments	21	**914**	760
Available-for-sale financial assets	28	**50**	49
Cash and cash equivalents	23	**1,130**	640
		5,798	5,407
Total assets		**11,855**	11,079
Current liabilities			
Trade and other payables	24	**(3,371)**	(3,291)
Current tax liabilities		**(281)**	(180)
Bank overdrafts, loans and other borrowings	25	**(221)**	(181)
Derivative financial instruments	21	**(1,404)**	(1,737)
Provisions for other liabilities and charges	27	**(140)**	(130)
		(5,417)	(5,519)
Net current assets/(liabilities)		**381**	(112)
Non-current liabilities			
Trade and other payables	24	**(20)**	(55)
Bank loans and other borrowings	25	**(1,793)**	(2,555)
Derivative financial instruments	21	**(11)**	(220)
Deferred tax liabilities	26	**(596)**	(241)
Retirement benefit obligations	34	**(55)**	(296)
Provisions for other liabilities and charges	27	**(581)**	(551)
		(3,056)	(3,918)
Net assets		**3,382**	1,642
Equity			
Called up share capital	29,30	**227**	226
Share premium account	30	**685**	657
Merger reserve	30	**467**	467
Capital redemption reserve	30	**16**	16
Other reserves	30	**1,928**	219
Shareholders' equity	30	**3,323**	1,585
Minority interests in equity	31	**59**	57
Total minority interests and shareholders' equity		**3,382**	1,642

(i) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet. Note 2 details the change of accounting presentation.

The Financial Statements on pages 54 to 138 were approved and authorised for issue by the Board of Directors on 21 February 2008 and were signed below on its behalf by:

Sam Laidlaw
Chief Executive

Nick Luff
Group Finance Director

The notes on pages 58 to 138 form part of these Financial Statements.

Financial Statements continued

Group Statement of Recognised Income and Expense

Year ended 31 December	Notes	2007 £m	2006 £m
Profit/(loss) for the year		**1,507**	(154)
Gains on revaluation of available-for-sale investments	30	**1**	–
Gains/(losses) on cash flow hedges	30	**169**	(645)
Exchange differences on translation of foreign operations	30	**15**	(23)
Actuarial gains on defined benefit pension schemes	30	**284**	475
Tax on items taken directly to equity	30	**(120)**	73
Net income/(expense) recognised directly in equity		**349**	(120)
Transferred to income and expense on cash flow hedges	30	**382**	(294)
Exchange differences transferred to income and expense on disposal of subsidiaries	30, 35	**(4)**	–
Tax on items transferred from equity	30	**(128)**	96
Transfers		**250**	(198)
Total recognised income and expense for the year		**2,106**	(472)
Total income and expense recognised in the year is attributable to:			
Equity holders of the parent		**2,104**	(473)
Minority interests		**2**	1
		2,106	(472)

The notes on pages 58 to 138 form part of these Financial Statements.

Group Cash Flow Statement

Year ended 31 December	Notes	2007 £m	2006 (restated) (i) £m
Operating cash flows before movements in working capital	32	**2,494**	1,892
Decrease/(increase) in inventories		**38**	(83)
Decrease/(increase) in receivables		**181**	(259)
Increase/(decrease) in payables		**44**	(150)
Cash generated from continuing operations		**2,757**	1,400
Interest received		**27**	13
Interest paid		**(3)**	(9)
Tax paid		**(401)**	(627)
Payments relating to exceptional charges		**(90)**	(113)
Net cash flow from continuing operating activities	32	**2,290**	664
Net cash flow from discontinued operating activities	32	**67**	73
Net cash flow from operating activities		**2,357**	737
Purchase of interests in subsidiary undertakings and businesses net of cash and cash equivalents acquired	35	**(262)**	(97)
Disposal of interests in subsidiary undertakings and businesses net of cash and cash equivalents disposed	35	**–**	(3)
Purchase of intangible assets (i)		**(185)**	(167)
Disposal of intangible assets		**14**	13
Purchase of property, plant and equipment (i)		**(563)**	(489)
Disposal of property, plant and equipment (i)		**76**	15
Investments in joint ventures and associates		**(45)**	(16)
Disposal of interests in associates and other investments		**–**	4
Interest received		**63**	40
Net (purchase)/sale of other financial assets		**(2)**	5
Net cash flow from continuing investing activities		**(904)**	(695)
Net cash flow from discontinued investing activities		**(60)**	(25)
Net cash flow from investing activities		**(964)**	(720)
Repurchase of ordinary share capital		**–**	(23)
Issue of ordinary share capital		**22**	56
Purchase of treasury shares		**(2)**	–
Interest paid in respect of finance leases		**(110)**	(43)
Other interest paid		**(114)**	(136)
Interest paid		**(224)**	(179)
Cash inflow from additional debt		**256**	838
Cash outflow from payment of capital element of finance leases		**(383)**	(21)
Cash outflow from repayment of other debt		**(107)**	(880)
Net cash flow from decrease in debt		**(234)**	(63)
Realised net foreign exchange loss on cash settlement of derivative contracts		**(8)**	(21)
Equity dividends paid		**(417)**	(384)
Net cash flow from continuing financing activities		**(863)**	(614)
Net cash flow from discontinued financing activities		**(25)**	17
Net cash flow from financing activities		**(888)**	(597)
Net increase/(decrease) in cash and cash equivalents		**505**	(580)
Cash and cash equivalents at 1 January (ii)		**592**	1,177
Effect of foreign exchange rate changes		**3**	(5)
Cash and cash equivalents at 31 December (ii)	23	**1,100**	592

(i) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet and to present The Consumers' Waterheater Income Fund as a discontinued operation. Note 2 details the change of accounting presentation and note 3 explains the deconsolidation of The Consumers' Waterheater Income Fund.

(ii) Cash and cash equivalents are stated net of overdrafts of £30 million (2006: £48 million).

The notes on pages 58 to 138 form part of these Financial Statements.

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Notes to the Financial Statements

1. General information

Centrica plc is a Company domiciled and incorporated in the United Kingdom under the Companies Act 1985. The address of the registered office is given on page 41. The nature of the Group's operations and its principal activities are set out in note 6 and in the Directors' Report – Business Review on pages 8 to 32.

The consolidated Financial Statements of Centrica plc are presented in pounds sterling. Operations and transactions conducted in currencies other than pounds sterling are included in the consolidated Financial Statements in accordance with the foreign currencies accounting policy set out in note 2.

2. Summary of significant accounting policies

The principal accounting policies applied in the preparation of these consolidated Financial Statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The consolidated Financial Statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as adopted by the European Union (EU) 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, and the assets and liabilities of the Group pension schemes 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 preparation of Financial Statements in conformity with IFRS requires the use of certain critical accounting estimates. It requires management to exercise its judgement in the processes of applying the Group's accounting policies. The areas involving a higher degree of judgement, complexity or areas where assumptions and estimates are significant to the consolidated Financial Statements are described in note 3.

(a) Standards, amendments and interpretations effective in 2007

In the current year the Group has adopted IFRS 7, Financial Instruments: Disclosures, which is effective for annual reporting periods beginning on or after 1 January 2007, and the related amendments to IAS 1, Presentation of Financial Statements. The impact of the adoption of IFRS 7 and the changes to IAS 1 has been to expand the disclosures provided in these Financial Statements regarding the Group's financial instruments and management of capital.

Four interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are IFRIC 7, Applying the Restatement Approach under IAS 29, Financial Reporting in Hyperinflationary Economies; IFRIC 8, Scope of IFRS 2; IFRIC 9, Re-assessment of Embedded Derivatives; and IFRIC 10, Interim Financial Reporting and Impairment. The adoption of these interpretations has not led to any changes in the Group's accounting policies.

(b) Standards, amendments and interpretations that are not yet effective and that have not been early adopted by the Group

At the date of authorisation of these Financial Statements, the following standards, amendments to existing standards and interpretations which have not been applied in these Financial Statements were in issue but not yet effective:

- IAS 23 (Amendment), Borrowing Costs, effective from 1 January 2009. The amendment to this standard is subject to EU endorsement. It requires an entity to capitalise borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset (one that takes a substantial period of time to get ready for use or sale) as part of the cost of that asset. The option of immediately expensing such borrowing costs will be removed. The Group intends to apply IAS 23 (Amended) from 1 January 2008, subject to endorsement by the EU. Subject to being endorsed, it will require a change to the Group's existing accounting policy, where such costs are immediately expensed;
- IFRS 8, Operating Segments, effective from 1 January 2009. This standard replaces IAS 14, Segment Reporting and requires segmental information reported to be based on that which Directors use internally for evaluating the performance of operating segments. The Group will apply IFRS 8 from 1 January 2009. The impact of adopting IFRS 8 is under assessment;
- IFRS 3 (Revised), Business Combinations was issued on 10 January 2008 and is subject to EU endorsement. It is applicable to business combinations effected on or after 1 January 2010, with earlier application permitted. The impact of adopting IFRS 3 in future periods will be considered in the event of a future business combination; and
- IAS 27 (Revised), Consolidated and Separate Financial Statements was issued on 10 January 2008 and is subject to EU endorsement. The revised standard is effective for annual periods beginning on or after 1 July 2009. The impact of adopting IAS 27 in future periods is under assessment.

The Directors anticipate that the adoption of the following amendments to standards and interpretations in future periods, which were also in issue but not effective at the date of authorisation of these Financial Statements, will have no material impact on the Financial Statements of the Group:

- IAS 1 (Amendment), Presentation of Financial Statements, effective from 1 January 2009, subject to EU endorsement;
- IAS 32 (Amendment), Financial Instruments: Presentation and IAS 1 (Amendment), Presentation of Financial Statements, effective from 1 January 2009, subject to EU endorsement;
- IFRS 2 (Amendment), Share Based Payment – Vesting Conditions and Cancellations, effective from 1 January 2009, subject to EU endorsement;

- IFRIC 11, IFRS 2 – Group and Treasury Share Transactions, effective for annual periods beginning on or after 1 March 2007;
- IFRIC 12, Service Concession Arrangements, effective for annual periods beginning on or after 1 January 2008;
- IFRIC 13, Customer Loyalty Programmes, effective for annual periods beginning on or after 1 July 2008; and
- IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction, effective for annual periods beginning on or after 1 January 2008.

(c) Changes of accounting presentation

The Group has adopted the following changes of accounting presentation in the year:

- Domestic energy suppliers are given energy savings targets by the Government related to the size of their customer base. Costs incurred by British Gas Residential under such energy saving programmes are presented as part of cost of sales in the Income Statement. Previously such costs were presented as operating costs. The Directors consider the change of accounting presentation better reflects the nature of the costs as a direct cost of supplying energy to domestic customers. The impact of the change of accounting presentation is to report £91 million of costs in the year within cost of sales. The impact on comparatives is to reclassify £90 million from operating costs to cost of sales.
- Capitalised exploration and evaluation costs associated with oil and gas activities, such as licence acquisition costs, exploratory drilling costs, trenching and sampling costs, are presented as intangible assets. Previously the Group presented such capitalised costs as property, plant and equipment. The Directors consider the change of accounting presentation better reflects the nature of such costs. The impact of the change in accounting presentation is to report £41 million of exploration and evaluation costs within intangible assets as at 31 December 2007 and £29 million in investing cash outflows relating to purchases of intangible assets for the year ending 31 December 2007. The impact on comparatives is to reclassify £24 million of capitalised costs from property, plant and equipment to intangible assets as at 31 December 2006 and to reclassify £23 million of investing cash outflows from purchases of property, plant and equipment to purchases of intangible assets for the year ending 31 December 2006.

(d) Change to reported segments

In 2007 the Group changed its reportable segments creating a Power generation segment and an Industrial and commercial reportable segment. Prior to 2007 these two segments were reported together as Industrial sales and wholesaling.

The new Power generation segment comprises the Group's UK generation assets including the Spalding power station, associated emissions activity, as well as flexible volume power procurement contracts. Beginning in 2007, sales of generated power from Centrica Energy to other Group segments is transferred and reported at fair value. Prior to 2007, the sale of generated power from Centrica Energy to other Group segments was transferred and reported at cost. As a result of the change, Power generation and Industrial and commercial are now reported separately. Consequently, the basis on which operating costs are allocated to other Group segments has also changed. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis. For the purpose of comparison, had the Group continued with its previous basis of segmental reporting with inter-segment transfers of power reported on a cost basis, and operating costs allocated to segments with reference to the cost methodology, the Power generation and Industrial and commercial segments together would have reported gross segment revenues of £1,027 million, inter-segment revenue of £185 million and externally reported segment revenue of £842 million and an operating profit before exceptional items and certain re-measurements of £130 million (loss of £8 million after exceptional items and certain re-measurements) for the year ending 31 December 2007. In addition for the year ending 31 December 2007, British Gas Residential would have reported an increase to operating profit of £61 million, British Gas Business would have reported an increase to operating profit of £9 million, Gas production and development would have reported an increase in operating profit of £24 million and Accord energy trading would have reported an increase in operating profit of £1 million, all before exceptional items and certain re-measurements.

(e) Income statement presentation

The Group's Income Statement and segmental note separately identify the effects of re-measurement 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, as described below.

Certain re-measurements

As part of its energy procurement activities the Group enters into a range of commodity contracts designed to achieve security of energy supply. These contracts comprise both purchases and sales and cover a wide range of volumes, prices and timescales. The majority of the underlying supply comes from high volume long-term contracts which are complemented by short-term arrangements. These short-term contracts are entered into for the purpose of balancing energy supplies and customer demand and to optimise the price paid by the Group. Short-term demand can vary significantly as a result of factors such as weather, power generation profiles and short-term movements in market prices.

Many of the energy procurement contracts are held for the purpose of receipt or delivery of commodities in accordance with the Group's purchase, sale or usage requirements and are therefore out of scope of IAS 39, Financial Instruments: Recognition and Measurement. However, a number of contracts are considered to be derivative financial instruments and are required to be fair valued under IAS 39, primarily because their terms include the ability to trade elements of the contracted volumes on a net-settled basis.

The Group has shown the fair value adjustments arising on these contracts separately in the certain re-measurements column. This is because the intention of management is, subject to short-term demand balancing, to use these energy supplies to meet customer demand. Accordingly, management believe the ultimate net charge to cost of sales will be consistent with the price of energy agreed in these contracts and that the fair value

Notes to the Financial Statements continued

adjustments will reverse as the energy is supplied over the life of the contract. This makes the fair value re-measurements very different in nature from costs arising from the physical delivery of energy in the period.

At the balance sheet date the fair value represents the difference between the prices agreed in the respective contracts and the actual or anticipated market price of acquiring the same amount of energy on the open market. The movement in the fair value taken to certain re-measurements in the Income Statement represents the unwind of the contracted volume delivered or consumed during the period, combined with the change in fair value of future contracted energy as a result of movements in forward energy prices during the year.

These adjustments represent the significant majority of the items included in certain re-measurements. In addition to these, however, the Group has identified a number of comparable contractual arrangements where the difference between the price which the Group expects to pay or receive under a contract and the market price is required to be fair valued by IAS 39. These additional items relate to cross-border transportation or transmission capacity, storage capacity and contracts relating to the sale of energy by-products, on which economic value has been created which is not wholly recognised under the requirements of IAS 39. For these arrangements the related fair value adjustments are also included under certain re-measurements.

These arrangements are managed separately from proprietary energy trading activities where trades are entered into speculatively for the purpose of making profits in their own right. These proprietary trades are included in the results before certain re-measurements.

Exceptional items
As permitted by IAS 1, Presentation of Financial Statements, certain items are presented separately. The items that the Group separately presents as exceptional are items which are of a non-recurring nature and, in the judgement of the Directors, need to be disclosed separately by virtue of their nature, size or incidence in order to obtain a clear and consistent presentation of the Group's underlying business performance. Items which may be considered exceptional in nature include disposals of businesses, business restructurings, the renegotiation of significant contracts and asset write-downs.

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 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.

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.

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 discounts, rebates, 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 trade and other receivables.

Proprietary energy trading: Revenue comprises both realised (settled) and unrealised (fair value changes) net gains and losses 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 associated with exploration and production sales (of natural gas, crude oil and condensates) is recognised when title passes to the customer. Revenue from the production of natural gas, oil and condensates in which the Group has an interest with other producers is recognised based on the Group's working interest and the terms of the relevant production sharing arrangements (the entitlement method). Differences between production sold and the Group's share of production are not significant.

Power generation: Revenue is recognised on the basis of power supplied during the 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, distribution, 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 – Corporate Responsibility Review on page 32, the Remuneration Report on pages 42 to 45 and in note 33, 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 awards 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: awards up to 2005	A Black-Scholes valuation augmented by a Monte Carlo simulation to predict the total shareholder return performance
LTIS: EPS awards after 2005	Market value on the date of grant
LTIS: TSR awards after 2005	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
SAS, SIP, DMSS and RSS	Market value on the date of grant

Foreign currencies

The consolidated Financial Statements are presented in pounds 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.

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 retranslation 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 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 as the cash paid and the aggregate of the fair values, at the date of exchange, of other assets given, liabilities incurred or assumed,

Notes to the Financial Statements continued

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 reassessment, 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 business combination in which the goodwill arose. 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.

Other intangible assets

Intangible assets acquired separately are measured on initial recognition at cost. Intangible assets include emissions trading schemes, renewable obligation certificates and certain exploration and evaluation expenditures, the accounting policies for which are dealt with separately below. For purchased application software, for example investments in customer relationship management and billing systems, cost includes contractors' charges, materials, directly attributable labour and directly attributable overheads.

Capitalisation begins when expenditure for the asset is being incurred and activities 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. 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 are derecognised on disposal, or when no future economic benefits are expected from their use.

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 the 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 20 years
Identifiable acquired brand	Indefinite

EU 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.

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

The initial cost of an asset comprises its purchase price or construction cost and any costs directly attributable to bringing the asset into operation. The purchase price or construction cost is the aggregate amount paid and the fair value of any other consideration given to acquire the asset.

Freehold land is not depreciated. Other property, plant and equipment, except upstream 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 and wind farms	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
Centrica uses the successful efforts method of accounting for exploration and evaluation expenditure. Exploration and evaluation expenditure associated with an exploration well, including acquisition costs related to exploration and evaluation activities, are initially capitalised as intangible assets. Certain expenditures such as geological and geophysical exploration costs are expensed. If the prospects are subsequently determined to be successful on completion of evaluation, the relevant expenditure including licence acquisition costs is transferred to property, plant and equipment and depreciated on a unit of production basis. 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.

When this provision gives access to future economic benefits, a decommissioning asset is recognised and included within property, plant and equipment. Changes in these estimates and changes to the discount rates are dealt with prospectively and reflected as an adjustment to the provision and corresponding decommissioning asset included within property, plant and equipment. For gas production facilities and offshore 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 current 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.

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

Notes to the Financial Statements continued

Impairment of property, plant and equipment 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 concerned.

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 immediately as an expense.

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 or 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

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 and 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 and estimated net realisable value.

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 difference between the expected return on scheme assets and the change in present value of scheme obligations resulting from the passage of time is recognised in the Income Statement within interest income or interest expense.

The retirement benefit obligation/asset 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 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 substantively 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.

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 substantively 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

Financial assets and financial liabilities are recognised in the Group 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 may not be able to collect the trade receivable. Balances are written off when recoverability is assessed as being remote.

(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 other borrowings

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

After initial recognition, interest-bearing loans and other 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 also adjusted to reflect the fair value movements associated with the hedged risks. Such 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

Prior to deconsolidation as explained in note 3, 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 up to the date of deconsolidation are included in the Income Statement within discontinued operations.

(f) Other financial assets

Available-for-sale financial assets are those non-derivative financial assets that are designated as available-for-sale, which are initially recognised at fair value, and 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. Accrued interest or dividends arising on available-for-sale financial assets are recognised in the Income Statement.

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

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

Certain purchase and sales contracts for the physical delivery of gas, power and oil 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.

Notes to the Financial Statements 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 Directors' Report – Governance on pages 39 to 40 and in note 4 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 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 at each reporting date. 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.

The Group enters into certain energy derivative contracts covering periods for which observable market data does not exist. The fair value of such derivatives is estimated by reference in part to published price quotations from active markets, to the extent that such observable market data exists, and in part by using valuation techniques, whose inputs include data, which is not based on or derived from observable markets. Where the fair value at initial recognition for such contracts differs from the transaction price, a fair value gain or fair value loss will arise. This is referred to as a day-one gain or day-one loss. Such gains and losses are deferred and amortised to the Income Statement based on volumes purchased or delivered over the contractual period until such time observable market data becomes available. When observable market data becomes available, any remaining deferred day-one gains or losses are recognised within the Income Statement. 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.

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 the host contracts and the host contracts are not carried at fair value, with gains or losses reported in the Income Statement. The closely related nature of embedded derivatives is re-assessed when there is a change in the terms of the contract which significantly modifies the future cash flows under the contract. Where a contract contains one or more embedded derivatives and providing that the embedded derivative significantly modifies the cash flows under the contract, the option to fair value the entire contract may be taken and the contract will be recognised at fair value with changes in fair value recognised in the Income Statement.

(h) Hedge accounting

For the purposes of hedge accounting, hedges are classified either as 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 exposure 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 on its recognition. 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.

3. Critical accounting judgements and key sources of estimation uncertainty

(a) 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).

The Consumers' Waterheater Income Fund

The Group has deconsolidated The Consumers' Waterheater Income Fund (the 'Fund') with effect from 1 December 2007, the date of an Internalisation Agreement entered into between Centrica and the Fund.

Centrica created the Fund in 2002 to refinance the water heater assets acquired with the Enbridge Services acquisition. The Group consolidated the Fund in accordance with the requirements of SIC-12, Consolidation – Special Purpose Entities, as the substance of the agreements put in place by Centrica indicated that the Fund was created for and on behalf of the Group. These agreements both predetermined the Fund's activities and provided Centrica with operational control, via responsibilities for servicing the Fund's asset portfolio and administering the Fund's activities.

In October 2006 the Trustees of the Fund appointed an independent Chief Executive Officer. The activities undertaken by the Fund started to change following this appointment through the independent acquisition of an immaterial business in late 2006, and the independent acquisition of the Toronto Hydro water heater rental business in February 2007, which provided the Fund with a limited number of rental customers held outside of the original contractual arrangements entered into with Centrica. Almost all the significant parts of the relationship, however, remained predetermined or controlled by Centrica. These changes in the conduct of the Fund were judged not to be sufficiently material to alter the Fund's status as a subsidiary in the 2006 Group accounts.

In 2007 the Trustees of the Fund have sought further changes in the conduct of the Fund. The Fund has recruited an independent Chief Financial Officer and has made further small acquisitions outside of the original contractual arrangements entered into with Centrica. On 1 December 2007, the existing Administration Agreement was replaced, at the instigation of the Fund, by a new Internalisation Agreement, which provides the Fund with access rights to key operational data and provides a basis for employees and business infrastructure to transfer to the Fund, such that it is capable of independent operation from Centrica. Subsequent to this Agreement the Fund has independently refinanced its activities. The Directors believe that the Internalisation Agreement represents a change to the original contractual arrangements with the Fund, and demonstrates that the Fund has both the desire and the ability to manage its own affairs. Accordingly, in 2007 the Directors judge that the Fund's activities are no longer predetermined such that its activities are being conducted on behalf of Centrica, and thus the Fund ceases to represent a subsidiary of the Centrica Group.

The Group has deconsolidated the Fund with effect from 1 December 2007, the date the Internalisation Agreement became effective and the date of the resultant loss of control, recognising an exceptional profit on disposal amounting to £227 million. The Fund's activities represented a separate major line of business of the Direct Energy segment, and contributed materially to Group borrowings. In order to provide a clear presentation of the impact of deconsolidating the Fund, the results in the current year and prior year have been presented as a discontinued operation distinct from continuing operations within the Group Income Statement. The details of the disposal and discontinued results are provided in note 35.

Finance lease – Third-party power station tolling arrangement

The Group has entered into a long-term tolling arrangement with the Spalding power station. The contract provides Centrica with the right to nominate 100% of the plant output until 2021 in return for a mix of capacity payments and operating payments. The capacity payments comprise both fixed-price and market-priced elements and are dependent on plant availability. Centrica holds an option to extend the tolling arrangement for a further 8 years, notice of which must be provided to the power station operator by 30 September 2020. If the extension option is exercised, Centrica is granted an option to purchase the station at the end of the extended tolling period. The option to purchase must be exercised by serving notice to the generator between 30 September 2027 and 30 September 2028. Should Centrica exercise the purchase option the generator can exercise an option to retain the station. Should both options be exercised the valuation of the options, and hence ownership of the asset, will be determined by an expert panel, appointed by both parties. Market-based compensation will be payable to Centrica if ownership is retained by the generator. The Directors have judged that the arrangement should be accounted for as a finance lease as the lease term is judged to be a major part of the economic life of the power station and the present value of the minimum lease payments at inception date of the arrangement amounted to a large part of the fair value of the power station at that time. Details of the finance lease asset, finance lease creditor and interest charges are included in notes 17, 25 and 10 respectively.

EU 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.

Notes to the Financial Statements continued

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 income 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.

(b) 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.

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 applying industry standards and using historical consumption patterns taking into account the industry reconciliation process for total gas and electricity usage by supplier. Management applies judgement to the measurement of the estimated energy supplied to customers and to the valuation of that energy consumption. An assessment is made of any factors that are likely to materially affect the ultimate economic benefits which will flow to the Group, including delays in processing, bill cancellation and re-bill rates and any customer or industry data quality issues. In the period subsequent to the implementation of the new billing system, operational exceptions have been running at a higher level and this has been taken account of in the judgements made. To the extent that the economic benefits are not expected to flow to the Group, the value of the revenue is not recognised. The judgements applied, and the assumptions underpinning these judgements, are considered to be appropriate. However, a change in these assumptions would have an impact on the amount of revenue recognised.

Industry reconciliation process – cost of sales
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. This difference in deemed supply is referred to as imbalance. The reconciliation process can result in either a higher or lower value of industry deemed supply than has been estimated as being supplied to customers by the Group, but in practice tends to result in a higher value of deemed supply. The Group then reviews the difference to ascertain whether there is evidence that its estimate of amounts supplied to customers is inaccurate or whether the difference arises from other causes. The Group's share of the resulting imbalance is included within commodity costs charged to cost of sales. Management estimates the level of recovery of imbalance 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 either the Income Statement or equity. 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 notes 4 and 28.

