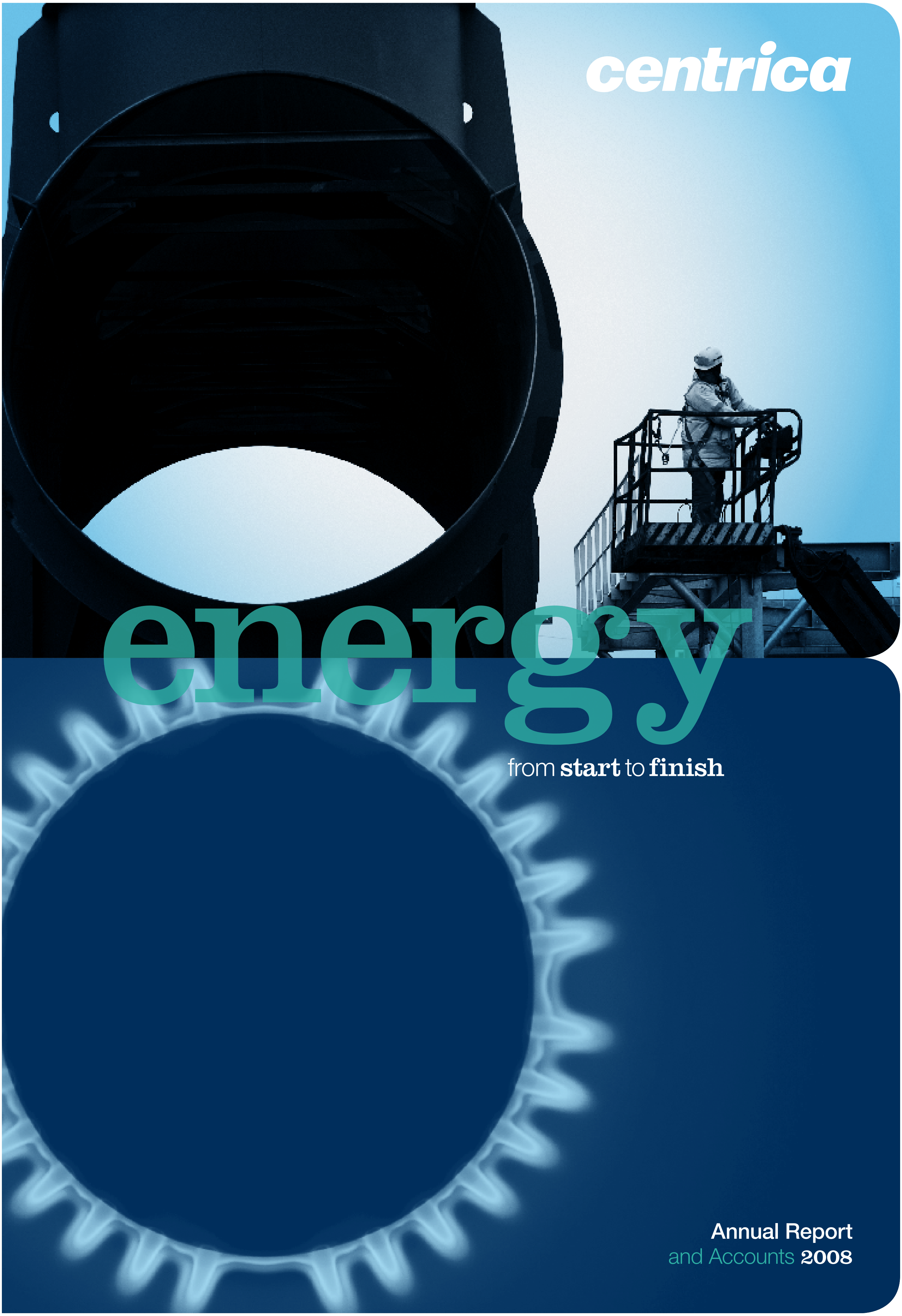
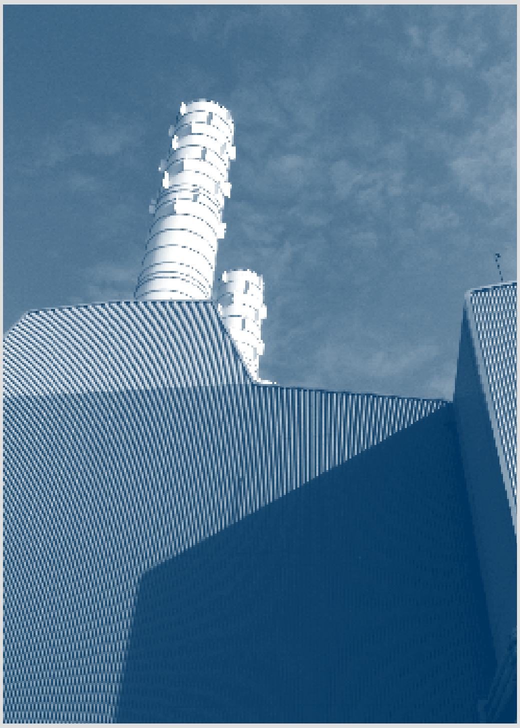


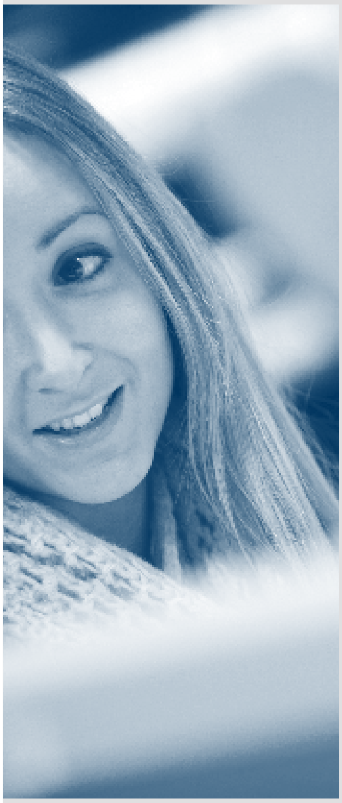
centrica

energy
from **start** to **finish**

Annual Report
and Accounts **2008**

www.centrica.com/report2008



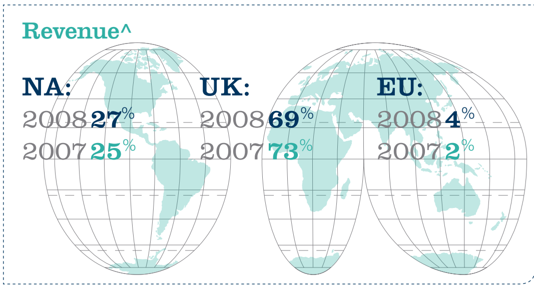


As an integrated energy company we're investing more now than ever in new sources of gas and power.

Energy expertise.
Energy efficiency.
For now, and for future generations.

At a Glance

Our businesses



British Gas Residential

2008	2007
£379m Operating profit^*	£571m Operating profit^*
8,100 Employees	9,200 Employees

The business:
We are the biggest energy supplier in Britain's domestic market. Operating under our British Gas brand (Scottish Gas in Scotland), we had 15.6 million gas and electricity customer accounts at the end of 2008, representing just over 40% of the gas market and 20% of the electricity market.

The market and our position:
British Gas Residential operates in the fully competitive energy supply market in Britain. Competitive positioning is based on brand recognition, the range of product propositions on offer, customer service quality, and retail price. The market has strong regulatory oversight. The deteriorating economic environment and unprecedented volatility in wholesale energy prices has led to increased focus on energy bills and the need for additional support for those defined as fuel poor.

British Gas has the largest programme in Britain to support vulnerable and in-need customers. Our range of fixed-price products has proved popular with customers seeking stability and certainty in their future energy bills. We now have over 3.5 million customers on fixed-price deals.

www.britishgas.co.uk

British Gas Business

2008	2007
£143m Operating profit^*	£120m Operating profit^*
2,100 Employees	2,000 Employees

The business:
We are Britain's leading supplier of energy to businesses, from small to medium-sized enterprises (SME) through to large industrial and commercial users. We offer a range of options from open tariffs to fixed-price contracts, and by the end of 2008 we had over 1 million customer supply points.

The market and our position:
The business market is highly sophisticated and there has been a rise in intermediaries – advisers who help customers manage the impact of volatile energy prices. With the prospect of tighter regulation around businesses' carbon emissions, we will be offering help to our customers to cut their energy usage and reduce their carbon footprint.

British Gas Business has a loyal customer base in part due to our dedicated account manager service, which provides a personalised customer service. Our recent acquisition of BMSi (an installer of specialist control systems to improve energy efficiency in commercial buildings) has added to the range of services that we can offer.

www.britishgasbusiness.co.uk

British Gas Services

2008	2007
£195m Operating profit^*	£151m Operating profit^*
15,400 Employees	15,200 Employees

The business:
We are Britain's largest operator in the installation and maintenance of domestic central heating and gas appliances employing around 9,500 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.

The market and our position:
We have seen a rise in competition in the contract cover market, from insurance and other energy companies. We have ensured we are offering customers greater choice by growing our range of products outside the original central heating care range. Our performance in the emergency 'on demand' market remains strong with over 65% of call outs converting to a contractual product. As energy prices rise and concern about emissions increases, new technologies become more attractive, and interest in home energy efficiency increases. So we expect customer demand to grow significantly for more integrated propositions. In 2008 we supported British Gas Residential in the launch of a bundled product, Dual Fuel Extra, and aim to expand such cross-selling during 2009.

www.britishgas.co.uk

British Gas New Energy

2008	2007
£(3m) Operating loss^*	£(2m) Operating loss^*
54 Employees	24 Employees

The business:
British Gas New Energy (BGNE) was established in 2007 to offer low-carbon solutions to customers. We now supply more energy efficiency products, such as insulation, than any other UK utility. We provide advice on saving energy and install a range of renewable and low-carbon microgeneration such as solar panels and heat pumps. We also provide two industry leading green energy tariffs.

The market and our position:
Many consumers understand that better energy efficiency and using cleaner energy are priorities in tackling climate change. This also remains a high political priority, with increasing Government policies to reduce carbon emissions from homes and businesses. We have responded to this evolving market by developing a range of low-carbon customer solutions. During 2008, more than half a million customers completed our Energy Savers Report. The energy efficiency measures we provided to homes delivered lifetime carbon savings of 17.87 million tonnes. We acquired a business that designs and installs solar photovoltaic systems and a low-carbon consulting business. We gained exclusive distribution rights for several combined heat and power technologies and invested in one of these developers.

www.britishgas.co.uk

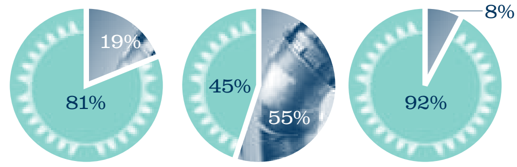
OUR MARKETS AND PROPORTION OF GROUP REVENUE

The map on the left illustrates how much revenue each of the regions contributed to the Group's total.

We can also take the Group as a whole and look at the contributions made by our downstream, customer-facing operations compared to the contribution made by our upstream assets and trading operations, as illustrated in the pie charts on the right.

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

Group revenue^ | **Operating profit^*** | **Employment workforce**



Downstream   Upstream

Centrica Energy

2008	2007
£879m Operating profit^*	£663m Operating profit^*
1,200 Employees	1,100 Employees

The business:
We source gas and electricity from our own production and from third parties, mainly to supply British Gas Residential and British Gas Business. Our gas fields can supply around 29% of our UK gas requirements, and we produce around 58% of our peak electricity requirements from our seven gas-fired power stations, four wind farms and major contracts.

The market and our position:
Both oil and gas prices saw record highs during 2008, and the UK power market tightened sharply with capacity shortfalls due to station outages in the UK fleet. We are investing in new gas assets by acquiring more fields in the North Sea, and also in developing our power generation and renewables fleet. Our Langage power station (one of the UK's cleanest fossil-fuelled power plants) is due to begin operation in 2009, and our investment programme to develop renewable energy from offshore and onshore wind farms is progressing. We have enough import capacity at the Isle of Grain liquefied natural gas (LNG) terminal to supply over 10% of our annual gas requirement, and have also announced our intention to acquire a 25% stake in the nuclear generator British Energy, which would add significantly to our portfolio.

centrica energy

www.centricaenergy.com

Centrica Storage

2008	2007
£195m Operating profit^*	£240m Operating profit^*
200 Employees	190 Employees

The business:
Centrica Storage operates the Rough storage facility which is the largest in the UK providing approximately 70% of current UK storage capacity. It consists of a partially depleted gas field under the North Sea, supported by a gas processing terminal at Easington, which we also manage. We sell gas storage and other services to Centrica Energy and a range of third parties. Centrica Storage also operates the Langeled terminal receiving Norwegian gas from the world's longest undersea pipeline.

The market and our position:
With the UK rapidly becoming more dependent on imported gas, increasing the country's gas storage capacity is essential in order to ensure security of supply. To meet these future requirements and develop Centrica Storage into a multi-asset, multi-product business we are planning to convert the largely depleted Bains gas field (near our Morecambe Bay fields) into a storage facility and have also acquired the onshore Caythorpe gas storage project in East Yorkshire.

In February 2009 we announced our intention to create an additional 60bcf gas storage field in the UK North Sea following the acquisition of a 70% share in the Baird gas field.

centrica storage

www.centrica-sl.co.uk

Direct Energy

2008	2007
£215m Operating profit^*	£187m Operating profit^*
5,000 Employees	4,800 Employees

The business:
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.

The market and our position:
North America has seen a year of change during 2008; energy markets have been affected by volatile wholesale gas prices and the economic downturn. On top of this, deregulation continues to be a hot topic with potential changes to carbon legislation under the new Obama administration. We are continuing to invest to grow and in 2008 acquired upstream gas assets from Rockyview and TransGlobe Energy in Canada. We also added to our customer base in the United States through the purchase of Strategic Energy. This makes Direct Energy one of North America's largest energy and energy-related services providers with more than 5 million customer relationships.

Direct Energy

www.directenergy.com

European Energy

2008	2007
£(56m) Operating loss^*	£17m Operating profit^*
250 Employees	200 Employees

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

The market and our position:
The European energy landscape is continuing its slow transformation, with ongoing merger and acquisition activity, significant evolution of wholesale markets, and increased unbundling activity, most notably in Germany and The Netherlands. Regulatory changes have also led to further unbundling and restructuring in Belgium, where in January 2009 we increased our shareholding in the generation and supply company SPE to a controlling 51%.

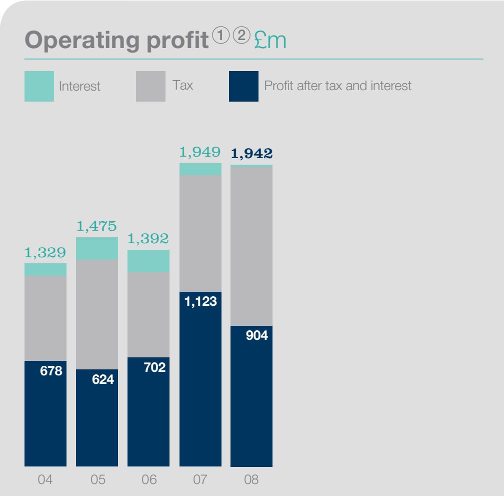
We are well positioned to take advantage of opportunities that may emerge in Europe. However the pace of deregulation is key and the returns will need to be competitive with other opportunities across the Group.

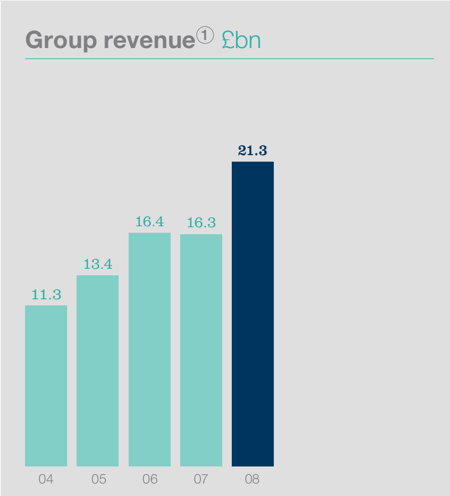
oxxio spe centrica energia centrica energie

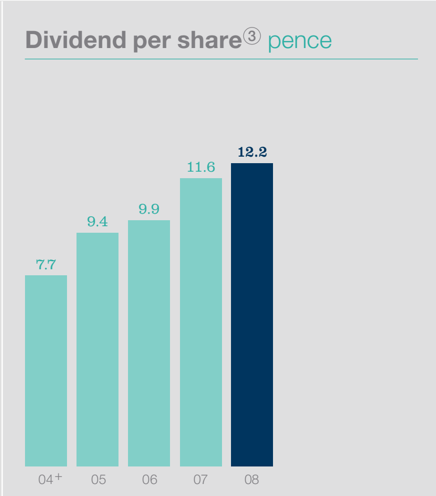
www.oxxio.nl
www.spe.be
www.centricaenergia.es
www.centrica-energie.de

Financial Highlights

Our performance







Year ended 31 December

Financial highlights	2008	2007
Group revenue[1]	£21.3bn	£16.3bn
Operating profit[1][2]	£1,942m	£1,949m
Earnings[1][2]	£904m	£1,123m
Adjusted basic earnings per share[1][2][3]	21.5p	27.2p
Ordinary dividend per share[3]	12.2p	11.57p

Statutory results	2008	2007
Group revenue[1]	£21.3bn	£16.3bn
Operating profit[1]	£460m	£2,184m
(Loss)/profit	£(144m)	£1,507m
Basic (loss)/earnings per share[3]	(3.5)p	36.5p

[1] from continuing operations
[2] including joint ventures and associates stated net of interest and taxation, and before exceptional items and certain re-measurements
[3] restated to reflect the bonus element of the Rights Issue
\+ excludes special dividend of 25 pence

Earnings and operating profit numbers are stated, throughout the commentary, before exceptional items and certain re-measurements where applicable – see note 2 for definition. The Directors believe this measure assists with better understanding the underlying performance of the Group. The equivalent amounts after exceptional items and certain re-measurements are reflected in note 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 2008. 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.

All references to 'the prior year', '2007' and 'last year' mean the 12 months ended 31 December 2007 unless otherwise specified. Throughout this Report references to British Gas include Scottish Gas.

Chairman's Statement

Performing well in a difficult year

"We remain focused on delivering stability and growth in Centrica for the benefit of our customers, employees and shareholders."

Centrica performed well in 2008, during what was a very difficult year for energy supply businesses. We witnessed previously unseen levels of volatility in wholesale gas and power prices. Oil prices rose to almost $150 per barrel and then fell back to below $50 as the high levels of global oil demand, which had been causing a tight supply position, reversed quite rapidly due to the recessionary impact of the global financial crisis.

Against this backdrop Centrica's financial performance in the year was good, with the higher upstream profits providing a partial hedge to the inevitable decline in retail profits during this time. We also made further progress on our strategic agenda which places Centrica on a much stronger footing both at home and abroad.

The sharp rises in world energy prices necessitated two retail price increases for UK consumers. We concentrated on providing some protection for our customers by reducing our operating costs through efficiency improvements, transforming the level of service we offer and increasing the support we provide to our vulnerable customers. Cost rigour was also evident across the rest of the Group as we reduced like-for-like operating costs against 2007.

In September we entered into a Memorandum of Understanding with EDF to acquire a 25% stake in the British Energy nuclear business. This potential investment is intended to provide a long-term hedge against volatile commodity prices and a platform for longer-term involvement in new nuclear power generation as a valuable source of growth. Beyond this we made further acquisitions of gas reserves in the North Sea and in North America. We also announced our intention, subject to successful studies, to build additional gas storage facilities which will help provide important additional security of supply for the UK.

In the year we delivered excellent results in our growth businesses. British Gas Business and British Gas Services once again reported strong growth in revenue and operating profit. In North America the economic climate proved challenging but the business held up well and also delivered a good performance.

In Europe we strengthened our presence by acquiring a controlling interest in SPE in Belgium. However in The Netherlands, where the market continues to favour integrated incumbents, Oxxio did not perform well and we have written down its carrying value.

Dividend

The Board of Directors is proposing a final dividend of 8.73 pence per share to be paid in June 2009, bringing our full year dividend to 12.2 pence, an increase of 5.4%. This is in line with our policy of delivering sustained real growth in the ordinary dividend.

Board changes

In March we announced the appointment of Mark Hanafin as Managing Director Centrica Energy and Europe, replacing Jake Ulrich. I would like to thank Jake for the dedication he has shown since the formation of Centrica in 1997 and the material contribution he has made in building our portfolio of gas, power and storage assets. Mark joined us from Shell where he was president and chief executive officer of Shell Energy North America.

Chairman's Statement continued

Know more about our year

Visit our Annual Report online.
www.centrica.com/report2008

In February 2009 we announced some changes to the business structure within Centrica and to the Executive Committee and the Board. We have combined British Gas Residential, British Gas Business and British Gas Services into a single customer-focused British Gas retail operation to maximise the value and growth potential. Phil Bentley assumes responsibility for the combined business with immediate effect. Phil remains a Director of Centrica plc.

Deryk King, President and Chief Executive Officer of Direct Energy and a member of Centrica's Executive Committee, has decided to retire and will leave his position with Direct Energy in July 2009, and subsequently depart from Centrica at the end of 2009. Deryk has built a very successful business for Centrica in North America over the last eight years. Deryk will be succeeded by Chris Weston who will take over as President and Chief Executive Officer of Direct Energy on 1 July 2009, after a period of handover. Over the last three years Chris transformed the operating and financial performance of British Gas Services and previously he headed up British Gas Business, our commercial energy supply operation. Chris will also join the Board of Directors of Centrica plc on 1 July 2009.

Paul Walsh, a Non-Executive Director of Centrica will step down from the Centrica Board at the Annual General Meeting on 11 May 2009. Paul joined the Board in March 2003. The search for a replacement has commenced.

Our employees

In February 2009, British Gas was recognised by The Sunday Times as one of the '20 Best Big Companies to Work For' which is a significant achievement. Our employees remain central to the success of Centrica, particularly during these times of great uncertainty and change. I want to thank them for the dedication, commitment, loyalty and professionalism which they continue to display.

The future

The economic landscape, dominated by the global financial squeeze, continues to worsen and Centrica is not immune to the effects of this. Energy markets remain volatile and erratic, placing pressure on parts of our business and on our customers.

In these challenging conditions the task of management will be to ensure we provide good service and competitive prices to all, support for the most vulnerable, a fair return and reward for our shareholders and long-term environmentally friendly sources of energy supply for the countries that we serve.

In the Chief Executive's review, Sam Laidlaw outlines the progress made to date against the strategic priorities of the Group and the direction and actions that will be taken as we look forward in 2009. In these unpredictable times, Centrica is well positioned, with a solid set of energy and services businesses and a strong financial position. I am confident that under Sam's leadership the management team will remain focused on delivering stability and growth in Centrica for the benefit of our customers, employees and shareholders.