Gas and liquids reserves
The volume of proven and probable gas and liquids reserves is an estimate that affects the unit of production depreciation of producing gas and oil property, plant and equipment as well as being a significant estimate affecting decommissioning estimates and impairment calculations. The factors impacting gas and liquids estimates, and the process for estimating reserve quantities, are described on page 147.

The impact of a change in estimated proven and probable reserves is dealt with prospectively by depreciating the remaining book value of producing assets over the expected future production. If proven and probable reserves estimates are revised downwards, earnings could be affected by higher depreciation expense or an immediate write-down (impairment) of the asset's book value.

Decommissioning costs
The estimated cost of decommissioning at the end of the producing lives of fields is reviewed periodically and is based on proven and probable reserves, price levels and technology at the balance sheet date. Provision is made for the estimated cost of decommissioning at the balance sheet date. The payment dates of total expected future decommissioning costs are uncertain and dependent on the lives of the facilities, but are currently anticipated to be between 2008 and 2042.

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 16.

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 34.

4. Financial risk management

The Group's normal operating, investing and financing activities expose it to a variety of financial risks: market risk (including commodity price risk, currency risk, interest rate risk and equity price risk), credit risk and liquidity risk. The Group's overall risk management process is designed to identify, manage and mitigate business risk, which includes, among others, financial risk. Further detail on the Group's overall risk management process is included within the Directors' Report – Governance on pages 39 to 40.

Financial risk management is overseen by the Group Financial Risk Management Committee (FRMC) according to objectives, targets and policies set by the Board. Commodity price risk management, and the associated credit risk management, is carried out in accordance with individual business unit financial risk management policies, as approved by the FRMC and the Board. Treasury risk management, including management of currency risk, interest rate risk, equity price risk and liquidity risk, and the associated credit risk management, is carried out by a central Group Treasury function in accordance with the Group's financing and treasury policy, as approved by the Board. Downstream credit risk management is carried out in accordance with business unit credit policies.

(a) Market risk management
Market risk is the risk of loss that results from changes in market prices (commodity prices, foreign exchange rates, interest rates and equity prices). The level of market risk to which the Group is exposed at a point in time varies depending on market conditions, expectations of future price or market rate movements and the composition of the Group's physical asset and contract portfolios.

(i) Commodity price risk management
The Group is exposed to commodity price risk in its energy procurement, downstream and proprietary energy trading activities.

Energy procurement and downstream activities
The Group's energy procurement and downstream activities consist of downstream positions, equity gas and liquids production and power generation, strategic procurement and sales contracts, market-traded purchase and sales contracts and derivative positions taken on with the intent of securing gas and power for the Group's downstream customers in the UK, Europe and North America from a variety of sources at an optimal cost. The Group actively manages commodity price risk by optimising its asset and contract portfolios making use of volume flexibility.

The Group is exposed to commodity price risk in its energy procurement and downstream activities because the cost of procuring gas and electricity to serve its downstream customers varies with wholesale commodity prices. The risk is primarily that market prices for commodities will fluctuate between the time that sales prices are fixed or tariffs are set and the time at which the corresponding procurement cost is fixed, thereby potentially reducing expected margins or making sales unprofitable.

The Group uses specific volumetric limits to manage the exposure to market prices associated with the Group's energy procurement and downstream activities to an acceptable level. Volumetric limits are supported by a Profit at Risk (PaR) methodology in the UK and a Value at Risk (VaR) methodology in North America and Europe to measure the Group's exposure to commodity price risk. PaR measures the estimated potential loss in a position or portfolio of positions associated with the movement of a commodity price for a given confidence level, over the remaining term of the position or contract portfolio. VaR measures the estimated potential loss for a given confidence level, over a predetermined holding period. The standard confidence level used is 95%.

The Group measures and manages the commodity price risk associated with the Group's entire energy procurement and downstream portfolio. Only certain of the Group's energy procurement and downstream contracts constitute financial instruments under IAS 39 (note 2). As a result, while the Group manages the commodity price risk associated with both financial and non-financial energy procurement and downstream contracts, it is the notional value of energy contracts being carried at fair value that represents the exposure of the Group's energy procurement and downstream books to commodity price risk according to IFRS 7. This is because energy contracts that are financial instruments under IAS 39 are accounted for on a fair value basis and changes in fair value immediately impact profit or equity. Conversely, energy contracts that are not financial instruments under IAS 39 are accounted for as executory contracts and changes in fair value do not immediately impact profit or equity, and as such, are not exposed to commodity price risk as defined by IFRS 7. So while the PaR or the VaR associated with energy procurement and downstream contracts outside the scope of IAS 39 is monitored for internal risk management purposes, these measures are not required to comply with IFRS 7.

The carrying value of energy contracts used in energy procurement and downstream activities at 31 December 2007 is disclosed in note 21 and a sensitivity analysis that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in the fair value or future cash flows of financial instruments associated with the Group's energy procurement and downstream activities as a result of changes in commodity prices is provided below in section (v).

Notes to the Financial Statements continued

Proprietary energy trading

The Group's proprietary energy trading activities consist of physical and financial commodity purchases and sales contracts taken on with the intent of benefiting in the short-term from changes in market prices or differences between buying and selling prices. The Group conducts its trading activities over the counter and through exchanges in the UK, North America and parts of the rest of Europe. The Group is exposed to commodity price risk as a result of its proprietary energy trading activities because the value of its trading assets and liabilities will fluctuate with changes in market prices for commodities.

The Group sets volumetric and VaR limits to manage the commodity price risk exposure associated with the Group's proprietary energy trading activities. The VaR used measures the estimated potential loss for a 95% confidence level over a one-day holding period. The holding period used is based on market liquidity and the number of days the Group would expect it to take to close off a trading position.

As with any modelled risk measure, there are certain limitations that arise from the assumptions used in the VaR analysis. VaR assumes that the future will behave like the past and that the Group's trading positions can be unwound or hedged within the predetermined holding period. Furthermore the use of a 95% confidence level, by definition, does not take into account changes in value that might occur beyond this confidence level.

The VaR, before taxation, associated with the Group's proprietary energy trading activities at 31 December 2007 was £9 million (2006: £8 million). The carrying value of energy contracts used in proprietary energy trading activities at 31 December 2007 is disclosed in note 21.

(ii) Currency risk management

The Group is exposed to currency risk on foreign currency denominated forecast transactions, firm commitments, monetary assets and liabilities (transactional exposure) and on its net investments in foreign operations (translational exposure).

Transactional currency risk

The Group is exposed to transactional currency risk on transactions denominated in currencies other than the underlying functional currency of the commercial operation transacting. The Group's primary functional currencies are pounds sterling in the UK, Canadian dollars in Canada, US dollars in the US and euros in Europe. The risk is that the functional currency value of cash flows will vary as a result of movements in exchange rates. Transactional exposure arises from the Group's energy procurement activities in the UK and in Canada, where a proportion of transactions are denominated in euros or US dollars and on certain capital commitments denominated in foreign currencies. In addition, in order to optimise the cost of funding, the Group has, in certain cases, issued foreign currency denominated debt, primarily in US dollars, euros or Japanese yen.

It is the Group's policy to hedge all material transactional exposures using forward contracts to fix the functional currency value of non-functional currency cash flows. At 31 December 2007, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or probable forecast transactions (2006: £nil).

Translational currency risk

The Group is exposed to translational currency risk as a result of its net investments in North America and Europe. The risk is that the pounds sterling value of the net assets of foreign operations will decrease with changes in foreign exchange rates. The Group's policy is to protect the pounds sterling book value of its net investments in foreign operations, subject to certain targets monitored by the FRMC, by holding foreign currency debt, entering into foreign currency derivatives or a mixture of both.

The Group measures and manages the currency risk associated with all transactional and translational exposures. In contrast, IFRS 7 requires disclosure of currency risk arising on financial instruments denominated in a currency other than the functional currency of the commercial operation transacting only. As a result, for the purposes of IFRS 7, currency risk excludes the Group's net investments in North America and Europe as well as foreign currency denominated forecast transactions and firm commitments. A sensitivity analysis that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in the fair value or future cash flows of foreign currency denominated financial instruments as a result of changes in foreign exchange rates is provided below in section (v).

(iii) Interest rate risk management

In the normal course of business the Group borrows to finance its operations. The Group is exposed to interest rate risk because the fair value of fixed rate borrowings and the cash flows associated with floating rate borrowings will fluctuate with changes in interest rates. The Group's policy is to manage the interest rate risk on long-term recourse borrowings by ensuring that the exposure to floating interest rates remains within a 30% to 70% range, including the impact of interest rate derivatives. Note 25 details the interest rates on the Group's bank overdrafts, loans and other borrowings by the earlier of contractual re-pricing and maturity date and a sensitivity analysis that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in interest rates is provided below in section (v).

(iv) Equity price risk management

The Group is exposed to equity price risk because certain available-for-sale financial assets, held by the Law Debenture Trust on behalf of the Company as security in respect of the Centrica Unapproved Pension Scheme, are linked to equity indices (note 34). Investments in equity indices are inherently exposed to less risk than individual equity investments because they represent a naturally diverse portfolio. Note 34 details the Group's other retirement benefit assets and liabilities.

(v) Sensitivity analysis

A financial instrument is defined in IAS 32 as any contract that gives rise to a financial asset of one entity (effectively the contractual right to receive cash or another financial asset from another entity) and a financial liability (effectively the contractual obligation to deliver cash or another financial asset to another entity) or equity instrument (effectively a residual interest in the assets of an entity) of another. IFRS 7 requires disclosure of a sensitivity analysis that is intended to illustrate the sensitivity of the Group's financial position and performance to changes in market variables (commodity prices, foreign exchange rates, interest rates and equity prices) as a result of changes in the fair value or cash flows associated with the Group's financial instruments. The sensitivity analysis provided discloses the effect on profit or loss and equity at 31 December 2007 assuming that a reasonably possible change in the relevant risk variable had occurred at 31 December 2007 and been applied to the risk exposures in existence at that date to show the effects of reasonably possible changes in price on profit or loss and equity to the next annual reporting date. The reasonably possible changes in market variables used in the sensitivity analysis were determined based on implied volatilities where available or historical data.

The sensitivity analysis has been prepared based on 31 December 2007 balances and on the basis that the balances, the ratio of fixed to floating rates of debt and derivatives, the proportion of energy contracts that are financial instruments, the proportion of financial instruments in foreign currencies and the hedge designations in place at 31 December 2007 are all constant. Excluded from this analysis are all non-financial assets and liabilities and energy contracts that are not financial instruments under IAS 39. The sensitivity to foreign exchange rates relates only to monetary assets and liabilities denominated in a currency other than the functional currency of the commercial operation transacting, and excludes the translation of the net assets of foreign operations to pounds sterling, but not the corresponding impact of net investment hedges.

The sensitivity analysis provided is hypothetical only and should be used with caution as the impacts provided are not necessarily indicative of the actual impacts that would be experienced because the Group's actual exposure to market rates is constantly changing as the Group's portfolio of commodity, debt, foreign currency and equity contracts changes. Changes in fair values or cash flows based on a variation in a market variable cannot be extrapolated because the relationship between the change in market variable and the change in fair value or cash flows may not be linear. In addition, the effect of a change in a particular market variable on fair values or cash flows is calculated without considering interrelationships between the various market rates or mitigating actions that would be taken by the Group. The sensitivity analysis provided below excludes the impact of proprietary energy trading assets and liabilities because the VaR associated with the Group's proprietary energy trading activities has already been provided above in section (i).

Notes to the Financial Statements continued

4. Financial risk management continued

The impacts of reasonably possible changes in commodity prices on profit and equity, both after taxation, based on the assumptions provided above are as follows:

Energy prices	2007 Base price (i)	2007 Reasonably possible increase in variable	2007 Reasonably possible decrease in variable	2006 Base price (i)	2006 Reasonably possible increase in variable	2006 Reasonably possible decrease in variable
UK gas (p/therm)	**51**	**+12**	**-12**	35	+6	-6
UK power (£/MWh)	**52**	**+11**	**-11**	35	+9	-9
UK coal (US$/tonne)	**101**	**+15**	**-15**	70	+10	-10
UK emissions (€/tonne)	**24**	**+5**	**-5**	7	+4	-4
UK oil (US$/bbl)	**88**	**+14**	**-14**	66	+7	-7
North American gas (p/therm)	**38**	**+4**	**-4**	36	+6	-6
North American power (£/MWh)	**28**	**+5**	**-5**	29	+5	-5

(i) The base price represents the average forward market price over the duration of the active market curve used in the sensitivity analysis provided.

Incremental profit/(loss)	2007 Impact on profit £m	2007 Impact on equity £m	2006 Impact on profit £m	2006 Impact on equity £m
UK energy prices (combined) – increase	**34**	**56**	91	67
UK energy prices (combined) – decrease	**(34)**	**(56)**	(91)	(67)
North American energy prices (combined) – increase	**103**	**54**	78	95
North American energy prices (combined) – decrease	**(103)**	**(54)**	(78)	(95)

The impacts of reasonably possible changes in interest rates on profit and equity, both after taxation, based on the assumptions provided above are as follows:

Interest rates and incremental profit/(loss)	2007 Reasonably possible change in variable %	2007 Impact on profit £m	2007 Impact on equity £m	2006 Reasonably possible change in variable %	2006 Impact on profit £m	2006 Impact on equity £m
UK interest rates	**+0.50**	**5**	**4**	+0.50	1	–
	-0.50	**(5)**	**(4)**	-0.50	(1)	–
US interest rates	**+0.50**	**–**	**2**	+0.25	1	3
	-0.50	**–**	**(2)**	-0.25	(1)	(3)
Canadian interest rates	**+0.50**	**(2)**	**–**	+0.25	–	–
	-0.50	**2**	**–**	-0.25	–	–

4. Financial risk management continued

The impacts of reasonably possible changes in foreign currency rates relative to pounds sterling on profit and equity, both after taxation, based on the assumptions provided above are as follows:

			2007			2006
Foreign exchange rates and incremental profit/(loss)	**Reasonably possible change in variable %**	**Impact on profit £m**	**Impact on equity £m**	Reasonably possible change in variable %	Impact on profit £m	Impact on equity £m
US dollar	**+10**	**(32)**	**14**	+5	(1)	(1)
	-10	**28**	**(12)**	-5	1	1
Canadian dollar	**+10**	**3**	**12**	+5	(1)	5
	-10	**1**	**(10)**	-5	1	(5)
Euro	**+10**	**(1)**	**18**	+5	(1)	8
	-10	**1**	**(17)**	-5	1	(8)

The impacts of reasonably possible changes in equity prices on profit and equity, both after taxation, based on the assumptions provided above are as follows:

			2007			2006
Equity prices and incremental profit/(loss)	**Reasonably possible change in variable %**	**Impact on profit £m**	**Impact on equity £m**	Reasonably possible change in variable %	Impact on profit £m	Impact on equity £m
FTSE 100	**+5**	**–**	**1**	+5	–	1
	-5	**–**	**(1)**	-5	–	(1)

(b) Credit risk management

Credit risk is the risk of loss associated with a counterparty's inability or failure to discharge its obligations under a contract. The Group is exposed to credit risk in its treasury, trading, energy procurement and downstream activities.

Treasury, trading and energy procurement activities

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. The Group uses master netting agreements to reduce credit risk and net settles payments with counterparties where net settlement provisions exist. In addition, the Group employs a variety of other methods to mitigate credit risk: margining, various forms of bank and parent company guarantees and letters of credit.

100% of the Group's credit risk associated with its treasury, trading and energy procurement activities is with counterparties in related energy industries or with financial institutions. The Group measures and manages the credit risk associated with the Group's entire treasury, trading and energy procurement portfolio. In contrast, IFRS 7 defines credit risk as the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation and requires disclosure of information about the exposure to credit risk arising from financial instruments only. Only certain of the Group's energy procurement contracts constitute financial instruments under IAS 39 (note 2). As a result, while the Group manages the credit risk associated with both financial and non-financial energy procurement contracts, it is the carrying value of financial assets within the scope of IAS 39 (note 28) that represents the maximum exposure to credit risk in accordance with IFRS 7 because credit losses associated with contracts that are not recognised on the Balance Sheet will not be recognised as such in the Income Statement.

Notes to the Financial Statements continued

4. Financial risk management continued

Downstream activities

In the case of business customers credit risk is managed by checking a company's creditworthiness and financial strength both before commencing trade and during the business relationship. For residential customers, creditworthiness is ascertained normally before commencing trade by reviewing an appropriate mix of internal and external information to determine the payment mechanism required to reduce credit risk to an acceptable level. Certain customers will only be accepted on a prepayment basis.

In some cases, an ageing of receivables is monitored and used to manage the exposure to credit risk associated with both business and residential customers. In other cases, credit risk is monitored and managed by grouping customers according to method of payment or profile.

Note 21 provides further detail of the Group's exposure to credit risk on derivative financial instruments, note 20 provides detail of the Group's exposure to credit risk on trade and other receivables, note 23 provides detail of the Group's exposure to credit risk on cash and cash equivalents and note 28 provides the carrying value of all financial assets representing the Group's maximum exposure to credit risk.

(c) Liquidity risk management

Liquidity risk is the risk that the Group will not have sufficient funds to meet it obligations as they come due. Cash forecasts identifying the Group's liquidity requirements are produced regularly and are stress-tested for different scenarios to ensure sufficient financial headroom exists for at least a 12-month period to safeguard the Group's ability to continue as a going concern.

In order to manage liquidity risk it is the Group's policy to maintain committed facilities of at least £1,000 million less available surplus cash resources, to raise at least 50% of its net debt (excluding non-recourse debt) over £200 million in the long-term debt market, to hold a maximum of £400 million of debt maturing in the same calendar year (excluding finance leases and non-recourse borrowings) and to maintain an average term to maturity in the recourse long-term debt portfolio greater than three years.

At 31 December 2007, the Group had undrawn committed bank borrowing facilities of £1,300 million (2006: £1,300 million), 321% (2006: 76%) of the Group's net debt over £200 million has been raised in the long-term debt market, the average term to maturity of the long-term debt portfolio was 7.1 years (2006: 7.3 years) and there is no calendar year where more than £400 million of debt (excluding finance leases and non-recourse borrowings) will be maturing (2006: same).

5. Capital management

The Group's objective when managing capital is to maintain an optimal capital structure and strong credit rating to minimise the cost of capital. In addition, in a number of areas in which the Group operates, the Group's strong capital structure and good credit standing are important elements of the Group's competitive position.

At 31 December 2007, the Group's long-term credit rating was A3 for Moody's Investor Services Inc. (2006: A3) and A for Standard & Poor's Rating Services (2006: A).

The Group monitors capital, using a medium-term view of 3-5 years, on the basis of a number of financial ratios generally used by industry and by the rating agencies. This includes monitoring gearing ratios, interest cover and cash flow to debt ratios. The Group is not subject to externally imposed capital requirements but as is common for most companies the level of debt that can be raised is restricted by the Company's Articles of Association. Net debt is limited to the greater of £5 billion and a gearing ratio of three times adjusted capital and reserves. This restriction can be amended or removed by the shareholders of the Company passing an ordinary resolution. As a result of the volatility introduced to the Group's reserves resulting from IAS 39, Financial Instruments: Recognition and Measurement, and IAS 19, Employee Benefits, changes are being sought to the definition of reserves in the Articles of Association at this year's Annual General Meeting.

The Group's capital structure is managed against the various financial ratios as required to maintain strong credit ratings.

In order to maintain or adjust the capital structure, the Group may adjust the amount of dividends paid to shareholders, return capital to shareholders, issue new shares, repurchase shares, issue debt or repay debt.

6. Segmental analysis

(i) 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 Directors' Report – Business Review, on pages 8 to 32.

(a) Revenue	2007 Gross segment revenue £m	2007 Less inter-segment revenue (i),(ii),(iii),(v) £m	2007 Group revenue £m	2006 (restated) (v),(vii) Gross segment revenue £m	2006 (restated) (v),(vii) Less inter-segment revenue (i),(ii),(iii),(v) £m	2006 (restated) (v),(vii) Group revenue £m
Continuing operations:						
British Gas Residential	**6,457**	**–**	**6,457**	7,112	–	7,112
British Gas Business	**2,431**	**–**	**2,431**	2,303	–	2,303
British Gas Services	**1,279**	**–**	**1,279**	1,104	–	1,104
Gas production and development (i)	**923**	**(624)**	**299**	1,291	(968)	323
Power generation (ii),(iv)	**880**	**(578)**	**302**	–	–	–
Industrial and commercial (iv)	**838**	**–**	**838**	–	–	–
Industrial sales and wholesaling (ii),(iv)	**–**	**–**	**–**	1,035	(152)	883
Accord energy trading (v)	**24**	**(12)**	**12**	57	(18)	39
Centrica Energy	**2,665**	**(1,214)**	**1,451**	2,383	(1,138)	1,245
Centrica Storage (iii)	**403**	**(63)**	**340**	358	(64)	294
Direct Energy (vi),(vii)	**3,992**	**–**	**3,992**	4,050	–	4,050
European Energy	**395**	**(3)**	**392**	295	–	295
	17,622	**(1,280)**	**16,342**	17,605	(1,202)	16,403
Discontinued operations:						
The Consumers' Waterheater Income Fund (vii) (note 35)	**42**	**–**	**42**	47	–	47
	42	**–**	**42**	47	–	47

Group revenue from continuing operations is derived from the following activities:

	2007 £m	2006 (restated) (vii) £m
Sales of goods	**14,621**	14,840
Rendering of services	**1,693**	1,539
Other income	**28**	24
Group revenue	**16,342**	16,403

(i) Inter-segment revenue arising in Gas production and development is derived from sales of gas produced for other Group segments.
(ii) Beginning in 2007, sales of generated power from Power generation to other Group segments is transferred and reported at fair value. Prior to 2007, the sale of generated power from Centrica Energy to other Group segments was transferred and reported at cost.
(iii) Inter-segment revenue arising within Centrica Storage represents the provision of storage facilities to other Group companies, on an arm's length basis.
(iv) In 2007, the Group changed its reportable segments creating a Power generation reportable segment and an Industrial and commercial reportable segment. Prior to 2007, these two segments were reported together as Industrial sales and wholesaling. The change to reported segments is detailed in note 2. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis.
(v) The external revenue presented for Accord energy trading comprises both realised (settled) and unrealised (fair value changes) from trading in physical and financial energy contracts. Inter-segment revenue arising in Accord represents the recharge of brokerage fees to other Group segments. Gross segment revenue and inter-segment revenue for Accord have both been increased by £18 million in 2006 to reflect the recharge of brokerage fees as inter-segment revenue to be consistent with the presentation provided in 2007.
(vi) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.
(vii) Restated to present The Consumers' Waterheater Income Fund as a discontinued operation as explained in note 3. Discontinued operations previously formed part of the Direct Energy segment. Direct Energy gross segment revenue inclusive of gross revenue from discontinued operations amounted to £4,034 million (2006: £4,097 million).

Notes to the Financial Statements continued

6. Segmental analysis continued

(b) Operating profit	Operating profit/(loss) before exceptional items and certain re-measurements year ended 31 December 2007 £m	2006 (restated) (iii) £m	Exceptional items (note 8) year ended 31 December 2007 £m	2006 £m	Certain re-measurements (note 8) year ended 31 December 2007 £m	2006 £m	Operating profit/(loss) after exceptional items and certain re-measurements year ended 31 December 2007 £m	2006 (restated) (iii) £m
Continuing operations:								
British Gas Residential	**571**	95	**–**	(214)	**39**	(724)	**610**	(843)
British Gas Business	**120**	87	**–**	–	**317**	(408)	**437**	(321)
British Gas Services	**151**	102	**–**	(66)	**–**	–	**151**	36
Gas production and development	**429**	864	**–**	–	**(16)**	32	**413**	896
Power generation (i)	**46**	–	**–**	–	**(43)**	–	**3**	–
Industrial and commercial (i)	**179**	–	**–**	–	**(95)**	–	**84**	–
Industrial sales and wholesaling (i)	**–**	(210)	**–**	–	**–**	440	**–**	230
Accord energy trading	**9**	32	**–**	–	**(3)**	6	**6**	38
Centrica Energy	**663**	686	**–**	–	**(157)**	478	**506**	1,164
Centrica Storage	**240**	228	**–**	(24)	**(8)**	2	**232**	206
Direct Energy (ii),(iii)	**187**	173	**–**	–	**53**	(264)	**240**	(91)
European Energy	**17**	7	**–**	–	**(9)**	(15)	**8**	(8)
Other operations (iv)	**–**	14	**–**	(27)	**–**	–	**–**	(13)
	1,949	1,392	**–**	(331)	**235**	(931)	**2,184**	130
Discontinued operations:								
The Consumers' Waterheater Income Fund (iii) (note 35)	**39**	50	**227**	–	**–**	–	**266**	50
OneTel (note 35)	**–**	(11)	**–**	–	**–**	–	**–**	(11)
	39	39	**227**	–	**–**	–	**266**	39

(i) In 2007, the Group changed its reportable segments creating a Power generation reportable segment and an Industrial and commercial reportable segment. Prior to 2007, these two segments were reported together as Industrial sales and wholesaling. The change to reported segments is detailed in note 2. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis.

(ii) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.

(iii) Restated to present The Consumers' Waterheater Income Fund as a discontinued operation as explained in note 3. Discontinued operations previously formed part of the Direct Energy segment. The Direct Energy segment result inclusive of the result from discontinued operations amounted to a profit of £226 million (2006: £223 million) before exceptional items and certain re-measurements and £506 million after exceptional items and certain re-measurements (2006: £41 million loss). Exceptional items and certain re-measurements of the Direct Energy segment inclusive of discontinued operations amounted to a credit of £280 million (2006: £264 million charge).

(iv) In 2006, operating profit before exceptional items and certain re-measurements includes a £20 million gain arising on revisions to the assumptions made in calculating the Group's defined benefit pension liability. The Schemes' rules were amended from 1 April 2006 to allow employees to commute a larger amount of their pension to a cash lump sum on retirement, in line with changes in the Finance Act.