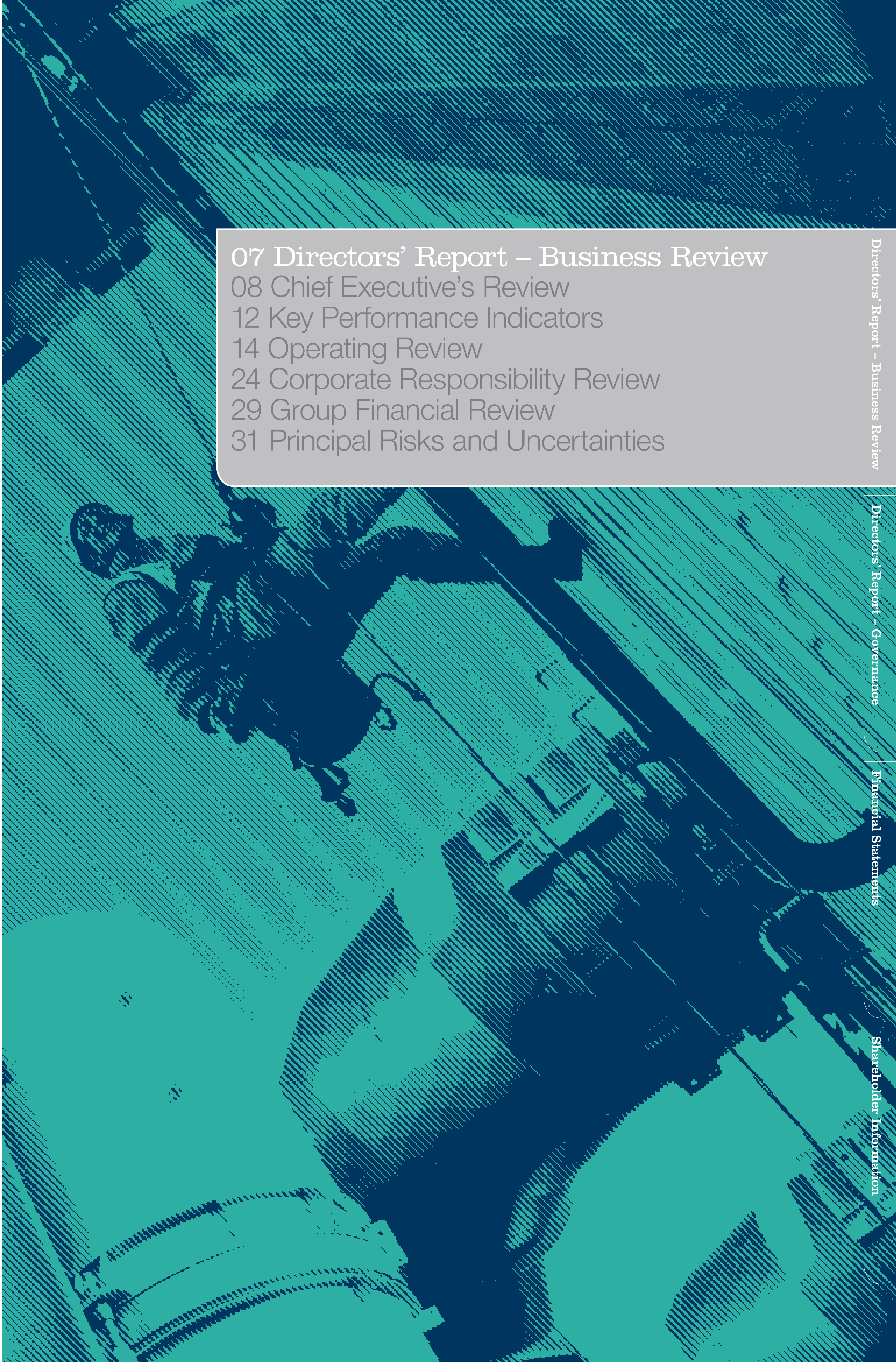
Roger Carr
Chairman
26 February 2009

OUR BUSINESS PRINCIPLES

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.

1. Demonstrating integrity in corporate conduct
2. Ensuring openness and transparency
3. Respecting human rights
4. Enhancing customer experiences and business partnerships
5. Valuing our people
6. Focusing on health, safety and security
7. Protecting the environment
8. Investing in communities

Our ongoing campaign to communicate these principles will help our employees, business partners and external audiences understand the standards we expect.



Chief Executive's Review

A year in the energy industry

"Centrica once again delivered a good financial performance in a year which provided a severe test for the business."

It has been a year of extraordinary turbulence in the commodity markets. During the first half of the year we experienced volatile and rapidly rising global oil and gas prices driven primarily by growing demand in Asia. In the second half the sharp contraction of credit markets caused a collapse of worldwide oil demand and the oil price. By the end of the year this started to feed through into a softening of the wholesale gas price. Although Centrica has navigated well through this market upheaval our profitability has been impacted with the upstream benefiting at the expense of downstream margins.

Only five years ago the energy environment in which we operate was very different to the one that we are in today. Then, wholesale gas markets were reasonably stable, security of supply was a distant concern with the UK self-sufficient in gas and exporting its excess to the continent – and new nuclear power was not universally welcome.

A great deal has changed.

Even though energy prices have softened as a result of the recession, the long-term trend remains upwards driven by the industrialisation of Asia, the increased costs of oil and gas extraction, political uncertainties surrounding sources of supply and the need to decarbonise our economies to meet the challenge of climate change. In the UK, domestic oil and gas production continues to decline and our import dependency is growing sharply. The power generation fleet is ageing and needs replacing with low-carbon technologies. In the US the new Obama administration has placed a high priority on meeting the challenge of climate change which, as in Europe, will place an additional but necessary cost on the consumer.

Taken together the triple challenges of ensuring security of supply, minimising climate change and providing affordable energy pose profound questions for the whole of the energy industry. There are no easy – or cheap – answers, although energy efficiency has a vital role to play. What is clear is that unprecedented levels of investment will be required over the next two decades to meet these challenges.

Gas

The UK is increasingly reliant on imports. Some 35% of UK gas was imported in 2008, and it is estimated that 70% will be imported by 2015. Demand for gas remains at high levels globally, despite the economic recession and the UK has to compete in the global marketplace. So Centrica is investing in new gas assets in the British and Norwegian sectors of the North Sea.

We are also investing in contracts and UK infrastructure to enable us to import increasing amounts of liquefied natural gas (LNG). In January 2009, we received the largest shipment of LNG ever delivered to the UK. But LNG is also a global product and the UK and Europe are competing with Asia and North America for LNG supplies.

Going forward, as additional LNG production comes on-stream and an increasing number of players enter the market, we will be pursuing a range of sourcing strategies.

Price volatility and supply constraints can be eased through storing gas bought during periods of low demand. The UK has relatively limited storage – we have around 16 days of gas storage compared to about 77 in Germany and 88 in France – and so this is another area in which Centrica is investing.

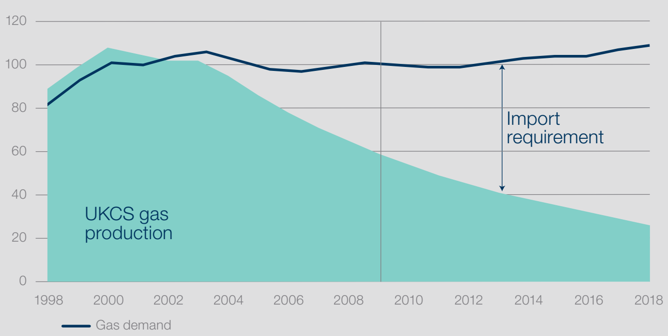
Power

The European Union and national governments are imposing strict limits on CO_2 emissions and stretching targets for the use of renewable energy. The European Renewables Directive, for example, will bind the UK to a 15% renewables target by 2020. The UK Government has suggested that this is likely to mean up to 30–35% of electricity could come from renewable sources compared with less than 5% today. According to the Government, this will require around £100 billion of investment.

However, renewables alone will not be able to fill the medium-term supply gap. The alternatives are gas, coal or nuclear power stations.

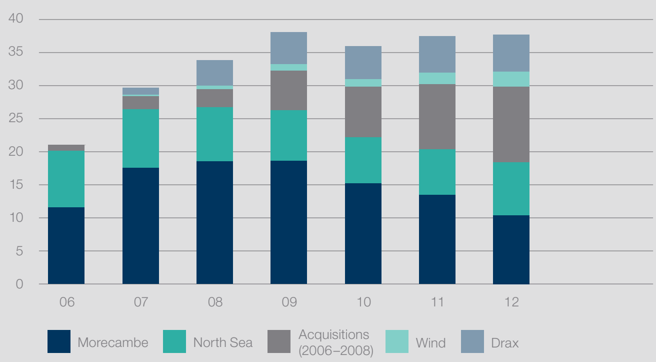
We are close to completing the first gas-fired power station to be built in the UK for almost five years, at a cost of £400 million and expect this to begin commercial operation later in 2009. We also

UK gas supply/demand 1998–2018



Source: Office of National Statistics, DECC, National Grid

Energy hedge ratio %



firmly believe that a vital longer-term contributor to energy security in a low-carbon world is new nuclear capacity. Much of the existing nuclear generation fleet will be retired over the next 15 years, and the replacement process has a very long lead time so decisions need to be made today. Our Rights Issue in December has provided the resources to enable us to be actively involved in this market.

Centrica's strategy needs to be able to address the complex issues that the industry faces, and to do so in ways that can deliver sustainable value for our shareholders. This requires us to manage all of the risks and opportunities we are facing with a clear vision and an understanding of where our corporate responsibilities lie. Our strategy must be able to respond appropriately to the needs of our vulnerable customers, to ensure the health and safety of our customers and employees, as well as meeting the challenges of security of supply and climate change.

I believe that it can, and that in seeking to create an integrated energy company, operating upstream by developing new sources of gas and power, and downstream with strong brands and innovative propositions, we have a robust approach to meeting the challenges ahead.

We have continued to operate the business in line with the strategic priorities we set at the end of 2006, and report on those over the next pages. In short the increasing extent of vertical integration in Centrica, the emphasis on operational excellence, the reduction of our cost base and the improvement in our customer service meant that we ended 2008 with a stronger business and momentum for the future.

PRIORITY 1 – TRANSFORM BRITISH GAS

British Gas Residential is the core of our business, and it needs to deliver consistently high levels of service and profitability if we are to succeed.

The transformation, therefore, aims to:

- **improve our price competitiveness, service levels and product offer**
- **reduce our costs through 'best-in-class' productivity while remaining a great place to work**
- **achieve long-term margins of 6–7%**

The progress we've made

During 2008 our customer service improved significantly. Average time to answer and to handle calls reduced further and our proportion of industry complaint levels fell by nearly a third over the year. Compared to 2007 we also increased the percentage of customer enquiries which were resolved on the first call and substantially reduced the transactional exceptions associated with the new billing system. These service improvements enabled further progress to be made on our cost reduction initiatives. Our operating cost base in 2008 was over £200 million lower than in 2006.

In October Ofgem published the initial findings of its probe into the energy supply industry in Britain. The report concluded that effective competition exists between the major suppliers. However, it did make recommendations to reduce certain retail price differentials, particularly relating to former incumbent electricity suppliers who charge different prices for in-area and out-of-area customers. It also suggested a reduction in tariffs for those customers with a prepayment meter, to more accurately reflect the additional cost involved in supplying those customers. British Gas complied with this recommendation in a matter of a few weeks.

What's next

We have created a strong foundation here over the last two years and now is the time to take British Gas to the next stage of its evolution. Building on our already strong brand in the UK we are seeking to deepen the customer relationship by combining the energy and services propositions. This will offset the gradual decline over time in the use of gas by consumers in the UK as we move to a lower carbon economy, and take full advantage of the increasing demand for energy efficient products and services. To best achieve this we will combine British Gas Residential, British Gas Business and British Gas Services into a single customer-focused organisation. This will enable us to launch new bundled products under the British Gas brand, products that customers want, to increase customer loyalty, to further reduce costs and to target even more efficiently the substantial support we already provide for our vulnerable customers. Phil Bentley, the current Managing Director of British Gas Energy, will run this new organisation. Chris Weston, current Managing Director of British Gas Services, will take over leadership of the Direct Energy business from Deryk King in July 2009.

Our strategic priorities

Transform British Gas	Sharpen the organisation and reduce costs	Reduce risk through integration	Build on our growth platforms
• New billing system complete • Service levels dramatically improved • Removed over £200m of costs since 2006 • Popular fixed-price and online propositions • Essentials tariff for vulnerable customers	• New senior management structure • Like-for-like Group operating costs reduced by £40 million • Becoming increasingly efficient	• First major UK power station for almost five years • Completed world's largest offshore wind farm development • Acquired more gas assets and received first LNG shipment • Announced two major new storage projects in 2008	• Strong customer growth in BGB • Increase in sale of BGS secondary products • Upstream and downstream acquisitions in North America

PRIORITY 2 – SHARPEN THE ORGANISATION AND REDUCE COSTS

We operate in a highly competitive market – for customers at national level and for global sources of energy.

In order to compete in the long term, our organisation has to be as lean and efficient as possible, with the people and structures that enable us to make the best use of the skills and resources we have.

The progress we've made

In July Mark Hanafin joined Centrica as Managing Director Centrica Energy and Europe. This further strengthened the executive team. Various initiatives in the year across the Group meant that we finished 2008 as a leaner organisation without affecting our ability to grow. This helped to reduce our Group like-for-like operating costs by £40 million, despite the inflationary pressures, particularly in the offshore services environment.

What's next

We have a strong leadership team in place and improved capital allocation, risk management and cost control processes, which will enable us to drive superior financial and operational performance. Going forward, we consider operating cost advantage to be a key competitive differentiator for Centrica and we will be relentless in the pursuit of further cost reductions, while enabling growth across the business.

PRIORITY 3 – REDUCE RISK THROUGH INTEGRATION

We need to produce more of the energy that we sell. In the UK, we are only able to supply 29% of our gas requirements from our own gas fields and 58% of our peak electricity demand from our own generation facilities. The remainder has to be bought in highly volatile world markets.

The progress we've made

During the year, we made good progress. We acquired additional gas assets in the British and Norwegian sectors of the North Sea. In March we increased our equity stake in the assets originally acquired from Newfield in 2007 and in October we completed our acquisition of assets in the Heimdal area of the North Sea. At the end of the year we announced an agreement to acquire an additional interest in the Peik gas field in the UK and in January 2009 we agreed to take additional equity in the York gas field. These deals provided us with both producing gas assets and valuable exploration and development prospects.

During the year Centrica Storage announced two important potential gas storage projects. In March we began engineering studies to explore the potential to convert the Bains gas field in the Morecambe Bay area into a storage field with a capacity of up to 20 billion cubic feet (bcf). In September we acquired the Caythorpe onshore gas field and began the process of converting it into a storage field capable of holding up to 7.5bcf of stored gas. In February 2009 we announced our intention to create an additional 60bcf gas storage field in the UK North Sea following the acquisition of a 70% share in the Baird gas field.

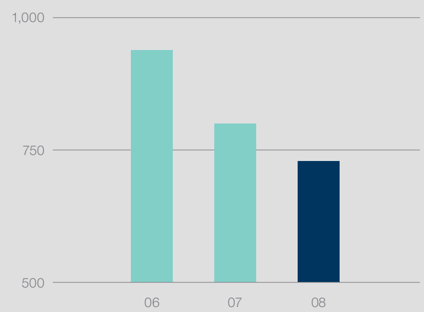
In power generation we completed the Lynn and Inner Dowsing wind farm development off the Lincolnshire coast, the largest operational offshore wind farm development in the world. In Devon, the construction of the Langage gas-fired power station continued, although the contractor has experienced some delays and we now expect the station to become operational towards the end of 2009.

In September we announced the signing of a Memorandum of Understanding with EDF to acquire a 25% share in the British Energy business. This would add significantly to our upstream position and provide us with a long-term hedge against volatile wholesale power prices, with access to power where the price is not impacted by the cost of oil and gas, and an opportunity to grow through new build nuclear construction in the UK.

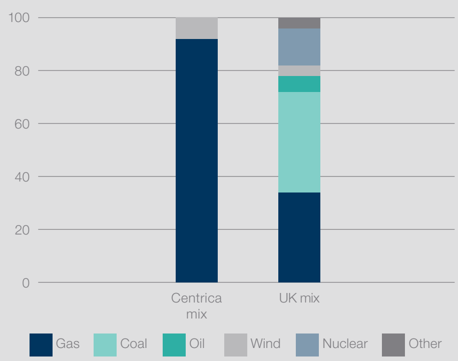
The proceeds from the successful £2.16 billion Rights Issue towards the end of the year provide us with the capital required to complete the British Energy transaction and make further material progress in increasing the upstream asset base and reducing risk.

Far left: In January 2009, we received the largest shipment of LNG ever delivered to the UK.
Middle: Centrica's UK headquarters in Berkshire.
Left: Our Direct Energy business in North America.

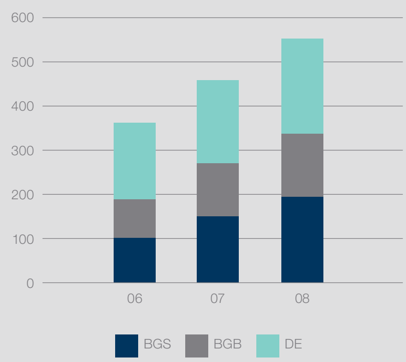
British Gas Residential operating expenditure £m



Generation mix %



Growth business EBIT £m
(earnings before interest and taxes)



What's next

We will continue to expand our power generation fleet as part of the overall upstream hedge to reduce the exposure to the increasing volatility in power prices and spreads. Here we will seek to cover an increasing amount of our UK electricity demand load and to grow and better align our generation mix with that of our competitors and the wider market. As part of this, our discussions with EDF, regarding us potentially acquiring 25% of British Energy are continuing. We will also pursue external financing to allow us to develop and build on our wind farm portfolio, and additional options to grow the size of our conventional gas-fired fleet of power stations.

In gas we are continuing to push ahead on reducing our exposure to the short-term volatility in wholesale gas prices by acquiring additional gas assets and striking gas contracts. In pursuing this we will focus most of our asset acquisition activity on the UK and Norwegian sectors of the North Sea while also continuing to evaluate LNG opportunities. Building closer relationships with National Oil Companies, to secure competitive long-term sources of gas for our customers, remains firmly on the agenda.

PRIORITY 4 – BUILD ON OUR GROWTH PLATFORMS

Centrica's growth businesses in the UK, Europe and North America have great potential for increasing the Group's profitability.

We are focusing on new opportunities, such as providing low-carbon products and services, and increasingly on integration in the North American business. This will see us concentrate on the geographies and service areas in which we are already strong, and support the retail businesses through the construction and acquisition of new power assets.

The progress we've made

The financial results in the year show real progress with this priority. In British Gas Business and British Gas Services we grew revenue, operating profit and customer numbers, while delivering ongoing cost efficiencies. In North America we faced a difficult economic environment. However here too we increased customer numbers and delivered a strong financial result, partially due to favourable exchange rate movements. Our acquisition in June of Strategic Energy doubled the size of our commercial and industrial (C&I) energy supply business and made us the third largest commercial supplier of energy in North America. In Europe, in January 2009 we completed the acquisition of an additional 25.5% of SPE, giving us a valuable controlling stake of 51%. Unfortunately Oxxio, our business in The Netherlands, recorded a disappointing loss*. We have taken action to stem losses here, including replacing management.

What's next

The reorganisation in British Gas provides us with an opportunity to increase the overall value of our customer base by expanding the overlap between our energy and services businesses through bundled offerings under a single brand. In North America we will also integrate further by building on the platform we have already established and tightening the focus on key geographies. In doing this we will establish a centralised service platform which enables us to compete more efficiently. With better focus will come a greater degree of integration, primarily through the selective acquisition and construction of gas and power assets, to provide growth opportunities and support for the retail businesses.

In summary

Following a record 2007, the financial performance in 2008 was good despite a much harsher environment. We made strong progress against the strategic priorities we set out at the end of 2006. The outlook for the global economy remains very challenging and in the UK 2009 could be particularly difficult for many of our customers, both residential and commercial. We will continue to place our customers' needs at the forefront of our agenda, alongside our determination to deliver increasing long-term value for our shareholders.

Sam Laidlaw
Chief Executive
26 February 2009

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

Measuring our performance

> "These key performance indicators provide us with a way of robustly measuring the Group's progress over the long term." **Sam Laidlaw,** Chief Executive

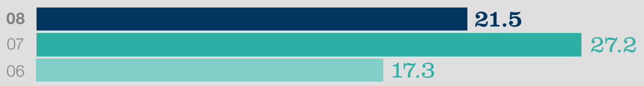
FINANCIAL KPIs

Adjusted basic earnings per share (EPS)

EPS is an industry standard determining corporate profitability for shareholders. 2007 was an exceptional year as a result of favourable commodity prices experienced in the first half of 2007 which drove profitability in the residential supply business.

Target/commitment – To deliver growth in adjusted EPS over a three-year period. This measure is used as one of the performance conditions in the Long Term Incentive Scheme, outlined on page 46.

Adjusted basic earnings per share pence*



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.

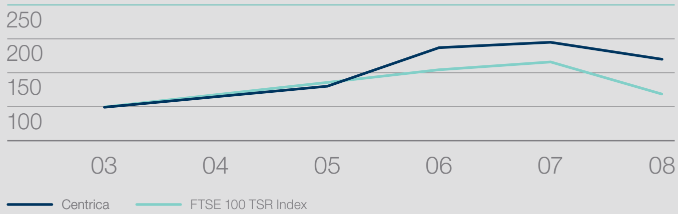
Total shareholder return (TSR)

The Board continues to believe that to realise the Company's long-term strategic goals, TSR is a valuable key performance indicator to assess the Company's performance in the delivery of shareholder value.

Centrica has outperformed the FTSE 100 Index by 43% over a five-year period.

Target/commitment – TSR is utilised as a measure of performance in the Company's Long Term Incentive Scheme, outlined on page 46.

Total shareholder return indices – Centrica and FTSE 100 Index for the five years ended 31 December 2008



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 Limited

Dividends per share

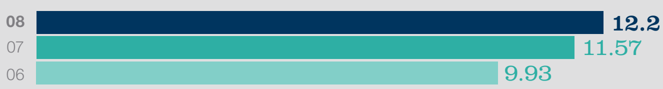
Dividends per share indicate the level of earnings distributed to Company shareholders.

The 2008 dividend shows an increase of 5.4% on the 2007 dividend.

Target/commitment – To deliver real growth per annum.

* Earnings per share and dividend per share figures have been restated to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

Ordinary dividend pence*



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.

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

To monitor how we're doing we have selected six high level key performance indicators (KPIs). These measures are robust and reflect the essential elements that define our success.

Three of them are financial measures as Centrica's primary purpose is to deliver returns to our shareholders.

But we cannot succeed without satisfying our customers, the commitment of our employees, and by growing the business in a sustainable, low-carbon way.

Separate KPIs relating to each individual business are reported in the Operating Review on pages 14 to 23.

NON-FINANCIAL KPIs

Customer satisfaction

Being responsible and responsive to the needs of our millions of customers is central to our business strategy. Once again British Gas Services enjoyed strong net promoter scores (NPS) and in 2008, Direct Energy increased its NPS score to 6.9% as a result of a range of front-line improvements. British Gas' retail energy score reduced in common with the rest of the industry, despite significant improvements to customer service. This is likely to be a result of two price rises in 2008.

Target – Continued focus on improving customer service and building our brand reputation remains a priority. We will look to continue improving on our Direct Energy score and to reverse the trend in British Gas customer satisfaction.

* In 2008 we aligned Direct Energy's NPS calculation with the UK's. We have recalculated Direct Energy's NPS for 2007 using this methodology.

Net promoter score 2008

-0.8%
British Gas
(2007: 3.1%)

6.9%
Direct Energy
(2007: 5.1%)*

The net promoter score (NPS) measures customers' responses to the question 'How likely would you be to recommend us as an energy supplier to a friend or relative (0-10)?' The score is calculated by the percentage of customers defined as promoters (scoring 9-10) minus the percentage defined as detractors (scoring 0-6).

Source: Internal calculations combining figures for residential, business and services divisions. Net promoter scores are collected through customer feedback forms and telephone interviews conducted by a third party supplier.

Carbon intensity

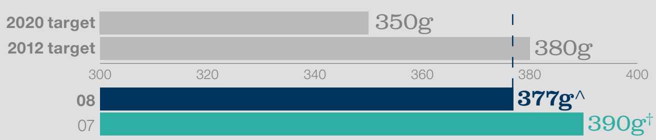
Centrica's power generation fleet has the lowest carbon intensity of any major energy supplier in Britain. We maintained this leadership position in 2008 when 377 grammes* of carbon dioxide were emitted for every kilowatt hour of power we produced.

Our 2008 performance exceeded the 2012 target and we are now focusing on the more challenging 2020 target.

Target – To reduce our UK power generation carbon intensity to 350g CO_2/kWh by 2020.

* 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.
^ 2008 data subject to final verification.
† Verified 2007 figure restated.

Carbon intensity g CO_2/kWh



Carbon intensity measures the volume of carbon dioxide (CO_2) emitted per unit of electricity generated. Investing in low-carbon generation, such as high-efficiency gas-fired power stations and offshore wind farms, is a key part of our business strategy.

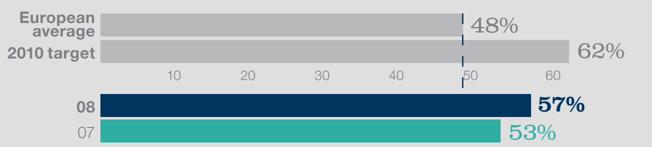
Source: Based on verified emissions data under the requirements of the EU Emissions Trading Scheme.

Employee engagement

We need the commitment of our employees to succeed. Measuring commitment and the factors that drive it are now the main focus of our employee engagement process, as this enables us to benchmark results more robustly. In 2008, there was a 94% response rate to our employee engagement survey. Commitment scores reached 57% Group-wide. This was well above the European average (48%). Engagement scores (reported in previous years) also rose to 4.11 in 2008 compared to 3.96 in 2007.

Target – The next full survey is in 2010 with a target commitment score of 62%. An interim survey will be run in 2009 with a target of 60%.

Engagement score %



The Centrica employee survey measures how people, from every team at all levels across the Group, feel about working for us. Questions include: Would you tell others this is a great place to work? Do you ever think about leaving? Does the Company inspire you to do your best?

Source: The survey is managed by an external supplier.

British Gas Residential

> "We had a year of unprecedented volatility in commodity prices."

BRITISH GAS RESIDENTIAL

The focus on delivering good customer service, reducing our cost base, maximising value from the customer base and providing an attractive environment for employees
has been central to the ongoing transformation of British Gas Residential.

British Gas Residential delivered a good financial performance during a year of unprecedented volatility in commodity prices. Wholesale gas prices peaked in September, having doubled over the previous 12 months, before falling over the balance of the year.

The rapid rise in wholesale energy prices during the first half of the year required price rises to customers in January and July in order to maintain reasonable profitability. Although there was a short-term increase in customer churn, sales of energy accounts remained high, with our Fixed Price 2011 proposition proving particularly popular in the third quarter of the year. At the end of 2008 we were serving 15.6 million accounts, of which 3.6 million had the reassurance of a fixed price product. In January 2009, as a result of a recent fall in wholesale energy prices and with energy bought at high prices in 2008 being partially used up, we announced a reduction of 10% in our standard gas tariffs and the introduction of a prompt payment discount for our credit customers.

The reorganisation of our business around customers and their needs is also having a positive impact. As a result of efficiency savings made through the focus on these lines of business we announced a reduction in the standard retail tariff for prepayment customers in November. This made us the first supplier to comply with the key recommendations of the Ofgem probe, published in October.

British Gas also continued to demonstrate industry leadership in supporting those customers less able to pay their fuel bills. Energy suppliers reached a voluntary agreement with Government in April 2008 to increase their collective spend on social programmes. British Gas has the largest commitment of all suppliers, £34 million during 2008/9, and with over 500,000 customers on our Essentials tariff, the UK's largest social tariff, we will spend more than double this amount to support the most vulnerable or in-need of our customers.

In July we launched our priority response product in conjunction with British Gas Services, Dual Fuel Extra. This gives around 500,000 of our highest consuming energy customers access to our priority response emergency central heating breakdown product. Early analysis indicates that this is increasing the loyalty of this group of customers.

Compared to 2007 the volume of incoming calls was 22% lower, reflecting improved internal processes and increased resolution of customer queries during the first contact which has reduced the level of repeat calls. These improvements also resulted in our share of Ombudsman's complaints falling to 25%, lower than our overall energy market share. After the price rise announced in July there was a temporary deterioration in our average speed to answer telephone calls. However by December these were back down to levels seen earlier in 2008.

In February 2009 British Gas was recognised by The Sunday Times as one of the '20 Best Big Companies to Work For', for the first time, an extremely pleasing and important accolade for a business where employee engagement is central to performance.

Revenue in the year was up by 20% to £7,769 million (2007: £6,457 million) as a result of the effect of higher average selling prices during the period, which were partially offset by slightly lower customer numbers.

With rapidly escalating wholesale gas prices, operating profit* was down by 34% to £379 million (2007: £571 million). This translated to a 4.9% margin (2007: 8.8%) and profit was reasonably even across the two halves of the year. Commodity costs increased year-on-year by 43% to £4,799 million (2007: £3,352 million) and there were also increases in transmission and metering costs of 7% to £1,862 million (2007: £1,734 million). The Carbon Emissions Reduction Target (CERT) replaced the Energy Efficiency Commitment (EEC) in April, doubling the obligation on UK energy suppliers. In September the Government announced its intention to expand the industry CERT target by a further 20% bringing the overall three-year target to £3.4 billion, and also announced the Community Energy Saving Programme (CESP), aimed at both suppliers and generators, which is expected to cost the industry £350 million over the next three years.

Operating costs fell by 9% to £729 million (2007: £800 million). Savings were made in our sales and support functions and in our call centres following lower incoming call volume. Net charges for bad debts were broadly unchanged as credits resulting from progress made in our debt collection processes and the ongoing improvements in the billing system allowed us to offset an underlying increase in bad debt costs. However, given the current economic pressures facing our customers and the higher retail tariffs, we expect our bad debt charge to increase in 2009.

Looking forward as we combine British Gas Residential, British Gas Services and British Gas Business, we expect to offer attractive energy efficiency products to customers, further increase customer loyalty and continue to reduce our cost base.

British Gas Residential key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Customer numbers (period end)						
Gas ('000)	**9,508**	10,018	(5)	9,508	10,018	(5)
Electricity ('000)	**6,062**	6,019	0.7	6,062	6,019	0.7
Total ('000)	**15,570**	16,037	(2.9)	15,570	16,037	(2.9)
Estimated market share (%)						
Gas	**43.5**	46.4	(2.9) ppts	43.5	46.4	(2.9) ppts
Electricity	**22.2**	22.4	(0.2) ppts	22.2	22.4	(0.2) ppts
Average consumption						
Gas (therms)	**547**	541	1.1	234	248	(6)
Electricity (kWh)	**3,957**	3,945	0.3	1,964	1,990	(1.3)
Total consumption						
Gas (mmth)	**5,345**	5,443	(1.8)	2,226	2,477	(10)
Electricity (GWh)	**23,880**	23,001	3.8	11,839	11,765	0.6
Revenue (£m)						
Gas	**5,211**	4,296	21	2,606	1,849	41
Electricity	**2,558**	2,161	18	1,340	1,111	21
Total	**7,769**	6,457	20	3,946	2,960	33
Commodity costs (£m)	**4,799**	3,352	43	2,484	1,698	46
Transmission and metering costs (£m)						
Gas	**1,264**	1,193	6	600	564	6
Electricity	**598**	541	11	298	273	9
Total	**1,862**	1,734	7	898	837	7
Operating costs (£m)	**729**	800	(9)	351	387	(9)
Operating profit (£m)*	**379**	571	(34)	213	38	461
Operating margin (%)	**4.9**	8.8	(3.9) ppts	5.4	1.3	4.1 ppts

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

British Gas Business

"British Gas Business continued to grow its overall customer base."

BRITISH GAS BUSINESS

Innovative propositions, such as dedicated account managers, have helped British Gas Business to grow by maintaining high levels of customer service, customer satisfaction and customer retention.

Despite challenging wholesale energy market conditions, British Gas Business delivered a very strong financial result and continued to grow its overall customer base. By the end of 2008 we were supplying over 1 million customer supply points. This included the addition of two small customer blocks. In October we successfully tendered for 37,000 SME electricity accounts, of which 26,000 had been retained at the year end, as part of Ofgem's supplier of last resort process, following the collapse of E4B. In November we added a further 39,000 electricity accounts through the acquisition for £3.5 million of BizzEnergy's customer base from the administrators of this privately owned energy supplier. In October we also announced the acquisition of BMSi, which increases our presence in the UK's expanding commercial energy-related services market.

Revenue for the year was up by 26% to £3,063 million (2007: £2,431 million), reflecting tariff increases and higher contract renewal rates following the increases experienced in wholesale input energy costs, combined with higher average customer numbers and increased consumption in both gas and power.

Service levels across the business remain high. First time resolution of customer queries continued to improve, resulting in fewer repeat calls and higher satisfaction levels across the commercial customer base. Customer retention in both larger commercial and SME customers also remained high. For the fourth year running British Gas Business was recognised as one of the UK's Top 50 'Best Workplaces' by the Financial Times.

Operating profit* for the year increased by 19% to £143 million (2007: £120 million). This was due to the maintenance of our gross margins and the identification of further operating cost efficiencies, including the renegotiation of our commercial broker fee structure. As a result our operating costs as a percentage of gross margin decreased to 62% (2007: 72%).

British Gas Business key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Customer supply points (period end)						
Gas ('000)	**415**	412	0.7	415	412	0.7
Electricity ('000)	**624**	542	15	624	542	15
Total ('000)	**1,039**	954	9	1,039	954	9
Average consumption						
Gas (therms)	**3,833**	3,729	2.8	1,604	1,602	0.1
Electricity (kWh)	**33,771**	32,644	3.5	16,976	16,750	1.3
Total consumption						
Gas (mmth)	**1,585**	1,524	4.0	667	665	0.3
Electricity (GWh)	**19,051**	17,356	10	9,882	9,056	9
Revenue (£m)						
Gas	**1,288**	1,037	24	613	441	39
Electricity	**1,775**	1,394	27	1,006	723	39
Total	**3,063**	2,431	26	1,619	1,164	39
Transmission and metering costs (£m)						
Gas	**224**	186	20	115	96	20
Electricity	**345**	298	16	184	156	18
Total	**569**	484	18	299	252	19
Operating profit (£m)*	**143**	120	19	88	72	22
Operating margin (%)	**4.7**	4.9	(0.2) ppts	5.4	6.2	(0.8) ppts

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

British Gas Services

> "British Gas Services increased the range of products on offer."

Directors' Report – Business Review
Directors' Report – Governance
Financial Statements
Shareholder Information

BRITISH GAS SERVICES

By responding to new customer needs with new products and better service delivery, British Gas Services has increased its customer base and financial performance. It is a growth business that is growing strongly.

British Gas Services delivered a strong overall performance in 2008 as we continued to reinforce and grow the business through high levels of customer service and a greater contribution from the growing range of products beyond the original central heating care range.

Revenue was up by 5% at £1,349 million (2007: £1,279 million) with particularly strong customer growth in our Plumbing and Drains and Home Electrical Care products, up by 6% and 11% respectively. By the end of the year we had increased the total number of customer product relationships by 5% to 8.1 million (2007: 7.6 million).

Our continued investment and commitment to high levels of customer service remained key to this growth. The overall level of service at our call centres and customer retention rates across most of our product range remained above prior year levels and the effectiveness of our engineers also improved. We introduced a new self-service online facility for our customers to book their annual service visits, and uptake to date has been encouraging. Service levels at our new National Distribution Centre (NDC), which underpins our overnight parts delivery commitment, have been high at 99%.

During the year we extended our range of services with the introduction of new insurance-based products that provide cover for water supply pipes and more general home emergencies. By December we had sold over 130,000 of these products. Our performance in the on-demand market remains strong, with over 65% of these customers subsequently converting to a contractual product. We also supported the launch of a bundled product, Dual Fuel Extra, in conjunction with British Gas Residential, which should enable us to deepen our relationship with those customers most valuable to British Gas.

Despite worsening economic conditions our Central Heating Installations business maintained activity at near 2007 levels, with 111,000 installations. Following the restructuring of this business and a major operation to minimise overheads and supply costs we improved operating profit substantially.

Overall operating profit* increased by 29% to £195 million (2007: £151 million), reflecting the continued strong growth of our higher margin secondary care products, improved efficiency and cost reductions across the business. Over the year targeted initiatives delivered £25 million of cost reductions. Operating costs as a percentage of gross margin decreased to 69% (2007: 74%) and the operating margin percentage rose to 14.5% (2007: 11.8%).

British Gas Services key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Customer product holdings (period end)						
Central heating service contracts ('000)	**4,571**	4,525	1.0	4,571	4,525	1.0
Kitchen appliances care (no. of customers) ('000)	**413**	414	(0.2)	413	414	(0.2)
Plumbing and drains care ('000)	**1,630**	1,536	6	1,630	1,536	6
Home electrical care ('000)	**1,305**	1,173	11	1,305	1,173	11
Insurance contracts ('000)	**133**	0	nm	133	0	nm
Total holdings ('000)	**8,052**	7,648	5	8,052	7,648	5
Central heating installations ('000)	**111**	113	(1.8)	57	58	(1.7)
Revenue (£m)						
Central heating service contracts	**736**	688	7	376	352	7
Central heating installations	**351**	348	0.9	177	187	(5)
Other	**262**	243	8	132	124	6
Total	**1,349**	1,279	5	685	663	3.3
Engineering staff employed	**9,500**	9,209	3.2	9,500	9,209	3.2
Operating profit (£m)*	**195**	151	29	110	88	25
Operating margin (%)	**14.5**	11.8	2.7 ppts	16.1	13.3	2.8 ppts

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

British Gas New Energy/ European Energy

"The Green Streets campaign is a unique social experiment in energy and carbon savings."

BRITISH GAS NEW ENERGY

As the UK moves towards a low-carbon future British Gas New Energy was established to develop a range of low-carbon solutions for homes and businesses. We provide energy efficiency and microgeneration products and services to customers.

During 2008, we continued to expand the range of products and services that we can offer our customers. In January we acquired a minority equity stake in Ceres Power Holdings plc and entered into a development and distribution agreement. Ceres is developing a fuel cell domestic boiler which generates electricity at the same time as producing heat. In September we entered the microgeneration market though our acquisition of Solar Technologies, an installer of solar photovoltaic technology. We expect the Government to introduce a feed-in tariff in 2010 which will strengthen this market by providing financial incentives for small-scale low-carbon generation.

In October we acquired Semplice Energy Limited, a low-carbon solutions company which offers consulting, design and systems integration to help businesses reduce their energy usage and use cleaner energy. We also entered into technology partnerships with Disenco, a developer of a micro combined heat and power appliance, and VPhase, a developer of energy saving products.

British Gas New Energy sought to raise awareness of energy efficiency through the successful 'Green Streets' campaign, where streets in the UK competed against each other to see which could save the most energy.

We also continue to deliver British Gas' regulatory obligations in energy efficiency under the Government's Carbon Emissions Reduction Target (CERT) programme. In 2008, the energy efficiency measures we provided to homes delivered lifetime carbon savings of almost 18 million tonnes.

EUROPEAN ENERGY

We are involved in power generation, energy management and retail energy supply in mainland Europe, where the development of a fully competitive energy market would provide significant growth opportunities.

Our European businesses experienced tough wholesale market conditions during 2008, reporting an operating loss* of £56 million (2007: operating profit* £17 million).

In Belgium, SPE continued to grow its customer base and now supplies over 1.5 million customers (2007: 1.4 million). Earnings, after tax and interest, of £8 million were in line with last year. In January 2009 we completed our acquisition from GdF of their 25.5% stake in SPE for an initial price of €515 million, giving us a controlling stake of 51%. On 23 February 2009 the first tranche of the PE2 agreement came into effect, giving SPE access to a further 250MW of nuclear power and triggering the payment to GdF of deferred consideration of €70 million (£65 million). Additional deferred consideration of up to €35 million is also payable contingent upon the approval of the second tranche of PE2, under which SPE would acquire access to an additional 285MW of discounted power output.

In The Netherlands, Oxxio faced highly volatile commodity prices and struggled to compete against vertically integrated incumbent players. Customer numbers fell slightly as a result and underlying trading results were weak. In addition, we experienced operational challenges, with the business suffering a billing backlog and overruns in procurement costs, both of which resulted in significant additional charges within the 2008 results. The operating loss* for the year was £63 million (2007: operating profit* £3 million). We have taken action to address the internal issues within the business, including putting a new management team in place, and progress has now been made in improving operational performance. In light of the 2008 loss, the carrying value of the goodwill associated with Oxxio has been written down by £45 million. This has been charged as an exceptional item which totalled £67 million, the remaining £22 million being a write-down of a receivable relating to historic overpayments of energy revenue tax where recovery is now uncertain.

In Spain and Germany changes during the year to the regulatory regimes were helpful to our businesses. In Spain the high voltage regulated tariff was removed allowing Centrica Energía, one of only three 100% green suppliers in the country, to make further progress in the high voltage power market. In Germany the restructure of the historic gas supply areas and the implementation of a new gas balancing regime were helpful.

Centrica Storage

"We announced our involvement in two major new build storage projects in 2008."

CENTRICA STORAGE

Gas storage is an integral part of the upstream supply chain, and a hedge against wholesale price volatility. Centrica – and the UK – does not have enough storage capacity and so we are investing in more.

Centrica Storage delivered a good financial performance in the year, against a backdrop of narrower year-on-year summer/winter gas price spreads. As a result of these narrower spreads, revenue in the period was down 14% to £280 million (2007: £327 million) primarily driven by a lower achieved standard bundled unit (SBU) price of 43.8 pence (2007: 57.4 pence). This was partially offset by additional revenue of £26 million generated from the sale of cushion gas in the last quarter of the year, although this did result in lower additional space sales and fewer gas optimisation opportunities. As a result of this lower revenue and an increased cost of fuel gas, operating profit* fell by 19% to £195 million (2007: £240 million).

Operationally the Rough field performed strongly in 2008, with injection and production availability of 99%. In the first half of the year we upgraded the two offshore compression trains for the field which enhanced injection rates. Since completing the acquisition in 2003 the continued investment has enabled us to create the financial equivalent of more than 80 million additional SBU sales in 2008. During the year the Easington terminal passed five years without a lost time incident and Centrica Storage's overall accident rate of below one lost time incident per million man hours compares very favourably with industry benchmarks.

In July approval was granted by Ofgem to modify the standard storage contract to include prepaid entry capacity rights. Centrica Storage now offers a range of products that give customers the choice of day ahead or within day withdrawal nominations as well as a choice of trading point and firmness.

During the year Centrica Storage also announced its involvement in two major new build storage projects. In March we announced the proposed conversion of the Bains gas field into a gas storage facility, with a potential capacity of up to 20bcf. In September we acquired Caythorpe Gas Storage Limited, which has planning permission to convert the onshore Caythorpe gas field to a gas storage facility, with a capacity of up to 7.5bcf. If completed, both of these projects would become operational by the winter of 2011/12, and will provide increased levels of flexibility, optionality and security through a multi-asset model.

In February 2009 a third new gas storage project was announced. Centrica Storage, in conjunction with Perenco, intends to convert the largely depleted Baird gas field into a facility that would have capacity to hold approximately 60bcf, just over half the capacity of Rough, the UK's largest gas storage facility.

Centrica Storage key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Average SBU price (calendar year) pence	**43.8**	57.4	(24)	38.8	53.4	(27)
Revenue (£m)						
Standard SBUs	**199**	261	(24)	89	122	(27)
Extra space	**20**	28	(29)	11	11	0
Optimisation	**1**	11	(91)	3	8	(63)
Cushion gas sales	**26**	0	nm	23	0	nm
Other	**34**	27	26	15	15	0
Total^	**280**	327	(14)	141	156	(10)
External turnover (£m)^	**221**	270	(18)	101	130	(22)
Cost of gas (£m)^	**22**	11	100	11	7	57
Operating profit (£m)*	**195**	240	(19)	102	112	(9)

^ restated to net off gas sales and purchases made as a result of optimisation activity
* including joint ventures and associates stated net of interest and taxation, and before certain re-measurements

Centrica Energy

" We built on our existing asset base with investments in the British and Norwegian sectors of the North Sea."

CENTRICA ENERGY

Centrica Energy is the part of the business that ensures security of supply for our customers. It is building the upstream operation that is vital for an integrated energy company, by investing in new sources of gas and power.

Centrica Energy delivered a strong financial performance in 2008, during a year when the average UK month-ahead gas price was at a record high of 61.4 pence per therm (p/th), more than double that experienced during 2007.

Gas production and development

Operating profit* in the gas production business increased to £1,164 million from £429 million in 2007. This performance was driven by an increase in overall hydrocarbon production volumes and higher achieved average sales prices. Gas sales volumes increased by 7% to 2,418 million therms (mmth) (2007: 2,260mmth) as we benefited from consistent Morecambe production and an increased contribution from the Rose and Statfjord fields. In total, hydrocarbon volumes increased by 8% to 46.8 million barrels of oil equivalent (mmboe) (2007: 43.3mmboe). Due to the higher wholesale market gas price the average gas selling price achieved rose to 59.1p/th (2007: 30.4p/th). Volume-related production costs increased broadly in line with production levels. Other production costs increased more rapidly due to the greater level of exploration and seismic activity and increased field operating costs, driven by the impact of recent acquisitions and industry cost inflation.

During the year we built on our existing asset base, announcing several additional equity investments in both UK continental shelf and Norwegian shelf assets. In March we increased our equity holding in the Grove and Seven Seas fields, acquired in 2007, to 92.5% and 90% at a cost of £36 million. After further development we expect to recognise around 32 billion cubic feet equivalent (bcfe) of reserves. In October we completed the acquisition of the Norwegian gas assets held by Marathon in the Heimdal area of the Norwegian North Sea for net consideration of £162 million. An additional investment of £125 million is expected to be required in order to recognise the total reserve potential of 154bcfe over the next four years. In December we announced an agreement to acquire an additional 66.67% equity holding in the UK portion of the Peik field for £20 million. Asset pre-emption rights and approvals were cleared in January 2009 and after further capital investment of around £140 million we expect to recognise 72bcfe of reserves.

As part of our ongoing capital investment programme we spent £108 million in 2008 on our existing gas asset portfolio and also approved significant additional development plans at an aggregate cost of over £200 million over the next three years. These include development at the Grove field where commercial gas was delivered from the first of a four-well programme during the fourth quarter of 2008 and the second well was successfully tested during January 2009. Our success in this highly complex procedure underlined the growing skill base which exists within Centrica in this environment. Drilling of the remaining two wells will continue during the first half of 2009. Further programmes during 2009 include the sanctioned development of the Seven Seas field, and the Babbage field where we have a 13% interest. In total we have recognised an additional 105bcfe of proven and probable reserves as a result of our UK acquisitions and developments.

During the year we also invested £43 million in our focused exploration programme. This included producing new seismic imaging around both the Morecambe Bay area and our licence blocks in Norway and Nigeria.

Power generation

The power generation segment delivered an operating profit* for the year of £7 million (2007: £46 million). Overall the financial performance of the fleet was held back by a forward sales contract which expires at the end of the first quarter of 2009, and unplanned outages at the South Humber Bank, Peterborough and Spalding power stations. This restricted our ability to capture higher market spark spreads during a period when the system supply margins remained tight.

Operationally, despite these outages, the average load factor across our conventional gas-fired power stations increased to 65% (2007: 55%) and the total power generated from our power portfolio rose to 23.4 terawatt hours (TWh) (2007: 19.8TWh).

By the end of the year we had completed the major construction work at the 180 megawatt (MW) Lynn and Inner Dowsing offshore wind farm development, where five of the six arrays are now exporting directly to the National Grid. We expect to be exporting from the final array in the first quarter of 2009, following a repair to the subsea cable. The successful in-house delivery of this project illustrates our ability to manage and derive value from large-scale complex engineering projects in this area.