6. Segmental analysis continued

(c) Included within operating profit	Share of results of joint ventures and associates net of interest and taxation year ended 31 December 2007 £m	2006 £m	Depreciation of property, plant and equipment year ended 31 December 2007 £m	2006 (restated) (ii) £m	Amortisation and write-downs of intangibles year ended 31 December 2007 £m	2006 (restated) (ii) £m
Continuing operations:						
British Gas Residential	**–**	–	**16**	17	**27**	35
British Gas Business	**–**	–	**3**	1	**19**	14
British Gas Services	**–**	–	**13**	13	**4**	–
Gas production and development (ii)	**–**	–	**250**	235	**8**	17
Power generation (i)	**4**	–	**93**	–	**1**	–
Industrial and commercial (i)	**–**	–	**1**	–	**–**	–
Industrial sales and wholesaling (i)	**–**	–	**–**	95	**–**	1
Accord energy trading	**–**	–	**–**	–	**–**	–
Centrica Energy	**4**	–	**344**	330	**9**	18
Centrica Storage	**–**	–	**24**	23	**–**	–
Direct Energy (ii),(iii),(iv)	**–**	–	**62**	61	**15**	13
European Energy	**1**	(12)	**2**	1	**10**	10
Other operations (v)	**–**	–	**9**	17	**8**	3
	5	(12)	**473**	463	**92**	93
Discontinued operations:						
The Consumers' Waterheater Income Fund (ii) (note 35)	**–**	–	**21**	23	**1**	–
	–	–	**21**	23	**1**	–

(i) In 2007, the Group changed its reportable segments creating a Power generation reportable segment and an Industrial and commercial reportable segment. Prior to 2007, these two segments were reported together as Industrial sales and wholesaling. The change to reported segments is detailed in note 2. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis.

(ii) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet and to present The Consumers' Waterheater Income Fund as a discontinued operation. Note 2 details the change of accounting presentation and note 3 details the deconsolidation of The Consumers' Waterheater Income Fund.

(iii) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.

(iv) Discontinued operations previously formed part of the Direct Energy segment.

(v) Depreciation of property, plant and equipment and amortisation and write-downs of intangibles in the Other operations segment are charged out to other Group segments.

Notes to the Financial Statements continued

6. Segmental analysis continued

(d) Assets and liabilities	Segment assets 31 December 2007 £m	Segment assets 31 December 2006 (restated) (i),(ii),(iii) £m	Segment liabilities 31 December 2007 £m	Segment liabilities 31 December 2006 (restated) (iii) £m	Net segment assets/(liabilities) 31 December 2007 £m	Net segment assets/(liabilities) 31 December 2006 £m	Average capital employed (vii) year ended 31 December 2007 £m	Average capital employed (vii) year ended 31 December 2006 £m
British Gas Residential	**1,035**	1,531	**(1,063)**	(1,193)	**(28)**	338	**400**	708
British Gas Business	**817**	807	**(430)**	(390)	**387**	417	**418**	358
British Gas Services	**258**	249	**(167)**	(192)	**91**	57	**67**	80
Gas production and development	**1,576**	1,170	**(480)**	(499)	**1,096**	671	**678**	810
Power generation (iv)	**2,173**	–	**(272)**	–	**1,901**	–	**1,422**	–
Industrial and commercial (iv)	**1,532**	–	**(1,889)**	–	**(357)**	–	**(80)**	–
Industrial sales and wholesaling (i),(iv)	**–**	2,999	**–**	(2,338)	**–**	661	**–**	1,482
Accord energy trading	**1,243**	1,239	**(1,377)**	(1,288)	**(134)**	(49)	**34**	(194)
Centrica Energy	**6,524**	5,408	**(4,018)**	(4,125)	**2,506**	1,283	**2,054**	2,098
Centrica Storage	**503**	479	**(189)**	(116)	**314**	363	**350**	355
Direct Energy (v)	**2,560**	2,546	**(993)**	(1,041)	**1,567**	1,505	**1,844**	1,846
European Energy (ii)	**432**	349	**(113)**	(80)	**319**	269	**292**	279
Other operations (i),(ii),(vi)	**99**	104	**(295)**	(223)	**(196)**	(119)	**(106)**	(47)
	12,228	11,473	**(7,268)**	(7,360)	**4,960**	4,113	**5,319**	5,677
Deferred tax assets/(liabilities)	**27**	226	**(596)**	(241)	**(569)**	(15)		
Current tax assets/(liabilities)	**40**	98	**(281)**	(180)	**(241)**	(82)		
Short-term deposits and other financial assets	**1,166**	697	**–**	–	**1,166**	697		
Bank overdrafts and loans	**–**	–	**(2,014)**	(2,736)	**(2,014)**	(2,736)		
Retirement benefit assets/(obligations)	**152**	–	**(55)**	(296)	**97**	(296)		
Other	**7**	1	**(24)**	(40)	**(17)**	(39)		
Non-operating assets/(liabilities)	**1,392**	1,022	**(2,970)**	(3,493)	**(1,578)**	(2,471)		
	13,620	12,495	**(10,238)**	(10,853)	**3,382**	1,642		
Less inter-segment (receivables)/payables	**(1,765)**	(1,416)	**1,765**	1,416	**–**	–		
	11,855	11,079	**(8,473)**	(9,437)	**3,382**	1,642		

(i) In 2007, the Group's investment in Barrow Offshore Wind Limited has been allocated to Power generation for reporting purposes. In 2006, the segment assets of the Industrial sales and wholesaling segment have been restated by £58 million to reflect this change.

(ii) In 2007, the Group's investment in Segebel SA and the goodwill related to the acquisition of Oxxio have been allocated to European Energy for external reporting purposes to align with internal management reporting. In 2006, the segment assets of the European Energy segment have been increased by £245 million to reflect this change.

(iii) Restated to reflect change in inter-segment settlement process between British Gas Residential, British Gas Business and Centrica Energy to align with the Group's external settlement process and to re-classify certain inter-segment funding balances from operating assets and liabilities to non-operating assets and liabilities to align with internal management reporting.

(iv) In 2007, the Group changed its reportable segments creating a Power generation reportable segment and an Industrial and commercial reportable segment. Prior to 2007, these two segments were reported together as Industrial sales and wholesaling. The change to reported segments is detailed in note 2. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis.

(v) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.

(vi) Other operations comprise Group Treasury, Information Services and other shared services.

6. Segmental analysis continued

(vii) Capital employed represents the investment required to operate each of the Group's segments. Capital employed is used by the Group to calculate the return on capital employed for each of the Group's segments as part of the Group's managing for value concept. Additional value is created when the return on capital employed exceeds the cost of capital. Net segment assets of the Group can be reconciled to the Group's capital employed as follows:

	2007 £m	2006 £m
Net segment assets	**4,960**	4,113
Less:		
Derivative financial instruments	**429**	1,180
Power generation assets under construction and gas assets under development	**(563)**	(175)
Cash at bank, in transit and in hand	**(53)**	(29)
Effect of averaging month-end balances	**546**	588
Capital employed	**5,319**	5,677

Notes to the Financial Statements continued

6. Segmental analysis continued

(e) Capital expenditure

	Capital expenditure on property, plant and equipment (note 17) year ended 31 December 2007 £m	2006 (restated) (ii) £m	Capital expenditure on other intangible assets (note 15) year ended 31 December 2007 £m	2006 (restated) (ii) £m
British Gas Residential	**3**	–	**2**	33
British Gas Business	**–**	4	**6**	54
British Gas Services	**16**	18	**3**	6
Gas production and development	**117**	246	**15**	17
Power generation (i)	**344**	–	**104**	–
Industrial and commercial (i)	**7**	–	**2**	–
Industrial sales and wholesaling (i)	**–**	92	**–**	61
Accord energy trading	**–**	–	**–**	–
Centrica Energy	**468**	338	**121**	78
Centrica Storage	**19**	14	**1**	–
Direct Energy (iii)	**99**	90	**29**	20
European Energy	**12**	7	**10**	9
Other operations	**11**	4	**9**	18
	628	475	**181**	218

(ii) Secondary reporting format – geographical segments

The Group operates in three main geographical areas:

	Revenue year ended 31 December 2007 £m	2006 (restated) (iv) £m	Total assets (based on location of assets) 31 December 2007 £m	2006 (restated) (v) £m	Capital expenditure on property, plant and equipment (note 17) (based on location of assets) year ended 31 December 2007 £m	2006 (restated) (ii) £m	Capital expenditure on other intangible assets (note 15) (based on location of assets) year ended 31 December 2007 £m	2006 (restated) (ii) £m
Continuing operations:								
UK (v)	**11,954**	11,934	**8,823**	8,137	**516**	371	**134**	189
North America (iv)	**3,992**	4,050	**2,576**	2,579	**99**	90	**29**	20
Rest of world (v)	**396**	419	**456**	363	**13**	14	**18**	9
	16,342	16,403	**11,855**	11,079	**628**	475	**181**	218

(i) In 2007, the Group changed its reportable segments creating a Power generation reportable segment and an Industrial and commercial reportable segment. Prior to 2007, these two segments were reported together as Industrial sales and wholesaling. The change to reported segments is detailed in note 2. Prior period comparatives have not been restated as it is impracticable to provide this information on an equivalent basis.
(ii) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet. Note 2 details the change of accounting presentation.
(iii) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.
(iv) Restated to present The Consumers' Waterheater Income Fund, previously reported in North America, as a discontinued operation as detailed in note 3.
(v) In 2007, the Group's investment in Segebel SA and the goodwill related to the acquisition of Oxxio have been allocated to the Rest of world, from the UK, for external reporting purposes to align with internal management reporting. In 2006, the segment assets of the Rest of world have been increased by £245 million to reflect this change.

7. Costs of continuing operations

Analysis of costs by nature	2007 £m	2006 (restated) (i),(ii) £m
Transportation, distribution and metering costs	**(2,775)**	(2,658)
Commodity costs	**(7,740)**	(8,547)
Depreciation, amortisation and write-downs	**(415)**	(407)
Employee costs	**(415)**	(366)
Other costs relating to energy consumption and provision of services	**(872)**	(786)
Total cost of sales	**(12,217)**	(12,764)
Depreciation, amortisation and write-downs	**(150)**	(149)
Employee costs (ii)	**(901)**	(967)
(Loss)/profit on disposal of property, plant and equipment and other intangible assets	**(7)**	17
Profit on disposal of businesses	**2**	3
Write-down of inventory	**–**	(1)
Impairment of trade receivables (note 20)	**(184)**	(179)
Foreign exchange gains	**–**	3
Other operating costs	**(950)**	(977)
Total operating costs before exceptional items	**(2,190)**	(2,250)
Exceptional items (note 8)	**–**	(331)
Total operating costs	**(2,190)**	(2,581)

(i) Restated to present costs incurred under the Group's energy savings programmes in cost of sales and to reflect the deconsolidation of The Consumers' Waterheater Income Fund. Note 2 details the change of accounting presentation and note 3 explains the deconsolidation of the Fund.
(ii) Employee costs have been increased by £41 million in 2006 to reflect certain employee costs previously reported in other operating costs to align with the current year's presentation of such costs.

Auditors' remuneration	2007 £m	2006 £m
Fees payable to the Company's auditor for the audit of the Company's annual accounts and Group consolidation	**2.2**	2.2
Fees payable to the Company's auditor and its associates for other services:		
The auditing of other accounts within the Group pursuant to legislation (including that of countries and territories outside the UK) (i)	**1.2**	1.2
Other services pursuant to legislation (i)	**0.5**	0.5
Other services relating to taxation	**–**	0.1
All other services	**0.5**	0.7
	4.4	4.7
Fees in respect of pension schemes:		
Audit	**0.1**	0.1

(i) Includes fees in respect of review performed on the interim Financial Statements.

It is the Group's policy to seek competitive tenders for all major consultancy and advisory projects. Appointments are made taking into account factors including expertise, experience and cost. In addition, the Board has approved a detailed policy defining the types of work for which the auditors can tender and the approvals required. In the past, 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.

Notes to the Financial Statements continued

8. Exceptional items and certain re-measurements

(a) Exceptional items (note 2)	2007 £m	2006 £m
Exceptional items recognised in continuing operations		
Systems write-down (i)	–	(196)
Business restructuring costs (ii)	–	(87)
Rough storage incident (iii)	–	(48)
Total exceptional items recognised in continuing operations	–	(331)
Tax credit on exceptional items (i),(ii),(iii)	–	93
Total exceptional items recognised in continuing operations after taxation	–	(238)
Discontinued operations:		
Profit on disposal of The Consumers' Waterheater Income Fund (note 35)	227	–
Total exceptional items recognised	227	(238)

(i) Systems write-down costs in 2006 comprised the write-down of certain major systems developments following a review of their existing and required future functionality. The cost comprises write-downs in British Gas Residential (£178 million) and British Gas Services (£18 million). A tax credit of £59 million was recognised in respect of these costs.
(ii) Business restructuring costs in 2006 comprised £67 million from staff reductions at the corporate centre (£3 million), British Gas Residential (£16 million) and British Gas Services (£48 million), and £20 million related to the closure of the head office of British Gas Residential. A tax credit of £20 million was recognised in respect of these costs.
(iii) Centrica Storage operations at Rough suffered a major interruption caused by a fire in February 2006. Our investment in emergency shutdown systems and prompt management action mitigated the damage to ensure no loss of life. Following a full assessment of the work needed to restore operations, the costs of the incident resulted in an exceptional charge before taxation of £48 million (of which £24 million was recognised within Other operations). A tax credit of £14 million was recognised in respect of the charge.

(b) Certain re-measurements (note 2)	2007 £m	2006 £m
Certain re-measurements recognised in relation to energy contracts		
Net gains/(losses) arising on delivery of contracts (i)	352	(287)
Net losses arising on market price movements and new contracts (ii)	(95)	(623)
Net losses arising on proprietary trades in relation to cross-border transportation or capacity contracts (iii)	(13)	(6)
Net re-measurement of energy contracts included within gross profit	244	(916)
Net losses arising on re-measurement of joint ventures' energy contracts (iv)	(9)	(15)
Net re-measurement included within Group operating profit	235	(931)
Taxation on certain re-measurements	(60)	270
Net re-measurement after taxation	175	(661)
Discontinued operations:		
Fair value (losses)/gains arising on re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund (v)	(19)	37
Total certain re-measurements	156	(624)

(i) As energy is delivered or consumed from previously contracted positions, the related fair value recognised in the opening Balance Sheet (representing the difference between forward energy prices at the opening balance sheet date and the contract price of energy to be delivered) is charged or credited to the Income Statement.
(ii) Represents fair value losses arising from the change in fair value of future contracted sales and purchase contracts as a result of changes in forward energy prices between reporting dates (or date of inception and the reporting date, where later).
(iii) Comprises movements in fair value arising on proprietary trades in relation to cross-border transportation or storage capacity, on which economic value has been created which is not wholly accounted for under the provisions of IAS 39.
(iv) Certain re-measurements included within Group operating profit also include the Group's share of the certain re-measurements relating to the energy procurement activities of joint ventures.
(v) Certain re-measurements included within discontinued operations comprise re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund. All other re-measurements are included within results before exceptional items and certain re-measurements.

9. Directors and employees

(a) Employee costs	2007 £m	2006 (restated) (i) £m
Wages and salaries	**1,074**	1,079
Social security costs	**88**	90
Other pension and retirement benefits costs	**123**	141
Deferred and Matching Share Scheme	**4**	–
Executive Share Option Scheme	**2**	3
Long Term Incentive Scheme	**12**	9
Sharesave Scheme	**8**	8
Share Incentive Plan	**2**	2
Share Award Scheme	**3**	1
	1,316	1,333

(i) Employee costs have been increased by £41 million in 2006 to reflect certain employee costs previously reported in other operating costs to align with the current year's presentation of such costs.

Details of Directors' remuneration, share-based payments and pension entitlements in the Remuneration Report on pages 42 to 51 form part of these Financial Statements. Details of employee share-based payments are given on pages 32, 43, 44, and 45 and in note 33. Details of the remuneration of key management personnel are given in note 37.

(b) Average number of employees during the year	2007 Number	2006 Number
British Gas Residential	**9,227**	11,061
British Gas Business	**2,008**	1,717
British Gas Services	**15,186**	14,560
Centrica Energy	**1,053**	956
Centrica Storage	**191**	193
Direct Energy (i)	**4,839**	5,059
European Energy	**214**	198
Other operations	**1,190**	1,549
	33,908	35,293
UK	**28,829**	30,029
North America	**4,839**	5,059
Rest of world	**240**	205
	33,908	35,293

(i) Direct Energy was disclosed as North American Energy and Related Services in the 2006 Annual Report and Accounts. This change was made to align with internal management reporting.

The average number of employees during the year provided above is based on headcount. In 2006, the average number of employees during the year was disclosed on a full-time equivalent basis totalling 33,933. The equivalent figure in 2007 is 32,634.

Notes to the Financial Statements continued

10. Net interest

	2007			2006 (restated) (i)		
	Interest expense £m	**Interest income £m**	**Total £m**	Interest expense £m	Interest income £m	Total £m
Continuing operations						
Cost of servicing net debt						
Interest income	**–**	**83**	**83**	–	40	40
Interest expense on bank loans and overdrafts (ii)	**(92)**	**–**	**(92)**	(155)	–	(155)
Interest expense on finance leases (including tolling agreements) (iii)	**(87)**	**–**	**(87)**	(47)	–	(47)
	(179)	**83**	**(96)**	(202)	40	(162)
Gains/(losses) on revaluation						
Fair value (losses)/gains on hedges	**(6)**	**5**	**(1)**	(1)	3	2
Fair value (losses)/gains on other derivatives	**(107)**	**42**	**(65)**	(8)	25	17
Net foreign exchange translation of monetary assets and liabilities	**–**	**58**	**58**	(20)	–	(20)
	(113)	**105**	**(8)**	(29)	28	(1)
Other interest						
Notional interest arising on discounted items	**(20)**	**55**	**35**	(15)	26	11
Interest on supplier early payment arrangements	**–**	**15**	**15**	–	11	11
Other interest (iv)	**(19)**	**–**	**(19)**	–	–	–
	(39)	**70**	**31**	(15)	37	22
Interest (expense)/income	**(331)**	**258**	**(73)**	(246)	105	(141)

(i) Restated to present The Consumers' Waterheater Income Fund as a discontinued operation as explained in note 3.
(ii) Includes £nil (2006: £66 million) interest payable on borrowings related to a bank's interest in Centrica Gas Production LP, a limited partnership, which was formed during 2005. The bank ceased to be a limited partner during 2006 and the arrangement with the bank was brought to an end on 11 August 2006.
(iii) Includes £40 million of net interest expense incurred on termination of the Humber finance lease.
(iv) The Group has reached agreement with Her Majesty's Revenue and Customs (HMRC) on a technical matter concerning intra-group transfer pricing of gas produced within the UK Continental Shelf dating back to 2000. The terms of the settlement resulted in a net charge of £13 million, comprising finance costs of £19 million on corporation tax deemed to have been paid late net of an associated £6 million tax credit.

11. Taxation

(a) Analysis of tax charge for the year	2007 £m	2006 (restated) (i) £m
The tax charge comprises:		
Current tax		
UK corporation tax	**309**	199
UK petroleum revenue tax	**200**	234
Tax on exceptional items and certain re-measurements (note 8)	**2**	(20)
Foreign tax	**48**	42
Adjustments in respect of prior years	**4**	(25)
Total current tax	**563**	430
Deferred tax		
Current year	**253**	79
Adjustments in respect of prior years	**(19)**	10
Change in tax rates (ii)	**(9)**	9
Tax on exceptional items and certain re-measurements (note 8)	**58**	(343)
UK petroleum revenue tax	**(32)**	(7)
Foreign deferred tax	**(1)**	8
Total deferred tax	**250**	(244)
Total tax on profit from continuing operations	**813**	186

(i) Restated to present The Consumers' Waterheater Income Fund as a discontinued operation as explained in note 3.
(ii) The effect of the decrease of 2% to the standard rate of UK corporation tax from 1 April 2008 on the relevant temporary differences at 31 December 2007 was a credit of £12 million. No other material amounts arose as a result of changes introduced by the Finance Act 2007. The effect of changes to foreign tax rates on the relevant temporary differences at 31 December 2007 was a charge of £3 million. The effect of the increase of 10% to the UK supplementary charge from 1 January 2006 on the relevant temporary differences at 31 December 2005 was a charge of £9 million.
(iii) Tax on items taken directly to equity is disclosed in note 30.

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, which is currently 30%. A supplementary charge of 20% is also currently applicable on the Group's UK upstream profits. Taxation for other jurisdictions is calculated at the rates prevailing in those respective jurisdictions.

Notes to the Financial Statements continued

11. Taxation continued

(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:

	2007 £m			2006 (restated) (i) £m		
	Results for the year before exceptional items and certain re-measurements £m	**Exceptional items and certain re-measurements £m**	**Results for the year £m**	Results for the year before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Results for the year £m
Profit from continuing operations before tax	**1,876**	**235**	**2,111**	1,251	(1,262)	(11)
Less: share of (profits)/losses in joint ventures and associates, net of interest and taxation	**(14)**	**9**	**(5)**	(3)	15	12
Group profit from continuing operations before tax	**1,862**	**244**	**2,106**	1,248	(1,247)	1
Tax on profit from continuing operations at standard UK corporation tax rate of 30% (2006: 30%)	**559**	**73**	**632**	374	(374)	–
Effects of:						
(Income)/expenses not (chargeable)/deductible for tax purposes	**11**	**–**	**11**	(12)	17	5
Adjustments in respect of prior years	**(15)**	**(15)**	**(30)**	(15)	–	(15)
Movement in unrecognised deferred tax assets	**16**	**–**	**16**	(71)	–	(71)
UK petroleum revenue tax rates	**118**	**–**	**118**	159	–	159
Overseas tax rates	**8**	**5**	**13**	7	(12)	(5)
Supplementary charge applicable to upstream profits	**65**	**(3)**	**62**	98	6	104
Changes to tax rates	**(9)**	**–**	**(9)**	9	–	9
Group tax charge on profit from continuing operations	**753**	**60**	**813**	549	(363)	186

(i) Restated to present The Consumers' Waterheater Income Fund as a discontinued operation as detailed in note 3.

(c) Factors that may affect future tax charges

The Group earns income from many activities, including oil and gas production in the UK, North America and elsewhere. On average, the Group pays taxes at higher rates than the UK statutory rate of 30% (2006: 30%). The impact of higher rates, including petroleum revenue tax and the supplementary charge on UK Continental Shelf profits, is subject to the mix of the Group's income. In the medium-term, the Group's effective tax rate is expected to remain above the UK statutory rate.

12. Dividends

	2007 £m	2006 £m
Prior year final dividend of 8.00 pence (2006: 7.40 pence) per ordinary share	**294**	269
Interim dividend of 3.35 pence (2006: 3.15 pence) per ordinary share	**123**	115
	417	384

The prior year final dividend was paid on 13 June 2007 (2006: 14 June). The interim dividend was paid on 14 November 2007 (2006: 15 November).

The Directors propose a final dividend of 9.65 pence per share (totalling £355 million) for the year ended 31 December 2007. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 12 May 2008. 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 2008.

13. Earnings per ordinary share

Basic earnings per ordinary share has been calculated by dividing the earnings attributable to equity holders of the Company for the year of £1,505 million (2006: loss of £155 million) by the weighted average number of ordinary shares in issue during the year of 3,673 million (2006: 3,643 million).

The Directors believe that the presentation of 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:

	2007		2006	
(a) Continuing and discontinued operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings/(loss) – basic	**1,505**	**41.0**	(155)	(4.3)
Net exceptional items after tax (notes 2 and 8)	**(227)**	**(6.2)**	238	6.6
Certain re-measurement (gains) and losses after tax (notes 2 and 8)	**(156)**	**(4.2)**	624	17.1
Earnings – adjusted basic	**1,122**	**30.6**	707	19.4
Earnings/(loss) – diluted	**1,505**	**40.3**	(155)	(4.3)
Earnings/(loss) – adjusted diluted	**1,122**	**30.0**	707	19.0

	2007		2006	
(b) Continuing operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings/(loss) – basic	**1,296**	**35.3**	(198)	(5.4)
Net exceptional items after tax (notes 2 and 8)	**–**	**–**	238	6.6
Certain re-measurement (gains) and losses after tax (notes 2 and 8)	**(175)**	**(4.8)**	661	18.0
Earnings – adjusted basic	**1,121**	**30.5**	701	19.2
Earnings/(loss) – diluted	**1,296**	**34.7**	(198)	(5.4)
Earnings/(loss) – adjusted diluted	**1,121**	**30.0**	701	18.9

	2007		2006	
(c) Discontinued operations	**£m**	**Pence per ordinary share**	£m	Pence per ordinary share
Earnings – basic	**209**	**5.7**	43	1.1
Earnings – diluted	**209**	**5.6**	43	1.1

Certain re-measurements (notes 2 and 8) included within operating profit comprise re-measurements arising on our energy procurement activities and re-measurement of proprietary trades in relation to cross-border transportation or capacity contracts. Certain re-measurements included within discontinued operations comprise re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund. All other re-measurements are included within results before exceptional items and certain re-measurements.

Notes to the Financial Statements continued

13. Earnings per ordinary share continued

In addition to basic and adjusted earnings per ordinary share, information is presented for diluted and adjusted diluted earnings per ordinary share. Under this presentation, no adjustments are made to the reported earnings for either 2007 or 2006, however the weighted average number of shares used as the denominator is adjusted for potentially dilutive ordinary shares. In 2006 no adjustment was made to the denominator for diluted earnings per share to reflect potentially dilutive ordinary shares, as to do so would decrease the loss per share.

	2007 million shares	2006 million shares
Weighted average number of shares used in the calculation of basic earnings per ordinary share	**3,673**	3,643
Estimated vesting of Long Term Incentive Scheme shares	**18**	19
Dilutive effect of shares to be issued at a discount to market value under the Sharesave Schemes	**26**	26
Potentially dilutive shares issuable under the Executive Share Option Scheme	**7**	28
Estimated vesting of Deferred and Matching Share Scheme shares	**7**	–
Estimated vesting of Share Incentive Plan and Employee Share Purchase Plan shares	**3**	2
Estimated vesting of Share Award Scheme and Restricted Share Scheme shares	**2**	1
Weighted average number of shares used in the calculation of diluted earnings per ordinary share	**3,736**	3,719

14. Goodwill

	2007 £m	2006 £m
Cost and net book value		
1 January	**1,055**	1,170
Acquisitions (note 35)	**58**	4
Disposals (note 35)	**(124)**	–
Exchange adjustments	**85**	(119)
31 December	**1,074**	1,055

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

	2007 £m	2006 £m
Direct Energy	**335**	288
Energy America	**23**	23
Enron Direct/Electricity Direct	**133**	133
Enbridge Services [(i)]	**79**	177
CPL/WTU	**186**	188
ATCO	**46**	40
Dyno-Rod	**17**	17
Residential Services Group	**67**	68
Oxxio	**90**	83
Newfield UK	**55**	–
Other	**43**	38
	1,074	1,055

(i) The Group has deconsolidated The Consumers' Waterheater Income Fund with effect from 1 December 2007. Goodwill has been attributed to the Fund on its disposal as explained in note 35.