In October we gained Government approval for a proposed 250MW offshore wind farm project off the Lincolnshire coast and are now evaluating tenders to confirm the project economics before making any further investment decisions. We also commenced a process to assess the potential for refinancing a portion of the current asset base and establishing joint venture partnerships going forward.

The 885MW Langage gas-fired power station project, the UK's first major power station development for almost five years, remains on budget. We now expect the plant to commence full commercial operation towards the end of 2009.

Industrial and commercial

This segment reported an operating loss* of £329 million (2007: £179 million operating profit*). The higher gas price environment experienced during 2008 resulted in input costs for these contracts increasing materially, while the index-linked pricing mechanisms also restricted the upward movement in the sales prices achieved. Despite a softening of gas prices during the fourth quarter of the year customer demand remained high, with volumes sold for the year increasing by 10% to 2,493mmth (2007: 2,260mmth).

Energy procurement

During the year we continued to seek gas supply contracts to diversify the price indexation and further build the contractual hedge position in Centrica. We successfully re-indexed an existing contract and also negotiated additional medium-term supply contracts; in total around 4 billion cubic meters (bcm) of gas per annum.

In November we commissioned our liquefied natural gas (LNG) import capacity at the Isle of Grain with a Q-flex tanker delivering approximately 193,000 cubic metres of LNG. This was the largest LNG tanker ever to be landed in the UK. Our annual import capacity of 3.4bcm positions us well for the increasing availability of LNG supply.

Accord trading

Accord delivered a strong operating profit* of £37 million, up significantly on the prior year (2007: £9 million), during an extremely volatile period for wholesale energy prices.

Centrica Energy key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Gas production						
Gas production volumes (mmth)						
Morecambe	**1,716**	1,574	9	696	832	(16)
Other	**702**	686	2.3	309	374	(17)
Total	**2,418**	2,260	7	1,005	1,206	(17)
Average gas sales price (p/therm)	**59.1**	30.4	94	67.8	36.5	86
Oil and condensate production volumes (Mboe)	**6.5**	5.6	16	3.2	2.6	23
Average oil and condensate sales price (£/boe)	**45.0**	33.3	35	46.6	33.6	39
Revenue (£m)	**1,784**	923	93	859	557	54
External revenue (£m)	**466**	299	56	229	162	41
Operating costs (£m)						
Volume-related production costs	**325**	291	12	144	163	(12)
Other production costs	**295**	203	45	189	88	115
Total	**620**	494	26	333	251	33
Operating profit (£m)*	**1,164**	429	171	526	306	72
Power generation						
Power generated (GWh)	**23,366**	19,845	18	11,830	8,122	46
Operating profit/(loss) (£m)*	**7**	46	(85)	12	(1)	nm
Industrial and commercial						
External sales volumes (mmth)	**2,493**	2,260	10	1,150	1,202	(4.3)
Average sales price (p/therm)	**41.6**	35.7	17	43.7	35.3	24
External revenue (£m)	**1,036**	838	24	511	443	15
Operating (loss)/profit (£m)*	**(329)**	179	nm	(173)	31	nm
Accord						
Operating profit (£m)*	**37**	9	311	10	(10)	nm
Centrica Energy operating profit (£m)*	**879**	663	33	375	326	15

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

Direct Energy

"Direct Energy delivered a strong set of results despite a difficult environment."

DIRECT ENERGY

Direct Energy continues to offer strong growth potential and now accounts for 27% of the Group's revenue. Expertise in energy procurement, retail services, growing upstream gas and power generation businesses, along with our balance sheet strength, position us well to take advantage of future opportunities.

Direct Energy delivered a strong set of results in 2008 despite a difficult economic and commodity environment. Revenue in the year was up 46% at £5,824 million (2007: £3,992 million), mainly as a result of the acquisition of Strategic Energy, greater activity in wholesale auctions, higher selling prices in retail energy, and the positive impact of the stronger US and Canadian currencies. Operating profit* was up 15% at £215 million (2007: £187 million), and was up by 4% on a constant currency basis as growth in the commercial and industrial business more than offset negatives in home and business services.

Mass markets energy

Mass markets energy delivered a good performance given the tough market conditions. In Canada customer numbers grew by 3% as we gained market share in Alberta where we have now switched 250,000 customer accounts from the regulated tariff to competitive products, and operating margins expanded in both Ontario and Alberta.

In the US North East customer numbers grew by 20% to more than 400,000 as we continued to grow our gas and power businesses in New York and increased our market share in Ohio and in Connecticut. We also benefited from an unusual combination of high demand and low wholesale gas prices in the cold weather during the latter part of the year, which resulted in stronger profits* during this time.

Texas customer numbers fell by 4% in the year and total demand dropped by over 15% as benign weather and conservation efforts by customers in the face of higher prices impacted average consumption per customer. An increase in Texas retail prices in June, and more stable commodity costs in the second half of the year resulted in improved performance compared to the first half, although the fall in competitor tariffs put pressure on the Texas business towards the end of the year and forced us to reduce prices early in 2009. Texas was also adversely impacted by two one-off issues. During the second quarter transmission congestion caused spikes in intra-day electricity balancing costs and in September Hurricane Ike damaged Houston's power infrastructure, causing a temporary but sharp reduction in demand. Despite these issues, Texas delivered operating margins of 9% in 2008.

Revenue for the year was up 9% to £2,652 million (2007: £2,437 million) and operating profit* grew 11% to £137 million (2007: £123 million). On a constant currency basis both revenue and operating profit* were broadly flat.

Commercial and industrial energy

Electricity sales in the year were almost double those in 2007, primarily as a result of the Strategic Energy acquisition and supported by organic growth in the existing businesses. Together with higher contract prices, and the favourable exchange rate, this resulted in revenue more than doubling to £2,015 million (2007: £978 million). On a constant currency basis revenue was up 88%. We now supply over 200,000 meter points, which positions us as the third largest commercial and industrial energy supplier in North America.

In the second half integration costs for Strategic Energy cancelled out the synergy benefits. However the integration is now essentially complete and we are on target to exceed the US$15 million of annual cost synergies announced at the time of the acquisition. As some of our competitors struggled in the tighter credit environment we also made significant progress in the second half in expanding margins to recover the higher cost of credit support. As a result operating profit* for this business was up substantially year-on-year at £11 million (2007: £1 million).

Home and business services

It was a difficult year for our services business, as the severe slowdown in US housing construction, which was 35% down on 2007, had a material impact on the US business. Our level of installations of equipment in new homes in the US fell by 13% and our backlog of sales awaiting installation fell by 25%. In response we cut costs sharply and continued to increase our emphasis on protection products, where customer numbers increased by 11%.

In Canada our customer base for protection products increased by 5%, mainly due to strong sales of total home protection plans.

Revenue was slightly up by 7% at £375 million (2007: £351 million) and operating profit* was marginally down year-on-year at £16 million (2007: £17 million). On a constant currency basis revenue was down 1% and operating profit* was down 20%.

Upstream and wholesale energy

Overall operating profit* was up 11% year-on-year at £51 million (2007: £46 million) and on a constant currency basis was up 2%. This small underlying increase reflected higher upstream gas profits offset by a reduction in power margins.

Our Texas power stations were affected by increasing capacity margins and lower spark spreads, which occasionally made it more economic to purchase power than to generate it. Together with a two-week unplanned outage at our Bastrop plant, this caused power generation volumes to drop by 7% to 4.7TWh (2007: 5.1TWh). We also encountered transmission congestion in West Texas which reduced power prices at times to very low levels, adversely impacting the profitability of our wind power purchase agreements.

Natural gas production volumes increased by 23% to 365mmth (2007: 297mmth) following rapid development of current reserves and the acquisitions of Rockyview Energy and the Canadian assets of TransGlobe Energy earlier in the year. The business also benefited in the first half from high gas prices on the portion of sales not forward sold, but on the current forward curve faces lower prices on open volumes in 2009.

Direct Energy key performance indicators

For the year ended 31 December	FY 2008	FY 2007	Δ%	H2 2008	H2 2007	Δ%
Mass markets energy						
Customer numbers (period end) ('000)	**3,092**	3,005	2.9	3,092	3,005	2.9
Revenue (£m)	**2,652**	2,437	9	1,281	1,098	17
Operating profit (£m)*	**137**	123	11	76	35	117
Operating margin (%)	**5.2**	5.0	0.2 ppts	5.9	3.2	2.7 ppts
Commercial and industrial energy						
Commercial and industrial gas sales (mmth)	**603**	627	(3.8)	241	271	(11)
Commercial and industrial electricity sales (GWh)	**27,411**	13,925	97	18,183	7,372	147
Revenue (£m)	**2,015**	978	106	1,303	495	163
Operating profit (£m)*	**11**	1	1,000	3	2	50
Operating margin (%)	**0.5**	0.1	0.4 ppts	0.2	0.4	(0.2) ppts
Home and business services						
Customer numbers (period end) ('000)	**2,140**	2,033	5	2,140	2,033	5
Revenue (£m)	**375**	351	7	207	182	14
Operating profit (£m)*	**16**	17	(6)	13	14	(7)
Operating margin (%)	**4.3**	4.8	(0.5) ppts	6.3	7.7	(1.4) ppts
Upstream and wholesale energy						
Gas production volumes (mmth)	**365**	297	23	182	147	24
Power generated (GWh)	**4,688**	5,053	(7)	2,342	2,504	(6)
Revenue (£m)	**782**	226	246	581	144	303
Operating profit (£m)*	**51**	46	11	32	26	23
Direct Energy turnover (£m)*	**5,824**	3,992	46	3,372	1,919	76
Direct Energy operating profit (£m)*	**215**	187	15	124	77	61
Operating margin (%)	**3.7**	4.7	(1.0) ppts	3.7	4.0	(0.3) ppts

Direct Energy key performance indicators

For the year ended 31 December
£m, at constant currency
2007 restated at 2008 weighted average exchange rate

	FY 2008	FY 2007	Δ%
Revenue			
Mass markets energy	**2,652**	2,667	(0.6)
Commercial and industrial energy	**2,015**	1,073	88
Home and business services	**375**	380	(1.3)
Upstream and wholesale energy	**782**	259	202
Direct Energy turnover	**5,824**	4,379	33
Operating profit*			
Mass markets energy	**137**	135	1.5
Commercial and industrial energy	**11**	2	450
Home and business services	**16**	20	(20)
Upstream and wholesale energy	**51**	50	2
Direct Energy operating profit*	**215**	207	3.9

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

Managing a sustainable business

"Corporate responsibility is central to the delivery of sustainable value for our shareholders."

Centrica is a major provider of essential services, a company that affects – and is affected by – the physical, social and ethical environments in which it works. A responsible approach to managing the associated risks and opportunities is integral to the successful delivery of the Company's strategy. Corporate responsibility (CR) is, therefore, central to the delivery of sustainable value for our shareholders.

During 2008, we have continued to review, understand and manage the social, environmental and economic impact of our operations. Sometimes this approach means taking decisions which put longer-term considerations before short-term ones, and it may mean that we choose not to undertake business which would be profitable but would be contrary to our values.

Such decisions require strong leadership and governance. They also require a clear strategy and clear values that are applied consistently throughout the business; and the ability to measure the impact of our choices in order to understand what we should do. Just as in any other part of the business.

OUR STRATEGY

Our CR strategy is to ensure the sustainability of our business by managing the risks and seizing the opportunities presented to us in areas where we have a direct impact. A successful approach can help us win business advantage and deliver value to our shareholders. Conversely, if we fail, we face reputational and financial risks.

Our key impact areas are:
- climate change and the environment
- serving our customers
- health and safety
- valuing our people
- our local impact
- our supply chain

We have spent – and continue to spend – considerable effort on refining performance indicators for these areas to give us the management information we need.

We seek to achieve a leadership position in areas such as climate change, health and safety and social programmes which are at the heart of our business and can help us be distinctive and deliver competitive advantage. In all of them we monitor the implementation of our policies through appropriate performance indicators and clear targets. We report on them over the following four pages.

These impact areas also help to frame our engagement with government, regulators, investors, customers, employees and other key stakeholders in each of our operating regions. Profound debates are taking place about climate change and the security of energy supply and it is part of our corporate responsibility to have opinions and contribute fully to those debates.

The understanding provided by the impact areas enables us to develop positions of advocacy on issues ranging from the development of the EU's renewable energy strategy and fuel poverty in the UK, to the operation of the global energy market.

We need to understand our impact on society in the broadest possible sense. And that understanding must then be reflected in what we do and how we do it.

LEADERSHIP AND GOVERNANCE

I am pleased that our Board-level Corporate Responsibility Committee (CRC) continues to receive strong commitment from our senior leadership and provides strategic oversight to our CR approach. The CRC was strengthened in late 2007 with the inclusion of a second Non-Executive Director and the Chief Executive within its membership. A senior manager is also now accountable for CR performance in each business. This structure has been increasingly effective in challenging the business units to address their CR risks and opportunities. The Committee meets four times a year and ensures that our day-to-day business operations respond to the opportunities and mitigate the risks posed by CR issues.

Process monitoring

Through continual challenge at CRC, we believe we have robust risk management and internal audit processes for our Group CR exposure and that our controls in high hazard activities are good. During 2008, we integrated non-financial key performance indicators (KPIs) into Group business performance metrics and the internal audit process.

Overseas governance

Direct Energy's Executive Committee enhanced CR governance by establishing its own CR Committee with responsibility for overseeing North American business-specific issues. This commitment to CR helped Direct Energy achieve recognition in a list of the Top 50 Most Responsible Corporate Citizens in Canada.

Our Group-wide business principles (listed on page 6) on corporate conduct continue to underpin all our actions. Following a 2007 programme to communicate these to our UK employees, Direct Energy introduced them during 2008. In 2009 we will focus on embedding these further through our risk and internal audit processes.

Where we have identified areas of higher risk, such as our operations in Nigeria, we are using the business principles to guide our corporate behaviour and to ensure that we commit to the highest standards of ethical conduct.

Developing our management culture

Also during 2008, we launched our Leadership Behaviours programme across the Group. This has been developed to support our leaders in understanding how they can improve our business, inspire our people and deliver exceptional customer service. These behaviours are currently being embedded into all our processes including training and development, performance management, recruitment and talent management. Assessing subsequent behavioural change is a challenge for the next 12 months.

CLIMATE CHANGE AND THE ENVIRONMENT

- The energy efficiency products provided by British Gas in 2008 equated to lifetime savings of 17.87 million tonnes of carbon dioxide
- We reduced our UK carbon intensity to 377g CO_2/kWh, the lowest of the major energy suppliers in Britain

Centrica is playing a crucial role in creating a sustainable low-carbon future, whilst securing energy supplies over the long term. We formed British Gas New Energy (BGNE) in 2007 as a commercial response to the challenge of global climate change.

Our climate change and environment strategy is to lead the market in responding to growing consumer demand for low-carbon products and services; maintain our low-carbon position on power generation; and work with our employees and suppliers to reduce the environmental impact of our operations.

Our work in these areas has been recognised for the second year running by our inclusion in the leadership index of the Carbon Disclosure Project.

Leading the consumer market for low-carbon products and services

The UK has a binding target to reduce CO_2 emissions by 80% by 2050 with a corresponding target of 15% of all energy coming from renewable sources by 2020. Smaller scale renewable technologies have a significant role to play in helping to achieve these aims and during the year BGNE made a number of acquisitions to help develop our capability in microgeneration.

These investments will enable us to install solar photovoltaic technology in the UK; develop combined heat and power systems for residential properties based on solid oxide fuel cell technology; and offer consulting services to help businesses reduce their energy usage. We will continue to look for acquisition opportunities to increase our range of low-carbon products and services.

We continue to offer green energy tariffs, although encouraging take-up of these remains challenging.

We have signed onto Ofgem's Green Supply Guidelines which define a Green Tariff as one that must deliver an additional environmental benefit. This will raise the standard of industry products, ensure genuine benefits for the environment and provide transparent and consistent information to reduce consumer confusion around tariff labelling.

In North America, Direct Energy is working with the Canadian government to develop a standard for carbon offset calculations from energy efficiency projects.

Within British Gas, our 18-month-long Green Streets competition between eight communities has highlighted practical solutions for consumers to make their homes more energy efficient.

We have also linked our expertise in energy efficiency to our programme of work with vulnerable customers. These customers are some of the main recipients of energy-saving products which we supply under our carbon emission reduction target (CERT) obligations.

British Gas is already the UK's leading supplier of A-rated high-efficiency boilers. The energy efficiency products provided under CERT in 2008, which included the distribution of 48 million low-energy light bulbs to our customers, equated to a lifetime carbon saving of 17.87 million tonnes of carbon dioxide. By the end of 2008 we had completed 50% of our three-year CERT target.

Maintaining our low-carbon position

We aim to invest in low-carbon generation. This currently includes high-efficiency gas-fired power stations and offshore wind farms, but we are also actively pursuing an interest in nuclear power through a proposed acquisition of 25% of British Energy.

Corporate Responsibility Review
continued

Our new efficient gas-fired power station at Langage, Devon will generate its first power in 2009. And our offshore wind farm development at Lynn and Inner Dowsing – currently the largest of its type in the world – has now been commissioned. In October 2008, we also obtained consent for the Lincs wind farm development.

In North America, commercial operation began at the 170MW Buffalo Gap 3 wind farm near Abilene, Texas, from where all the electricity produced will be purchased by Direct Energy under a seven-year power purchase agreement.

During 2008 we further reduced our carbon intensity in line with our target of achieving a figure of 350g CO_2/kWh by 2020. In 2008, the energy we supplied had the lowest carbon emissions of any major supplier in Britain.

Reducing our operational footprint

We are also focused on reducing our own operational carbon footprint and are creating an understanding and culture among our employees appropriate for a business leading the way towards a low-carbon future. In 2008, British Gas joined our upstream assets in achieving certification to ISO 14001 from the British Standards Institute. This Standard covers our 26,000 employees in the UK, highlighting their commitment to and awareness of our environmental management systems. We aim to complete certification across Direct Energy by the end of 2010.

Employee engagement as a result of internal communication campaigns and the work of locally based 'Green Teams' of employee champions has cut UK office energy consumption by 7.23% exceeding our target of 5%. In 2008, 14% less waste was sent to landfill when compared to 2007 and 64% of our UK waste was recycled, exceeding both our targets in these areas.

In 2008 Direct Energy's Climate Change Committee approved a carbon footprint management programme that addresses the greenhouse gas emissions of the North American fleet, business travel and facilities. Direct Energy reduced emissions by an estimated 7%, although these reductions are mainly attributable to a slowing economy and fewer business miles travelled.

KPI	2008	2007
Carbon intensity of UK power generation (g CO_2/kWh) **What's next:** Reduce UK power generation carbon intensity to 350g CO_2/kWh by 2020.	377*	390
Lifetime carbon savings for UK household energy efficiency products provided (million tonnes) **What's next:** Provide energy efficiency products in 2009 with total lifetime carbon savings of 13.2m tonnes of CO_2 to meet our CERT obligation.	17.87	n/a†
Year-on-year percentage reduction in energy (electricity and gas) consumption savings across our UK property portfolio **What's next:** Achieve 5% reduction in UK office energy use in 2009.	7.23%	–

* 2008 data subject to final verification.
† The basis on which carbon savings are calculated has changed making a comparison with 2007 inapplicable

SERVING OUR CUSTOMERS

- British Gas increased the number of accounts on the Essentials tariff for vulnerable customers by 55%
- An estimated 1.4 million vulnerable and in-need customers have benefited from British Gas support in 2008

We are committed – and have long been committed – to providing proactive help to our vulnerable customers and to working alongside the UK Government to seek ways of alleviating fuel poverty.

Since 2005 we have pursued a range of initiatives to support older customers and those who are disabled or on income-related benefits. We made a voluntary public commitment not to disconnect anyone we knew to be vulnerable and we provide extensive debt advice to help those struggling to pay their energy bills.

Poverty and vulnerability are also important issues in our North American markets, although the concept of fuel poverty is not as prominent as it is in the UK. Direct Energy has tailored a number of programmes for different regions, such as 'Neighbor to Neighbor' in Texas and the 'Seniors Discount Tariff' in Ohio to provide support for vulnerable customers.

Fuel poverty became an increasingly significant issue in the UK during 2008 with the latest figures from National Energy Action estimating fuel poverty in Great Britain is currently affecting more than 5 million households. But many of its causes – in particular low income compounded by unemployment – are beyond our control as an energy supplier. Instead we are focusing our resources where we can have the most impact. Through British Gas' partnership with five charities, we are improving the way we identify vulnerable customers and are looking to provide better means of targeting those most in need to make our programmes more effective.

In July 2008 we were obliged to increase tariffs for domestic gas and electricity as a result of sharply increased wholesale energy prices. The price rise focused the attention of the media and UK Government on our approach to those hardest hit by the increases. Our approach to supporting our more vulnerable customers is an example of how we are prepared to take decisions which put longer-term considerations before short-term ones, and refuse to act in ways that would be contrary to our values.

To help customers with these price rises and as part of our CERT obligations, British Gas will install energy efficient products in many customers' homes over the three years from April 2008, delivering an estimated value of over £1 billion – the largest such initiative in the UK. In addition, our planned investments to secure energy from a diverse range of sources aim to mitigate the effects of future volatility in wholesale prices.

Energy suppliers reached a voluntary agreement with Government in April 2008 to increase their collective spend on social programmes. British Gas has the largest commitment of all suppliers at £34 million during 2008/09 but by the end of this period we will have spent more than double this amount on our Essentials programme for vulnerable customers.

We launched a new Essentials tariff in July 2008 which protected vulnerable customers from the price rise until April 2009 and provided free energy efficiency measures to reduce their consumption. Our more recent Essentials Advance initiative, offering vulnerable and in-need customers free energy efficiency measures and a £50 rebate once measures are installed, is in line with the Government's 'save money, save energy' programme.

By the end of 2008, there were more than 526,000 accounts on our Essentials tariff for vulnerable and in-need customers, a 55% increase compared to 2007.

In total, we provided support to an estimated 1.4 million vulnerable or in-need customers during 2008 and remain committed to playing a leading role in this area.

KPI	2008	2007
Number of customer accounts on 'Essentials' tariff (UK) **What's next:** Commitment to manage up to 750k Essential accounts.	**526,500**	340,000

HEALTH AND SAFETY

- We achieved a 5% reduction in the rate of lost time injuries per 100,000 hours worked

The health and safety of our employees, contractors, customers and the communities in which we live and work is a top priority. Despite our continued focus in this area, a British Gas engineer was tragically involved in a fatal incident during the year. Our thoughts and deepest sympathies are with his family.

A new health, safety and environment (HS&E) sub-committee of the Executive has been set up to determine the policies, targets and KPIs we need to meet our strategic vision and objectives for HS&E.

Health and safety is a standing item on the agenda of all Executive Committee meetings and business quarterly performance review meetings with the Chief Executive.

Following a detailed internal examination of our management systems, we believe that we have effective processes for managing the condition of our plant and equipment. Accident rates in our upstream assets are low.

However, while trends in many of our businesses show improvements, our overall lost time injury (LTI) rates are high, with British Gas Services accounting for more than 80% of our accidents. To decrease injury rates, British Gas Services has launched a major programme of safety improvements, including a high profile internal awareness campaign.

Our main occupational health issues in the UK are related to musculoskeletal disorders and mental health. We are currently reviewing our procedures and introducing new KPIs to improve our reporting in this area. We are also exploring a proposal to develop a Group-wide approach to managing these issues and their impact on our business. We remain committed to improving overall health and safety performance that will enable us to benchmark more positively with other leading companies in future years.

KPI	2008	2007
Lost time injuries (LTI)/100,000 hours worked **What's next:** 20% LTI reduction on 2008 performance to 0.8.	**1.00**	1.05*
Total number of fatalities	**1**	0

* We have restated the 2007 LTI figure following a review of the data and the reclassification of a number of accidents.