15. Other intangible assets

	Application software £m	Renewable obligation certificates £m	Brands (i) £m	Customer relationships £m	Consents £m	Exploration and evaluation expenditure (ii) £m	Other £m	**Total £m**
Cost								
1 January 2007 (ii)	398	27	57	69	29	24	37	**641**
Additions – acquired from a third party	23	97	–	–	–	30	5	**155**
Additions – internally generated	26	–	–	–	–	–	–	**26**
Acquisitions (note 35)	–	–	–	10	–	12	–	**22**
Disposals of subsidiaries (note 35)	–	–	–	(9)	–	–	(1)	**(10)**
Disposals	(11)	–	–	–	–	–	–	**(11)**
Exploration and evaluation expenditure transferred to producing assets (note 17)	–	–	–	–	–	(17)	–	**(17)**
Surrenders	–	(72)	–	–	–	–	–	**(72)**
Write-downs	–	–	–	–	–	(13)	–	**(13)**
Exchange adjustments	11	1	–	2	–	5	3	**22**
31 December 2007	**447**	**53**	**57**	**72**	**29**	**41**	**44**	**743**
Aggregate amortisation and impairment								
1 January 2007	160	–	–	20	–	–	15	**195**
Charge for the year	53	–	–	10	–	–	17	**80**
Disposals of subsidiaries (note 35)	–	–	–	(1)	–	–	–	**(1)**
Disposals	(6)	–	–	–	–	–	–	**(6)**
Exchange adjustments	7	–	–	3	–	–	–	**10**
31 December 2007	**214**	**–**	**–**	**32**	**–**	**–**	**32**	**278**
Net book value								
31 December 2007	**233**	**53**	**57**	**40**	**29**	**41**	**12**	**465**

Notes to the Financial Statements continued

15. Other intangible assets continued

	Application software £m	Renewable obligation certificates £m	Brands (i) £m	Customer relationships £m	Consents £m	Exploration and evaluation expenditure (ii) £m	Other £m	Total £m
Cost								
1 January 2006 (ii)	535	48	57	41	29	16	5	731
Additions – acquired from a third party	15	60	–	4	–	34	30	143
Additions – internally generated	71	–	–	–	–	–	4	75
Acquisitions	–	–	–	27	–	–	–	27
Disposals	(20)	–	–	–	–	–	(2)	(22)
Exploration and evaluation expenditure transferred to producing assets (note 17)	–	–	–	–	–	(2)	–	(2)
Surrenders	–	(81)	–	–	–	–	–	(81)
Write-downs	(196)	–	–	–	–	(20)	–	(216)
Exchange adjustments	(7)	–	–	(3)	–	(4)	–	(14)
31 December 2006	398	27	57	69	29	24	37	641
Aggregate amortisation and impairment								
1 January 2006	135	–	–	10	–	–	1	146
Charge for the year	48	–	–	11	–	–	14	73
Disposals	(18)	–	–	–	–	–	–	(18)
Exchange adjustments	(5)	–	–	(1)	–	–	–	(6)
31 December 2006	160	–	–	20	–	–	15	195
Net book value								
31 December 2006	238	27	57	49	29	24	22	446

(i) Brands represent 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 has reviewed potential threats from competition, the risks of technological obsolescence and the expected usage of the brand by management.

(ii) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet. Note 2 details the change of accounting presentation.

16. 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:

Cash-generating unit	Acquisition to which goodwill relates	2007 Carrying amount of goodwill £m	2007 Carrying amount of indefinite lived brand £m	2007 Total £m	2006 Carrying amount of goodwill £m	2006 Carrying amount of indefinite lived brand £m	2006 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	**186**	**–**	**186**	188	–	188
Canada mass markets	Direct Energy/ATCO	**293**	**–**	**293**	253	–	253
Canada Direct Energy business services	Direct Energy/ATCO	**88**	**–**	**88**	75	–	75
Canada home services (i)	Enbridge Services/others	**83**	**–**	**83**	177	–	177
US home services	Residential Services Group	**67**	**–**	**67**	68	–	68
Europe – Oxxio	Oxxio	**90**	**–**	**90**	83	–	83
Other (ii)	Various	**117**	**–**	**117**	61	–	61
		1,074	**57**	**1,131**	1,055	57	1,112

(i) Carrying amount of goodwill also contains goodwill from other Canada home services acquisitions which are not significant compared with the aggregate carrying value of goodwill reported within the Group. The Group has deconsolidated The Consumers' Waterheater Income Fund with effect from 1 December 2007. Goodwill has been attributed to the Fund on its disposal as explained in note 35.

(ii) Goodwill balances allocated across multiple cash-generating units. The amount of goodwill allocated to each cash-generating unit is not significant compared with the aggregate carrying value of goodwill reported within the Group.

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 three years. These business plans have been approved by the Board 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 three-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, Belgium 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. Discount rates applied to North American cash-generating units range from 9.4% to 9.5%, and from 8.5% to 11.2% for UK and Europe cash-generating units on a pre-tax basis. Growth rates used to extrapolate cash flow projections beyond the period covered by the most recent forecasts range from 1% to 2.5%.

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: for existing contract customers this is based on contracted margins. For new and renewal contract customers this is based on achieved gross margin in the period prior to the approval of the business plan, adjusted in some areas to reflect market conditions. For tariff customers this is based on current prices in the period prior to the approval of the business plan, adjusted for the Group's view of the forward energy curve.
- Budgeted market share: based on the average market share achieved immediately prior to the approval of the business plan, adjusted for growth forecasts based on sales and marketing activity.

British Gas Services – Dyno-Rod

- Budgeted franchise fee income: based on the average income achieved immediately prior to the approval of the business plan, adjusted for growth forecasts based on sales and marketing activity.
- Budgeted cost growth: based on the cost growth in the period prior to the approval of the business plan.

Notes to the Financial Statements continued

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

Texas residential energy

- Budgeted gross margin: based on the average gross margin achieved prior to the approval of the business plan, adjusted to reflect market conditions.
- Budgeted market prices: based on a combination of the Group's view of forward gas and power prices immediately prior to the approval of the business plan and the price impact of targeted margins.
- Budgeted consumption: based on past experience of the average consumption per customer prior to the approval of the business plan.
- Budgeted customer numbers: based on past experience in the three years prior to the approval of the business plan adjusted for an expected marginal decline in customer numbers.

Canada mass markets

- Budgeted gross margin: for existing customers this is based on contracted margins. For new and renewal contract customers this is based on gross margin achieved in the period immediately prior to the approval of the business plan.
- Budgeted market share: based on average market share achieved in the period immediately prior to the approval of the business plan, adjusted for growth and decline assumptions specific to each of the competitive and regulated businesses.
- Budgeted market prices: for existing customers this is based on contracted prices. For new or renewal customers this is based on the Group's view of forward gas and power prices in Canada.
- Budgeted cost growth: based on current and forecasted experience required to support customer acquisition, renewal, retention and other servicing activities.

Canada Direct Energy business services

- Budgeted gross margin: based on gross margins achieved through recent sales and renewal activity and potentially adjusted for future expected market conditions.
- Budgeted churn: based on historic actual attrition and renewal rates prior to the approval of the business plan.
- Budgeted revenue growth: based on management's view of forward commodity cost curves as provided by the internal energy management group at the time of approval of the business plan to determine future selling prices. Volume growth is estimated based on average achieved growth in the past, uplifted by expected future growth as a result of the planned sales activities that management believes to be reasonably attainable.

Canada home services

- Budgeted gross margin: based on gross margins achieved in the period immediately prior to the approval of the business plan.
- Budgeted revenue growth: based on the average revenue growth achieved for the three-year period prior to the approval of the business plan, uplifted for additional product offerings.

US home services

- Budgeted gross margin: based on gross margins achieved in the period immediately prior to the approval of the business plan.
- Budgeted revenue growth: based on the average revenue growth achieved over the last three years prior to the approval of the business plan, uplifted for growth targets based on expected market penetration in certain key US state markets.

Europe – Oxxio

- Budgeted revenue growth: based on revenue in the period immediately prior to the approval of the business plan, uplifted for expected growth in customer base, cross-selling of products and reduction of customer churn.
- Budgeted gross margin: based on the average gross margin achieved in periods prior to the approval of the business plan, adjusted for the expected impact arising from the unbundling of the gas and electricity markets going forward.
- Budgeted operating expenditure: based on historical trends, adjusted for cost improvement programmes implemented.

The Group 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 recoverable amounts to be less than the carrying amounts of the cash-generating units.

17. Property, plant and equipment

	Land and buildings (i) £m	Plant, equipment and vehicles (ii),(iii) £m	Power generation (iii),(iv) £m	Gas storage and production (iii),(iv),(v),(vi) £m	**Total £m**
Cost					
1 January 2007 (vi),(vii)	38	648	1,732	4,860	**7,278**
Additions	–	76	386	166	**628**
Exploration and evaluation expenditure transferred to producing assets (note 15)	–	–	–	17	**17**
Acquisitions (note 35)	–	10	–	244	**254**
Disposals of subsidiaries (note 35)	–	(323)	–	–	**(323)**
Disposals	–	(173)	(52)	(1)	**(226)**
Revisions and additions to decommissioning liability	–	–	12	80	**92**
Exchange adjustments	1	50	(2)	67	**116**
31 December 2007	**39**	**288**	**2,076**	**5,433**	**7,836**
Aggregate depreciation and impairment					
1 January 2007 (vii)	16	222	244	3,141	**3,623**
Charge for the year	1	75	107	311	**494**
Disposal of subsidiaries (note 35)	–	(102)	–	–	**(102)**
Disposals	–	(90)	(48)	–	**(138)**
Exchange adjustments	–	16	2	31	**49**
31 December 2007	**17**	**121**	**305**	**3,483**	**3,926**
Net book value					
31 December 2007	**22**	**167**	**1,771**	**1,950**	**3,910**

	Land and buildings (i) £m	Plant, equipment and vehicles (ii),(iii) £m	Power generation (iii),(iv) £m	Gas storage and production (iii),(iv),(v),(vi) £m	Total £m
Cost					
1 January 2006 (vi),(vii)	45	779	1,632	4,554	7,010
Additions	–	75	107	293	475
Exploration and evaluation expenditure transferred to producing assets (note 15)	–	–	–	2	2
Acquisitions	–	–	31	3	34
Disposals	(7)	(144)	(12)	(28)	(191)
Revisions and additions to decommissioning liability	–	–	–	87	87
Exchange adjustments	–	(62)	(26)	(51)	(139)
31 December 2006	38	648	1,732	4,860	7,278
Aggregate depreciation and impairment					
1 January 2006 (vii)	17	301	143	2,895	3,356
Charge for the year	1	87	107	291	486
Disposals	(2)	(135)	(3)	(26)	(166)
Exchange adjustments	–	(31)	(3)	(19)	(53)
31 December 2006	16	222	244	3,141	3,623
Net book value					
31 December 2006	22	426	1,488	1,719	3,655

Notes to the Financial Statements continued

17. Property, plant and equipment continued

(i) The net book value of land and buildings comprises the following:

	2007 £m	2006 £m
Freeholds	**14**	14
Long leaseholds	**1**	1
Short leaseholds	**7**	7
	22	22

(ii) In 2006 the net book value of the fixed assets of The Consumers' Waterheater Income Fund (the Fund) within plant, equipment and vehicles was £197 million. Debt issued by a subsidiary of the Fund, without recourse to the Group, was secured on the assets. The Fund was deconsolidated with effect from 1 December 2007 as explained in note 3.

(iii) Assets in the course of construction are included within the following categories of property, plant and equipment:

	2007 £m	2006 £m
Plant, equipment and vehicles	**7**	9
Power generation	**393**	88
Gas storage and production	**202**	73
	602	170

(iv) Assets held under finance leases included in totals above	2007 Power generation £m	2007 Gas storage and production £m	2007 Total £m	2006 Power generation £m	2006 Gas storage and production £m	2006 Total £m
Cost at 1 January	**882**	**415**	**1,297**	883	419	1,302
Additions	**4**	**–**	**4**	–	–	–
Disposals	**–**	**–**	**–**	(1)	(4)	(5)
Transferred out of assets held under finance leases (viii)	**(417)**	**–**	**(417)**	–	–	–
Cost at 31 December	**469**	**415**	**884**	882	415	1,297
Aggregate depreciation at 1 January	**89**	**344**	**433**	50	340	390
Charge for the year	**60**	**8**	**68**	39	6	45
Disposals	**–**	**–**	**–**	–	(2)	(2)
Transferred out of assets held under finance leases (viii)	**(59)**	**–**	**(59)**	–	–	–
Aggregate depreciation at 31 December	**90**	**352**	**442**	89	344	433
Net book value at 31 December	**379**	**63**	**442**	793	71	864

Power generation assets are subject to the following restrictions:

	2007 £m	2006 £m
Net book value of assets to which title is restricted (Spalding finance lease asset)	**379**	407
Net book value of assets pledged as security for liabilities (viii)	**–**	386

(v) The net book value of decommissioning costs included within gas storage and production assets was £209 million (2006: £124 million).

(vi) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet. Note 2 details the change of accounting presentation.

(vii) 1 January 2006 cost and aggregate depreciation balances for plant, equipment and vehicles were increased to reflect fully depreciated assets that were found to be still in use. There was no impact on net book value. These assets were fully disposed of on deconsolidation of The Consumers' Waterheater Income Fund as explained in note 3.

(viii) Relates to the Humber Power Station that was the subject of a finance lease that was terminated during the year.

18. Interests in joint ventures and associates

(a) Share of net assets/cost	Investments in joint ventures and associates: Investments £m	Investments in joint ventures and associates: Goodwill (i) £m	Shareholder loans (i) £m	**Total £m**
1 January 2007	171	26	23	**220**
Additions	1	4	38	**43**
Increase in shareholder loans	–	–	2	**2**
Share of profits for the year	5	–	–	**5**
Exchange adjustments	15	–	–	**15**
31 December 2007	**192**	**30**	**63**	**285**

(i) On 12 July 2007 the Group acquired a 50% stake in the equity of Braes of Doune Wind Farm (Scotland) Limited for £42 million in cash.

	Investments in joint ventures and associates: Investments £m	Investments in joint ventures and associates: Goodwill £m	Shareholder loans £m	Total £m
1 January 2006	185	26	12	223
Increase in shareholder loans	–	–	11	11
Share of losses for the year	(12)	–	–	(12)
Exchange adjustments	(2)	–	–	(2)
31 December 2006	171	26	23	220

(b) Share of joint ventures' assets and liabilities

The Group's share of joint ventures' gross assets and gross liabilities at 31 December 2007 principally comprises its interests in Braes of Doune Wind Farm (Scotland) Limited (renewable power generation), Barrow Offshore Wind Limited (renewable power generation) and Segebel SA (energy supply).

	Braes of Doune Wind Farm (Scotland) Limited £m	Barrow Offshore Wind Limited £m	Segebel SA £m	Other (i) £m	**2007 Total £m**	2006 Total £m
Share of current assets	7	13	79	1	**100**	109
Share of non-current assets	37	65	248	–	**350**	299
	44	78	327	1	**450**	408
Share of current liabilities	(24)	(8)	(46)	–	**(78)**	(97)
Share of non-current liabilities	(19)	(29)	(101)	(1)	**(150)**	(114)
	(43)	(37)	(147)	(1)	**(228)**	(211)
Shareholder loans	38	23	–	2	**63**	23
Interests in joint ventures and associates	39	64	180	2	**285**	220
Net (debt)/cash included in share of net assets	(39)	(26)	31	(1)	**(35)**	(5)

(i) Other includes the Group's interest in Coots (CO_2 pipeline construction) and the Group's investment in a start-up joint venture Home Assistance UK Ltd (Insurance mediation). Neither of these interests in joint ventures are significant relative to the Group's interests in joint ventures in aggregate.

Notes to the Financial Statements continued

18. Interests in joint ventures and associates continued

(c) Share of joint ventures' result	Braes of Doune Wind Farm (Scotland) Limited £m	Barrow Offshore Wind Limited £m	Segebel SA £m	2007 Total £m	2006 Total £m
Income	2	7	377	**386**	344
Expenses	(2)	(2)	(375)	**(379)**	(363)
	–	5	2	**7**	(19)
Tax	–	(1)	(1)	**(2)**	7
Share of post-tax results of joint ventures and associates	–	4	1	**5**	(12)

The Group's share of the investments in and results of Braes of Doune Wind Farm (Scotland) Limited and Barrow Offshore Wind Limited are included within the Power generation segment in 2007. The Group's share of the investment in and results of Barrow Offshore Wind Limited were included within the Industrial and wholesaling segment in 2006. The Group's share of the investment in and results of Segebel SA are included within the European Energy segment.

19. Inventories

	2007 £m	2006 £m
Gas in storage and transportation	**134**	168
Other raw materials and consumables	**84**	77
Finished goods and goods for resale	**23**	25
	241	270

There are no inventories which are carried at fair value less cost to sell (2006: £nil). The Group consumed £488 million of inventories (2006: £390 million) during the year.

20. Trade and other receivables

	2007 Current £m	2007 Non-current £m	2006 Current £m	2006 Non-current £m
Financial assets:				
Trade receivables	**1,405**	**22**	1,491	13
Accrued energy income	**1,678**	**–**	1,730	–
Other receivables	**553**	**11**	382	3
	3,636	**33**	3,603	16
Less: Provision for credit losses	**(431)**	**–**	(319)	–
	3,205	**33**	3,284	16
Non-financial assets:				
Prepayments and other receivables	**218**	**–**	306	–
	3,423	**33**	3,590	16

20. Trade and other receivables continued

Trade and other receivables include financial assets representing the contractual right to receive cash or other financial assets from residential customers, business customers and treasury, trading and energy procurement counterparties as follows:

	2007		2006	
	Current £m	Non-current £m	Current £m	Non-current £m
Financial assets by class:				
Residential customers	**1,960**	**23**	2,232	12
Business customers	**802**	**9**	681	4
Treasury, trading and energy procurement counterparties	**874**	**1**	690	–
	3,636	**33**	3,603	16
Less: Provision for credit losses	**(431)**	**–**	(319)	–
	3,205	**33**	3,284	16

Receivables from residential and business customers are generally considered to be fully performing until such time as the payment that is due remains outstanding past the contractual due date. Contractual due dates range from being due upon receipt to due in 30 days. An ageing of the carrying value of trade and other receivables that are past due but not considered to be individually impaired by class is as follows:

	2007		2006	
Days past due	Residential customers £m	Business customers £m	Residential customers £m	Business customers £m
Less than 30 days	**276**	**55**	281	68
30-89 days	**174**	**41**	103	28
Less than 90 days	**450**	**96**	384	96
90-182 days	**91**	**47**	72	34
183-365 days	**98**	**37**	62	21
Greater than 365 days	**62**	**17**	33	7
	701	**197**	551	158

At 31 December 2007 there were £87 million of receivables, net of provisions for credit losses, from residential customers (2006: £98 million) that were considered to be individually impaired. There were no individually impaired receivables, net of provisions for credit losses, from business customers or from treasury, trading and energy procurement counterparties. Receivables from residential customers are generally reviewed for impairment on an individual basis once a customer discontinues their relationship with the Group.

The provision for credit losses is based on an incurred loss model and is determined by application of expected default and loss factors, determined by historical loss experience and current sampling to the various balances receivable from residential and business customers on a portfolio basis, in addition to provisions taken against individual accounts. Balances are written off when recoverability is assessed as being remote. Movements in the provision for credit losses by class are as follows:

2007	Residential customers £m	Business customers £m	**Total £m**
1 January	(270)	(49)	**(319)**
Impairment of trade receivables	(132)	(52)	**(184)**
Receivables written off	55	20	**75**
Exchange adjustments	(3)	–	**(3)**
31 December	**(350)**	**(81)**	**(431)**

Notes to the Financial Statements continued

20. Trade and other receivables continued

2006	Residential customers £m	Business customers £m	Total £m
1 January	(228)	(40)	(268)
Impairment of trade receivables	(143)	(36)	(179)
Receivables written off	102	27	129
Exchange adjustments	(1)	–	(1)
31 December	(270)	(49)	(319)

At 31 December 2007 the Group held £36 million (2006: £16 million) of customer deposits for the purposes of mitigating the credit risk associated with receivables from residential and business customers.

At 31 December 2007 there was no provision for credit losses associated with receivables from treasury, trading and energy procurement counterparties (2006: £nil) because all balances are considered to be fully recoverable. Exposure to credit risk associated with receivables from treasury, trading and energy procurement counterparties is monitored by counterparty credit rating as follows:

Receivables from treasury, trading and energy procurement counterparties by credit rating	Carrying value £m	AAA £m	AA £m	A £m	BBB £m	BB or lower £m	Unrated £m
2007	**875**	7	189	277	129	26	247
2006	690	4	116	252	125	46	147

The unrated counterparty receivables are comprised primarily of amounts due from subsidiaries of rated entities, exchanges or clearing houses. Receivables from treasury, trading and energy procurement counterparties are managed in accordance with the Group's credit risk management policies as described in note 4.

21. Derivative financial instruments

Derivative financial instruments are generally held for the purposes of proprietary energy trading, treasury management or energy procurement. Derivatives held for the purposes of proprietary energy trading are carried at fair value, with changes in fair value recognised in the Group's results for the year before exceptional items and certain re-measurements, with the exception of certain derivatives related to cross-border transportation and capacity contracts (note 2). Derivative financial instruments held for the purposes of treasury management or energy procurement are also carried at fair value, with changes in the fair value of derivatives relating to treasury management reflected in the results for the year before exceptional items and certain re-measurements, and those relating to energy procurement reflected in certain re-measurements. In cases where a derivative qualifies for hedge accounting, derivatives are classified as fair value hedges, cash flow hedges or hedges of a net investment in a foreign operation. Notes 2 and 22 provide further detail on the Group's hedge accounting.

Energy contracts designated at fair value through profit and loss include certain energy contracts that the Group has, at its option, designated at fair value through profit and loss under IAS 39 because the energy contract contains one or more embedded derivatives that significantly modify the cash flows under the contract (note 2).

21. Derivative financial instruments continued

The carrying values of derivative financial instruments by product type for accounting purposes are as follows:

	2007 £m	2006 £m
Derivative financial instruments – held for proprietary energy trading		
Derivative financial instruments – held for trading under IAS 39		
Energy derivatives – assets	**44**	225
Energy derivatives – liabilities	**(52)**	(199)
	(8)	26
Derivative financial instruments – held for the purposes of treasury management or energy procurement		
Derivative financial instruments – held for trading under IAS 39		
Energy derivatives – assets	**789**	503
Energy derivatives – liabilities	**(1,100)**	(1,143)
Interest rate derivatives – assets	**2**	2
Interest rate derivatives – liabilities	**(5)**	(4)
Foreign exchange derivatives – assets	**19**	17
Foreign exchange derivatives – liabilities	**(80)**	(4)
	(375)	(629)
Energy contracts designated at fair value through profit and loss		
Energy derivatives – assets	**9**	3
Energy derivatives – liabilities	**(86)**	(57)
	(77)	(54)
Derivative financial instruments in hedge accounting relationships		
Energy derivatives – assets	**123**	16
Energy derivatives – liabilities	**(68)**	(500)
Interest rate derivatives – liabilities	**(7)**	(40)
Foreign exchange derivatives – assets	**–**	11
Foreign exchange derivatives – liabilities	**(17)**	(10)
	31	(523)
Net total	**(429)**	(1,180)

The net total reconciles to the Balance Sheet as follows:

	2007 £m	2006 £m
Derivative financial instruments – non-current assets	**72**	17
Derivative financial instruments – current assets	**914**	760
	986	777
Derivative financial instruments – current liabilities	**(1,404)**	(1,737)
Derivative financial instruments – non-current liabilities	**(11)**	(220)
	(1,415)	(1,957)
Net total	**(429)**	(1,180)

The contracts included within energy derivatives are subject to a wide range of detailed specific terms but comprise the following general components:

	2007 £m	2006 £m
Short-term forward market purchases and sales of gas and electricity:		
UK and Europe	**107**	(260)
North America	**(80)**	(238)
Structured gas purchase contracts	**250**	(226)
Structured gas sales contracts	**(553)**	(390)
Other	**(65)**	(38)
Net total	**(341)**	(1,152)

Notes to the Financial Statements continued

21. Derivative financial instruments continued

Net gains/(losses) on derivative financial instruments due to re-measurement	2007 Income Statement £m	2007 Equity £m	2006 Income Statement £m	2006 Equity £m
Financial assets and liabilities measured at fair value through profit and loss:				
Derivative financial instruments – held for proprietary energy trading	**(5)**	**–**	8	–
Derivative financial instruments – held for trading under IAS 39	**230**	**–**	(840)	–
Energy contracts designated at fair value through profit and loss	**(35)**	**–**	(54)	–
Derivative financial instruments in hedge accounting relationships	**3**	**535**	(30)	(837)
	193	**535**	(916)	(837)

Derivative-related credit risk – assets

Credit risk from derivative transactions is generated by the potential for the counterparty to default on its contractual obligations. Therefore, derivative-related credit risk is represented by the positive fair value of the instrument and is normally a small fraction of the contract's notional amount. Credit risk from derivatives is measured and managed by counterparty credit rating as follows:

Fair value of derivative financial instruments with a positive fair value by counterparty credit rating	Carrying value £m	AAA £m	AA £m	A £m	BBB £m	BB or lower £m	Unrated £m
2007	**986**	–	372	272	51	–	291
2006	777	–	236	322	111	53	55

To manage derivative-related counterparty credit exposure, the Group employs the use of margining and set-off rights in some agreements. Under margining agreements, the Group has the right to request that the counterparty pay down or collateralise the current fair value of its derivatives position when the position passes a specified threshold. At 31 December 2007 the Group was holding £93 million (2006: £33 million) of cash as collateral against counterparty balances, and had pledged £118 million (2006: £61 million) of cash as collateral, principally under margin calls to cover exposure to mark-to-market positions on derivative contracts. Generally, cash paid or received as collateral is interest-bearing and is free from any restriction over its use.