VALUING OUR PEOPLE

- Employee commitment has increased by an average of over 3% in most businesses
- British Gas is creating more than 1,500 new skilled jobs over the coming years

During the year we employed an average of 32,817 people: 27,538 in the UK; 4,991 in North America; and 288 in the rest of the world.

We want to ensure that we attract and retain the best talent and offer an environment in which all our employees can flourish.

Employee engagement

We want Centrica to be a great place to work and our engagement survey helps us to measure employee attitudes and opinions.

Overall, there was a 94% response rate to the 2008 survey, up from 84% in 2007. Scores for employee commitment have increased across most business units by an average of more than 3%. This is well in excess of UK benchmarks and also above both European and global benchmarks.

We are aiming to hold the next full engagement survey in 2010, where we are targeting a commitment of 62%. An interim survey will be held in 2009 as a 'temperature check'.

Diversity and inclusion

We are committed to pursuing both equality and diversity in all our activities and continue to work with external organisations to share best practice and identify performance improvement opportunities.

Our sixth 'Equal Pay Review' concluded that Centrica's reward processes and implementation, including performance assessment, were not subject to gender bias. Female representation within Centrica's senior leadership team is currently 24% against a Company average of 30% female employees. The British Gas Services Academy has a dedicated Diversity and Inclusion team tasked with improving the representation of female engineering recruits and those from ethnic minorities. The team was recognised by Personnel Today, winning the 2008 award for 'Diversity in the Workplace'. Direct Energy has a Diversity and Inclusion Council to oversee strategy in North America.

We also continue to support initiatives to provide employment opportunities for people from under-represented groups, including those with a disability, carers and lone parents. We recently joined other top employers in the UK Government's flagship National Employment Partnership, working with Jobcentre Plus to speed up recruitment, highlight vacancies and boost on-the-job training. Our existing partnership with Jobcentre Plus has recruited more than 200 people over the past two years.

Recruitment and retention

In an economic downturn, providing work can be a significant act of corporate responsibility.

British Gas is trebling its recruitment of apprentice gas engineers over the coming years creating more than 1,000 new jobs. This will also see the business invest £30 million in training across its network of five UK Engineering Academy training centres.

We continued to make progress in attracting and retaining employees and increasing productivity and morale through effective employee engagement. Unplanned employee attrition reduced across most business units, including British Gas Residential where the reduction was 16%.

In 2008 there were significant changes in our graduate recruitment and development process. An improved marketing and assessment strategy achieved better access to the highest calibre graduates and a new placement rotation process met business needs and graduate aspirations. The Summer Placement Programme, which provides ten-week work placements grew to equal size and also became a significant route to the main graduate programme.

Centrica was named as a Top 50 graduate recruiter by both Oxford and Cambridge Universities and the Summer Placement Programme was a finalist in the 2008 National Council for Work Experience Awards.

Our approach to flexible working is seen by employees and managers alike as a key factor in both the attraction of staff and a reason for their staying. A research project undertaken by Cranfield University highlighted that flexible working is an important business tool, improving recruitment, retention and overall employee engagement. It is also embedded in our culture with 65% of respondents to the 2008 research saying that they worked flexibly and more than 29% having formal flexible working arrangements in place.

KPI	2008	2007
Percentage of employees committed to Centrica (measured through the Employee Engagement Survey) **What's next:** Employee commitment score of 60% by 2009 and 62% by 2010.	**57%**	53%
Employees from ethnic minority groups (%)	**15.3%**	15.2%
Employee gender (female/male %)	**30.0/70.0**	30.2/69.8

LOCAL IMPACT

- More than 8,000 schools have signed up to the British Gas Generation Green programme

We aim to work with the communities in which we operate for our mutual benefit. We do this by understanding local social and environmental issues and by taking action to address those issues. We also build strong community relations through our support for local organisations and by encouraging our own employees to get involved in a range of volunteering opportunities. For example, more than 180 engineers from British Gas Services gave up their own time to install around 130 boilers for customers in need across the country.

On a wider scale, over 8,000 UK schools have signed up to the British Gas Generation Green programme. Schools can win prizes such as solar panels and energy audits by collecting 'leaves' which reward measures to tackle climate change. The next phase of the programme encourages our employees to volunteer in the schools to build stronger links with local communities.

In India, British Gas is working with agency partners EXL and WNS to build relations with local communities. For example, with EXL we have co-funded the creation of a new secondary school for 280 pupils near Delhi.

In Nigeria, where youth unemployment is a key issue, we are developing community investment and skills acquisition programmes, which have already enabled 25 young people to study at the Maritime Academy of Nigeria. Our focus on stakeholder dialogue here, and at other operations such as our UK wind farm developments, has helped us to resolve issues at the earliest opportunity and ensure all risks are taken into account and managed effectively.

KPI	2008	2007
Total community contributions*^ (£m)	**52.9**	30.2

* Combination of figures calculated from London Benchmarking Group methodology and cost of voluntary programmes to support vulnerable customers in the UK.
^ Group cash donations during the year amounted to £5.9 million (2007: £4.1 million). This included a donation of £3.6 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.

SUPPLY CHAIN

- We developed corporate responsibility clauses for our supplier contracts

As a large international company, we have responsibilities for the application of appropriate business practice throughout our supply chain.

Following sign-off of our Responsible Procurement and Supplier Management Policy in December 2007, we developed robust foundations for embedding responsible procurement into our procurement and supplier management processes. Our approach is to integrate the identification of non-financial risks in our supply chain into our 'business as usual' procurement process. This includes incorporating corporate responsibility clauses in contracts with suppliers.

During the year we hosted two workshops with 18 of our strategic suppliers to communicate our new policy and to create a platform to discuss and share best practice on supply chain responsibility.

All suppliers responded positively to our approach and provided useful insights on how other companies are implementing and embedding responsible procurement.

M E Francis

Mary Francis CBE
Senior Independent Director
26 February 2009

Group Financial Review

Providing value to shareholders

"2008 was a year of sound earnings* in the face of volatile markets driven by profitability across most of our businesses, with continued progress in our growth businesses."

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

Group revenue

Group revenue from continuing operations was up 31% at £21.3 billion (2007: £16.3 billion). Revenue in our UK upstream and downstream businesses increased, with higher commodity prices reflected in higher achieved prices upstream, and higher retail prices downstream. There was underlying growth in North America, particularly in the commercial and industrial supply business, and this was also aided by favourable exchange rates.

Group operating profit

Group operating profit* from continuing operations was broadly flat at £1,942 million (2007: £1,949 million). Increases in gas production and development due to higher volumes and selling prices were offset by reductions in the industrial and commercial segment of Centrica Energy and British Gas Residential due to higher wholesale input prices.

Group profit

Group profit* on a continuing basis was down 20% to £904 million (2007: £1,123 million). The reduction in earnings* resulted primarily from a higher tax charge of £1,027 million (2007: £753 million). This increase reflected the change in mix of profits, with an increase in highly taxed gas production profit, and the lack of immediate tax relief on the losses incurred in Oxxio, offset by a £55 million deferred tax credit resulting from a change in legislation relating to the availability of tax relief for upstream decommissioning costs. The resultant effective tax rate for the Group was 53% (2007: 40%). Net interest payments were at £11 million (2007: £73 million), reflecting the relatively low level of net debt during the year.

The statutory loss for the year was £144 million (2007: profit of £1,507 million). The reconciling items between adjusted Group profit* and the statutory loss are related to exceptional items and certain re-measurements as explained below.

Earnings per share and dividends

Adjusted earnings per share* fell by 21% to 21.5 pence in 2008 from 27.2 pence in 2007.

The Group reported a statutory basic loss per share of 3.5 pence, down from basic earnings per share of 36.5 pence in 2007, reflecting the post-tax impact of certain re-measurements which were negative in 2008, having been positive in 2007.

In addition to the interim dividend of 3.47 pence per share, we propose a final dividend of 8.73 pence giving a total ordinary dividend of 12.2 pence for the year (2007: 11.57 pence), an increase of 5%.

Cash flow

Group operating cash flow before movements in working capital was down from £2,494 million in 2007 to £2,397 million. After working capital adjustments, operational interest, tax and cash flows associated with exceptional charges in prior years, this stood at £297 million (2007: £2,357 million). This decrease in operating cash flow is primarily due to an outflow of cash collateral associated with margining agreements, an increase in cash taxes paid and increased working capital that resulted from the higher retail prices.

The net cash outflow from investing activities increased to £1,122 million (2007: £964 million). This included expenditure on the new Langage power station in Devon, and on completing the Lynn and Inner Dowsing wind farm development, as well as the acquisitions of Strategic Energy in the US, the Caythorpe onshore storage opportunity and the gas assets in the Heimdal area of the North Sea.

There was a net cash inflow from financing activities of £2,603 million (2007: outflow of £888 million). This net cash inflow resulted primarily from the £2.16 billion Rights Issue described in notes 5, 29 and 30 and bond issues detailed in note 25.

Net debt and interest

The Group's net debt level at 31 December 2008 was £511 million (2007: £795 million). This reflected the cash movements described above together with the increase in the sterling value of our foreign currency debt, as sterling fell against both the US dollar and the euro.

Group Financial Review continued

Net assets

During the year net assets increased to £4,386 million from £3,382 million as at 31 December 2007. The increase was primarily due to the impact of the Rights Issue, partially offset by non-cash negative movements in the mark-to-market value of hedging derivatives and actuarial losses on our pension schemes.

Exceptional items

Exceptional charges of £67 million were incurred relating to Oxxio, our business in The Netherlands. £45 million of this was an impairment charge to write down the carrying value of the goodwill that arose upon acquisition of Oxxio. The goodwill has been assessed as having a lower value as a result of lower expectations for future growth in customer numbers and for future margins due to the structure of the competitive market in The Netherlands. The remaining £22 million of the exceptional charge is a write-down of a receivable relating to historic overpayments of energy revenue tax by Oxxio. Uncertainty as to the timing and amount of the recovery of this receivable make it no longer appropriate to recognise the receivable as an asset.

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 charges to operating profit relating to these re-measurements of £1,415 million (2007: net credit of £235 million), primarily from marking-to-market some contracts relating to our energy procurement activities. As gas and power were delivered under these contracts, net out-of-the-money mark-to-market positions were unwound generating a net credit to the Income Statement in the period of £10 million (2007: net credit of £352 million). As forward prices decreased in the second half of the year the portfolio of contracts fair-valued under IAS 39 reported a net charge on revaluation of £1,421 million (2007: charge of £104 million). The remaining charge of £4 million (2007: charge of £13 million) reflects positions relating to cross-border capacity and storage contracts.

The net loss of £1,415 million on the re-measurement of energy contracts largely represents unrealised mark-to-market loss created by gas and power purchase contracts which are priced above the current wholesale market value of energy. This loss is calculated with reference to forward energy prices and therefore the extent of the overall economic profit or loss arising over the life of these contracts is uncertain and is entirely dependent upon the level of future wholesale energy prices.

Business combinations and capital expenditure

During the year, in Canada we acquired Rockyview Energy and 100% of the Canadian gas assets of TransGlobe Energy, and in the US we acquired Strategic Energy, an electricity supplier. We also acquired interests in gas and oil assets in the Heimdal area of the North Sea and Caythorpe, a depleted onshore gas field that we propose to convert to a gas storage facility, along with a number of smaller acquisitions for total cash consideration of £395 million as explained in note 35.

Details of capital expenditure are provided in note 6(e) of the Financial Statements.

Principal risks and uncertainties

The Group's risk management process remains unchanged from 31 December 2007. A description of the impact of the volatility in wholesale commodity prices and the weakness of credit markets on financial risk management is provided in note 4 to the Financial Statements.

Capital management

During the year, the Group raised proceeds of approximately £2.16 billion, net of issue costs of approximately £65 million, through a three for eight Rights Issue of new ordinary shares at 160 pence per share. The Group raised £750 million from the sterling bond market in September 2008, with tranches maturing in 2018 and 2033, and €750 million was raised from the euro market in November 2008, in a single tranche maturing in 2013. Including bond issuance and new loans raised in the early part of 2009, we have raised over £4 billion of new debt and equity capital in the last six months. This puts us in a strong position to fund new investments and to maintain sufficient liquidity headroom to handle the significant swings in margin cash and working capital that result from volatile commodity prices.

Related party transactions

Related party transactions are described in note 37 to the Financial Statements.

Events after the balance sheet date

On 20 January 2009, the Group completed the acquisition of 50% of the issued share capital of Segebel SA for cash consideration of €515 million (£477 million) plus transaction costs, bringing the Group's total ownership interest in Segebel SA to 100%. Further consideration of up to €105 million (£97 million) is payable, of which €70 million (£65 million) is expected to be paid in March 2009. This transaction results in the Group acquiring a controlling interest in Segebel SA which in turn, holds a controlling stake of 51% in SPE SA, a Belgian energy company. As such, this transaction also results in the Group obtaining a controlling interest in SPE SA which will therefore be consolidated as a subsidiary in the Group's accounts. Details of this acquisition are provided in note 39 to the Financial Statements.

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

Nick Luff
Group Finance Director
26 February 2009

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

Principal Risks and Uncertainties

Managing our risks

> "Centrica, like all businesses, faces a number of risks and uncertainties that could affect the delivery of the Group's strategic objectives."
>
> **Nick Luff,** Group Finance Director

We place considerable importance on internal controls and have a robust risk management process, which is designed to identify, manage and mitigate business risk in order to support the creation of long-term, sustainable returns for shareholders. This process is described in more detail in the Corporate Governance Report on pages 41 to 42.

Described below are the principal risks and uncertainties the Group can foresee. It is not an exhaustive list, some future risks may be as yet unknown and other risks, currently regarded as immaterial, could turn out to be material.

GLOBAL ECONOMIC CONDITIONS

A general reduction in business activity resulting from the current downturn in the global economy could lead to a loss of income for the Group. Current credit market conditions mean that financial institutions are applying more stringent lending criteria and the availability of debt is low by historical standards. This could make it more costly for us to raise funds to take advantage of opportunities. Our business performance could also be impacted by increased exposure to the default of wholesale counterparties, including financial institutions and customers with bad debts, as economic conditions in the UK and North America worsen.

Our risk management process has helped identify and manage the increased financial risks. We have placed particular emphasis on ensuring that sufficient liquidity is available to allow the Group to realise its growth ambitions; the Rights Issue has helped with this objective. There has also been an increased focus on credit issues, which may impact us if our customers and suppliers have liquidity problems, and on the cash required to manage the margin arrangements associated with the commodity trading we undertake.

We expect the current economic conditions to continue for some time and will continue to seek to mitigate the risks that arise while identifying and exploiting opportunities.

EXTERNAL MARKET FACTORS

Exposure to movements in commodity prices

A significant proportion of the Group's profitability depends on our ability to manage our exposure to wholesale commodity prices for gas, oil, coal, carbon and power, all of which have been very volatile during the past year. The price of gas in the UK is particularly important, as we produce substantially less gas from our own resources than we need to meet retail demand and demand from our fleet of gas-fired power stations. The Group must assess the risk of procuring commodities at fixed prices to meet uncertain levels of demand that are subject to seasonal fluctuations. With volatile prices, there is a risk that surplus commodity positions cannot be sold to the wholesale markets profitably and that any commodity short position cannot be covered at a cost that can be passed on to customers. The unpredictable nature of commodity prices also hampers the calculation of reliable forecasts by the Group to support investment decisions, potentially leading to lower than expected returns.

We manage these risks by hedging a proportion of the exposure for a number of years ahead, linked to the underlying profiles of our customers' energy requirements. This is done through purchasing and developing upstream assets such as gas fields, power stations and wind farms, bilateral agreements for gas and power, purchases of commodities on recognised exchanges and the use of financial instruments such as oil and gas swaps (see note 4 to the Financial Statements on page 74). The potential British Energy transaction is an example of how we may secure a proportion of our customers' expected energy requirements.

While hedging may reduce our exposure to wholesale price volatility, significant longer-term price increases or decreases may require us to change the price at which we sell to our customers on variable tariffs. Where we do pass increased commodity prices through to our customers or fail to pass on decreased commodity prices, those customers may switch to our competitors, which could have an adverse effect on our business.

Climate change

Centrica's approach to climate change will shape our future operations and, ultimately, the long-term success of our business. Our strategy is to lead the consumer market for low-carbon energy products and services; to maintain our low-carbon position in power generation, and to reduce the environmental impact of our operations.

However, operating in a low-carbon economy may present significant additional risks. For example, the need to comply with recent legislation – such as European Union environmental directives and UK renewable energy and energy efficiency targets – may lead to higher costs. In addition, there are risks if the legislative framework fails to deliver the necessary carbon price over the longer term to ensure the viability of investment in new technologies. An ineffective UK planning regime could make it difficult to develop new assets such as wind farms and other power generation infrastructure. There are also risks – and opportunities – in potential investment in nuclear power generation as a means of reducing our exposure to volatile wholesale gas and electricity prices.

The US approach to carbon legislation could shift following the election of President Obama, and we are monitoring the situation closely. The move towards energy efficiency could have a positive effect on our services business, especially in North America, where government subsidies are being made available for this work.

Changing customer behaviour, including a growing demand for low-carbon products and services, could result in reduced sales volumes. In the medium term, new technologies such as micro combined heat and power units, and smart metering, could also affect demand and therefore the Group's earnings. We cannot be certain that our strategy will successfully mitigate against the risks or enable us to take advantage of opportunities that may present themselves.

Further information on our approach to climate change is available in the Corporate Responsibility Review on pages 25 and 26.

Level of competitive activity

We operate in highly competitive energy supply markets, especially in the UK and North America, where customers switch suppliers based on price and service levels, as well as competitor activity.

We also operate in the home services market. In the UK, competitive pressures are increasing as energy and other service providers, such as insurance companies, seek to strengthen their market positions. The economic environment in North America is also making trading more difficult in this market.

To retain our competitive position, we combine attractive products and propositions with high-quality customer service, maintain an efficient cost structure and, for energy supply, buy energy competitively. We actively monitor customer satisfaction and competitor activity, and respond to changing circumstances by developing new customer offerings. We also focus on reducing operating costs, as failure to do so could significantly affect our business.

Regulatory and political factors

Energy markets in the UK, North America and Europe are closely regulated. Changes to the regulatory regimes could affect our ability to meet our financial goals. Changes to the retail supply and wholesale industry procedures we have to comply with could affect our operating costs. And material increases to the regulated charges we pay for use of transmission, distribution and other infrastructure would affect our margins if such increases could not be passed on to customers.

Political and consumer concern over rising energy prices and fuel poverty led to an Ofgem probe into the UK energy market. This concluded that the fundamental structures of a competitive market are in place, and that the transition to effective competitive markets is well advanced. However, it identified a number of areas where this transition should be accelerated.

This will likely result in further consumer protection measures through the supply licence. If the industry does not agree on the licence changes, Ofgem could make a reference to the Competition Commission. The Government could also intervene and introduce measures such as a windfall tax on the Group's free carbon allowances, or price controls for certain customer segments.

The Government has announced its intention to require the deployment of smart metering across Britain, but is still determining key details such as the rate of deployment and the industry model for metering. This creates risk and uncertainty in terms of our contractual and operational arrangements for the provision of metering services. An accelerated deployment would result in the premature replacement of conventional meters, triggering early termination payments by British Gas, not all of which is likely to be recovered through customer charges.

Progress on many aspects of European market liberalisation has been limited, though recently announced divestment initiatives by certain companies will provide important structural change. However, the prospects for effective competition in energy markets in continental Europe are impacted by consolidation activity, which could affect not only our participation in those markets, but also our ability to source and transport gas from Europe to the UK.

Uncertainty over political or regulatory intervention in energy markets in North America could have an impact on the projected growth of our operations. President Obama has indicated his intention not only to enforce existing legislation, but also to increase the reliability of energy supply and the focus on protecting the environment. The impact on our business is uncertain. The 2009 session of the Texas Legislature began in mid-January with the issue of regulation of competitive electricity markets, and we have a highly skilled team in place to monitor the session which ends in June 2009. Ontario shows little sign of moving away from low and stable regulated electricity pricing, and is considering introducing additional consumer protection measures. Specific reviews regarding electricity deregulation are ongoing in a limited number of jurisdictions, but energy policy, particularly relating to electricity, remains a highly politicised topic throughout North America.

We continue to engage with regulators, government ministers and senior officials in all of our markets through targeted contact programmes.

Security of supply

As UK gas reserves have declined, the UK energy market has become increasingly reliant on gas from Norway and mainland Europe, together with liquefied natural gas from other parts of the world. Key elements of security of supply, therefore, are access to reserves and the reliability of the storage, pipeline and gas processing infrastructure. Any break in this supply chain could jeopardise the supply to customers and impact the Group's earnings.

Similarly, the UK electricity market depends on the reliability of UK power stations, in particular ageing nuclear stations, with security of supply at risk during periods of outage across the system.

Centrica depends on third parties for gas and power and cannot guarantee the security of supply chains, including from the risk of terrorist activity or sabotage of power stations or pipelines.

To respond to this changing environment, we support the development of new infrastructure to bring gas to the UK and store it. In addition, we will continue to acquire and develop new assets in the UK and overseas, and sign long-term supply contracts to replace declining gas reserves. We continually review our security arrangements to protect these assets.

OPERATIONAL FACTORS

Health and safety

There are significant health, safety and environmental (HS&E) hazards associated with operating our onshore and offshore gas production, exploration, gas storage and power generation assets. In addition, our service engineers in the UK and North America make more than 10 million home visits each year. Significant breaches of HS&E regulations could affect the safety of individuals, gas and/or power production, and result in the Group incurring liabilities which could affect our reputation or business performance.

The Board is responsible for ensuring that Centrica has the appropriate culture and arrangements for meeting its HS&E responsibilities, and the Chief Executive is accountable to the Board for delivery. Our risk management and governance processes meet internationally recognised standards; HS&E is the first item of every meeting of the Executive Committee; and quarterly HS&E performance reports are submitted to the Board, specifically including process safety. The Group has also recently established a new, senior cross-business HS&E Committee to help develop our improvement strategy, and has issued new Group HS&E standards which define the expectations against which we will audit. We continue to target risk reduction in all our operations.

Further information on our approach is available in the Corporate Responsibility Review on page 27.

UK customer service

The delivery of good quality customer service is central to our business strategy and there is a risk that customers will leave British Gas if they experience unacceptable customer service or perceive that we are failing to maintain service quality. For example, the implementation in 2007 of a new billing system for UK residential energy customers led to an unacceptable decline in customer service levels and in customer numbers.

We carefully monitor service throughout our retail operations, and continued focus in this area has resulted in service improvements and fewer customer complaints.

Brand and reputation

Our business principles (listed on page 6), apply to all employees and business partners, and 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 both 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 trademarks and related logos for use in Britain. 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 trademarks and logos, this could adversely affect our competitive position.

Information risk

Effective and secure information systems are essential for the efficient management and accurate billing of our customers, effective power generation and successful energy trading and hedging activities. The confidentiality, integrity and availability of our information systems could be affected by factors that include human error, ineffective design or operation of key controls or through malfunction or deliberate attack. Outages and interruptions could affect our ability to conduct day-to-day operations and any compromise of the confidentiality of information could impact our reputation with current and potential customers.

There are a number of controls in place to manage this risk including network segregation, monitoring, access restrictions on storage systems, regular third-party security reviews and vulnerability assessments of infrastructure and applications. Business continuity plans are in place to help recover from significant outages or interruptions. To improve efficiency, we continue to invest in our systems supported by strong project management to minimise the associated implementation risk.

Outsourcing and offshoring

We have outsourced several activities, including business-critical information technology services and back office and processing functions, which support our businesses in the UK and North America. Some of the outsourcing contracts are offshore. As with any contractual relationship, there are inherent risks to be mitigated, and these are actively managed.

The Centrica Executive Committee regularly reviews progress and a centre of expertise has been developed to capture and share best practice.