Maturity profiles of derivative financial instruments – liabilities

IFRS 7 requires disclosure of a maturity analysis for financial liabilities that shows remaining contractual maturities on an undiscounted basis. The following maturity analysis shows the remaining contractual maturities on an undiscounted basis for the Group's derivative financial instruments that are in a loss position at the balance sheet date and will be settled on a net basis:

Energy derivatives that will be settled on a net basis	2007 £m	2006 £m
Less than one year	**(128)**	(296)
One to five years	**(53)**	(113)
More than five years	**(2)**	(15)
	(183)	(424)

Interest rate derivatives that will be settled on a net basis	2007 £m	2006 £m
Less than one year	**(9)**	(5)
One to five years	**(4)**	(25)
More than five years	**(1)**	(10)
	(14)	(40)

21. Derivative financial instruments continued

Certain of the Group's energy contracts that are accounted for as derivatives are for the physical purchase of energy. In these cases IFRS 7 requires disclosure of a maturity analysis that shows cash outflows on all purchase contracts on an undiscounted basis, including those derivative contracts in a gain position at the balance sheet date as follows:

Energy procurement contracts that are carried at fair value	2007 £m	2006 £m
Less than one year	**(12,076)**	(10,652)
One to five years	**(17,559)**	(16,175)
More than five years	**(6,719)**	(7,638)
	(36,354)	(34,465)

The Group's foreign exchange derivative contracts will be settled on a gross basis. In these cases IFRS 7 requires disclosure of a maturity analysis that shows cash outflows on all derivative contracts on an undiscounted basis, including those derivative contracts in a gain position at the balance sheet date. In addition to cash outflows on all foreign exchange derivative contracts that are gross settled on an undiscounted basis, the following analysis also provides disclosure of the related cash inflows as follows:

	2007		2006	
Foreign exchange derivatives that will be settled on a gross basis	Outflow £m	Inflow £m	Outflow £m	Inflow £m
Less than one year	**(1,898)**	**1,851**	(1,390)	1,404
One to five years	**(811)**	**785**	(436)	442
More than five years	**(130)**	**112**	(104)	81
	(2,839)	**2,748**	(1,930)	1,927

22. Hedge accounting

For the purposes of hedge accounting, hedges are classified either as fair value hedges, cash flow hedges or hedges of net investments in foreign operations. Note 2 details the Group's accounting policies in relation to derivatives qualifying for hedge accounting under IAS 39. The fair values of derivative and primary financial instruments in hedge accounting relationships at 31 December were as follows:

	2007		2006	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges	**–**	**9**	–	12
Cash flow hedges	**123**	**67**	21	538
Net investment hedges:				
Primary financial instruments	**–**	**74**	–	117
Derivative financial instruments	**–**	**16**	6	–

Fair value hedges

The Group's fair value hedges consist of interest rate swaps, cross-currency interest rate swaps and forward rate agreements used to protect against changes in the fair value of fixed-rate long-term debt due to movements in market interest rates. For qualifying fair value hedges, all changes in the fair value of the hedging instrument and in the fair value of the hedged item in relation to the risk being hedged are recognised in income within net interest expense.

Notes to the Financial Statements continued

22. Hedge accounting continued

Gains or losses arising on fair value hedges at 31 December were as follows:

Gains/(losses)	**2007 £m**	2006 £m
On hedging instruments	**5**	(14)
On hedged items attributable to the hedged risk	**(6)**	16
	(1)	2

Cash flow hedges

The Group's cash flow hedges consist primarily of: (a) physical and financial gas and power purchase contracts used to protect against the variability in future cash flows associated with highly probable forecast purchases of gas and power due to movements in market commodity prices; (b) forward foreign exchange contracts used to protect against the variability of functional currency denominated cash flows associated with non-functional currency denominated highly probable forecast transactions; and (c) interest rate swaps, cross-currency interest rate swaps and forward rate agreements used to protect against the variability in cash flows associated with floating-rate borrowings due to movements in market interest rates.

Gains and losses are initially recognised in the cash flow hedging reserve in equity and are transferred to the Income Statement when the forecast cash flows affect the Income Statement. Note 30 details movements in the cash flow hedging reserve. The ineffective portion of gains and losses on cash flow hedging are recognised immediately in the Income Statement. During 2007 the Group recognised a gain of £nil (2006: loss of £9 million) due to cash flow hedge ineffectiveness.

Net investment hedges

The Group's net investment hedges consist of foreign currency debt issued in the same currency as the net investment, foreign exchange forwards and cross-currency interest rate swaps used to protect against the variability in the pounds sterling value of the Group's net investments in foreign operations due to movements in the relative strength of foreign currencies to pounds sterling.

Gains and losses on the effective portion of the hedge are recognised in equity and transferred to the Income Statement on disposal of the foreign operation. Gains and losses on the ineffective portion of the hedge are recognised immediately in the Income Statement. During 2007 the Group did not recognise any gains or losses due to net investment hedge ineffectiveness (2006: £nil).

23. Cash and cash equivalents

	2007 £m	2006 £m
Cash at bank, in transit and in hand	**53**	29
Short-term deposits	**1,077**	611
Cash and cash equivalents	**1,130**	640

Cash and cash equivalents includes £40 million (2006: £38 million) held by the Group's insurance subsidiary undertakings that is not readily available to be used for other purposes within the Group.

Cash and cash equivalents by counterparty credit rating	**Carrying value £m**	AAA £m	AA £m	A £m	Unrated £m
2007	**1,130**	246	783	95	6
2006	640	198	284	158	–

24. Trade and other payables

	2007 Current £m	2007 Non-current £m	2006 Current £m	2006 Non-current £m
Financial liabilities:				
Trade payables	**925**	**–**	982	–
Other payables	**756**	**14**	731	26
Accruals				
Commodity costs	**736**	**–**	598	–
Transportation, distribution and metering costs	**104**	**–**	105	–
Operating and other accruals	**572**	**–**	547	–
	1,412	**–**	1,250	–
	3,093	**14**	2,963	26
Non-financial liabilities:				
Other payables and accruals	**131**	**2**	143	21
Deferred income	**147**	**4**	185	8
	3,371	**20**	3,291	55

Maturity analysis of financial liabilities within trade and other payables	2007 £m	2006 £m
Less than 90 days	**2,908**	2,829
90-182 days	**24**	23
183-365 days	**161**	111
	3,093	2,963
Greater than 365 days	**14**	26
	3,107	2,989

Notes to the Financial Statements continued

25. Bank overdrafts, loans and other borrowings

	Interest rate %	Principal m	2007 Current £m	2007 Non-current £m	2007 Total £m	2006 Current £m	2006 Non-current £m	2006 Total £m
Recourse borrowings								
Bank overdrafts and loans			70	277	347	56	108	164
Bonds (by maturity date)								
25 July 2008	3.500	€75	57	–	57	–	–	–
8 September 2008	Floating	€100	74	–	74	–	68	68
9 March 2009	4.129	£250	–	253	253	–	252	252
2 November 2012	6.103	£400	–	400	400	–	396	396
27 February 2013	1.045	¥3,000	–	13	13	–	14	14
24 October 2016	5.706	£300	–	300	300	–	298	298
4 September 2026	Floating	£150	–	153	153	–	153	153
			131	1,119	1,250	–	1,181	1,181
Commercial paper			–	–	–	100	–	100
Obligations under finance leases (including power station tolling arrangements) (iii)			20	397	417	25	783	808
			221	1,793	2,014	181	2,072	2,253
Non-recourse borrowings								
Bonds (by maturity date) (i)								
28 January 2013	4.700	C$275	–	–	–	–	120	120
28 January 2015	5.245	C$225	–	–	–	–	98	98
			–	–	–	–	218	218
Units of The Consumers' Waterheater Income Fund (ii)			–	–	–	–	265	265
			221	1,793	2,014	181	2,555	2,736

(i) This debt is issued by The Consumers' Waterheater Income Fund (the Fund). The Group has deconsolidated the Fund with effect from 1 December 2007 as explained in notes 3 and 35.
(ii) Prior to the deconsolidation of the Fund with effect from 1 December 2007 units of the Fund were treated as debt in the Group Financial Statements.

(iii) Future finance lease commitments	Minimum lease payments 2007 £m	Capital element of lease payments 2007 £m	Minimum lease payments 2006 £m	Capital element of lease payments 2006 £m
Amounts payable:				
Within one year	43	20	51	25
Between one and five years	179	98	248	153
After five years	376	299	767	630
	598	417	1,066	808
Less future finance charges	(181)		(258)	
Present value of lease obligations	417		808	

In addition to the minimum lease payments, tolling charges are payable, calculated based on effective operating hours of the station. During the year £22 million (2006: £18 million) of tolling charges were paid in respect of the Spalding tolling contract. There are no restrictions under the finance leases in either the current or prior year.

25. Bank overdrafts, loans and other borrowings continued

Maturity profile of the Group's borrowings including interest and principal:

Recourse borrowings:	2007 £m	2006 £m
Within one year (i)	**322**	280
Between one and five years	**1,198**	825
After five years	**1,215**	1,981
	2,735	3,086
Non-recourse borrowings:		
Within one year	**–**	11
Between one and five years	**–**	65
After five years	**–**	500
	2,735	3,662
Interest payments	**(721)**	(926)
	2,014	2,736

(i) Recourse borrowings include amounts repayable on demand of £30 million (2006: £48 million). At 31 December 2007, the Group had undrawn committed bank borrowing facilities of £1,300 million (2006: £1,300 million) which mature in 2010.

Currency composition of the Group's borrowings:

	2007			2006		
Recourse borrowings:	Before impact of foreign currency derivatives £m	Impact of foreign currency derivatives £m	After impact of foreign currency derivatives £m	Before impact of foreign currency derivatives £m	Impact of foreign currency derivatives £m	After impact of foreign currency derivatives £m
Pounds sterling	**1,731**	**182**	**1,913**	1,955	103	2,058
US dollars	**56**	**(56)**	**–**	162	(62)	100
Euros	**131**	**(57)**	**74**	68	–	68
Canadian dollars	**27**	**–**	**27**	27	–	27
Japanese yen	**42**	**(42)**	**–**	41	(41)	–
New Zealand dollars	**27**	**(27)**	**–**	–	–	–
	2,014	**–**	**2,014**	2,253	–	2,253
Non-recourse borrowings:						
Canadian dollars	**–**	**–**	**–**	483	–	483
	2,014	**–**	**2,014**	2,736	–	2,736

Earlier of contractual re-pricing and maturity:

2007	Average effective interest rate %	Total £m	Within one year £m	One to five years £m	More than five years £m
Bank overdrafts and loans	**5.8**	**347**	232	21	94
Bonds	**5.3**	**1,250**	284	651	315
Obligations under finance leases	**5.8**	**417**	20	98	299
		2,014	536	770	708
Impact of interest rate derivatives		**–**	627	(464)	(163)
		2,014	1,163	306	545

2006	Average effective interest rate %	Total £m	Within one year £m	One to five years £m	More than five years £m
Bank overdrafts and loans	4.4	164	61	38	65
Bonds	5.4	1,181	220	252	709
Commercial paper	5.5	100	100	–	–
Obligations under finance leases	5.2	808	392	90	326
Non-recourse Canadian dollar bonds	4.9	218	–	–	218
Units of The Consumers' Waterheater Income Fund	N/A	265	–	–	265
		2,736	773	380	1,583
Impact of interest rate derivatives		–	424	(223)	(201)
		2,736	1,197	157	1,382

Notes to the Financial Statements continued

26. Deferred and current 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	Marked-to-market £m	Total £m
1 January 2006	180	(72)	(59)	24	(249)	480	(100)	243	**447**
Change to rate on UK upstream profits	–	(18)	–	6	–	32	(11)	–	**9**
(Credit)/charge to income	(3)	1	(4)	2	17	95	(110)	(266)	**(268)**
Charge/(credit) to equity	–	–	–	–	143	–	–	(312)	**(169)**
Exchange and other adjustments	–	–	–	–	–	–	–	(4)	**(4)**
31 December 2006	177	(89)	(63)	32	(89)	607	(221)	(339)	**15**
Changes to tax rates	–	–	–	–	(6)	(23)	20	–	**(9)**
(Credit)/charge to income	(10)	5	(23)	11	48	96	74	58	**259**
Charge to equity [(i)]	–	–	–	–	75	–	–	173	**248**
Acquisition of subsidiary (note 35)	–	–	–	–	–	127	(81)	–	**46**
Exchange and other adjustments	–	–	–	–	–	–	7	3	**10**
31 December 2007	**167**	**(84)**	**(86)**	**43**	**28**	**807**	**(201)**	**(105)**	**569**

(i) The charge to equity for retirement benefit obligations and other provisions includes a credit of £11 million in respect of tax rate changes.

Certain deferred tax assets and liabilities have been offset where there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority. The following is an analysis of the deferred tax balances (after offset) for financial reporting purposes:

	2007 £m	2006 £m
Deferred tax liabilities	**596**	241
Deferred tax assets	**(27)**	(226)
	569	15

The following is an analysis of the deferred tax balances before offset:

	2007 £m	2006 £m
Deferred tax assets crystallising within one year	**(124)**	(32)
Deferred tax assets crystallising after one year	**(502)**	(798)
	(626)	(830)
Offset against deferred tax liabilities	**599**	604
Net deferred tax assets	**(27)**	(226)
Deferred tax liabilities crystallising within one year	**113**	34
Deferred tax liabilities crystallising after one year	**1,082**	811
	1,195	845
Offset against deferred tax assets	**(599)**	(604)
Net deferred tax liabilities	**596**	241

At the balance sheet date the Group had certain deductible temporary differences of £376 million (2006: £318 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 £62 million (2006: £36 million) existed in respect of the Group's overseas investments. The deferred tax liability arising on these temporary differences is estimated to be £3 million (2006: £8 million), which has been provided for.

Current tax assets of £40 million (2006: £98 million) include £20 million (2006: £94 million) of recoverable petroleum revenue tax (PRT). These sums represent refunds of instalment payments made during the second half of the year which are in excess of the final liability. PRT instalment payments are calculated by reference to the previous period's profitability, not the profits of the period in which they are paid. The 2006 sum was recovered in March 2007.

27. Provisions for other liabilities and charges

Current provisions for other liabilities and charges	1 January 2007 £m	Acquisitions and disposals £m	Charged in the year £m	Unused and reversed in the year £m	Revisions and additions £m	Transferred from non-current £m	Utilised £m	**31 December 2007 £m**
Restructuring costs [i]	102	–	2	(3)	–	19	(83)	**37**
Decommissioning costs [iii]	–	–	–	–	–	5	(2)	**3**
Sales contract loss provision [ii]	16	–	–	–	–	–	(14)	**2**
Renegotiations provision [iv]	–	–	–	–	–	84	–	**84**
Other [v]	12	–	4	(3)	–	1	–	**14**
	130	**–**	**6**	**(6)**	**–**	**109**	**(99)**	**140**

Non-current provisions for other liabilities and charges	1 January 2007 £m	Acquisitions and disposals £m	Charged in the year £m	Unused and reversed in the year £m	Revisions and additions £m	Transferred to current £m	Exchange adjustments £m	**31 December 2007 £m**
Restructuring costs [i]	46	–	5	–	–	(19)	–	**32**
Decommissioning costs [iii]	395	14	13	–	92	(5)	2	**511**
Renegotiation provisions [iv]	85	–	6	–	–	(84)	–	**7**
Other [v]	25	2	7	(2)	–	(1)	–	**31**
	551	**16**	**31**	**(2)**	**92**	**(109)**	**2**	**581**

	2007		2006	
Financial and non-financial liabilities within provisions for other liabilities and charges	**Current £m**	**Non-current £m**	Current £m	Non-current £m
Financial liabilities:				
Restructuring costs [i]	**35**	**31**	102	42
Renegotiation provisions [iv]	**84**	**7**	–	85
Other [v]	**7**	**5**	12	18
	126	**43**	114	145
Non-financial liabilities:				
Restructuring costs [i]	**2**	**1**	–	4
Sales contract loss provision [ii]	**2**	**–**	16	–
Decommissioning costs [iii]	**3**	**511**	–	395
Other [v]	**7**	**26**	–	7
	14	**538**	16	406
	140	**581**	130	551

Notes to the Financial Statements continued

27. Provisions for other liabilities and charges continued

Maturity analysis for financial liabilities within provisions for other liabilities and charges on an undiscounted basis	2007 £m	2006 £m
Within one year	**126**	114
Between one and two years	**13**	127
Between two and five years	**16**	15
After five years	**16**	14
	171	270

(i) The restructuring provisions relate to significant restructuring programmes undertaken to achieve the Group's stated cost reduction targets. Included within the provision are costs related to surplus properties of £51 million (2006: £60 million) estimated with reference to the expected cost to be incurred to the point of lease termination, including costs for dilapidations and sub-letting. The provisions are expected to be utilised between 2008 and 2022.

(ii) The sales contract loss provision relates to the acquisition of a portfolio of gas customers by the Group. Certain of the contracts acquired were identified as being out of the money at the date of acquisition, and the sales contract loss provision was established in respect of them.

(iii) 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 is dependent on the lives of the facilities but is anticipated to occur between 2008 and 2042. The charge to income includes £13 million of notional interest (2006: £10 million).

(iv) 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 in excess of 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 movement in the year included £nil released to the Income Statement following a revision of the estimated future payments (2006: £11 million). The charge for the year includes £6 million of notional interest (2006: £5 million).

(v) Other provisions include outstanding litigation for a number of items (none of which are individually significant) 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 358.75 pence at 31 December 2007 (2006: 354.50 pence) and is expected to be utilised between 2008 and 2010.

28. Fair value of financial instruments

The fair value of a financial instrument is the amount at which the financial instrument could be exchanged in an arm's length transaction between knowledgeable and willing parties under no compulsion to act. The Group has documented internal policies for determining fair value, including methodologies used to establish valuation adjustments required for credit risk.

The fair values of the Group's financial instruments together with the carrying amounts included in the Balance Sheet are analysed as follows:

	2007		2006	
Financial assets	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Loans and receivables:				
Trade and other receivables, net of provisions				
Residential customers	**1,633**	**1,633**	1,974	1,974
Business customers	**730**	**730**	636	636
Treasury, trading and energy procurement counterparties	**875**	**875**	690	690
Cash and cash equivalents	**1,130**	**1,130**	640	640
	4,368	**4,368**	3,940	3,940
Financial assets measured at fair value through profit and loss:				
Derivative financial instruments – held for proprietary energy trading	**44**	**44**	225	225
Derivative financial instruments – held for trading under IAS 39	**810**	**810**	522	522
Energy contracts designated at fair value through profit and loss	**9**	**9**	3	3
Derivative financial instruments in hedge accounting relationships	**123**	**123**	27	27
	986	**986**	777	777
Available-for-sale financial assets:				
Debt	**79**	**79**	75	75
Equity	**10**	**10**	11	11
	89	**89**	86	86

	2007		2006	
Financial liabilities	**Carrying value £m**	**Fair value £m**	Carrying value £m	Fair value £m
Financial liabilities measured at amortised cost:				
Trade and other payables	**(3,107)**	**(3,107)**	(2,989)	(2,989)
Bank overdrafts, loans and other borrowings				
Bank overdrafts and loans	**(347)**	**(338)**	(164)	(162)
Bonds	**(1,250)**	**(1,246)**	(1,181)	(1,176)
Commercial paper	**–**	**–**	(100)	(100)
Obligations under finance leases (including power station tolling arrangements)	**(417)**	**(417)**	(808)	(814)
Non-recourse Canadian dollar bonds	**–**	**–**	(218)	(227)
Non-recourse units of The Consumers' Waterheater Income Fund	**–**	**–**	(265)	(265)
Provisions	**(169)**	**(169)**	(259)	(259)
	(5,290)	**(5,277)**	(5,984)	(5,992)
Financial liabilities at fair value through profit and loss:				
Derivative financial instruments – held for proprietary energy trading	**(52)**	**(52)**	(199)	(199)
Derivative financial instruments – held for trading under IAS 39	**(1,185)**	**(1,185)**	(1,151)	(1,151)
Energy contracts designated at fair value through profit and loss	**(86)**	**(86)**	(57)	(57)
Derivative financial instruments in hedge accounting relationships	**(92)**	**(92)**	(550)	(550)
	(1,415)	**(1,415)**	(1,957)	(1,957)

Notes to the Financial Statements continued

28. Fair value of financial instruments continued

Financial instruments valued at their carrying values

Due to their nature and/or short-term maturity, the fair values of trade and other receivables, cash and cash equivalents, trade and other payables and provisions are estimated to approximate their carrying values.

Available-for-sale financial assets

The fair values of available-for-sale financial assets are based on quoted market prices, when available. If quoted market prices are not available fair values are estimated using observable market data.

Bank overdrafts, loans and other borrowings

The fair values of bonds, Canadian dollar bonds and units of The Consumers' Waterheater Income Fund (prior to deconsolidation of the Fund as explained in note 3) are based on quoted market prices. The fair values of bank loans have been determined by discounting cash flows with reference to relevant market rates of interest. The fair values of overdrafts and commercial paper are assumed to equal their book values due to the short-term nature of these amounts. The fair values of obligations under finance leases have been determined by discounting contractual cash flows with reference to the Group's cost of borrowing.

Derivative financial instruments and energy contracts designated at fair value through profit and loss

The fair values of foreign exchange and interest rate derivatives are determined by reference to closing market rates at the balance sheet date. The fair values of energy derivatives are determined using valuation techniques based in part on observable market data and in part on internal estimates not currently supported by observable market data. The extent to which fair values of energy derivatives are based on observable market data is determined by the extent to which the market for the underlying commodity is judged to be active. The Group has judged each of the markets in which it operates as active, in both 2007 and 2006, for the purposes of accounting as follows:

Active period of markets	Gas	Power	Coal	Emissions	Oil
UK (years)	2	2	4	5	4
North America (years)	5	5	N/A	N/A	N/A

The fair values of energy contracts within the scope of IAS 39 that settle inside the active period of the market are based on quoted market prices and expected volumes, discounted at a rate of 6% (2006: 5%). The fair values of derivative financial instruments in North America and Europe are based primarily on quoted market prices. In the UK, however, certain energy contracts extend beyond the active period of the market. The fair values of energy contracts that extend beyond the active period of the market are determined by reference in part to published price quotations in active markets and in part by using valuation techniques based on commodity prices derived using assumptions that are based on internal market expectations and expected volumes, discounted using a discount rate of 5% (2006: 5%).

The net fair value of energy contracts recorded in the Financial Statements determined using valuation techniques based on non-observable market variables at 31 December 2007 is a £322 million liability (2006: £262 million liability). The total change in fair value of energy contracts estimated using valuation techniques based on variables not supportable by market prices that was recognised in the Income Statement during the year ended 31 December 2007 amounted to a loss of £100 million (2006: loss of £117 million).

While internal market forecasts outside the active period of the market reasonably reflect all factors that market participants would consider in setting a price, these expectations are not currently supportable by active forward market quotes. The fair values of these contracts would change significantly if the assumptions in respect of gas, power, coal, emissions or oil prices were changed to reasonably possible alternatives. The impacts of reasonably possible changes to assumed gas, power, emissions, coal and oil prices on the net fair value of the Group's derivative financial instruments determined using valuation models based on non-observable market data are as follows:

28. Fair value of financial instruments continued

Energy price	2007 Reasonably possible increase in variable	2007 Reasonably possible decrease in variable	2006 Reasonably possible increase in variable	2006 Reasonably possible decrease in variable
UK gas (p/therm)	**+12**	**-12**	+6	-6
UK power (£/MWh)	**+11**	**-11**	+10	-10
UK coal (US$/tonne)	**+15**	**-15**	+10	-10
UK emissions (€/tonne)	**+6**	**-6**	+5	-5
UK oil (US$/bbl)	**+14**	**-14**	+7	-7

Increase/(decrease) in fair value	2007 £m	2006 £m
UK energy prices – increase	**85**	89
UK energy prices – decrease	**(100)**	(86)

The impacts disclosed above result from changing the assumptions used for fair valuing energy contracts in relation to gas, power, emissions, coal and oil prices to reasonably possible alternative assumptions at the balance sheet date. The fair value impacts only concern those contracts entered into which are within the scope of IAS 39 and are marked-to-market based on valuation models using assumptions that are not currently observable in an active market. The sensitivity analysis provided is hypothetical only and should be used with caution as the impacts provided are not necessarily indicative of the actual impacts that would be experienced because the Group's actual exposure to market rates is constantly changing as the Group's portfolio of energy contracts changes. Changes in fair values based on a variation in a market variable cannot be extrapolated because the relationship between the change in market variable and the change in fair value may not be linear.

Where the fair value at initial recognition for such contracts differs from the transaction price a day-one gain or loss will arise. Such gains and losses are deferred and amortised to the Income Statement based on volumes purchased or delivered over the contractual period until such time as observable market data becomes available (see note 2 for further detail). The amount that has yet to be recognised in the Income Statement relating to the difference between the fair value at initial recognition (the transaction price) and the amount that would have arisen had valuation techniques used for subsequent measurement been applied at initial recognition, less subsequent releases, is as follows:

Net deferred (gains)/losses	2007 £m	2006 £m
At 1 January	**(62)**	13
Net losses deferred on new transactions	**(103)**	(9)
Recognised in the Income Statement during the period:		
Amortisation	**3**	–
Unobservable inputs becoming observable	**(4)**	(66)
At 31 December	**(166)**	(62)

Notes to the Financial Statements continued

29. Called up share capital

	2007 £m	2006 £m
Authorised share capital of the Company		
4,455,000,000 ordinary shares of $6^{14}/_{81}$p each		
(2006: 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		
3,679,980,311 ordinary shares of $6^{14}/_{81}$p each		
(2006: 3,662,721,068 ordinary shares of $6^{14}/_{81}$p each)	**227**	226

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

	2007 Number	2006 Number
1 January	**3,662,721,068**	3,623,982,266
Shares repurchased (i)	**–**	(8,950,000)
Shares issued under employee share schemes (ii)	**17,259,243**	47,688,802
31 December	**3,679,980,311**	3,662,721,068

The closing price of a Centrica ordinary share on 31 December 2007 was 358.75 pence (2006: 354.50 pence).