Upstream asset performance and development

There is a risk that we suffer financial loss due to the unplanned breakdown of one or more of our power stations or gas assets. We manage this risk through a range of measures including technical assessment of the status of our assets, regular monitoring of performance and condition and investment to deliver the required capability and mitigate risk.

We also manage a wide range of major capital projects to develop our upstream portfolio. The risk profiles of the individual projects vary and we are exposed to financial loss to a varying degree. We seek to mitigate financial loss through insurance, contractual arrangements, partnership arrangements and active project management.

FINANCIAL FACTORS

Liquidity

Liquidity risk is the risk that we are unable to meet our financial obligations as they fall due. This risk is increased by the margin cash arrangements associated with some wholesale commodity contracts. Managing liquidity risk is particularly important in the current economic environment where the availability of capital is limited. Cash forecasts identifying the liquidity requirements for the Group are produced at least monthly and these are assessed for different scenarios including the liquidity impact of significant changes in commodity prices or a credit rating downgrade. Our cash forecasts are reviewed regularly by the Financial Risk Management Committee, Centrica Executive Committee and the Board.

The liquidity forecasting and assessments are designed to ensure that there is sufficient time for the Group to react to possible future cash constraints. This may be done by limiting discretionary cash outflows and/or limiting the volume of commodity transactions subject to margin cash arrangements. We also have policies to maintain a minimum level of committed borrowing facilities and ensure that a proportion of debt should be long-term and spread over a range of maturities.

The Rights Issue proceeds and two bond issues in the second half of 2008 mean that the Group had significant liquidity at the end of the year to mitigate this risk. Potential acquisitions are expected to utilise surplus liquidity which is currently available to the Group.

Credit rating

The current strong credit rating of the Group (long-term debt: A3 stable outlook (Moody's), A credit watch negative outlook (S&P); short-term debt: P-2 stable outlook (Moody's), A-1 credit watch negative outlook (S&P)), means that we benefit from high levels of credit from our existing counterparties. Any material deterioration of these ratings may increase the cost of funding and could mean that we would need to increase our levels of security for existing energy procurement and hedging contracts, which could affect our cash position, limit our ability to trade in commodity markets and the implementation of our hedging strategy. However, sufficient liquidity is maintained to limit the immediate financial impact of any credit rating reduction.

In the current economic environment there is also the risk that our counterparties may want to restrict the level of credit which they make available to us even if our credit rating remains unchanged. This could restrict our ability to enter into fixed price commodity contracts and increase the commodity risk within the business.

Counterparty default

As part of our normal operations, we often have significant amounts owed to us by energy counterparties and our customers. In addition, we often hold large cash balances on deposit with financial institutions. In the current business environment, there is an increased risk of a counterparty default which may, among other things, reduce the Group's cash flows.

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- or P1/A1 from Moody's or S&P respectively. Energy trading activities are undertaken with counterparties for whom specific credit limits are set. Exposures are reviewed by the Financial Risk Management Committee.

Pensions

We maintain a variety of pension schemes including defined benefit schemes. The pension fund liabilities are partially matched with a portfolio of assets, leaving potential risk around the mortality rate, inflation and returns on assets. The schemes contain 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 the current business environment with volatile bond and unstable equity markets there is an increased risk that large deficits may arise on our pension schemes.

In addition, actions by the pension regulators or the trustees, and/or any material revisions to existing pension legislation could require increased contributions by the Group to the pension fund. The next formal triennial valuations for the main schemes are due to be performed as at 31 March 2009. As part of this exercise the investment and funding strategies for each of the schemes will be reviewed and the trustees and the Company will need to agree new contribution schedules. The actuarial valuations of the schemes may give higher deficits than have been recognised on the Group's Balance Sheet and this will be the basis for agreeing any deficit contributions. The risks associated with the pension schemes are regularly reviewed and, in combination with expert external advice, action is taken where necessary.

Currency fluctuations

Through wholly owned subsidiaries in the United States and Canada and wholly owned and partly owned European entities, the Group has exposure in US and Canadian dollars and euros. Operational and capital expenditure cash flows may also be in currencies other than those used by our subsidiaries. The Group's profitability could be adversely affected if the results and cash flows associated with these subsidiaries fall or cash outflows rise because of currency fluctuations against pounds sterling, the reporting currency of the Group.

Our policy is to use hedging instruments to manage the impact of currency fluctuations. 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 timing of such exposures, the senior treasury and finance management decide on the appropriate hedging activity required on a case-by-case basis.

Interest rate fluctuations

The Group is exposed to movements in interest rates which affect the amount of interest paid on borrowings and the return on our cash investments. 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 manage interest rate risk on long-term borrowings.

Further details on these financial risks can be found in notes 4 and 34 to the Financial Statements on pages 74 and 123.

Board of Directors and Executive team

1. Roger Carr
Chairman (62) N,R
Roger Carr joined the Board as a Non-Executive Director in 2001. He was appointed Chairman of the Board in May 2004 and is Chairman of the Nominations Committee. He is chairman of Cadbury plc and a non-executive director of the Bank of England. Until June 2008, he was chairman of Mitchells & Butlers plc.

2. Sam Laidlaw
Chief Executive (53) C,D,E,N
Sam Laidlaw joined Centrica 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 a trustee of the medical charity RAFT.

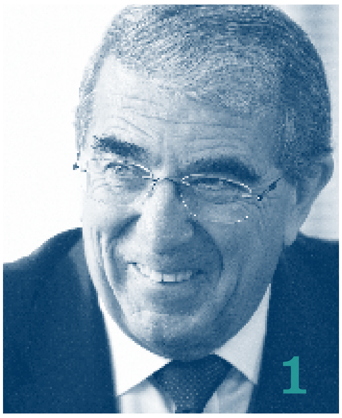
3. Helen Alexander CBE
Non-Executive Director (52) A,N,R
Helen Alexander joined the Board in January 2003 and is Chairman of the Remuneration Committee. She is a vice-president of the CBI, a senior adviser of Bain Capital and a non-executive director of Rolls-Royce plc. She is a trustee of the Tate Gallery and an honorary fellow of Hertford College, Oxford. Until July 2008, she was chief executive of the Economist Group. Formerly, she was a non-executive director of BT Group plc and Northern Foods plc.

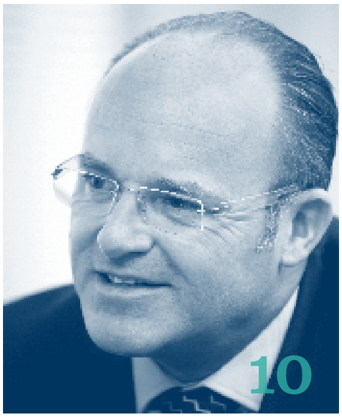
4. Phil Bentley
Managing Director, British Gas (50) C,E
Phil Bentley joined Centrica as Group Finance Director in 2000, a position he held until the end of February 2007 when he was appointed Managing Director, British Gas. He was also Managing Director, Europe between July 2004 and September 2006. Formerly, 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 (60) A,C,N,R
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 and St. Modwen Properties plc and a trustee and treasurer of the Almeida Theatre. She is a former director general of the Association of British Insurers, a former non-executive director of the Bank of England and Alliance & Leicester plc, and was a senior civil servant in the Treasury and the Prime Minister's Office.

6. Mark Hanafin
Managing Director, Centrica Energy and Europe (49) E
Mark Hanafin joined Centrica as Managing Director, Centrica Energy and Europe in July 2008. He was previously president and chief executive officer of Shell Energy North America in Houston. Mark began his career with Shell in 1986 in the UK, holding positions in sales, trading and commercial management. In 1999 he joined the team that created the global LPG business for Shell and went on to manage the new global LPG Supply and Trading division. Prior to joining Shell, Mark worked for General Electric Company.

7. Nick Luff
Group Finance Director (41) D,E
Nick Luff joined Centrica 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.





Key to membership of committees

A – Audit Committee
C – Corporate Responsibility Committee
D – Disclosure Committee
E – Executive Committee
N – Nominations Committee
R – Remuneration Committee

8. Andrew Mackenzie

Non-Executive Director (52) A,C,N,R

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 took up in November 2008. From 2004, he was with Rio Tinto, 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 remained a trustee until June 2008.

9. Paul Rayner

Non-Executive Director (54) A,N,R

Paul Rayner joined the Board in September 2004 and is Chairman of the Audit Committee. In September 2008, he was appointed as a non-executive director of Boral Limited and in July 2008, he was also appointed as a non-executive director of Qantas Airways Limited. He was finance director of British American Tobacco plc from 2002 until April 2008. In 1991 he joined Rothmans Holdings Limited in Australia, holding senior executive appointments, and became chief operating officer of British American Tobacco Australasia Limited in September 1999.

10. Paul Walsh

Non-Executive Director (53) A,N,R

Paul Walsh joined the Board in March 2003. He is chief executive of Diageo plc, having previously been chief operating officer and having served in a variety of management roles. He is a non-executive director of Federal Express Corporation, a member of the Council of the University of Reading, deputy chairman of the Prince of Wales International Business Leaders Forum, a member of the Business Council for Britain and chairman of the Scotch Whisky Association.

Executive team

11. Grant Dawson

General Counsel & Company Secretary (49) D,E

Grant Dawson has been General Counsel & Company Secretary of Centrica since the demerger from British Gas plc in February 1997, having joined British Gas in October 1996.

12. Deryk King

President and Chief Executive Officer, Direct Energy (61) C,E

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 (44) C,E

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 (55) E

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. She is also Chairman of the Centrica Pension Schemes.

15. Chris Weston

Managing Director, British Gas Services (45) E

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 is committed to the highest standards of corporate governance and believes that such standards are critical to overall business integrity and performance.

This report explains how the Company applies the principles of the 2006 Combined Code on Corporate Governance (the Code).

Board of Directors

The Directors consider that the Board effectively leads and controls the Group. The powers of the Directors are set out in the Company's Articles of Association (Articles), which are available on the Company's website. To accommodate recent changes in company law, the Company adopted a new set of Articles at the 2008 Annual General Meeting.

The Board has a schedule of matters specifically reserved for its approval, which is also available for inspection on the Company's website. In particular, the Board is responsible for:

- changes in the capital structure of the Company;
- development of strategy and major policies;
- the appointment and removal of Directors and the Company Secretary;
- reviewing management performance;
- interim dividend payments and recommendation of final dividends;
- approval of the annual operating plan, the financial statements and major acquisitions and disposals;
- the Group's corporate responsibility arrangements including health, safety and environmental matters;
- the Group's corporate governance and system of internal control; and
- matters not in the ordinary course of business.

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 the necessary amount of time to attend to the Company's affairs.

2008 Board and committee meetings attendance

	Board	Audit Committee	Remuneration Committee	Nominations Committee	Corporate Responsibility Committee
Number of meetings	**12**	**4**	**5**	**3**	**4**
Roger Carr	12		4	3	
Sam Laidlaw	12			3	4
Phil Bentley	12				4
Mark Hanafin (i)	7				
Nick Luff	12				
Jake Ulrich (ii)	3				
Helen Alexander	11	4	5	2	
Mary Francis	12	4	5	3	4
Andrew Mackenzie	11	3	5	3	4
Paul Rayner	11	4	3	2	
Paul Walsh	7	3	2	1	

(i) Mark Hanafin joined the Board on 14 July 2008.
(ii) Jake Ulrich resigned from the Board on 12 May 2008.

Board meetings

The Board holds regular scheduled meetings throughout the year. Unscheduled supplementary meetings also take place as and when necessary. During the year, the Company had nine scheduled meetings and three unscheduled supplementary meetings. A committee of the Board, set up solely to consider and approve technical aspects of the Company's Rights Issue, met on three further occasions during the year.

The Board continually monitors the development of the Group's strategy and one of its meetings is specifically devoted to this. Comprehensive papers are presented to, and discussed by, the Board during this review. During the year, the Board undertook a full review of the Group's overall strategy with the assistance of an independent external consultant.

Details of attendance by Directors at Board and committee meetings during 2008 are set out in the table above.

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.

Board constitution and appointments

The Board is made up of an appropriate balance of Executive and independent Non-Executive Directors. The roles of Chairman and Chief Executive are separate. This established division of responsibility is formalised in writing and has been approved by the Board.

The Non-Executive Directors play a key governance role and bring an external dimension to the Board's deliberations through their range of knowledge, experience and insight from other sectors. As part of its annual review of corporate governance, the Board considered the independence of each Non-Executive Director (other than the Chairman) against the criteria specified in the Code and determined that each remained independent.

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

A formal, rigorous and transparent process is followed during the selection and subsequent appointment of new Directors to the Board. This process is described in the section on the Nominations Committee on page 40. On 14 July 2008, Mark Hanafin was appointed to the Board as Managing Director, Centrica Energy and Europe and he will be seeking reappointment as a Director of the Company at the 2009 Annual General Meeting (AGM). Mark Hanafin replaced Jake Ulrich, who resigned from the Board on 12 May 2008. On 26 February 2009, the Chairman announced a number of changes to the composition of the Board. Chris Weston, who is currently Managing Director of British Gas Services will be appointed to the Board on 1 July 2009 and will assume responsibility for the Company's North American business following Deryk King's retirement. Chris Weston will therefore seek reappointment to the Board at the 2010 Annual General Meeting. Phil Bentley will assume responsibility for the newly combined British Gas business and will remain a member of the Board. Paul Walsh, who has served as a Non-Executive Director since March 2003, will retire from the Board at the conclusion of the AGM. A search for a suitable replacement has commenced.

In accordance with the Companies Act 2006, the Board considered and authorised each Director's reported actual and potential conflicts of interest during the year. Each Director abstained from approval of their own reported conflicts. The Board will continue to monitor and review potential conflicts of interest on a regular basis.

In accordance with the Code and the Company's Articles, all Directors are subject to reappointment by shareholders at the first AGM following their appointment to the Board and thereafter are subject to reappointment every third year. Non-Executive Directors are initially appointed for a three-year term and, subject to review and reappointment by shareholders, can serve up to a maximum of three such terms. Upon the recommendation of the Nominations Committee, Mark Hanafin, Sam Laidlaw and Andrew Mackenzie will be proposed for reappointment at the 2009 AGM, each to serve a three-year term. The Code states that any length of service beyond six years for a Non-Executive Director should be subject to particularly rigorous review and should take into account the need for progressive refreshing of the Board. In view of this, Helen Alexander, who joined the Board in January 2003, is and will in future seek reappointment to the Board on an annual basis.

Full details of Directors' service contracts, emoluments and share interests are set out in the Remuneration Report on pages 44 to 55. Directors' biographies including their Board committee membership are set out on pages 36 and 37.

Directors' indemnities and insurance

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

Board evaluation

The Board conducted a formal evaluation of its own performance and that of its committees and individual Directors. The evaluation was carried out with the assistance of an independent external facilitator, Egon Zehnder International, in respect of the year ended 31 December 2008.

The 2008 Board evaluation process followed up on the previous year's effectiveness review and the Board considered whether sufficient improvements had been made on the identified issues.

The 2008 Board evaluation focused on the following key themes: board structure, organisation and dynamics; efficiency and effectiveness; strategic review and debate; risk management and governance; review of specific decisions made in 2008; business performance; people; and key issues for 2009.

The facilitator carried out the evaluation process using a comprehensive questionnaire, which was considered and completed by each of the Directors and the General Counsel & Company Secretary. In addition to this, the Senior Independent Director chaired a meeting of the independent Non-Executive Directors in the absence of the Chairman to appraise the Chairman's individual performance.

A consolidated report of the output from the evaluation exercise was prepared by the facilitator and this was presented to the Board for review and consideration.

The evaluation report concluded that the Board and its committees continue to operate effectively although a small number of actions and improvements were identified. In particular, the Board identified the following enhancements, which will be incorporated into the future Board programme to ensure that the operation of the Board and its committees continue to improve:

- greater visibility of senior management by the Board;
- greater focus on global issues and succession in North America;
- site visits; and
- post investment reviews.

The Chief Executive's performance is reviewed regularly by the Chairman and the Chief Executive reviews the performance of the other Executive Directors. In addition, the Remuneration Committee assesses the performance of the Executive Directors in connection with its determination of senior management remuneration levels as explained in the Remuneration Report on pages 44 to 55.

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

Board development

All new Directors appointed to the Board receive a comprehensive induction briefing tailored to meet their individual needs. Ongoing development and training is provided to Directors at Board meetings and, where appropriate, committee meetings. During the year, Directors received regular updates and presentations on changes and developments to the business, and to the legislative and regulatory environments in which the Group operates.

In particular, the Board was briefed on the following key issues during 2008:

- Companies Act 2006 provisions – especially Directors' conflicts of interest;
- commodity market and hedging strategy;
- health, safety and environmental developments;
- tax strategy and governance; and
- smart metering and meter reading developments.

The Directors have full access to the advice and services of the General Counsel & Company Secretary. They also have the option to seek independent professional advice in respect of their duties at the Company's expense.

Board committees

The Board has delegated authority to its committees to carry out certain tasks as defined in each committee's respective terms of reference. During the year, the Board conducted a comprehensive review of each of its committees' terms of reference against best practice and approved revised terms. The written terms of reference for the Audit, Remuneration, Nominations, Corporate Responsibility, Executive and Disclosure Committees are available on the Company's website and hard copies are available upon request.

All of the independent Non-Executive Directors are members of the Audit, Remuneration and Nominations Committees. The Board considers that this membership structure provides a consistency of membership within each of these principal committees and avoids undue reliance on particular members. Minutes of committee meetings are made available to all Directors on a timely

Corporate Governance Report continued

basis and the chairmen of each of the Audit, Remuneration, Nominations and Corporate Responsibility Committees provide updates to the Board at subsequent Board meetings.

A chart setting out the Company's Board and Executive Committee structure is set out below.

Details of each committee, including membership, are set out in the following committee reports:

Audit Committee

The members of the Audit Committee are Paul Rayner (Chairman), Helen Alexander, Mary Francis, Andrew Mackenzie and Paul Walsh. In accordance with the Code, Paul Rayner is identified as having recent and relevant financial experience. The Board has determined that each member of the Committee is independent and that the membership meets the requirements of the Code.

The key function of the Audit Committee is to review the effectiveness of the Company's financial reporting and internal control policies together with the procedures for the identification, assessment and reporting of risks. In accordance with its terms of reference, the Committee is authorised by the Board to:

- monitor the integrity of the Company's financial statements and any formal announcements relating to the Company's financial performance, including a review of the significant financial reporting judgements contained within 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 monitoring their independent status; and
- establish and oversee appropriate whistleblowing and fraud prevention arrangements within the Company.

During the year the Committee met on four occasions. At each of these scheduled meetings, the Committee met privately with the external auditors, and separately with the Head of Internal Audit.

The Committee received regular comprehensive reports from the Head of Internal Audit, senior management and the external auditors, PricewaterhouseCoopers LLP. The Committee also requested clear objectives, timescale and achievement milestones against which performance could be clearly measured in respect of all ongoing issues.

The Committee considered a number of key issues during the year and in particular reviewed:

- British Gas Residential revenue recognition;
- risk profile of the Group's business model and risk mitigation;
- information technology general controls;
- management of commodity risk; and
- ongoing compliance with the undertakings in respect of Centrica Storage Limited.

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 84. In addition, the Committee was provided with reports of all non-audit assignments awarded to the external auditors and, on a regular 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 44 to 55.

Nominations Committee

The members of the Nominations Committee are Roger Carr (Chairman), Helen Alexander, Mary Francis, Sam Laidlaw, Andrew Mackenzie, Paul Rayner and Paul Walsh. The Committee's membership is comprised of a majority of independent Non-Executive Directors. The primary responsibilities of the Committee are to:

- make appropriate recommendations to the Board for the appointment of replacement or additional Directors;
- devise and consider succession planning arrangements for Directors and other senior executives; and

Governance structure

- regularly review the structure, size and composition of the Board and make recommendations to the Board with regard to any proposed changes.

The Committee met on three occasions during the year and considered the proposed appointment of Mark Hanafin as Managing Director, Centrica Energy and Europe to replace Jake Ulrich, who resigned from the Board on 12 May 2008.

In making its appointment recommendations to the Board, the Committee reviews the overall 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 candidate attributes.

In addition to this appointment, the Committee considered:
- the reappointment of Directors retiring by rotation at the 2008 Annual General Meeting;
- Board and senior management succession planning; and
- Board constitution changes and appointments.

Corporate Responsibility Committee

The members of the Corporate Responsibility Committee are Mary Francis (Chairman), Phil Bentley, Deryk King, Sam Laidlaw, Andrew Mackenzie and Catherine May.

A report detailing the work carried out by the Corporate Responsibility Committee during the year is included within the Corporate Responsibility section on pages 24 to 28.

Executive Committee

The members of the Executive Committee are the Executive Directors and those key senior managers whose biographical details are set out on pages 36 and 37. Sam Laidlaw is Chairman of the Committee.

The Committee is responsible for the day-to-day management of the Group's operations within the limits set out in the Group's delegation of authority, which was reviewed and approved by the Board during the year. The Committee also has a schedule of matters specifically reserved for its approval.

The Committee has delegated certain tasks to the following sub-committees:
- the Group Risk Management Committee;
- the Group Financial Risk Management Committee;
- the Health, Safety and Environment Committee; and
- the Investment Committee.

During the year, the Committee conducted a thorough review of the terms of reference in respect of the Group Financial Risk Management, Health, Safety and Environment, and Investment Committees and approved revised terms.

Disclosure Committee

The members of the Disclosure Committee are Sam Laidlaw (Chairman), Nick Luff and Grant Dawson.

The Committee met on a number of occasions during the year and is responsible for implementing and monitoring systems and controls in respect of the management and disclosure of inside information. The Committee is also responsible for ensuring that all regulatory announcements, shareholder circulars, prospectuses and other documents issued by the Company comply with any applicable legal or regulatory requirements.

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. The Board is proactive in obtaining an understanding of shareholder views on a number of key matters affecting the Group.

The Chief Executive and Group Finance Director held regular meetings with the Company's major shareholders during the year. A key topic of discussion during the year was the Company's Rights Issue, which was succesfully completed during December 2008, following approval at the Company's General Meeting held on 21 November 2008.

The Chairman and the Senior Independent Director attended the meetings at which the annual and interim results were 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 their concerns and key issues.

The Company's AGM provides all shareholders with the opportunity to further develop their understanding of the Company and to ask questions of the full Board on the matters put to the meeting, including the Annual Report. At the AGM, the Chairman and the Chief Executive present a review of the Group's business. A poll is conducted on each resolution at all Company General Meetings. All shareholders also have the opportunity to cast their votes in respect of proposed resolutions by proxy, either electronically or by post.

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 deemed inappropriate.

Formal reports of investor feedback are presented to the Board at each Board meeting.

Centrica's website contains up-to-date information for shareholders and other interested parties including share price information, news releases, speeches from the AGM, presentations to the investment community and a section on shareholder services. The Company's Annual Report and Annual Review are also published on the website and these are available to shareholders from the date of publication.

Compliance statement

Throughout the year ended 31 December 2008, the Company fully complied with the provisions set out in Section 1 of the Code with the exception of provision A.4.3 which currently states that no individual should be appointed to a second chairmanship of a FTSE 100 company. In July 2008, the Chairman of the Company was appointed as chairman of Cadbury plc following its demerger from Cadbury Schweppes plc. The Board believes that the Chairman's commitment and contribution to the Company will not suffer as a consequence of this appointment. This provision has been removed from the new 2008 Combined Code, which the Company will report against in 2010.

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

Corporate Governance Report continued

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 Group level. Where significant risks have been identified, a control infrastructure has been established to ensure day-to-day monitoring and management of risks. The Centrica Executive Committee reviews the risks identified by the Group Risk Management Committee at its monthly meetings to assure itself that the significant risks facing the Group are being managed appropriately. Centrica Storage Limited, which is subject to undertakings given to the 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 2008, 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 31 to 34 of this report. In addition, the Audit Committee is provided with the results of internal audit reviews conducted by the internal audit 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 are 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, are assessed. In 2008 the self-certification process was completed at half year and full year ends. The results of the annual process, together with the conclusions of the internal reviews by Internal Audit, 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 2008 to the date of this report, and is satisfied that the Group complies with the Turnbull Guidance. The Board will continue routinely to challenge management in order to ensure that 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, the Board continues to adopt the going concern basis in preparing the Financial Statements. Further details of the Group's liquidity position and going concern review are provided in note 4 of the Financial Statements on page 78.