(i) The share repurchase programme is currently suspended. During 2006 the Company purchased, and subsequently cancelled, 8.95 million ordinary shares at prices ranging from 248.43 pence per share to 254.98 pence per share, with an average of 250.30 pence per share. The total cost of the purchases including expenses was £23 million which has been charged against distributable reserves, of which £0.6 million related to the nominal value and has been recognised in the capital redemption reserve.

(ii) 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:

	2007	2006
Number	**17,259,243**	47,688,802
Nominal value (£m)	**1.1**	2.9
Consideration (£m) (net of issue costs £nil (2006: £nil))	**22**	56

(iii) The Centrica Employees Share Trust (Trust) was established to acquire ordinary shares in the Company by subscription or purchase, with funds provided by way of interest-free loans or by capital contribution from the Company, to satisfy rights to shares on the vesting of allocations made under the Company's long-term incentive arrangements as explained in note 33.

	2007			2006		
Shares held in Trust	**Number of shares million**	**Cost £m**	**Market value £m**	Number of shares million	Cost £m	Market value £m
1 January	**–**	**–**	**–**	–	–	–
Shares purchased	**0.5**	**2**	**2**	–	–	–
Shares subscribed	**4.7**	**18**	**18**	7.6	22	22
Shares released under Long Term Incentive Scheme	**(4.7)**	**(18)**	**(18)**	(7.6)	(22)	(22)
31 December	**0.5**	**2**	**2**	–	–	–

30. Reserves

	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserves £m	Total £m	Minority interest £m	Total equity £m
	Attributable to equity holders of the Company							
1 January 2007	226	657	467	16	219	**1,585**	57	**1,642**
Exchange differences on translation of foreign operations	–	–	–	–	15	**15**	–	**15**
Exchange differences transferred to Income Statement	–	–	–	–	(4)	**(4)**	–	**(4)**
Actuarial gains on defined benefit pension schemes	–	–	–	–	284	**284**	–	**284**
Gains on revaluation of available-for-sale assets	–	–	–	–	1	**1**	–	**1**
Cash flow hedges:								
Net fair value gains	–	–	–	–	169	**169**	–	**169**
Transfers to Income Statement	–	–	–	–	382	**382**	–	**382**
Tax on items taken directly to/from equity	–	–	–	–	(248)	**(248)**	–	**(248)**
	226	657	467	16	818	**2,184**	57	**2,241**
Profit for the year	–	–	–	–	1,505	**1,505**	2	**1,507**
Employee share schemes:								
Purchase of treasury shares	–	–	–	–	(2)	**(2)**	–	**(2)**
Share issue	1	28	–	–	–	**29**	–	**29**
Exercise of awards	–	–	–	–	(7)	**(7)**	–	**(7)**
Value of services provided	–	–	–	–	31	**31**	–	**31**
Dividends	–	–	–	–	(417)	**(417)**	–	**(417)**
31 December 2007	**227**	**685**	**467**	**16**	**1,928**	**3,323**	59	**3,382**

Other reserves	Revaluation reserve £m	Foreign currency translation reserve £m	Cash flow hedging reserve £m	Profit and loss reserve £m	Total other reserves £m
1 January 2007	10	(26)	(326)	561	**219**
Exchange differences on translation of foreign operations	–	16	(1)	–	**15**
Exchange differences transferred to Income Statement	–	(4)	–	–	**(4)**
Actuarial gains on defined benefit pension schemes	–	–	–	284	**284**
Gains on revaluation of available-for-sale assets	–	–	–	1	**1**
Cash flow hedges:					
Net fair value gains	–	–	169	–	**169**
Transfers to Income Statement	–	–	382	–	**382**
Tax on items taken directly to/from equity	–	–	(173)	(75)	**(248)**
	10	(14)	51	771	**818**
Profit for the year	–	–	–	1,505	**1,505**
Employee share schemes:					
Purchase of treasury shares	–	–	–	(2)	**(2)**
Exercise of awards	–	–	–	(7)	**(7)**
Value of services provided	–	–	–	31	**31**
Dividends	–	–	–	(417)	**(417)**
31 December 2007	**10**	**(14)**	**51**	**1,881**	**1,928**

Notes to the Financial Statements continued

30. Reserves continued

	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserves £m	Total £m	Minority interest £m	Total equity £m
	Attributable to equity holders of the Company							
1 January 2006	224	595	467	15	1,085	2,386	56	2,442
Exchange differences on translation of foreign operations	–	–	–	–	(23)	(23)	–	(23)
Actuarial gains on defined benefit pension schemes	–	–	–	–	475	475	–	475
Cash flow hedges:								
Net fair value losses	–	–	–	–	(645)	(645)	–	(645)
Transfers to Income Statement	–	–	–	–	(294)	(294)	–	(294)
Tax on items taken directly to/from equity	–	–	–	–	169	169	–	169
	224	595	467	15	767	2,068	56	2,124
Loss for the year	–	–	–	–	(155)	(155)	1	(154)
Employee share schemes:								
Share issue	3	62	–	–	–	65	–	65
Exercise of awards	–	–	–	–	(9)	(9)	–	(9)
Value of services provided	–	–	–	–	23	23	–	23
Repurchase of shares	(1)	–	–	1	(23)	(23)	–	(23)
Dividends	–	–	–	–	(384)	(384)	–	(384)
31 December 2006	226	657	467	16	219	1,585	57	1,642

Other reserves	Revaluation reserve £m	Foreign currency translation reserve £m	Cash flow hedging reserve £m	Profit and loss reserve £m	Total other reserves £m
1 January 2006	10	(3)	301	777	1,085
Exchange differences on translation of foreign operations	–	(23)	–	–	(23)
Actuarial gains on defined benefit pension schemes	–	–	–	475	475
Cash flow hedges:					
Net fair value losses	–	–	(645)	–	(645)
Transfers to Income Statement	–	–	(294)	–	(294)
Tax on items taken directly to/from equity	–	–	312	(143)	169
	10	(26)	(326)	1,109	767
Loss for the year	–	–	–	(155)	(155)
Employee share schemes:					
Exercise of awards	–	–	–	(9)	(9)
Value of services provided	–	–	–	23	23
Repurchase of shares	–	–	–	(23)	(23)
Dividends	–	–	–	(384)	(384)
31 December 2006	10	(26)	(326)	561	219

Merger reserve

On 17 February 1997 BG plc (formerly British Gas plc) demerged certain businesses (grouped together under GB Gas Holdings Limited (GBGH)) to Centrica plc. Prior to demerger, the companies comprising the Centrica businesses were transferred to GBGH, a subsidiary undertaking of BG plc. Upon demerger the share capital of GBGH was transferred to Centrica plc and was recorded at the nominal value of shares issued to BG plc shareholders. In accordance with sections 131 and 133 of the Companies Act 1985, no premium was recorded on the shares issued. On consolidation, the difference between the nominal value of the Company's shares issued and the amount of share capital and share premium of GBGH at the date of demerger was credited to a merger reserve.

30. Reserves continued

Capital redemption reserve
In accordance with section 170 (1) of the Companies Act 1985, the Company has transferred to the capital redemption reserve an amount equal to the nominal value of shares repurchased and subsequently cancelled. The repurchase of shares includes transaction costs charged directly to the profit and loss reserve of £nil (2006: £nil).

Revaluation reserve
During 2005 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 in the company, was recorded as a revaluation reserve adjustment.

Foreign currency translation and net investment hedging reserve
The foreign currency translation and net investment hedging reserve comprises exchange translation differences on foreign currency net investments, offset by exchange translation differences on borrowings and derivatives classified as net investment hedges under the requirements of IAS 39. Exchange gains of £48 million (2006: £105 million loss) on net investments in overseas undertakings have been offset in reserves against exchange losses of £32 million (2006: £82 million gain) on foreign currency borrowings and other instruments used for hedging purposes.

Cash flow hedging reserve
The cash flow hedging reserve comprises fair value movements on instruments designated as cash flow hedges under the requirements of IAS 39. Note 22 provides further detail on cash flow hedging.

Analysis of transfers from cash flow hedging reserve to Income Statement by line item	2007 £m	2006 £m
Gross profit	(391)	231
Net interest expense	9	63
	(382)	294

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 and currency hedges, is as follows:

	2007 £m	2006 £m
Within one year	17	(266)
Between one and five years	34	(58)
After five years	–	(2)
	51	(326)

The maturity profile reflects the timing of expected transfers from the cash flow hedging reserve to the Income Statement as and when the hedged item affects the Income Statement which is, for the most part, on delivery of physical volumes for energy contracts and the accrual of interest for debt contracts.

Profit and loss reserve	Treasury shares £m	Share-based payments reserve £m	Other £m	Profit and loss reserve £m
1 January 2007	–	38	523	561
Actuarial gains on defined benefit pension schemes	–	–	284	284
Gains on revaluation of available-for-sale investments	–	–	1	1
Tax on items taken directly to/from equity	–	–	(75)	(75)
	–	38	733	771
Profit for the year	–	–	1,505	1,505
Employee share schemes:				
Purchase of treasury shares	(2)	–	–	(2)
Exercise of awards	–	(18)	11	(7)
Value of services provided	–	31	–	31
Dividends	–	–	(417)	(417)
31 December 2007	(2)	51	1,832	1,881

Notes to the Financial Statements continued

30. Reserves continued

Profit and loss reserve	Share-based payments reserve £m	Other £m	Profit and loss reserve £m
1 January 2006	42	735	777
Actuarial gains on defined benefit pension schemes	–	475	475
Tax on items taken directly to/from equity	–	(143)	(143)
	42	1,067	1,109
Loss for the year	–	(155)	(155)
Employee share schemes:			
Exercise of awards	(27)	18	(9)
Value of services provided	23	–	23
Repurchase of shares	–	(23)	(23)
Dividends	–	(384)	(384)
31 December 2006	38	523	561

Profit and loss reserve

Cumulative actuarial gains arising on defined benefit pension schemes recognised in the profit and loss reserve amounted to £723 million (2006: £439 million). Cumulative gains of £3 million (2006: £2 million) on available-for-sale financial assets were included within the profit and loss reserve.

Aggregate tax taken directly to reserves amounted to a charge of £248 million (2006: £169 million credit), of which a charge of £75 million relates to deferred tax arising on actuarial gains on the Group's defined benefit schemes (2006: £143 million), and a charge of £173 million relates to deferred tax arising on gains and losses on available-for-sale investments and cash flow hedges (2006: £312 million credit). The deferred tax charge relating to actuarial gains on the Group's defined benefit schemes includes an £11 million credit in respect of a change in tax rates.

31. Minority interests

	2007 £m	2006 £m
At 1 January	**57**	56
Profit on ordinary activities after taxation	**2**	1
At 31 December	**59**	57

Minority interests at 31 December 2007 relate to a 30% economic interest (2006: 30%) held by Lloyds TSB Bank plc in GF Two Limited (formerly Goldfish Holdings Limited) and its subsidiary, GF One Limited (formerly Goldfish Bank Limited).

32. Notes to the Group Cash Flow Statement

Reconciliation of Group operating profit to net cash flow from operating activities	2007 £m	2006 (restated) (i) £m
Continuing operations		
Group operating profit including share of result of joint ventures and associates	2,184	130
Less share of (profits)/losses of joint ventures and associates	(5)	12
Group operating profit before share of joint ventures and associates	2,179	142
Add back:		
Amortisation and write-down of intangible assets	92	93
Depreciation of property, plant and equipment	473	463
Systems write-down	–	196
Employee share scheme costs	29	23
Profit on sale of businesses	(2)	(3)
Loss/(profit) on sale of property, plant and equipment, and other intangible assets	7	(17)
Movement in provisions	(66)	84
Re-measurement of energy contracts (ii)	(218)	911
Operating cash flows before movements in working capital	2,494	1,892
Decrease/(increase) in inventories	38	(83)
Decrease/(increase) in receivables	181	(259)
Increase/(decrease) in payables	44	(150)
Cash generated from continuing operations	2,757	1,400
Income taxes paid	(341)	(311)
Net petroleum revenue tax paid	(60)	(316)
Net interest received	24	4
Payments relating to exceptional charges	(90)	(113)
Net cash flow from continuing operating activities	2,290	664
Discontinued operations (note 35)		
Group operating profit before share of joint ventures and associates	266	50
Add back:		
Amortisation of intangible assets	1	–
Depreciation of property, plant and equipment	21	23
Profit on disposal of subsidiary	(227)	–
Loss on sale of property, plant and equipment, and other intangible assets	5	–
Operating cash flows before movements in working capital	66	73
Decrease/(increase) in receivables	1	(1)
Increase in payables	–	1
Net cash flow from discontinued operating activities	67	73
Net cash flow from operating activities	2,357	737

(i) Restated to present exploration and evaluation expenditure, previously reported in property, plant and equipment, in other intangible assets on the Balance Sheet and to present The Consumers' Waterheater Income Fund as a discontinued operation. Note 2 details the change of accounting presentation and note 3 explains the deconsolidation of The Consumers' Waterheater Income Fund.
(ii) Adds back unrealised (profits)/losses arising from re-measurement of energy contracts, including those related to proprietary trading activities.

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.

Notes to the Financial Statements continued

33. Share-based payments

Employee share schemes are designed to encourage participants to align their objectives with those of shareholders. Centrica operates eight employee share schemes – the Deferred and Matching Share Scheme (DMSS) beginning in 2007, the Executive Share Option Scheme (ESOS), the Long Term Incentive Scheme (LTIS), Sharesave, the Share Award Scheme (SAS), the Restricted Share Scheme (RSS) beginning in 2007, the Share Incentive Plan (SIP) and the Employee Share Purchase Plan (ESPP). These are described in the Directors' Report – Corporate Responsibility Review on page 32 and in the Remuneration Report on pages 42 to 45. There were no other share-based payment transactions during the period.

DMSS

Awards under the DMSS are generally reserved for employees within the senior executive group. The scheme operates over a four-year vesting period. Under normal conditions the grant date of the scheme is the first day of each bonus year. This is followed by a vesting period of four years, being the bonus year plus a three-year performance period. In 2006, the first year of the scheme, shareholders' approval was obtained at the AGM on 19 May 2006 and as such the grant date reflects the date of this approval. The fair value of the award reflects the market value of the shares at the grant date. The scheme comprises three separable elements:

(a) Deferred shares

The scheme requires participants to defer 20% of their annual bonus into the scheme. The shares are held in trust over the three-year performance period, during which time they cannot be withdrawn. An employee who leaves prior to the vesting date will forfeit their right to the shares. All shares held in trust will be eligible to receive dividends. The number of shares deferred is estimated from the participant's maximum bonus and the likelihood of bonus payout in the bonus year. Subsequent revisions are made based on the actual bonus paid in the year.

(b) Investment shares

The scheme allows participants to elect to invest an additional amount of their annual bonus into the scheme up to a maximum of 50% of their total potential bonus for the year. This 50% limit includes the amount automatically deferred each year. The number of shares invested is estimated based on the maximum bonus in year one. The shares may be funded directly from the employee or through a release of the employee's LTIS shares. Subsequent to the bonus year, the shares are held in trust over the three-year performance period and vest unconditionally at election, thus the shares carry no additional IFRS 2 expense. Participants can unconditionally withdraw the invested shares at any point throughout the vesting period. The shares are eligible to receive dividends.

(c) Matching shares

Deferred and investment shares will be matched with conditional matching shares, which will be released upon the achievement, over a three-year performance period, of three-year cumulative Group economic profit performance targets. Group economic profit is calculated by taking Group operating profit before exceptional items and certain re-measurements after tax and subtracting a charge for capital employed based on the weighted average cost of capital. The number of matching shares that will vest will be determined on a straight-line basis from a zero match for no growth in economic profit up to a two-times match for growth of 25% or above. The number of matching shares, subject to the performance conditions, is grossed up to reflect the impact of tax and National Insurance. The number of matching shares 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. The likelihood of achieving the performance conditions is taken into account in calculating the number of awards expected to vest. Estimates are made in year one and revised in subsequent years. An employee that leaves prior to the vesting date will forfeit their right to the shares.

The fair values and the related assumptions used in the calculations are as follows:

Grant date	1 January 2007	19 May 2006
Share price at grant date	**£3.55**	£2.65
Exercise price	**£nil**	£nil
Number of investment shares (i)	**492,090**	489,642
Number of deferred shares originally granted (i)	**434,768**	432,605
Number of matching shares originally granted (i)	**2,654,925**	2,641,716
Vesting period	**4 yrs**	3.6 yrs
Contractual life	**4 yrs**	3.6 yrs
Expected dividend yield	**n/a**	n/a
Expected forfeitures	**25%**	25%
Expected performance lapses	**0%**	0%
Fair value per share allocated	**£3.55**	£2.65

33. Share-based payments continued

(i) The number of shares originally granted and fair value allocated are estimated on the grant date and then adjusted following the announcement of the actual annual performance bonus and subsequent investment by participants. A reconciliation of movements in allocations of deferred and matching shares actually made is shown below:

	2007 Number
Outstanding at start of period	–
Granted	3,074,321
Exercised	–
Forfeited	(53,676)
Outstanding at the end of the period	3,020,645
Exercisable at the end of the period	–

There were no shares released during the period.

Notes to the Financial Statements continued

33. 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 legal date of grant which approximates, or is the same as, the grant date for accounting purposes. The contractual life of an option is ten years. Awards under the ESOS are generally reserved for employees within the senior executive group. The most recent award was made in 2006. There are no further awards planned at this time. 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. The fair values and the related assumptions used in the calculations are as follows:

Grant date	27 April 2006	23 September 2005	1 April 2005	1 September 2004	18 March 2004	1 September 2003	24 March 2003
Share price at grant date	£2.99	£2.46	£2.28	£2.46	£2.28	£1.80	£1.47
Exercise price	£2.85	£2.51	£2.29	£2.45	£2.24	£1.78	£1.47
Number of options originally granted	6,220,098	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	3 yrs
Expected volatility (i)	24%	30%	30%	27%	27%	35%	35%
Contractual option life	10 yrs	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	5 yrs
Risk-free rate	4.70%	4.80%	4.70%	5.00%	5.01%	4.45%	4.44%
Expected dividend yield	4.10%	4.37%	4.37%	4.82%	4.82%	3.09%	3.09%
Expected forfeitures	25%	25%	25%	25%	25%	25%	25%
Fair value per option	£0.59	£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%. 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:

	2007 Number	2007 Weighted average exercise price £	2006 Number	2006 Weighted average exercise price £
Outstanding at start of period	**24,088,668**	**2.33**	34,542,481	2.05
Granted	**–**	**–**	6,220,098	2.85
Exercised	**(2,564,114)**	**2.21**	(13,063,314)	1.86
Forfeited	**(1,983,529)**	**2.47**	(3,610,597)	2.31
Outstanding at the end of the period	**19,541,025**	**2.33**	24,088,668	2.33
Exercisable at the end of the period	**8,794,230**	**2.03**	6,454,131	1.94

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

2007 Range of exercise prices	2007 Weighted average exercise price	2007 Number of shares	2007 Average remaining contractual life Years	2006 Range of exercise prices	2006 Weighted average exercise price	2006 Number of shares	2006 Average remaining contractual life Years
£1.40 – £1.49	**£1.47**	**2,656,985**	**5.3**	£1.40 – £1.49	£1.47	2,799,139	6.3
£2.20 – £2.29	**£2.27**	**10,204,013**	**6.4**	£2.20 – £2.29	£2.27	13,690,124	7.4
£2.40 – £2.49	**£2.40**	**1,294,990**	**3.6**	£2.40 – £2.49	£2.40	1,515,850	4.7
£2.50 – £2.59	**£2.51**	**221,639**	**7.8**	£2.50 – £2.59	£2.51	291,235	8.8
£2.80 – £2.89	**£2.85**	**5,163,398**	**8.3**	£2.80 – £2.89	£2.85	5,792,320	9.3
	£2.33	**19,541,025**	**6.5**		£2.33	24,088,668	7.6

For options exercised during the period the weighted average share price was £3.86 (2006: £2.92).

33. 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. For awards made up to 2005, the number of shares 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 with 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. Shares are released to participants immediately following the end of the period in which TSR performance is assessed, but 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. For awards made from 2006, the vesting of only half of each award is made on the basis of TSR performance. For this half of the award, the calculation of TSR performance as compared with the TSR of other FTSE 100 Index shares is consistent with awards made to the end of 2005, except that allocations are valued using a Monte Carlo simulation model. The number of shares released is increased on a sliding scale between 25% and 100% if Centrica's TSR is ranked between 50th and 20th. The vesting of the remaining half of awards made since 2006 is dependent on earnings per share (EPS) growth. This is considered a non-market condition under IFRS 2 and dividends attach to the awards, requiring the shares to be fair valued at market value on the date of grant. The likelihood of achieving the performance conditions is taken into account in calculating the number of awards expected to vest. For shares that vest on awards made from 2006 (for both TSR and EPS portions) the cash payment is increased to reflect the dividends that would have been paid on them during the performance period. The fair values and the related assumptions used in the calculations are as follows:

Grant date	**14 September 2007**	**4 April 2007**	4 September 2006	19 May 2006	2 May 2006	23 September 2005	1 April 2005	1 September 2004	1 April 2004
Share price at grant date	**£3.77**	**£3.91**	£3.03	£2.65	£3.01	£2.46	£2.28	£2.46	£2.30
Exercise price	**£nil**	**£nil**	£nil	£nil	£nil	£nil	£nil	£nil	£nil
Number of shares originally granted	**228,423**	**6,239,643**	654,396	1,456,064	6,153,355	456,421	8,408,130	310,460	9,765,341
Vesting period	**3 yrs**	**3 yrs**	3 yrs	2.9 yrs	2.9 yrs	3 yrs	3 yrs	3 yrs	3 yrs
Expected volatility (i)	**21%**	**21%**	22%	22%	21%	30%	30%	27%	27%
Contractual life	**3 yrs**	**3 yrs**	3 yrs	2.9 yrs	2.9 yrs	3 yrs	3 yrs	3 yrs	3 yrs
Expected life	**3 yrs**	**3 yrs**	3 yrs	2.9 yrs	2.9 yrs	3 yrs	3 yrs	3 yrs	3 yrs
Risk-free rate	**5.40%**	**5.40%**	4.80%	4.80%	4.70%	4.80%	4.68%	5.00%	5.04%
Expected dividend yield	**n/a**	**n/a**	n/a	n/a	n/a	4.37%	4.37%	4.82%	4.82%
Expected forfeitures	**20%**	**20%**	20%	20%	20%	20%	20%	20%	20%
Average volatility of FTSE 100	**30%**	**30%**	30%	30%	30%	30%	30%	30%	30%
Average cross-correlation of FTSE 100	**(ii)**	**(ii)**	(ii)	(ii)	(ii)	(ii)	(ii)	30%	30%
Fair value per share allocated – TSR awards	**£2.26**	**£2.26**	£1.66	£1.38	£1.80	£1.20	£1.03	£1.25	£1.17
Fair value per share allocated – EPS awards	**£3.77**	**£3.91**	£3.03	£2.65	£3.01	n/a	n/a	n/a	n/a

(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%. 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. 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:

Notes to the Financial Statements continued

33. Share-based payments continued

	2007 Number	2006 Number
Outstanding at start of period	**20,989,594**	26,434,295
Granted	**6,468,066**	8,263,815
Exercised	**(4,655,598)**	(7,538,399)
Forfeited – performance related	**(57,315)**	(2,342,414)
Forfeited – non performance related	**(2,918,980)**	(3,827,703)
Outstanding at the end of the period	**19,825,767**	20,989,594
Exercisable at the end of the period	**35,159**	–

(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 commensurate with the performance period of the awards.

For shares released during the period the weighted average share price was £3.91 (2006: £2.89).

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, including interest earned. 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. The fair values and the related assumptions used in the calculations are as follows:

Grant date	4 April 2007	4 April 2007	10 April 2006	10 April 2006	6 April 2005	6 April 2005	1 April 2004	1 April 2004	8 April 2003
Share price at grant date	**£3.91**	**£3.91**	£2.86	£2.86	£2.36	£2.36	£2.30	£2.30	£1.59
Exercise price	**£2.91**	**£2.91**	£2.38	£2.38	£1.88	£1.88	£1.83	£1.83	£1.07
Number of options originally granted	**3,095,084**	**6,231,230**	3,587,711	8,548,648	4,329,658	5,791,571	3,854,639	7,407,793	37,280,748
Vesting period	**5 yrs**	**3 yrs**	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs
Expected volatility (i)	**27%**	**21%**	25%	23%	30%	30%	27%	27%	35%
Contractual option life	**5.5 yrs**	**3.5 yrs**	5.5yrs	3.5 yrs	5.5 yrs	3.5 yrs	5.5 yrs	3.5 yrs	5.5 yrs
Expected life	**5 yrs**	**3 yrs**	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs	3 yrs	5 yrs
Risk-free rate	**5.2%**	**5.4%**	4.5%	4.5%	4.65%	4.64%	5.13%	5.04%	3.90%
Expected dividend yield	**3.7%**	**3.7%**	4.1%	4.1%	4.37%	4.37%	4.82%	4.82%	3.09%
Expected forfeitures	**40%**	**25%**	40%	25%	40%	25%	40%	25%	40%
Fair value per option	**£1.28**	**£1.14**	£0.72	£0.65	£0.68	£0.64	£0.61	£0.58	£0.64

(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%. 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:

	2007		2006	
	Number	Weighted average exercise price £	Number	Weighted average exercise price £
Outstanding at start of period	**55,295,229**	**£1.58**	73,748,195	£1.30
Granted	**9,326,314**	**£2.91**	12,136,359	£2.38
Exercised	**(9,634,541)**	**£1.64**	(26,279,815)	£1.14
Forfeited	**(3,654,241)**	**£2.09**	(4,308,655)	£1.67
Expired	**(5,349)**	**£1.78**	(855)	£1.78
Outstanding at the end of the period	**51,327,412**	**£1.78**	55,295,229	£1.58
Exercisable at the end of the period	**67,165**	**£1.81**	13,406	£1.07

33. Share-based payments continued

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

			2007				2006
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**	**23,365,748**	**0.9**	£1.00 – £1.09	£1.07	26,461,884	1.9
£1.70 – £1.79	**£1.78**	**24,775**	**0.0**	£1.70 – £1.79	£1.78	2,493,279	0.9
£1.80 – £1.89	**£1.87**	**9,483,726**	**1.8**	£1.80 – £1.89	£1.86	15,027,623	2.3
£1.90 – £1.99	**£1.91**	**706**	**0.0**	£1.90 – £1.99	£1.91	3,886	0.0
£2.30 – £2.39	**£2.38**	**9,801,701**	**2.5**	£2.30 – £2.39	£2.38	11,308,557	3.5
£2.90 – £2.99	**£2.91**	**8,650,756**	**3.6**	£2.90 – £2.99	–	–	–
	£1.78	**51,327,412**	**1.9**		£1.58	55,295,229	2.3

For options exercised during the period the weighted average share price at the date of exercise was £3.77 (2006: £2.80).