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 also confirm that the Directors' Report contained within the Annual Report includes a fair review of the development and performance of the business and the position of the Group, together with a description of the principal risks and uncertainties that it faces.

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 and the Directors' Remuneration Report 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 they are aware, there is no relevant audit information of which the Company's auditors are unaware; and they have taken all steps that they ought to have taken as Directors to make themselves aware of any relevant audit information and to establish that the Company's auditors are aware of that information.

The Company has not entered into an auditor liability limitation agreement with its auditors during the year.

Governance
continued

Other statutory information

Major acquisitions and disposals

Full details of acquisitions and disposals are disclosed in the Business Review on pages 8 to 34 and note 35 to the Financial Statements on page 126.

Events after the balance sheet date

Events after the balance sheet date are disclosed in note 39 to the Financial Statements on page 132.

Related party transactions

Related party transactions are set out in note 37 to the Financial Statements on pages 130 and 131.

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 2008 was 37 (2007: 37) for the Group (excluding Accord Energy Limited) and 39 (2007: 28) for the Company.

Share capital

The Company's authorised and issued share capital as at 31 December 2008, together with details of shares issued during the year, is set out in note 29 to the Financial Statements on page 110. Each ordinary share of the Company carries one vote.

During the year, the Company announced a Rights Issue on the basis of three new shares for every eight shares held on 14 November 2008, at a subscription price of 160 pence per share. Further details of the Rights Issue are set out in notes 5, 29 and 30 to the Financial Statements.

Authority to purchase shares

The Company was authorised at the 2008 Annual General Meeting to purchase its own shares, within certain limits and as permitted by the Articles. A renewal of this authority will be proposed at the 2009 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 2008.

Material shareholdings

At 25 February 2009, Centrica had received notification of the following material shareholdings pursuant to the Disclosure and Transparency Rules:

	Ordinary shares	% of share capital	Nature of holding
AXA S.A.	95,867,976	1.88	Direct
AXA S.A.	399,144,148	7.81	Indirect
Legal & General Group	239,387,171	4.69	Direct
Legal & General Group	26,761,940	0.52	Indirect
Petronas	199,375,000	3.90	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 forthcoming AGM.

This Directors' Report comprising pages 8 to 43 has been approved by the Board and signed on its behalf by:

Grant Dawson
General Counsel & Company Secretary
26 February 2009

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

Remuneration Report

This report details the Company's executive remuneration policy and includes information on the remuneration of the Directors for the financial year ended 31 December 2008.

Composition and role of the Remuneration Committee

Throughout 2008, 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. The formal terms of reference were reviewed during the year and are available on the Company's website.

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 Human Resources Director, the Group Reward Director, the Chief Executive, the General Counsel & Company Secretary and external consultants.

At its meetings in 2008, the Committee considered, amongst other things, the following:

- the 2007 Remuneration Report;
- achievement of performance targets in respect of the 2007 Annual Incentive Scheme (AIS) and the vesting of existing awards made under the long-term share-based incentive arrangements;
- levels of base salary;
- setting award levels and performance targets in respect of the 2008 AIS and awards made under the long-term share-based incentive arrangements;
- proposed terms of appointment of the new Managing Director Centrica Energy and Europe;
- effectiveness of the AIS;
- changes to the eligibility criteria of the Sharesave Scheme; and
- the impact of the extended prohibited period for dealing in shares and the subsequent Rights Issue on the operation of the Group's Share Schemes.

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 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 among other things, 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 Centrica's 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 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.

The Committee recently conducted a review against the above criteria and proposed changes to the future policy and framework of executive remuneration arrangements and, in particular, consulted with a number of major shareholders regarding changes to the operation of the AIS and Deferred and Matching Share Scheme (DMSS) going forward, as outlined later in this report. These changes become effective during 2009.

In 2008, executive remuneration comprised base salary, AIS, an allocation of shares under the Long Term Incentive Scheme (LTIS), and an allocation of shares under the 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 one-off allocation of shares under the Special Long Term Incentive Scheme (SLTIS) and a grant of options under the Special Executive Share Option Scheme (SESOS) were made to Mark Hanafin in accordance with the terms of his engagement.

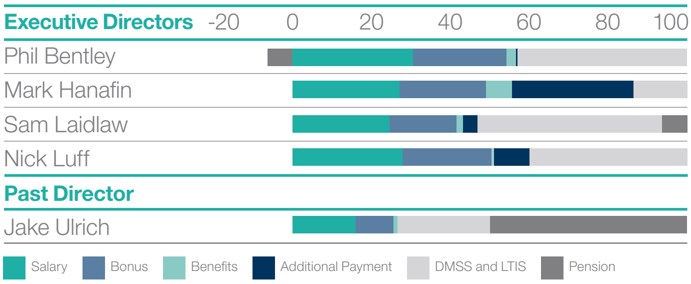
A minimum shareholding policy requires the retention of a value of shares as follows: the Chief Executive – twice his base salary; all other Executive Directors – 1.25 times their base salary; and, executives immediately below Board level – base salary. Achievement against this requirement for Executive Directors is set out in the table on page 51.

The Centrica Pension Plan (CPP) which was formerly known as the Centrica Management Pension Scheme (CMPS) (a contributory final salary arrangement) was closed to new employees on 30 June 2003. Phil Bentley and Jake Ulrich, having been employed prior to this date participated in the scheme during 2008. Alternative arrangements are made for new employees, including Executive Directors, after the closing date referred to above. Full disclosure of the pension arrangements for the Executive Directors is given on page 55.

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 2009.

In 2008, the total emoluments of the Executive Directors, detailed on page 50, consisted of components in the following proportions:

Relative proportions of the components of each Executive Director's remuneration (%) in 2008



Note: Salary and benefits are the actual amounts received during 2008, in the case of Mark Hanafin since 14 July 2008, his date of appointment; AIS is that paid in respect of 2008 as reflected in the emoluments table on page 50; additional payments include interest payments as a result of the delayed operation of the DMSS; a salary supplement in lieu of pension paid to Mark Hanafin, Sam Laidlaw and Nick Luff; a cash payment to Mark Hanafin in lieu of bonus payable by his previous employer and a payment to Nick Luff in lieu of provision of a company car – see page 50; DMSS and LTIS are the estimated value in accordance with note 2 to the Financial Statements on pages 62 to 71, of the awards made in 2008, provided that all performance conditions are met in full at the end of the relevant performance periods; and pension, for Phil Bentley and Jake Ulrich in the Centrica Pension Plan (CPP), is the increase in actual transfer value for 2008 over the notional transfer value for 2007 less the Director's contributions during 2008; pension for Sam Laidlaw is the actual amount of the contribution made by the Company to his personal pension.

The total emoluments of the five senior executives immediately below Board level for 2008, calculated on the same basis as the emoluments of the Executive Directors detailed on page 50, fell into the following bands:

Bands £000	Number of senior executives
900 – 1,000	1
800 – 899	1
700 – 799	–
600 – 699	2
500 – 599	–
400 – 499	1

Components of remuneration

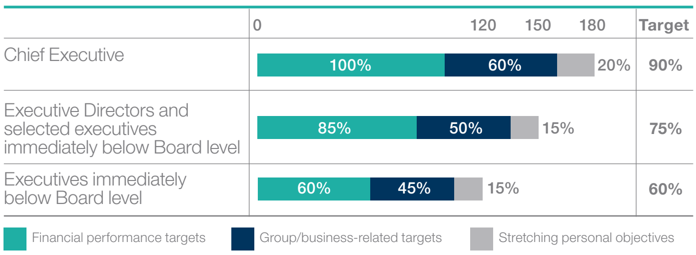
Base salary

The Committee establishes 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 based on information from independent sources. Base salaries are reviewed annually. In respect of 2009 it has been decided that no base salary increases will be awarded to the Executive Directors or to other members of the senior management team except where individuals have had a significant change to their responsibilities. For members of CPP, 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 senior executives and aligns their interests with those of Centrica's shareholders. For 2008, the target and maximum bonus opportunity, together with the relative proportions of the components that made up the maximum bonus opportunity, were as follows:

Maximum % bonus opportunity



As shown in the chart above, a balanced range of measures is used to determine overall AIS performance. In 2008, the primary financial measure was Group Economic Profit (EP). In addition, each Business Unit had a number of business metrics focusing on their key strategic priorities for the year. Example metrics include cost reduction targets, project completion and customer satisfaction levels. 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 line with current policy, a bonus will be forfeited if overall performance is deemed to be unsatisfactory.

Twenty per cent of annual bonuses paid in respect of 2006 and 2007 were deferred automatically and invested in the DMSS (see pages 46 and 47). To incentivise Executive Directors to focus on creating long-term value for shareholders and to deliver sustained high performance, the deferral in respect of 2008 and thereafter will increase from 20% to 40% of any AIS award for the Chief Executive and to 30% for Executive Directors and executives immediately below board level.

In 2009, the maximum and target bonus opportunity will remain 180% and 90% of base salary respectively for the Chief Executive and 150% and 75% of base salary respectively for the other Executive Directors.

Remuneration Report continued

Deferred and Matching Share Scheme (DMSS)
An award under the DMSS is normally made to Executive Directors and other senior executives in April of each year. However, in 2008 the award was delayed due to the Executive Directors and other senior executives being subject to prolonged dealing restrictions as a result of the Company being in a prohibited period under the Company's Model Code. 20% of the AIS paid in April 2008 was, however, deferred automatically at that time and subsequently invested in Centrica shares (deferred shares) once the Company had ceased to be in a prohibited period. Participants were also given the opportunity to invest an additional amount in Centrica shares (investment shares) funded from the actual bonus paid 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 2007. In order to restore participants to the position they would have been in had the Company been able to operate the scheme under the normal timetable, the Committee determined that the three-year period during which time the deferred and investment shares cannot be withdrawn would be deemed to have commenced in April 2008. Deferred and investment shares were matched with conditional shares (matching shares), which will only be released upon the achievement of a performance target (see table on page 47). The performance target, is based on performance over three financial years and is unaffected by the delayed operation of the DMSS.

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 Centrica's 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.

Following consultation with major shareholders there will be a change to the operation of the DMSS for 2009 and thereafter. The performance condition for awards of matching shares will remain as three-year growth in EP. However, EP growth will be measured on a three-year point-to-point basis going forward, rather than a three-year cumulative calculation of growth. No changes are being proposed to the maximum bonus opportunities, the maximum matching opportunity of 2:1, the straight-line vesting criteria or the three-year EP growth target of 25%. The Company believes that this change will encourage executives to invest in the scheme and so align their interests with Centrica's shareholders and help drive long-term performance.

Long Term Incentive Scheme (LTIS)
Under the LTIS conditional allocations of shares up to a maximum of 200% of base salary may be made to Executive Directors and other senior executives.

In 2008, 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 for the Executive Directors, the Remuneration Committee carefully considered the total shareholder return (TSR) and diluted adjusted earnings per share (EPS) performance conditions attaching to the award to ensure they were 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 (ie to exceed the Retail Prices Index (RPI) by 30% or more over the performance period for full vesting) was sufficiently stretching. The maximum number of shares that could be transferred to each Executive Director upon satisfaction of the performance conditions in full appears on page 53. The release of allocations will be subject to the performance conditions as set out in the table on page 47.

To create a closer alignment with the interests of Centrica's 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.

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 on page 47.

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 Limited (an independent third party) in respect of comparative TSR and audited figures in respect of EPS.

Performance condition summary

Deferred and Matching Share Scheme

Award year	Vesting criteria	Performance condition over three-year period
2007 & 2008	100% of matching shares on cumulative Group Economic 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
2008	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 between 25% and 100% for ranking between median and upper quintile.
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 between 25% and 100% 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 between 25% and 100% for ranking between median and upper quintile.
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. Re-testing 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%.

† EPS represents the Group's diluted adjusted earnings per share.
* The Committee has determined that, for the pre-2006 LTIS and for that part of the 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).

Remuneration Report continued

Special Long Term Incentive Scheme (SLTIS)
During 2008, under the SLTIS a one-off allocation was made to Mark Hanafin to replace awards from his previous employer, in accordance with the terms of his engagement. The SLTIS rules were based on the existing LTIS rules and enable an allocation to be made that will vest in two equal tranches on 28 February 2009 and 2010, respectively. In accordance with the rules of the SLTIS there are no performance conditions attaching to the shares other than continued employment with the Company. In the event of a change of control the number of shares that vest will not be subject to time-apportionment.

Executive Share Option Scheme (ESOS)
No grants of options under the ESOS were made during 2008. Details of options granted prior to 2008 and still held by Executive Directors are shown on page 54.

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.

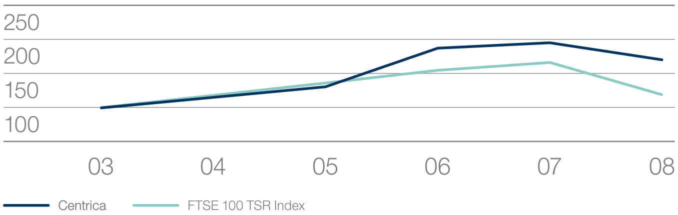
The EPS performance conditions in respect of options granted from 2001 to March 2004 under the ESOS (as set out in the table on page 47) could be measured annually for a further two years from the third anniversary of the date of grant of the options, with the performance conditions increasing proportionately. Having reviewed market practice, the Committee removed the provision for re-testing of performance measures in respect of all option grants from September 2004.

Special Executive Share Option Scheme (SESOS)
In 2008, a grant of unapproved options was made under the SESOS to Mark Hanafin to replace awards from his previous employer, in accordance with the terms of his engagement. The SESOS rules were based on the existing ESOS rules. However, in accordance with the rules of the SESOS the grant is not subject to any performance conditions and is immediately exercisable and will remain so until the tenth anniversary of grant.

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 RREV, to continue with the financial target of EP in respect of the AIS and DMSS; and diluted adjusted 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.

Rights Issue
In December 2008 the performance conditions under the LTIS, ESOS and the DMSS were reviewed by the Committee and appropriate adjustments were made to reflect the dilutive effect of the Rights Issue. Previously reported EPS was restated in accordance with IAS 33 and dividends per share for the six months ended 30 June 2008, and the preceding five years were also restated to take account of the bonus element of the Rights Issue. TSR was similarly adjusted by a rate of 0.8902, being the formally agreed Rights Issue adjustment formula determined by dividing the theoretical ex-rights price (238.36p) by the closing share price on the last date the shares traded cum-rights (267.75p).

Total shareholder return indices – Centrica and FTSE 100 Index for the five years ended 31 December 2008



Source: Althos Limited
31 December 2003 = 100

The graph compares the Company's TSR performance with that of the FTSE 100 Index for the five years ended 31 December 2008.

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 2008 is shown on page 53.

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 in order to meet the requirements of the ESOS in 2008, newly issued shares were used. Shares were bought in the market and are held in Trust to satisfy allocations made under the SLTIS and SESOS during 2008.

Pension
The pension arrangements of the Executive Directors are fully disclosed on page 55.

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. During the year, Mark Hanafin, 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, Nick Luff on 1 March 2007 and Mark Hanafin on 14 July 2008. Each has a service contract that contains a notice period of two years, which reduces to one year on the second anniversary of their respective date of appointment. The notice period contained in Sam Laidlaw's contract has now reduced to one year.

The dates of the Executive Directors' service contracts are set out in the table on page 50.

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 2008, Phil Bentley received £67,250 as a non-executive director of Kingfisher plc, Sam Laidlaw received £76,667 as a non-executive director of HSBC Holdings plc and Nick Luff received £47,000 as a non-executive director of QinetiQ Group plc.

Non-Executive Directors
Non-Executive Directors including the Chairman do not have 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 50. Roger Carr's letter of appointment contains a six-month notice period. The Chairman's fees are approved by the Remuneration Committee. The fees of the Non-Executive Directors are approved by the Executive Committee, whose current members are: the Executive Directors (Sam Laidlaw, Phil Bentley, Mark Hanafin and Nick Luff) and five other senior executives (Grant Dawson, Deryk King, Catherine May, Anne Minto and Chris Weston) all of whose biographies are included on pages 36 and 37.

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 level of fees paid by other companies.

The annual fees currently 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 and were last reviewed in July 2007. 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 44 to page 49 up to this statement has not been audited. From this point until the end of the report on page 55, the disclosures, with the exception of the graph on page 53, have been audited by the Company's auditors, PricewaterhouseCoopers LLP.

Remuneration Report continued

Directors' emoluments

		Base salary/fees £000	Annual Incentive Scheme (AIS) £000 (i)	Additional payments £000 (ii) (iii)	Benefits £000 (iv)	**Total emoluments 2008 £000 (v)**	Total emoluments 2007 £000 (v)
Executive Directors	**Date of service contract**						
Phil Bentley	13 September 2000	582	457	5	45	**1,089**	1,125
Mark Hanafin (vi)	14 July 2008	246	201	281	60	**788**	–
Sam Laidlaw	1 July 2006	906	629	137	58	**1,730**	1,870
Nick Luff (vii)	1 March 2007	553	454	185	4	**1,196**	989
Past Director	**Date of leaving the Board**						
Jake Ulrich (viii)	12 May 2008	210	128	–	14	**352**	1,033
		2,497	1,869	608	181	**5,155**	5,017
Non-Executive Directors	**Date of appointment**						
Helen Alexander	1 January 2003	72	–	–	–	**72**	69
Roger Carr	1 January 2001	450	–	–	–	**450**	413
Mary Francis	22 June 2004	92	–	–	–	**92**	84
Andrew Mackenzie	1 September 2005	60	–	–	–	**60**	58
Paul Rayner	23 September 2004	78	–	–	–	**78**	75
Paul Walsh	1 March 2003	60	–	–	–	**60**	58
		812	–	–	–	**812**	757
Total emoluments		3,309	1,869	608	181	**5,967**	5,774

(i) Of the AIS bonus agreed by the Committee in respect of Sam Laidlaw and other Executive Directors, 60% and 70% respectively is paid in cash and is included above. 40% of the agreed bonus for Sam Laidlaw (£419,436) and 30% of the agreed bonus for each Executive Director (range between £86,045 and £195,876) is deferred automatically and invested as deferred shares in the Deferred and Matching Share Scheme (DMSS) – see pages 51 and 52. Mark Hanafin was appointed to the Board on 14 July 2008 and received AIS pro-rated for the period from his date of appointment, subject to 30% deferral and investment as deferred shares, as outlined above. Jake Ulrich retired from the Company on 31 July 2008 and received AIS pro-rated for the period to his date of retirement subject to 20% deferral in accordance with the rules of the AIS at that time (AIS figure shown is for the period from 1 January to 12 May 2008, being his date of resignation from the Board). Jake Ulrich was not entitled to participate in the DMSS during 2008.

(ii) Sam Laidlaw is contractually entitled to a salary supplement of 40% of base pay in lieu of any pension provision. This amounted to £362,560 in 2008 (2007: £349,180) of which £232,500 (2007: £168,750) was paid directly by the Company into his personal pension plan and is disclosed in the notes on page 55. The balance of £130,060 (2007: £180,430) is included above under the heading 'Additional payments'. Mark Hanafin and Nick Luff are contractually entitled to a salary supplement of 40% and 30% of base pay respectively in lieu of any pension provision. In addition, cash payments to Mark Hanafin in lieu of bonus payable by his previous employer (for the period 1 January to 14 July 2008) and Nick Luff in lieu of the provision of a company car are also included above under the heading 'Additional payments'.

(iii) Executive and past Directors received a taxable interest payment in October 2008 at the rate of 6.25% in respect of the notional interest accrued on the 20% of the annual bonus, paid in April 2008 under the AIS, which was deferred automatically at that time in accordance with the rules of the DMSS and held until the DMSS could be operated. The purchase of deferred and investment shares and the conditional award of matching shares were made on 13 October 2008.

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

(v) The following are excluded from the table above:
- (a) pensions – see page 55;
- (b) share options – see page 54. No Executive Director exercised share options during the year. The aggregate of the amount of gains made by Executive Directors on the exercise of share options for 2007 was £615,839; and
- (c) Long Term Incentive Scheme (LTIS) – see pages 51 and 53. The aggregate value of shares vested to Executive Directors under the LTIS was £587,332 (2007: £1,000,974).

(vi) The 2008 total emoluments figure in respect of Mark Hanafin is for the period from 14 July 2008 (being the date of his appointment to the Board) to 31 December 2008.

(vii) The 2007 total emoluments figure in respect of Nick Luff is for the ten-month period from 1 March 2007 (being the date of his appointment to the Board) to 31 December 2007. It includes an additional payment of £145,000 (being a salary supplement of 30% of base pay in lieu of any pension provision).

(viii) The 2008 total emoluments figure in respect of Jake Ulrich is for the period from 1 January 2008 to 12 May 2008 (being the date of his resignation from the Board). He was also paid £77,164 under the rules of the AIS in respect of the period 13 May to 31 July 2008, the date he left the Company.

Directors' interests in shares

The following table and the tables on pages 52 and 53 show the interests of the Directors who held office at the end of the year in the ordinary shares of the Company and, for the Executive Directors who served during the year, their interests in the Company's share schemes:

Directors as at 31 December 2008	**Shareholdings as at 31 December 2008 (i)**	Shareholdings as at 1 January 2008 or on later appointment (iii)	**DMSS total matching shares as at 31 December 2008 (i)**	DMSS total matching shares as at 1 January 2008 or on later appointment (iii)	**LTIS and SLTIS total allocations of shares as at 31 December 2008 (i)**	LTIS total allocations of shares as at 1 January 2008 or on later appointment (iii)
Executive Directors						
Phil Bentley (iv) (v)	**1,004,410**	623,718	**309,992**	181,727	**1,081,655**	740,346
Mark Hanafin (v) (vi)	**–**	–	**–**	–	**560,642**	–
Sam Laidlaw (iv) (v)	**647,817**	341,964	**757,695**	272,431	**1,680,993**	891,320
Nick Luff (iv) (v)	**368,298**	200,255	**417,352**	169,871	**726,679**	276,545
Past Director						
Jake Ulrich (ii) (v)	**1,245,448**	861,229	**90,227**	181,726	**376,877**	743,626
Non-Executive Directors						
Helen Alexander	**3,465**	2,520	**–**	–	**–**	–
Roger Carr	**26,441**	19,230	**–**	–	**–**	–
Mary Francis	**3,500**	981	**–**	–	**–**	–
Andrew Mackenzie	**28,875**	21,000	**–**	–	**–**	–
Paul Rayner	**6,875**	5,000	**–**	–	**–**	–
Paul Walsh	**6,187**	4,500	**–**	–	**–**	–

(i) Shareholdings, DMSS matching shares, LTIS and SLTIS allocations shown as at 31 December 2008, incorporate the impact of the Rights Issue, effective from 15 December 2008. For every eight existing Centrica plc shares held on 14 November 2008, shareholders received the right to buy three new Centrica plc shares at 160 pence per share. Conditional share awards, including the DMSS matching shares and LTIS allocations, were subject to an adjustment to reflect the dilutive effect of the Rights Issue on these awards and were multiplied by a factor of 1.1233.
(ii) DMSS matching shares and LTIS allocations for Jake Ulrich have been time-apportioned to his date of leaving the Company on 31 July 2008, and adjusted to incorporate the impact of the Rights Issue, as outlined in note (i).
(iii) Shareholdings, DMSS matching shares and LTIS allocations are shown as at 1 January 2008 or in the case of Mark Hanafin, at 14 July 2008, his date of appointment.
(iv) As at 25 February 2009, the shareholdings of Phil Bentley, Sam Laidlaw and Nick Luff had each increased by 138 shares acquired through the Share Incentive Plan.
(v) Executive and past Directors' shareholdings shown 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 and SLTIS are provided separately in the table above and in more detail in their respective tables on pages 52 and 53.
(vi) LTIS allocations for Mark Hanafin include an allocation of 372,382 shares made for the year under the LTIS and subject to the performance conditions set out in the table on page 47. An additional 188,260 shares were awarded to Mark Hanafin under SLTIS as part of the terms of his engagement; vesting of these shares will occur in two equal tranches, on 28 February 2009 and 2010 respectively, provided that he remains in continued employment with the Company.