SAS

Under the SAS, allocations of shares in Centrica plc are made to selected employees of the Group. Awards under the SAS are generally reserved for certain selected employees at middle management levels, based on recommendation by the Chief Executive and the Group Director, Human Resources. There is no contractual eligibility for SAS and each year's award is made independently from previous awards. Allocations are subject to no performance conditions and vest unconditionally subject to continued employment with the Group in two stages – half of the award vesting after two years, the other half vesting after three years. On vesting, additional shares or a cash payment are made to reflect dividends that would have been paid on the allocations during the retention period. The fair value is therefore considered to be the market value at date of grant. The fair values and related assumptions used to calculate the cost to the Group are as follows:

Grant date	**4 April 2007**	**4 April 2007**	3 April 2006	3 April 2006
Share price at grant date	**£3.91**	**£3.91**	£2.84	£2.84
Exercise price	**£nil**	**£nil**	£nil	£nil
Number of options originally granted	**585,022**	**584,781**	780,367	780,143
Vesting period	**3 yrs**	**2 yrs**	3 yrs	2 yrs
Contractual option life	**3 yrs**	**2 yrs**	3 yrs	2 yrs
Expected forfeitures	**25%**	**15%**	25%	15%
Fair value per option	**£3.91**	**£3.91**	£2.84	£2.84

Notes to the Financial Statements continued

33. Share-based payments continued

A reconciliation of movements in the allocations is as follows:

	2007 Number	2006 Number
Outstanding at start of period	**1,464,559**	–
Granted	**1,169,803**	1,560,510
Exercised	**(22,781)**	(3,096)
Forfeited	**(147,319)**	(92,855)
Outstanding at end of period	**2,464,262**	1,464,559
Exercisable at end of period	**–**	–

For shares released during the period, the weighted average share price at the date of release was £3.75 (2006: £3.40).

RSS

Under the RSS, allocations of shares in Centrica plc are made to employees of the Group on a highly selective basis. Awards under the RSS are reserved for certain selected key employees at senior management levels, based on recommendation by the Chief Executive and the Group Director, Human Resources. Neither the Executive Directors nor the next tier of executive management is eligible to participate. There is no contractual eligibility for RSS and each year's award is made independently from previous awards. 2007 was the first year of awards. Allocations are subject to no performance conditions and vest unconditionally subject to continued employment within the Group in one or two stages dependent on the individual awards. On vesting, additional shares or a cash payment are made to reflect dividends that would have been paid on the allocations during the retention period. The fair value is therefore considered to be the market value at date of grant. The fair values and related assumptions used to calculate the cost to the Group are as follows:

Grant date	29 June 2007	4 June 2007	4 June 2007	4 April 2007	4 April 2007	4 April 2007
Share price at grant date	**£3.88**	**£3.78**	**£3.78**	**£3.91**	**£3.91**	**£3.91**
Exercise price	**£nil**	**£nil**	**£nil**	**£nil**	**£nil**	**£nil**
Number of options originally granted	**59,407**	**78,534**	**47,117**	**53,157**	**89,322**	**36,166**
Vesting period	**3 yrs**	**3 yrs**	**2 yrs**	**3 yrs**	**2 yrs**	**1 yr**
Contractual option life	**3 yrs**	**3 yrs**	**2 yrs**	**3 yrs**	**2 yrs**	**1 yr**
Expected forfeitures	**25%**	**25%**	**15%**	**25%**	**15%**	**5%**
Fair value per option	**£3.88**	**£3.78**	**£3.78**	**£3.91**	**£3.91**	**£3.91**

A reconciliation of movements in the allocations is as follows:

	2007 Number
Outstanding at start of period	**–**
Granted	**363,703**
Exercised	**–**
Forfeited	**–**
Outstanding at the end of the period	**363,703**
Exercisable at the end of the period	**–**

There were no shares released during the period.

33. Share-based payments continued

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 £3.72 (2006: £2.97). A reconciliation of matching shares held in trust is as follows:

	2007 Number	2006 Number
Unvested at start of period	**2,500,916**	2,067,233
Granted	**633,348**	771,767
Shares sold and transferred out of the plan	**(292,005)**	(199,711)
Forfeited	**(122,955)**	(138,373)
Unvested at end of period	**2,719,304**	2,500,916

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 £3.69 (2006: £2.97). A reconciliation of matching shares granted is shown below:

	2007 Number	2006 Number
Unvested at start of period	**369,163**	208,329
Granted	**200,398**	230,916
Vested	**(167,687)**	(29,353)
Forfeited	**(36,096)**	(40,729)
Unvested at end of period	**365,778**	369,163

Notes to the Financial Statements continued

34. Pensions

Substantially all of the Group's UK employees at 31 December 2007 were members of one of the three main schemes: the Centrica Pension Scheme, the Centrica Engineers' Pension Scheme and the Centrica Management Pension Scheme (together the approved pension schemes). The Centrica Pension Scheme (final salary section) and the Centrica Management Pension Scheme (a final salary scheme) were closed to new members from 1 April 2003. The Centrica Pension Scheme has an open career average salary section. The Centrica Engineers' Pension Scheme (final salary section) was closed to new members from 1 April 2006, and a career average salary section was added to the scheme at that date. These schemes are defined benefit schemes and are tax-approved funded arrangements. They are subject to independent valuations at least every three years, on the basis of which the qualified actuary certifies the rate of employer 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 2006, 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 2007 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 2007 %**	31 December 2006 %
Rate of increase in employee earnings	**4.40**	4.00
Rate of increase in pensions in payment and deferred pensions	**3.40**	3.00
Discount rate	**5.80**	5.00
Inflation assumption	**3.40**	3.00

The assumptions relating to longevity underlying the pension liabilities at the balance sheet date have been based on a combination of standard actuarial mortality tables, scheme experience and other relevant data, and include a medium cohort allowance for future improvements in longevity, as published by the Institute of Actuaries. The assumptions are equivalent to future longevity for members in normal health approximately as follows:

	2007		2006	
Life expectancy at age 65 for a member:	**Male Years**	**Female Years**	Male Years	Female Years
Currently aged 65	**20.2**	**21.8**	20.2	21.7
Currently aged 45	**21.4**	**22.9**	21.3	22.9

At 31 March 2006, the date of the most recent actuarial review, the schemes had approximately 31,900 members and beneficiaries (20,850 male and 11,050 female).

The other demographic assumptions have been set having regard to the latest trends in scheme experience and other relevant data. The assumptions are reviewed and updated as necessary as part of the periodic actuarial valuation of the pension schemes.

	2007		2006	
Impact of changing material assumptions	**Increase/ decrease in assumption**	**Indicative effect on scheme liabilities %**	Increase/decrease in assumption	Indicative effect on scheme liabilities %
Rate of increase in employee earnings	**0.25%**	**+/-2**	0.25%	+/-2
Rate of increase in pensions in payment and deferred pensions	**0.25%**	**+/-4**	0.25%	+/-4
Discount rate	**0.25%**	**-/+6**	0.25%	-/+6
Inflation assumption	**0.25%**	**+/-6**	0.25%	+/-6
Longevity assumption	**1 year**	**+/-2**	1 year	+/-2

34. Pensions continued

The expected rate of return and market value of the assets and the present value of the liabilities in the schemes at 31 December were:

	Expected rate of return per annum 2007 %	Valuation 2007 £m	Expected rate of return per annum 2006 %	Valuation 2006 £m
UK equities	**8.1**	**1,549**	7.8	1,486
Non-UK equities	**8.1**	**931**	7.8	857
Fixed-interest bonds	**5.8**	**412**	5.3	312
Index-linked bonds	**4.5**	**351**	4.3	213
Property	**6.8**	**50**	6.2	68
Cash and other assets	**5.4**	**34**	5.0	52
Total fair value of plan assets	**7.4**	**3,327**	7.2	2,988
Present value of defined benefit obligation		**(3,230)**		(3,284)
Net asset/(liability) recognised in the Balance Sheet		**97**		(296)
Associated deferred tax (liability)/asset recognised in the Balance Sheet		**(28)**		89
Net pension asset/(liability)		**69**		(207)
Net asset/(liability) recognised in the Balance Sheet comprises:				
Surpluses		**152**		–
Deficits		**(55)**		(296)
		97		(296)

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 returns 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 the schemes' liabilities above are £31 million (2006: £27 million) relating to unfunded pension arrangements. Included within non-current available-for-sale financial assets are £30 million (2006: £29 million) of investments, held by the Law Debenture Trust on behalf of the Company, as security in respect of the Centrica Unapproved Pension Scheme.

Analysis of the amount charged to operating profit	2007 £m	2006 £m
Current service cost	**127**	143
Plan amendment (i)	**–**	(20)
Loss on curtailment	**–**	18
Net charge to operating profit	**127**	141

(i) The Schemes' rules were amended from 1 April 2006 to allow employees to commute a larger amount of their pension to a cash lump sum on retirement, in line with changes to the Finance Act. Accordingly, the assumptions made in calculating the Group's defined benefit pension liability were revised, and a gain of £20 million was recognised in Group operating profit before exceptional items and certain re-measurements. Future revisions to the assumptions will be reflected within the Statement of Recognised Income and Expense.

Analysis of the amount credited to notional interest	2007 £m	2006 £m
Expected return on pension scheme assets	**221**	194
Interest on pension scheme liabilities	**(166)**	(168)
Net credit to notional interest income	**55**	26

Notes to the Financial Statements continued

34. Pensions continued

Analysis of the actuarial gain/(loss) recognised in the Statement of Recognised Income and Expense	2007 £m	2006 £m
Actual return less expected return on pension scheme assets	**(38)**	95
Experience gains and losses arising on the scheme liabilities	**(16)**	145
Changes in assumptions underlying the present value of the schemes' liabilities	**338**	235
Actuarial gain to be recognised in the Statement of Recognised Income and Expense before adjustment for tax	**284**	475
Cumulative actuarial gains and losses recognised in reserves at 1 January	**439**	(36)
Cumulative actuarial gains and losses recognised in reserves at 31 December	**723**	439

Five year history of surplus/(deficit)	2007 £m	2006 £m	2005 £m	2004 £m	2003 £m
Plan assets	**3,327**	2,988	2,570	2,041	2,353
Defined benefit obligation	**(3,230)**	(3,284)	(3,390)	(2,760)	(3,491)
Surplus/(deficit)	**97**	(296)	(820)	(719)	(1,138)

Five year history of experience gains and losses	2007	2006	2005	2004	2003
Difference between the expected and actual return on scheme assets:					
Amount (£m)	**(38)**	95	307	64	202
Percentage of scheme assets	**1.1%**	3.2%	11.9%	3.1%	8.6%
Experience gains and losses on scheme liabilities:					
Amount (£m)	**(16)**	145	21	134	(64)
Percentage of the present value of scheme liabilities	**0.5%**	4.4%	0.6%	4.9%	1.8%
Total actuarial gain/(loss) recognised in the Statement of Recognised Income and Expense:					
Amount (£m)	**284**	475	(126)	90	(281)
Percentage of the present value of scheme liabilities	**8.8%**	14.5%	3.7%	3.3%	8.0%

Movement in the defined benefit obligation during the year	2007 £m	2006 £m
1 January	**3,284**	3,390
Movements in the year:		
Current service cost	**127**	143
Plan amendment	**–**	(20)
Loss on curtailment	**36**	18
Interest on scheme liabilities	**166**	168
Plan participants' contributions	**25**	25
Benefits paid from schemes	**(87)**	(60)
Benefits paid by company	**(1)**	–
Actuarial (gain)/loss	**(322)**	(380)
Acquisitions	**2**	–
31 December	**3,230**	3,284

34. Pensions continued

Movement in plan assets during the year	2007 £m	2006 £m
1 January	2,988	2,570
Movements in the year:		
Expected return on scheme assets	221	194
Actuarial (loss)/gain	(38)	95
Employer contributions	218	164
Plan participants' contributions	25	25
Benefits paid from schemes	(87)	(60)
31 December	3,327	2,988

Agreed future employer contribution rates (pensionable salary and % of pensionable salary) for the three main defined benefit schemes	2007 £m	2007 %
Centrica Pension Scheme – Final salary section	149	22.4
Centrica Pension Scheme – CRIS section	90	10.9
Centrica Engineers' Pension Scheme – Final salary section	174	23.0
Centrica Engineers' Pension Scheme – CERIS section	32	12.5
Centrica Management Pension Scheme	71	22.6

Notes to the Financial Statements continued

35. Acquisitions and disposals

(i) Acquisitions

During the year, the Group acquired 100% of the issued share capital of Newfield UK Holdings Limited from Newfield International Holdings Inc for cash consideration of £250 million (£242 million base consideration, plus adjustments for working capital and indebtedness arising between the effective date and the completion date). Other smaller acquisitions are described in section (b).

The purchase method of accounting was adopted in all cases. The analysis of assets and liabilities acquired, and the fair value of these acquisitions, are 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) Newfield UK Holdings Limited	IFRS carrying values pre-acquisition £m	Fair value £m
Other intangible assets	–	12
Property, plant and equipment	97	244
Inventory	2	2
Trade and other receivables	4	4
Cash and cash equivalents	3	3
Trade and other payables	(8)	(8)
Provisions for other liabilities and charges	(14)	(16)
Deferred tax liabilities	–	(46)
Net assets acquired	84	195
Goodwill arising		55
Cash consideration		**250**

The Group acquired 100% of the issued share capital of Newfield UK Holdings Limited on 5 October 2007 for cash consideration of £250 million. Newfield UK Holdings Limited is an exploration and production group with activities focused in the UK Southern Gas Basin. The acquired business contributed a profit after tax of £7 million to the Group for the period from 5 October 2007 to 31 December 2007. The book values of assets and liabilities have been adjusted to align with the fair values of assets and liabilities acquired. The adjustments to recognise other intangible assets and property, plant and equipment at fair value mainly relate to the acquired exploration assets and producing gas field assets. Goodwill has principally arisen in relation to the recognition of deferred tax on these fair value adjustments.

(b) Other acquisitions

On 8 February 2007, the Group's subsidiary The Consumers' Waterheater Income Fund acquired the water heater rental business of Toronto Hydro Energy Services Inc. for cash consideration of £18 million. The fair value of net assets acquired comprised £10 million for water heater fixed assets and £8 million for intangible assets representing acquired contractual customer relationships. In addition, the Fund acquired approximately 3,400 water heaters from Festival Hydro Inc. for cash consideration of £0.7 million on 1 November 2007. Net assets acquired, including intangible assets, were recorded at their determined fair values of £0.7 million. No goodwill was recorded on these acquisitions. The Group has deconsolidated The Consumers' Waterheater Income Fund with effect from 1 December 2007 as explained in note 3. These acquired businesses are included in the assets and liabilities of the Fund as deconsolidated with effect from 1 December 2007, with associated cash flows included within discontinued activities.

The Group acquired the home appliance service assets of Mabe Canada Inc. on 22 January 2007 (consideration £3 million, goodwill £2.5 million) and the home appliance service/repair business of Factory Appliance (consideration £0.5 million, goodwill £0.4 million) on 7 May 2007. On 14 September 2007 the residential new construction, service and replacement business CA Woods was acquired by the Group (consideration £0.8 million, goodwill £0.5 million).

35. Acquisitions and disposals continued

The pro forma consolidated results of the Group, as if the 2007 acquisitions had been made at the beginning of the period, include revenues from continuing operations of £16,382 million and a profit after tax of £1,506 million. The pro forma results have been calculated using the Group's accounting policies. In preparing the pro forma results, revenue and costs have been included as if the businesses were acquired on 1 January 2007 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 indicative of the future results of the combined Group.

During 2007, the Group paid £11 million of contingent and deferred consideration, £10 million representing the final contingent payment relating to the acquisition of CPL/WTU in 2002 and £1 million representing a deferred payment relating to the acquisition of Wainstones Power Limited in 2004.

(ii) Disposals

(a) Discontinued operation – The Consumers' Waterheater Income Fund

As explained in note 3, the Group has deconsolidated The Consumers' Waterheater Income Fund (the Fund) with effect from 1 December 2007. The Group previously consolidated the Fund in accordance with SIC-12, Consolidation – Special Purpose Entities. An analysis of assets and liabilities disposed of and the pre-tax profit arising on disposal is presented below:

	£m
Attributable goodwill	124
Other intangible assets – customer relationships and other	9
Property, plant and equipment – water heaters	221
Trade and other receivables – current	4
Cash and cash equivalents	15
Trade and other payables – current	(8)
Bank overdrafts and loans	(15)
Issued bonds	(248)
Borrowings – units of The Consumers' Waterheater Income Fund	(325)
Exchange differences on translation of foreign operations	(4)
Net liabilities disposed of	(227)
Gain on disposal of discontinued operation	227
Proceeds on disposal	**–**

Attributable goodwill represents the portion of goodwill within the Canada home services cash-generating unit which is allocated to the operations of the Fund on its deconsolidation. Goodwill arose on the Enbridge Services acquisition in 2002. The water heater assets acquired as part of this acquisition were transferred to the Fund on its creation in 2002. Goodwill has been attributed to the Fund on its deconsolidation on the basis of the relative fair value of both the Fund and the remaining operations contained within the Canada home services cash-generating unit.

At the date of deconsolidation the Group held a nil% interest in the Fund. Accordingly, £nil proceeds arise on deconsolidating the Fund from the Group accounts. The units in the Fund have historically been accounted for as a financial liability of the Group as opposed to a minority interest in equity due to the redemption rights which attach to them. This liability has only ever represented a liability of the Fund and has therefore been previously presented as non-recourse borrowings. On deconsolidating the Fund, a gain of £227 million arises principally as a result of extinguishing this liability, net of attributable goodwill. Given its materiality and non-recurring nature this gain is presented as exceptional within the Income Statement.

Notes to the Financial Statements continued

35. Acquisitions and disposals continued

The Fund's activities represent a separate major line of business for the Direct Energy segment and contributed materially to Group borrowings. In order to provide a clear and consistent presentation of the impact of deconsolidating the Fund, the results in the current year and prior year have been presented as a discontinued operation distinct from continuing operations within the Group Income Statement. The effect of the discontinued operation on the Direct Energy segment results is presented in note 6. An analysis of the results of The Consumers' Waterheater Income Fund presented as a discontinued operation within the Group Income Statement is as follows:

			2007			2006
	Results for the period to 1 December before exceptional items and certain re-measurements £m	**Exceptional items and certain re-measurements £m**	**Results for the period to 1 December £m**	Results for the year before exceptional items and certain re-measurements £m	Exceptional items and certain re-measurements £m	Results for the year £m
Revenue	**42**	**–**	**42**	47	–	47
Cost of sales [(i)]	**27**	**–**	**27**	25	–	25
Gross profit	**69**	**–**	**69**	72	–	72
Operating costs	**(30)**	**–**	**(30)**	(22)	–	(22)
Operating profit	**39**	**–**	**39**	50	–	50
Net interest expense	**(38)**	**(19)**	**(57)**	(42)	37	(5)
Profit/(loss) before taxation	**1**	**(19)**	**(18)**	8	37	45
Tax credit	**–**	**–**	**–**	6	–	6
Profit/(loss) after taxation from discontinued operation	**1**	**(19)**	**(18)**	14	37	51
Gain on disposal of discontinued operation	**–**	**227**	**227**	–	–	–
Taxation on gain on disposal of discontinued operation	**–**	**–**	**–**	–	–	–
Discontinued operations	**1**	**208**	**209**	**14**	**37**	**51**

(i) Included in discontinued operations is elimination of the cost of sales incurred on sales of water heaters from Direct Energy to the Fund resulting in a credit to the cost of sales reported above.

In previous years, the Group has been subject to capital gains tax on the sell-down of its equity in the Fund. At the date of deconsolidation the Group held a nil equity interest in the Fund and £nil proceeds arose on deconsolidating the Fund from the Group accounts. Accordingly, £nil tax arises on the gain on deconsolidation.

Centrica continues to service the majority of the Fund's assets and continues to procure water heater assets for the Fund. The revenues received from the Fund for undertaking these activities is included as part of the continuing operations of the Direct Energy segment as shown in note 37.

(b) Discontinued operation – OneTel

In 2006, the finalisation of the OneTel disposal resulted in a charge to the Income Statement of £8 million net of a £3 million tax credit.

36. Commitments and contingencies

(a) Commitments

Commitments in relation to the acquisition of property, plant and equipment	2007 £m	2006 £m
Construction of a power station at Langage	**201**	219
Construction of Lynn and Inner Dowsing wind farms	**114**	99
Redevelopment of Statfjord gas field	**83**	72
Other	**69**	102
	467	492

Commitments in relation to the acquisition of intangible assets	2007 £m	2006 £m
Renewable obligation certificates	**1,075**	869
Carbon emissions certificates	**224**	122
Certified emission reduction certificates	**99**	91
Other	**49**	30
	1,447	1,112

Commitments in relation to other contracts	2007 £m	2006 £m
Liquefied natural gas capacity	**754**	522
Transportation capacity	**445**	461
Outsourcing of services	**167**	36
Other	**110**	76
	1,476	1,095

(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 until the costs of such decommissioning have been irrevocably discharged and the relevant Department of Business, Enterprise and Regulatory Reform (formerly 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:

	2007 £m	2006 £m
Within one year	**88**	80
Between one and five years	**165**	172
After five years	**146**	160
	399	412

Notes to the Financial Statements continued

36. Commitments and contingencies continued

	2007 £m	2006 £m
The total of future minimum sub-lease payments expected to be received under non-cancellable operating sub-leases at 31 December	**8**	17
Lease and sub-lease payments recognised as an expense in the year were as follows:		
Minimum lease payments	**60**	67
Contingent rents – renewables (i)	**48**	30

(i) The Group has entered into long-term arrangements with renewable providers to purchase physical power, renewable obligation certificates and levy exemption certificates from renewable sources. Payments made under these contracts are contingent upon actual production and therefore the commitment to a minimum lease payment included above is £nil (2006: £nil). Payments made for physical power are charged to the Income Statement as incurred and disclosed as contingent rents.

(d) Contingent liabilities
There are no contingent liabilities.

(e) Guarantees and indemnities
In connection with the Group's 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 creditworthiness. The extent of credit support is contingent upon the balance owing to the third party at the point of deterioration.

(f) 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.

Commodity purchase commitments are estimated, on an undiscounted basis, as follows:

	2007 £m	2006 £m
Within one year	**8,400**	7,800
Between one and five years	**18,100**	16,100
After five years	**9,100**	10,400
	35,600	34,300

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 maturity analysis of energy derivatives disclosed in note 21. Only certain procurement and sales contracts are within the scope of IAS 39 and included in note 21. 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.

37. Related party transactions

During the year the Group entered into the following transactions with related parties who are not members of the Group:

	2007			2006		
	Sale of goods and services £m	Purchase of goods and services £m	Other transactions £m	Sale of goods and services £m	Purchase of goods and services £m	Other transactions £m
Barrow Offshore Wind Limited	**–**	**14**	**2**	–	8	1
Braes of Doune Wind Farm (Scotland) Limited	**–**	**10**	**–**	–	–	–
The Consumers' Waterheater Income Fund	**72**	**–**	**2**	65	–	2
	72	**24**	**4**	65	8	3

37. Related party transactions continued

Balances outstanding with related parties at 31 December were as follows:

	2007 Amounts owed from related parties £m	2007 Amounts owed to related parties £m	2007 Provision for bad or doubtful debt relating to amounts owed from related parties £m	2006 Amounts owed from related parties £m	2006 Amounts owed to related parties £m	2006 Provision for bad or doubtful debt relating to amounts owed from related parties £m
Barrow Offshore Wind Limited	**26**	**4**	**–**	23	3	–
Braes of Doune Wind Farm (Scotland) Limited	**–**	**4**	**–**	–	–	–
The Consumers' Waterheater Income Fund	**3**	**–**	**–**	3	–	–
	29	**8**	**–**	26	3	–

Barrow Offshore Wind Limited and Braes of Doune Wind Farm (Scotland) Limited are both joint ventures of the Group.

The Consumers' Waterheater Income Fund was deconsolidated with effect from 1 December 2007. The deconsolidation is explained in note 3. The transactions disclosed in the tables above reflect all transactions entered into with the Fund for the full year.

Remuneration of key management personnel	2007 £m	2006 £m
Short-term benefits	**8**	8
Post-employment benefits	**3**	5
Share-based payments	**5**	3
	16	16

Key management personnel comprise members of the Board and Executive Committee, a total of 15 individuals at 31 December 2007 (2006: 13). Key management personnel and their families purchase gas, electricity and home services products from the Group for domestic purposes on an arm's length basis.

38. Fixed-fee service contracts

Fixed-fee service contracts are entered into with home services customers in the UK and North America (HomeCare: 100, 200, 300, 400, HomeCare Flexi: 100, 200, 300, 400, Gas Appliance Care, Gas Appliance Check, Plumbing and Drains Care, Plumbing and Drains Care Flexi, Kitchen Appliance Care, Home Electrical Care and Home Electrical Care Flexi in the UK, and Heating Protection, Cooling Protection and Plumbing and Drains Protection in North America). These contracts continue 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 into, 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 affect 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 HomeCare: 100, 200, 300, 400 (excluding electrical fixtures), HomeCare Flexi: 100, 200, 300, 400 (excluding electrical fixtures), 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 HomeCare 400 (electrical fixtures only), HomeCare Flexi: 400 (electrical fixtures only), Home Electrical Care, Home Electrical Care Flexi, Kitchen Appliance Care, Plumbing and Drains Care and Plumbing and Drains Care Flexi);
- no limit to the number of call-outs to carry out work included within the selected agreement; and
- caps on certain maintenance and repair costs within fixed-fee contracts.

Notes to the Financial Statements continued

38. Fixed-fee service contracts continued

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 12-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 12-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 affect 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; and
- 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; and
- 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.

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 £7 million (2006: £7 million). The contracts are not exposed to any interest rate risk or significant credit risk and do not contain any embedded derivatives.

	2007 £m	2006 £m
Total revenue	**885**	785
Expenses relating to fixed-fee service contracts	**727**	683
Deferred income	**34**	37

The claims notified during the year were £269 million (2006: £258 million) and were exactly matched by expenses related to fixed-fee service contracts. All claims are settled immediately and in full.

39. Events after the balance sheet date

The Directors propose a final dividend of 9.65 pence per share (totalling £355 million) for the year ended 31 December 2007. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 12 May 2008. 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 2008.

On 14 January 2008 the Group acquired 88.4% of the outstanding common shares of publicly traded oil and gas company Rockyview Energy Inc. (Rockyview) for cash consideration of C$68 million (£34 million) and the remaining 11.6% of the outstanding common shares of Rockyview by 19 February 2008 in a series of transactions for additional cash consideration of C$9 million (£5 million). The fair values of assets and liabilities acquired and stated below are provisional because the Directors have not yet reached a final determination on all aspects of the fair value exercise.

	IFRS carrying values pre-acquisition £m	Fair value £m
Other intangible assets	7	10
Property, plant and equipment	64	54
Trade and other receivables	6	6
Trade and other payables	(24)	(24)
Provisions for other liabilities and charges	(2)	(6)
Deferred tax liabilities	(4)	(1)
Net assets acquired	47	39
Cash consideration		**39**

Notes to the Financial Statements continued

40. Principal undertakings

31 December 2007	Country of incorporation/formation	% Group holding in ordinary shares and net assets	Principal activity
Subsidiary undertakings (i)			
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 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 Energie GmbH	Germany	100	Wholesale energy trading
Centrica Energy Operations Limited	England	100	Power generation
Centrica KL Limited	England	100	Power generation
Centrica KPS Limited	England	100	Power generation
Centrica Langage Limited	England	100	Power generation
Centrica PB Limited	England	100	Power generation
Centrica Renewable Energy Limited	England	100	Renewable energy holding company
Centrica Resources Limited (ii)	England	100	Gas and oil production
Centrica Resources (Nigeria) Limited	Nigeria	100	Upstream exploration
Centrica Resources (Norge) AS	Norway	100	Upstream exploration
Centrica RPS Limited	England	100	Power generation
Centrica SHB Limited	England	100	Power generation
Centrica Storage Limited	England	100	Gas storage
Coastal Energy Limited	England	85	Clean coal generation
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 Inc	USA	100	Wholesale energy trading
Direct Energy Marketing Limited	Canada	100	Energy supply and home services
Direct Energy Partnership	Canada	100	Energy supply
Direct Energy Resources Partnership	Canada	100	Gas production
Direct Energy Services LLC	USA	100	Energy supply and home services
Dyno Holdings Limited	England	100	Home services
Energy America LLC	USA	100	Energy supply
Frontera Generation LP	USA	100	Power generation
GB Gas Holdings Limited	England	100	Holding company
Glens of Foudland Windfarm Limited	England	100	Power generation
Hydrocarbon Resources Limited	England	100	Gas production
Oxxio BV	Netherlands	100	Energy supply
Paris Generation LP	USA	100	Power generation
Residential Services Group Inc	USA	100	Holding company
The Centrica Gas Production LP	England	100	Gas production
WTU Retail Energy LP	USA	100	Energy supply
Joint ventures (i)			
Barrow Offshore Wind Limited	England	50	Wind farm construction
Braes of Doune Wind Farm (Scotland) Limited	Scotland	50	Power Generation
Segebel SA	Belgium	50	Holding company

(i) All principal undertakings are indirectly held by the Company. The information is only given for those subsidiaries which in the Directors' opinion principally affect the figures shown in the Financial Statements.
(ii) During the year, the Group acquired Newfield Petroleum UK Limited and changed its name to Centrica Resources Petroleum UK Limited. The assets of Centrica Resources Petroleum UK Limited were transferred to Centrica Resources Limited on 31 December 2007.

Independent Auditors' Report to the Members of Centrica plc

Independent Auditors' report to the members of Centrica plc

We have audited the parent Company Financial Statements of Centrica plc for the year ended 31 December 2007 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 2007.

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 members 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 whether in our opinion the information given in the Directors' Report (comprising the Directors' Report – Business Review and the Directors' Report – Governance) is consistent with the parent Company Financial Statements.

In addition, we report to you if, in our opinion, 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 Chairman's Statement, the Directors' Report, the Gas and Liquids Reserves, Five Year Record and Shareholder Information. 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 2007;
- 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; and
- the information given in the Directors' Report is consistent with the parent Company Financial Statements.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
21 February 2008

Company Balance Sheet

31 December	Notes	2007 £m	2006 £m
Fixed assets			
Tangible fixed assets	iii	**43**	84
Investments in subsidiary undertakings	iv	**2,080**	2,057
		2,123	2,141
Current assets			
Debtors (amounts falling due within one year)	v	**5,571**	5,146
Current asset investments	vi	**1,066**	608
Cash at bank and in hand		**1**	8
		6,638	5,762
Creditors (amounts falling due within one year)			
Borrowings	vii	**(167)**	(168)
Other creditors	viii	**(3,830)**	(2,710)
		(3,997)	(2,878)
Net current assets		**2,641**	2,884
Total assets less current liabilities		**4,764**	5,025
Creditors (amounts falling due after more than one year)			
Borrowings	vii	**(1,378)**	(1,269)
Provisions for liabilities and charges	ix	**(13)**	(25)
Net assets		**3,373**	3,731
Capital and reserves – equity interests			
Called up share capital	29	**227**	226
Share premium account	x	**685**	657
Capital redemption reserve	x	**16**	16
Other reserves	x	**2,445**	2,832
Shareholders' funds	xi	**3,373**	3,731

The Financial Statements on pages 140 to 146 were approved and authorised for issue by the Board of Directors on 21 February 2008 and were signed on its behalf by:

Sam Laidlaw
Chief Executive

Nick Luff
Group Finance Director

The notes on pages 141 to 146 form part of these Financial Statements, along with notes 29 and 33 to the Group Financial Statements.

Notes to the Company Balance Sheet

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.

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 Company's profit after tax for the year ended 31 December 2007 was £5 million (2006: £1,939 million).

Employee share schemes
The Group has a number of employee share schemes, detailed in the Directors' Report – Corporate Responsibility Review on page 32, the Remuneration Report on pages 42 to 45 and in note 33, 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 awards 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: awards up to 2005	A Black-Scholes valuation augmented by a Monte Carlo simulation to predict the total shareholder return performance
LTIS: after 2005 EPS awards	Market value on the date of grant
LTIS: after 2005 TSR awards	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
SAS, SIP, DMSS and RSS	Market value on the date of grant

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 pounds 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 three 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 post-retirement benefits
The Company's employees participate in a number of the Group's defined benefit pension schemes as described in note 34 to the Group Financial Statements. 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 to the Group Financial Statements) can be found in note 34 to the Group Financial Statements.

Notes to the Company Balance Sheet continued

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 substantively 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 substantively enacted by the balance sheet date.

Deferred tax is measured on a non-discounted basis.

Financial instruments

The Company's accounting policies for financial instruments are consistent with those of the Group, and are disclosed in note 2 to the Group Financial Statements. The Company's financial risk management policies are consistent with those of the Group and are described in the Directors' Report – Governance on pages 39 to 40 and in note 4 to the Group Financial Statements.

The Company is exempted by FRS 29 from providing detailed disclosures in respect of its financial instruments because the Company is included within the Group's consolidated accounts and its financial instruments are incorporated into the disclosures in note 4 to the Group Financial Statements.

ii. Directors and employees

Included within the Company's profit and loss account for the year are wages and salaries costs of £74 million (2006: £91 million), social security costs of £7 million (2006: £9 million) and other pension and retirement benefit costs of £17 million (2006: £25 million).

Details of Directors' remuneration, share-based payments and pension entitlements in the Remuneration Report on pages 42 to 51 form part of these Financial Statements. Details of employee share-based payments are given on pages 32, 43, 44, and 45 and in note 33. Details of the remuneration of key management personnel are given in note 37.

The average number of employees of the Company during the year was 1,174 (2006: 1,529), all of whom were employed in the UK.

iii. Tangible fixed assets

	Plant, equipment and vehicles £m
Cost	
1 January 2007	**148**
Additions	**13**
Disposals	**(82)**
31 December 2007	**79**
Depreciation and amortisation	
1 January 2007	**64**
Charge for the year	**13**
Disposals	**(41)**
31 December 2007	**36**
Net book value	
31 December 2007	**43**
31 December 2006	**84**

iv. Investments in subsidiary undertakings

	Investments in subsidiaries' shares £m
Cost	
1 January 2007	**2,057**
Additions and disposals (i)	**23**
31 December 2007	**2,080**

(i) Additions and disposals represent the net change in shares to be issued under employee share schemes in Group undertakings.

v. Debtors

Amounts falling due within one year	2007 £m	2006 £m
Amounts owed by Group undertakings	**5,545**	5,058
Derivative financial instruments (i)	**11**	70
Other debtors	**4**	7
Prepayments and other accrued income	**11**	11
	5,571	5,146

(i) Derivative financial instruments comprise foreign currency derivatives held for trading of £9 million (2006: £28 million), interest rate derivatives held for trading of £2 million (2006: £31 million) and foreign currency derivatives held for hedging of £nil (2006: £11 million). The fair value of these derivatives is equivalent to the carrying value.

Notes to the Company Balance Sheet continued

vi. Current asset investments

	2007 £m	2006 £m
Money market investments	**1,066**	608

£30 million (2006: £29 million) of investments were held by the Law Debenture Trust, on behalf of the Company, as security in respect of the Centrica Unapproved Pension Scheme (note 34 to the Group Financial Statements).

vii. Borrowings

	2007		2006	
Amounts falling due	**Within one year £m**	**After one year £m**	Within one year £m	After one year £m
Bank loans and overdrafts	**36**	**259**	68	88
Bonds	**131**	**1,119**	–	1,181
Commercial paper (i)	**–**	**–**	100	–
	167	**1,378**	168	1,269

(i) Commercial paper has a face value of £nil (2006: £102 million).

The Company's financial instruments and related disclosures are included within the consolidated accounts of the Group. In accordance with the requirements of FRS 29, further detailed disclosure in respect of the Company is not included. Disclosures in respect of the Group's borrowings and other financial instruments are provided in notes 25 and 4 respectively to the Group Financial Statements.

viii. Other creditors

Amounts falling due within one year	2007 £m	2006 £m
Trade creditors	**19**	22
Amounts owed to Group undertakings	**3,671**	2,559
Derivative financial instruments (i)	**68**	68
Taxation and social security	**2**	3
Accruals and deferred income	**70**	58
	3,830	2,710

(i) Derivative financial instruments comprise foreign currency derivatives held for trading of £39 million (2006: £13 million), interest rate derivatives held for trading of £5 million (2006: £32 million) interest rate derivatives held for hedging of £7 million (2006: £12 million) and foreign currency derivatives held for hedging of £17 million (2006: £11 million). The fair value of these derivatives is equivalent to the carrying value.

ix. Provisions for liabilities and charges

	1 January 2007 £m	Profit and loss charge £m	Utilised in the year £m	Unused and released £m	**31 December 2007 £m**
Restructuring and other provisions	25	3	(7)	(8)	**13**

Potential unrecognised deferred corporation tax assets amounted to £14 million (2006: £16 million), primarily relating to unutilised tax losses. The Company does not expect to be able to utilise these losses within the foreseeable future.

ix. Provisions for liabilities and charges continued

Restructuring and other provisions principally represent estimated liabilities for contractual settlements, liabilities for redundancy costs associated with the restructuring announced in 2005 and 2006 and National Insurance in respect of employee share scheme liabilities. The National Insurance provision was based on a share price of 358.75 pence at 31 December 2007 (31 December 2006: 354.50 pence). The majority of the amounts are expected to be utilised between 2008 and 2010.

x. Reserves

	Share premium account £m	Capital redemption reserve £m	Cash flow hedging reserve £m	Profit and loss account £m	**Total £m**
1 January 2007	657	16	1	2,831	**3,505**
Profit for the year (i)	–	–	–	5	**5**
Gains on revaluation of cash flow hedges	–	–	3	–	**3**
Dividends	–	–	–	(417)	**(417)**
Employee share schemes:					
Purchase of treasury shares	–	–	–	(2)	**(2)**
Value of services provided	–	–	–	31	**31**
Exercise of awards	–	–	–	(7)	**(7)**
Share issue	28	–	–	–	**28**
31 December 2007	685	16	4	2,441	**3,146**

(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 year was £5 million (2006: £1,939 million) before dividends paid of £417 million (2006: £384 million). The Company's profit includes dividends received from subsidiary undertakings of £nil (2006: £1,967 million).

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

	Treasury shares £m	Share-based payments reserve £m	Other £m	**Profit and loss account £m**
1 January 2007	–	38	2,793	**2,831**
Profit for the year (i)	–	–	5	**5**
Dividends	–	–	(417)	**(417)**
Employee share schemes:				
Purchase of treasury shares	(2)	–	–	**(2)**
Value of services provided	–	31	–	**31**
Exercise of awards	–	(18)	11	**(7)**
31 December 2007	(2)	51	2,392	**2,441**

(i) Includes a £1 million loss on re-measurement of interest rate derivatives and bonds designated as the hedged item (2006: £2 million gain) and a £2 million loss on re-measurement of foreign currency derivatives (2006: £17 million gain). Further details of the Company's interest rate and foreign currency derivatives are included within the financial instrument disclosures in notes 4, 21 and 22 to the Group Financial Statements.

Notes to the Company Balance Sheet continued

xi. Movements in shareholders' funds

	2007 £m	2006 (i) £m
1 January	**3,731**	2,134
Profit attributable to the Company (i)	**5**	1,939
Gains on revaluation of cash flow hedges	**3**	6
Dividends paid to shareholders	**(417)**	(384)
Employee share schemes:		
Purchase of treasury shares	**(2)**	–
Value of services provided	**31**	23
Exercise of awards	**(7)**	(29)
Share issue	**29**	65
Repurchase of shares (note 29 to the Group Financial Statements)	**–**	(23)
Net movement in shareholders' funds for the financial year	**(358)**	1,597
31 December	**3,373**	3,731

(i) Profit attributable to the Company includes dividends received from subsidiary undertakings of £nil (2006: £1,967 million).

The Directors propose a final dividend of 9.65 pence per share (totalling £355 million) for the year ended 31 December 2007. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 12 May 2008. These Financial Statements do not reflect this dividend payable, which will be accounted for in shareholders' funds as an appropriation of retained earnings in the year ending 31 December 2008.

Details of the Company's share capital are provided in notes 29 and 30 to the Group Financial Statements.

xii. Commitments and indemnities

(a) Other commitments
At 31 December 2007, the Company had commitments of £138 million (2006: £21 million) relating to contracts with outsource service providers. Other commitments at 31 December amount to £7 million (2006: £9 million).

(b) Lease commitments
At 31 December 2007, there were £1 million of land and buildings and £1 million of vehicle lease commitments in relation to non-cancellable operating leases for the Company (2006: £1 million and £2 million respectively). The Company has guaranteed operating commitments of a subsidiary undertaking at 31 December 2007 of £7 million (2006: £7 million) in respect of land and buildings.

(c) Guarantees and indemnities
Refer to note 36(e) to the Group Financial Statements 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 2007, the credit risk exposure under financial guarantees issued by Centrica plc was £1,487 million (2006: £1,612 million).

Gas and Liquids Reserves (unaudited)

The Group's estimates of reserves of gas and liquids are reviewed as part of the half year and full year reporting process and updated accordingly. A number of factors affect the volumes of gas and liquids reserves, including the available reservoir data, commodity prices and future costs. Due to the inherent uncertainties and the limited nature of reservoir data, estimates of reserves are subject to change as additional information becomes available.

The Group discloses proven and probable gas and liquids reserves, representing the central estimate of future hydrocarbon recovery. Reserves for Centrica operated fields are estimated by in-house technical teams composed of geoscientists and reservoir engineers. Reserves for non-operated fields are estimated by the operator, but are subject to internal review and challenge.

As part of the internal control process related to reserves estimation, an audit of the reserves, including the application of the reserves definitions, is undertaken by an independent technical auditor. Reserves are estimated in accordance with a formal policy and procedure standard.

The Group has estimated proven and probable gas and liquids reserves in the UK and North America.

The principal fields in the UK are South Morecambe, North Morecambe, Statfjord and the Rough field associated with Centrica Storage. The UK reserves estimates are consistent with the guidelines and definitions of the Society of Petroleum Engineers and World Petroleum Congress. An annual reserves audit has been carried out by ERC Energy Resource Consultants Ltd.

The principal fields in North America are Medicine Hat, Entice and Bashaw, located in the province of Alberta, Canada. The North American reserves estimates have been evaluated in accordance with the Canadian Oil and Gas Evaluation Handbook (COGEH) reserves definitions and are consistent with the guidelines and definitions of the Society of Petroleum Engineers and the World Petroleum Congress. The North American reserves evaluation has been carried out by Sproule Associates Limited.

Estimated net proven and probable reserves of gas (billion cubic feet)	UK	North America	**Total**
1 January 2007	1,519	272	**1,791**
Revisions of previous estimates (i)	71	79	**150**
Purchases of reserves in place (ii)	61	–	**61**
Production	(218)	(29)	**(247)**
31 December 2007	**1,433**	**322**	**1,755**

Estimated net proven and probable reserves of liquids (million barrels)	UK	North America	**Total**
1 January 2007	42	3	**45**
Revisions of previous estimates	(4)	–	**(4)**
Purchases of reserves in place	1	–	**1**
Production	(6)	–	**(6)**
31 December 2007	**33**	**3**	**36**

(i) Includes revised net reserves additions in the UK for Morecambe and Bains and reductions from Maria and the Brae Area fields and primarily additions to the Medicine Hat field in North America.
(ii) Reflects the 85% equity acquisition in the Grove Field.

Liquids reserves include oil, condensate and natural gas liquids.

Five Year Record

Results

Year ended 31 December	As reported under UK GAAP 2003 £m	Restated to IFRS* 2004 £m	2005 £m	2006 £m	**2007 £m**
Group revenue from continuing operations	16,817	11,325	13,407	16,403	**16,342**
Operating profit from continuing operations before goodwill amortisation, exceptional items, and certain re-measurements including share of joint ventures and associates:					
British Gas Residential	136	242	90	95	**571**
British Gas Services	70	72	111	102	**151**
British Gas Business	51	68	77	87	**120**
Centrica Energy	561	773	903	686	**663**
Centrica Storage	40	69	154	228	**240**
Direct Energy	100	99	147	173	**187**
European Energy	–	5	(9)	7	**17**
Other operations	–	1	2	14	**–**
	958	1,329	1,475	1,392	**1,949**
Operating profit/(loss) from discontinued operations, net of tax:					
The Consumers' Waterheater Income Fund (i)	30	33	38	50	**39**
OneTel (ii)	4	3	12	(11)	**–**
The AA (iii)	93	80	–	–	**–**
Goldfish Bank (iv)	(27)	–	–	–	**–**
Exceptional items and certain re-measurements (net of tax)	(53)	833	340	(862)	**383**
Goodwill amortisation (net of tax credit)	(161)	–	–	–	**–**
Profit/(loss) attributable to the Group	500	1,591	1,012	(155)	**1,505**
	Pence	Pence	Pence	Pence	**Pence**
Earnings/(loss) per ordinary share	11.8	38.0	27.4	(4.3)	**41.0**
Adjusted earnings/(loss) per ordinary share (v)	16.8	18.1	18.2	19.4	**30.6**

Assets and liabilities

At 31 December	As reported under UK GAAP 2003 £m	Restated to IFRS* 2004 £m	2005 £m	2006 £m	**2007 £m**
Intangible assets including goodwill	1,614	1,567	1,739	1,501	**1,539**
Other non-current assets	2,827	3,791	4,490	4,171	**4,518**
Net current assets/(liabilities)	241	155	666	(112)	**381**
Long-term liabilities and provisions	(1,945)	(3,205)	(4,453)	(3,918)	**(3,056)**
Net assets	2,737	2,308	2,442	1,642	**3,382**
Debt, net of cash and money market investments:					
Net (debt)/cash (excluding Goldfish Bank and non-recourse debt)	163	(508)	(1,060)	(1,527)	**(795)**
The Consumers' Waterheater Income Fund (non-recourse) debt	(216)	(217)	(532)	(483)	**–**
	(53)	(725)	(1,592)	(2,010)	**(795)**

* 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 2007.
(ii) Discontinued in 2005.
(iii) Discontinued in 2004.
(iv) Discontinued in 2003.
(v) 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 2003 £m	Restated to IFRS* 2004 £m	2005 £m	2006 £m	**2007 £m**
Cash flow from operating activities before exceptional payments	992	1,294	1,192	850	**2,447**
Exceptional payments	–	(25)	(48)	(113)	**(90)**
Net cash flow from investing activities	–	497	(529)	(720)	**(964)**
Disposals and acquisitions	292	–	–	–	**–**
Cash flow before financing	652	1,766	615	17	**1,393**

Shareholder Information

Electronic communications and the Centrica website

At the 2007 Annual General Meeting (AGM), the Company passed a resolution allowing the Centrica website to be used as the primary means of communication with its shareholders. A shareholder consultation card was sent with the proxy forms to shareholders in March 2007 enabling them to choose to either:

- receive shareholder documentation by website communication by providing an email address; or
- continue to receive shareholder documentation in hard copy by returning the personalised card attached to the AGM proxy form.

If the completed card was not returned, shareholders were deemed in accordance with the Companies Act 2006 to have agreed to receive shareholder documentation via the Centrica website. These shareholders, and those who positively elected for website communication, were sent, immediately prior to the publication date, a written notification that the 2007 shareholder documents are available to view on the Centrica website at **www.centrica.com/reports2007**.

The new electronic arrangements provide shareholders with the opportunity to access information in a timely manner and help Centrica to reduce both its costs and its impact on the environment.

The Centrica website at **www.centrica.com** also provides news and details of the Company's activities with links to its business sites.

The investors' section of the website contains up-to-date information for shareholders including:

- comprehensive share price information;
- financial results;
- dividend payment dates and amounts; and
- access to shareholder documents such as the Annual Report and Accounts, and Annual Review and Summary Financial Statements.

Shareholders who register to receive shareholder documentation from Centrica electronically can:

- view the Annual Report and Accounts on the day it is published;
- receive an email alert when shareholder documents are available;
- cast their AGM vote electronically; and
- manage their shareholding quickly and securely online.

Visit **www.centrica.com/shareholders** for more information and to register for electronic shareholder communication.

Centrica shareholder helpline

Centrica's shareholder register is maintained by Equiniti, which is responsible for making dividend payments and updating the register.

If you have a query on the following:

- transfer of shares;
- change of name or address;
- lost share certificate;
- lost or out-of-date dividend cheques and payment of dividends into a bank or building society account; or
- death of the registered holder of shares or any other query relating to your Centrica shareholding, please contact Equiniti:

Telephone: 0871 384 2985*
Text phone: 0871 384 2255*

Write to: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA

Email: centrica@equiniti.com

*Calls to these numbers are charged at 8 pence per minute from a BT landline. Other telephony providers' costs may vary.

A range of frequently asked questions is also available at **www.centrica.com/shareholders**.

The Centrica FlexiShare service

FlexiShare

FlexiShare is a 'corporate nominee', sponsored by Centrica and administered by Equiniti Financial Services Limited. 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.

By transferring your shares into FlexiShare you will benefit from:
- low-cost share dealing facilities provided by a panel of independent share dealing providers;
- 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.

Participants will have the same rights to attend and vote at general meetings as all other shareholders. There is no charge for holding your shares in FlexiShare, nor for transferring in or out at any time.

For further details about FlexiShare, please call the Centrica shareholder helpline on 0871 384 2985* 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 0871 384 2985* 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.

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 also 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 above) offers a year-round, low-cost dealing service to its participants.

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.

American Depositary Receipts

Centrica has a Level 1 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 Mellon
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 001 201 680 6825 from outside the US.
Or website address: **www.adrbny.com**

ShareGift

ShareGift (registered charity 1052686) is an independent charity which provides a free service for shareholders wishing to dispose charitably of small parcels 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 0871 384 2985*.

Shareholder Information continued

Financial calendar

23 April 2008	Ex-dividend date for 2007 final dividend
25 April 2008	Record date for 2007 final dividend
12 May 2008	AGM, Queen Elizabeth II Conference Centre, London SW1
11 June 2008	Payment date for 2007 final dividend
31 July 2008	Announcement date for 2008 interim results
12 November 2008	Payment date for proposed 2008 interim dividend

Analysis of shareholders as at 31 December 2007

Distribution of shares by the type of shareholder	Holdings	Shares
Nominees and institutional investors	9,850	3,349,757,280
Individuals (certificated)	777,310	330,223,031
Total	787,160	3,679,980,311

Size of shareholding	Number of holdings	Shares
1–500	619,418	142,900,643
501–1,000	102,928	72,082,115
1,001–5,000	59,564	101,732,177
5,001–10,000	3,124	21,297,293
10,001– 50,000	1,065	19,826,153
50,001–100,000	196	14,622,445
100,001– 1,000,000	522	198,928,376
1,000,001 and above	343	3,108,591,109
Total	787,160	3,679,980,311

As at 31 December 2007 there were 78,613 participants in the Centrica FlexiShare service, with an aggregate shareholding of 92,235,615 shares, registered in the name of Lloyds TSB Registrars Corporate Nominee Limited.

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 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 British Gas shares was in the proportion Centrica 27.053% and British Gas 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 $5\frac{5}{9}$ 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; and
- on 25 October 2004, the ordinary share capital was consolidated on the basis of nine new ordinary shares of $6\frac{14}{81}$ pence for every ten ordinary shares of $5\frac{5}{9}$ 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.

Accessibility

If you would like this Annual Report in an alternative format, such as large print, Braille or audio, you can request these in the following ways:

Telephone 0800 917 6564 **Textphone** 18001 0800 917 6564

Please note that these numbers should be used to request copies of alternative formats only. For general shareholder enquiries, please use the shareholder helpline 0871 384 2985*.

*Calls to this number are charged at 8 pence per minute from a BT landline. Other providers' telephony costs may vary.

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