From 1 January 2008 to 25 February 2009, none of the Directors had any interests in the securities of the Company's subsidiary or associated undertakings. During the period from 1 January 2009 to 25 February 2009 there were no changes to the Directors' interests in shares apart from the acquisitions of shares under the Share Incentive Plan as outlined in note (iv) above.

Executive Directors' minimum shareholding policy

As stated on page 44, 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 individual requirement and achievement as at 31 December 2008 against that requirement.

Directors as at 31 December 2008	**Base salary £000 (i)**	**Value of shareholdings £000 (ii)**	**Minimum shareholding requirement as % of base salary**	**Actual shareholding as % of base salary**	Target to be achieved by
Executive Directors					
Phil Bentley	**587**	**2,672**	**125**	**455**	Achieved
Mark Hanafin	**530**	**–**	**125**	**–**	13 July 2013
Sam Laidlaw	**915**	**1,723**	**200**	**188**	30 June 2011
Nick Luff	**560**	**980**	**125**	**175**	Achieved

(i) Base salary is annual salary following the 2008 Salary Review and effective from 1 April 2008 or, in the case of Mark Hanafin, at 14 July 2008, his date of appointment.
(ii) The value of shareholdings is based on the closing price of a Centrica ordinary share of 266 pence on the last trading day of 2008 (31 December).

Remuneration Report continued

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

	Deferred and investment shares acquired on 13 October 2008 (i) (ii) (iv)	Deferred, investment and transferred shares acquired on 4 April 2007 (i) (ii)	Conditional matching shares awarded on 13 October 2008 (i) (ii) (iii) (iv)	Conditional matching shares awarded on 4 April 2007 (i) (ii) (iii)
Phil Bentley	51,312	71,334	105,859	204,133
Mark Hanafin	–	–	–	–
Sam Laidlaw	182,209	115,980	451,674	306,021
Nick Luff	91,926	68,904	226,536	190,816
Jake Ulrich (v)	–	70,094	–	90,227
Market price at allocation date	255.50p	348.53p	255.50p	348.53p
End of performance period	2 Apr 2011	3 Apr 2010	2 Apr 2011	3 Apr 2010

(i) Executive and past Directors' DMSS allocations are shown as at 31 December 2008 and incorporate the impact of the Rights Issue, effective from 15 December 2008. For every eight existing DMSS deferred and investment shares held on 14 November 2008, Executive Directors received the Right (the Rights) to three new Centrica plc shares at 160 pence per share. The Rights attaching to deferred shares were automatically tail-swallowed (ie such number of Rights were sold as was necessary to raise sufficient funds to take up the balance of unsold Rights), in accordance with the rules of the scheme, and the Rights attaching to investment shares were treated in accordance with the instructions of the Executive or past Director, who had the same choices as ordinary shareholders. Conditional share awards, including the DMSS matching shares, were subject to an adjustment to reflect the dilutive effect of the Rights Issue and were multiplied by a factor of 1.1233 and their respective market prices at allocation were multiplied by a factor of 0.8902.

(ii) In 2007 and 2008, 20% of gross bonus paid (before the deduction of income tax and National Insurance contributions) was automatically deferred and invested in Centrica shares (deferred shares). Participants have the opportunity to make a further investment (investment shares), funded from net annual bonus, so that the maximum total investment (on a gross basis) is 50% of the individual's maximum bonus entitlement for the preceding year.

(iii) At allocation 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.

(iv) During 2008, operation of the DMSS was delayed due to the Executive Directors and other senior executives being subject to dealing restrictions as a result of the Company being in a prolonged prohibited period under the Company's Model Code. 20% of the annual bonus payable in April 2008 under the AIS was, however, deferred automatically at that time and held until the DMSS could be operated. The purchase of deferred and investment shares and the conditional award of matching shares were made on 13 October 2008.

(v) DMSS matching shares awarded to Jake Ulrich on 4 April 2007 have been time-apportioned to his date of leaving the Company on 31 July 2008, and adjusted to incorporate the impact of the Rights Issue, as outlined in note (i).

The following table gives details of the LTIS and SLTIS allocations for Executive Directors who served during the year:

	Vested during 2008	In performance period						
Date of allocation	1 April 2005 (i) (ii)	3 April 2006 (i) (iii) (iv) (v)	4 September 2006 (i) (iv)	4 April 2007 (i) (iv)	3 April 2008 (i) (iv)	26 September 2008 (i) (vi)	26 September 2008 (i) (vi)	1 September 2008 (i) (iv)
Phil Bentley	186,070	313,231	–	332,329	436,095	–	–	–
Mark Hanafin	–	–	–	–	–	94,130	94,130	372,382
Sam Laidlaw	–	–	485,082	516,137	679,774	–	–	–
Nick Luff	–	–	–	310,643	416,036	–	–	–
Jake Ulrich (vii)	189,754	229,987	–	146,890	–	–	–	–
Market price at allocation date	202.97p	252.83p	269.30p	348.53p	269.21p	290.88p	290.88p	284.65p
End of performance period	31 Mar 08	2 Apr 09	3 Sep 09	3 Apr 10	2 Apr 11	28 Feb 09	28 Feb 10	31 Aug 11
Market price at vesting date	265.38p							

(i) Executive and past Directors' vested and unvested LTIS and SLTIS allocations are shown, for comparative purposes, as at 31 December 2008 and incorporate the impact of the Rights Issue, effective from 15 December 2008. Allocations were subject to an adjustment to reflect the dilutive effect of the Rights Issue and were multiplied by a factor of 1.1233 and the respective market price at allocation and vesting date, where applicable, were multiplied by a factor of 0.8902.

(ii) At the end of the performance period to 31 March 2008, the Company ranked 45th in the relevant comparator group. Consequently, 57.5% of the original allocations were released to participants on 3 April 2008. 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 unadjusted 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 and subject to the impact of the Rights Issue effective on 15 December 2008, is reflected in the shareholdings as at 31 December 2008 on page 51.

(iii) 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.

(iv) 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. 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 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.

(v) 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.

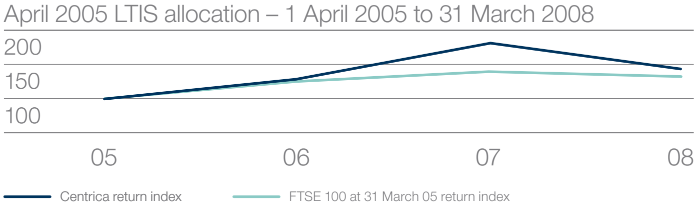
(vi) Shares were awarded to Mark Hanafin under the terms of the SLTIS on 26 September 2008. In accordance with the rules of the SLTIS there are no performance conditions attaching to the shares other than continued employment with the Company. In the event of a change of control the number of shares that vest will not be subject to time-apportionment.

(vii) Allocations made to Jake Ulrich on 3 April 2006 (278,849) and 4 April 2007 (295,851), which remained outstanding on 12 May 2008, being the date of his resignation from the Board, have been time-apportioned to his date of leaving the Company on 31 July 2008 and adjusted to incorporate the impact of the Rights Issue, as outlined in note (i).

The following graph, provided by Alithos Limited (an independent third party), shows the TSR performance of the Company and that of the relevant LTIS comparator group. It has not been audited by the Company's auditors, PricewaterhouseCoopers LLP. It relates to the 2005 LTIS allocations which vested in 2008.

TSR indices – Centrica and LTIS comparator group

April 2005 LTIS allocation – 1 April 2005 to 31 March 2008



Remuneration Report continued

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 2008 or on later appointment (iv)	Options granted during the year (iv)	Options exercised during the year	Options lapsed during the year	**Options held as at 31 December 2008 (v) (vi)**	Original exercise price (pence) (iv)	Adjusted exercise price (pence) (v)	Date from which exercisable	Expiry date
Phil Bentley									
ESOS (i)	308,269	–	–	–	**346,277**	240.05	213.70	Jun 2004	May 2011
ESOS (i)	364,768	–	–	–	**409,744**	224.80	200.12	Apr 2005	Apr 2012
ESOS (i)	559,345	–	–	–	**628,312**	146.60	130.50	Mar 2006	Mar 2013
ESOS (i)	401,875	–	–	–	**451,426**	223.95	199.36	Mar 2007	Mar 2014
ESOS (i)	441,723	–	–	–	**496,187**	228.65	203.55	Apr 2008	Mar 2015
ESOS (i)	371,799	–	–	–	**417,642**	285.10	253.80	Apr 2009	Apr 2016
Sharesave (iii)	3,244	–	–	–	**3,643**	291.30	259.32	Jun 2010	Nov 2010
	2,451,023	–	–	–	**2,753,231**				
Mark Hanafin									
SESOS (ii)	–	299,130	–	–	**336,012**	287.50	255.94	Sep 2008	Sep 2018
Sam Laidlaw									
Sharesave (iii)	3,244	–	–	–	**3,643**	291.30	259.32	Jun 2010	Nov 2010
Nick Luff									
Sharesave (iii)	–	6,581	–	–	**7,392**	255.27	227.24	Jun 2013	Nov 2013
Jake Ulrich									
ESOS (i) (vi)	337,429	–	–	–	**379,033**	240.05	213.70	Jun 2004	Oct 2009
ESOS (i) (vi)	387,010	–	–	–	**434,728**	224.80	200.12	Apr 2005	Oct 2009
ESOS (i) (vi)	593,451	–	–	–	**666,624**	146.60	130.50	Mar 2006	Oct 2009
ESOS (i) (vi)	63,591	–	–	–	**71,431**	223.95	199.36	Mar 2007	Oct 2009
ESOS (i) (vi)	450,470	–	–	–	**506,013**	228.65	203.55	Apr 2008	Oct 2009
ESOS (i) (vi)	371,799	–	–	–	**417,642**	285.10	253.80	Apr 2009	Oct 2009
Sharesave (iii) (vi)	3,244	–	–	–	**3,643**	291.30	259.32	Aug 2008	Jan 2009
	2,206,994	–	–	–	**2,479,114**				

(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 47 and 48.

(ii) **Special Executive Share Option Scheme (SESOS)**
Options were granted to Mark Hanafin under the terms of the SESOS on 26 September 2008. In accordance with the rules of the SESOS the grant is not subject to any performance conditions and is immediately exercisable and will normally remain so until the tenth anniversary of grant.

(iii) **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.

(iv) Executive and past Directors' ESOS, SESOS and Sharesave grants and their respective option prices are shown as at 1 January 2008 or in the case of Mark Hanafin, at 14 July 2008, his date of appointment.

(v) Executive and past Directors' ESOS, SESOS and Sharesave grants and their respective option prices are shown as at 31 December 2008, and incorporate the impact of the Rights Issue, effective from 15 December 2008. Conditional awards, including ESOS, SESOS and Sharesave grants were subject to an adjustment to reflect the dilutive effect of the Rights Issue and the number of shares under option was multiplied by a factor of 1.1233 and the respective option price was multiplied by a factor of 0.8902.

(vi) The Committee exercised its discretion, in accordance with the rules of the ESOS, to permit Jake Ulrich to exercise his options up to six months from the third anniversary of the last date on which an option was granted ie at any time before 3 October 2009. All of his options are exercisable except those granted in 2006 which have not yet met the relevant performance conditions. Under the rules of the Sharesave his outstanding options were exercisable until 31 January 2009.

The closing price of a Centrica ordinary share on the last trading day of 2008 (31 December) was 266 pence. The range during the year was 207.50 pence (low) and 316 pence (high), (355 pence prior to adjustment for the bonus element of the Rights Issue).

Directors' pensions

Of the five Executive Directors who served during 2008, Phil Bentley and Jake Ulrich are members of the Centrica Pension Plan (CPP) which was formerly known as the Centrica Management Pension Scheme (CMPS). Mark Hanafin, Sam Laidlaw and Nick Luff, who all joined the Company in recent years, are not members of any of Centrica's pension schemes.

Centrica Pension Plan (CPP)

The CPP 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 guidelines. As a result of the changes introduced by Centrica following the 2004 Finance Act, benefits at 6 April 2006 from the registered scheme, the CPP, could not exceed the Lifetime Allowance (£1.5 million for the 2006/07 tax year) after taking account of retained benefits from all other sources notified to Centrica at this time. The CUPS provides any additional benefits in excess of the maximum amount that could be provided through the CPP on the members' uncapped pensionable earnings. The benefits that arise under CUPS 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 at 6 April 2006, 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 CPP (£)

	Accrued pension as at 31 December 2008 (i)	Accrued pension as at 31 December 2007	Increase in accrued pension less inflation (ii)	**Transfer value as at 31 December 2008 or at earlier date of leaving (iv)**	Transfer value as at 31 December 2007	**Contribution paid in 2008**	Difference in transfer value less contributions (iv)	Transfer value of increase in accrued pension excluding inflation
Phil Bentley	**146,000**	126,900	12,755	**1,309,300**	1,396,800	**34,200**	(122,420)	75,500
Jake Ulrich (iii)	**158,600**	212,600	(64,630)	**3,885,900**	3,200,500	**20,245**	665,155	–

(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 2008. The pension accrual rates for 2008 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 2007 by the rate of inflation (5.0%) and deducting this from the accrued pension as at 31 December 2008. The rate of inflation used was 5.0%, the annual rate to 30 September 2008, the date used for pension increases under the scheme.

(iii) Jake Ulrich retired on 31 July 2008. Under the rules of the CPP and CUPS Jake Ulrich (aged 55 years 5 months on leaving) was entitled to an actuarially reduced pension on the standard terms for a normal deferred leaver taking payment of their pension before normal retirement age.

(iv) The reduction in the transfer values less contributions at 31 December 2008 is due to the change in market conditions which determine the calculation of transfer values. A change in the transfer value calculation basis was also introduced in September 2008. Had the transfer value been calculated on the accrued pension at 31 December 2008 but using the calculation basis in force at 31 December 2007, the transfer value of the accrued pension would have amounted to £1,032,100 for Phil Bentley and £4,437,900 for Jake Ulrich. The difference in the transfer value less contributions would have amounted to (£399,620) for Phil Bentley and £1,217,155 for Jake Ulrich.

Pay in lieu of pension provision

Under the terms of their contracts of employment, Mark Hanafin, Sam Laidlaw and Nick Luff are entitled to a salary supplement in lieu of pension provision. Mark Hanafin and Sam Laidlaw are each entitled to 40% of base salary, while Nick Luff is entitled to 30% of base salary. With the exception of £232,500 paid directly by the Company into Sam Laidlaw's personal pension plan, these amounts are disclosed in the Directors' emoluments table on page 50.

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

Grant Dawson
General Counsel & Company Secretary
26 February 2009

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 2008 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 2008 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 (IFRS) 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 in to 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 Statement 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 – At a Glance, Financial Highlights, the Chairman's Statement, the Directors' Report, the unaudited part of the Directors' Remuneration 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 IFRS as adopted by the European Union, of the state of the Group's affairs as at 31 December 2008 and of its result 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

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
26 February 2009

Group Income Statement

Year ended 31 December	Notes	2008 Results for the year before exceptional items and certain re-measurements (i) £m	2008 Exceptional items and certain re-measurements (i) £m	2008 Results for the year £m	2007 (restated) (ii), (iii) Results for the year before exceptional items and certain re-measurements (i) £m	2007 (restated) (ii), (iii) Exceptional items and certain re-measurements (i) £m	2007 (restated) (ii), (iii) Results for the year £m
Continuing operations							
Group revenue (ii)	6	21,345	–	21,345	16,272	–	16,272
Cost of sales (ii)	7	(17,139)	–	(17,139)	(12,147)	–	(12,147)
Re-measurement of energy contracts (i)	6,8	–	(1,411)	(1,411)	–	244	244
Gross profit		4,206	(1,411)	2,795	4,125	244	4,369
Operating costs before exceptional items	7	(2,280)	–	(2,280)	(2,190)	–	(2,190)
Impairment of Oxxio goodwill and other assets	8	–	(67)	(67)	–	–	–
Operating costs		(2,280)	(67)	(2,347)	(2,190)	–	(2,190)
Share of profits in joint ventures and associates, net of interest and taxation (i)	6,8,18	16	(4)	12	14	(9)	5
Group operating profit	6	1,942	(1,482)	460	1,949	235	2,184
Interest income	10	658	–	658	258	–	258
Interest expense	10	(669)	–	(669)	(331)	–	(331)
Net interest expense	10	(11)	–	(11)	(73)	–	(73)
Profit from continuing operations before taxation		1,931	(1,482)	449	1,876	235	2,111
Taxation on profit from continuing operations	11	(1,027)	434	(593)	(753)	(60)	(813)
Profit/(loss) from continuing operations after taxation		904	(1,048)	(144)	1,123	175	1,298
Profit/(loss) from discontinued operations (i)		–	–	–	1	(19)	(18)
Gain on disposal of discontinued operations	8	–	–	–	–	227	227
Discontinued operations		–	–	–	1	208	209
Profit/(loss) for the year		904	(1,048)	(144)	1,124	383	1,507
Attributable to:							
Equity holders of the parent		903	(1,048)	(145)	1,122	383	1,505
Minority interests	31	1	–	1	2	–	2
		904	(1,048)	(144)	1,124	383	1,507
		Pence		Pence	Pence		Pence
Earnings/(loss) per ordinary share (iii)							
From continuing and discontinued operations:							
Basic	13			(3.5)			36.5
Adjusted basic	13	21.5			27.2		
Diluted	13			(3.5)			35.9
From continuing operations:							
Basic	13			(3.5)			31.4
Adjusted basic	13	21.5			27.2		
Diluted	13			(3.5)			30.9
Interim dividend paid per ordinary share (iii)	12			3.47			2.98
Final dividend proposed per ordinary share (iii)	12			8.73			8.59

(i) Certain re-measurements (notes 2 and 8) included within operating profit comprise re-measurement arising on 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 in 2007 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) Group revenue and cost of sales have been restated to report gas sales revenue of Centrica Storage net of cost of sales to better reflect the nature of the transactions as explained in note 2.
(iii) Earnings per ordinary share and dividend per ordinary share figures have been restated to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

The notes on pages 62 to 134 form part of these Financial Statements.

Group Balance Sheet

31 December	Notes	2008 £m	2007 £m
Non-current assets			
Goodwill	14	**1,510**	1,074
Other intangible assets	15	**671**	465
Property, plant and equipment	17	**4,680**	3,910
Interests in joint ventures and associates	18	**330**	285
Deferred tax assets	26	**311**	27
Trade and other receivables	20	**34**	33
Derivative financial instruments	21	**195**	72
Available-for-sale financial assets	28	**35**	39
Retirement benefit assets	34	**73**	152
		7,839	6,057
Current assets			
Inventories	19	**412**	241
Current tax assets	26	**39**	40
Trade and other receivables	20	**5,335**	3,423
Derivative financial instruments	21	**1,720**	914
Available-for-sale financial assets	28	**63**	50
Cash and cash equivalents	23	**2,939**	1,130
		10,508	5,798
Total assets		**18,347**	11,855
Current liabilities			
Trade and other payables	24	**(4,364)**	(3,371)
Current tax liabilities		**(365)**	(281)
Bank overdrafts, loans and other borrowings	25	**(330)**	(221)
Derivative financial instruments	21	**(3,932)**	(1,404)
Provisions for other liabilities and charges	27	**(29)**	(140)
		(9,020)	(5,417)
Net current assets		**1,488**	381
Non-current liabilities			
Trade and other payables	24	**(67)**	(20)
Bank loans and other borrowings	25	**(3,218)**	(1,793)
Derivative financial instruments	21	**(157)**	(11)
Deferred tax liabilities	26	**(448)**	(596)
Retirement benefit obligations	34	**(186)**	(55)
Provisions for other liabilities and charges	27	**(865)**	(581)
		(4,941)	(3,056)
Net assets		**4,386**	3,382
Equity			
Called up share capital	29,30	**315**	227
Share premium account	30	**729**	685
Merger reserve	30	**467**	467
Capital redemption reserve	30	**16**	16
Other reserves	30	**2,799**	1,928
Shareholders' equity	30	**4,326**	3,323
Minority interests in equity	31	**60**	59
Total minority interests and shareholders' equity		**4,386**	3,382

The Financial Statements on pages 58 to 134 were approved and authorised for issue by the Board of Directors on 26 February 2009 and were signed below on its behalf by:

Sam Laidlaw
Chief Executive

Nick Luff
Group Finance Director

The notes on pages 62 to 134 form part of these Financial Statements.

Group Statement of Recognised Income and Expense

Year ended 31 December	Notes	2008 £m	2007 £m
(Loss)/profit for the year		**(144)**	1,507
(Losses)/gains on revaluation of available-for-sale financial assets	30	**(19)**	1
(Losses)/gains on cash flow hedges	30	**(318)**	169
Exchange differences on translation of foreign operations	30	**(29)**	15
Actuarial (losses)/gains on defined benefit pension schemes	34	**(399)**	284
Tax on items taken directly to equity	30	**203**	(120)
Net (expense)/income recognised directly in equity		**(562)**	349
Transferred to income and expense on cash flow hedges	30	**(30)**	382
Transferred to assets and liabilities on cash flow hedges	30	**1**	–
Exchange differences transferred to income and expense on disposal of subsidiaries	30	**–**	(4)
Tax on items transferred from equity	30	**5**	(128)
Transfers		**(24)**	250
Total recognised income and expense for the year		**(730)**	2,106
Total income and expense recognised in the year is attributable to:			
Equity holders of the parent		**(731)**	2,104
Minority interests		**1**	2
		(730)	2,106

The notes on pages 62 to 134 form part of these Financial Statements.

Group Cash Flow Statement

Year ended 31 December	Notes	2008 £m	2007 £m
Operating cash flows before movements in working capital		**2,397**	2,494
(Increase)/decrease in inventories		**(143)**	38
(Increase)/decrease in trade and other receivables		**(1,377)**	181
Increase in trade and other payables		**425**	44
Cash generated from continuing operations		**1,302**	2,757
Income taxes paid		**(374)**	(341)
Net petroleum revenue tax paid		**(533)**	(60)
Interest received		**23**	27
Interest paid		**(47)**	(3)
Payments relating to exceptional charges		**(74)**	(90)
Net cash flow from continuing operating activities	32	**297**	2,290
Net cash flow from discontinued operating activities	32	**–**	67
Net cash flow from operating activities		**297**	2,357
Purchase of interests in subsidiary undertakings and businesses net of cash and cash equivalents acquired	35	**(395)**	(262)
Purchase of intangible assets	6	**(184)**	(185)
Disposal of intangible assets		**12**	14
Purchase of property, plant and equipment	6	**(626)**	(563)
Disposal of property, plant and equipment		**11**	76
Investments in joint ventures and associates		**–**	(45)
Repayments of loans to joint ventures and associates		**19**	–
Interest received		**63**	63
Net purchase of available-for-sale financial assets		**(22)**	(2)
Net cash flow from continuing investing activities		**(1,122)**	(904)
Net cash flow from discontinued investing activities		**–**	(60)
Net cash flow from investing activities		**(1,122)**	(964)
Issue of ordinary share capital (i)		**2,202**	22
Purchase of treasury shares		**(3)**	(2)
Interest paid in respect of finance leases		**(23)**	(110)
Other net interest paid		**(274)**	(114)
Net interest paid		**(297)**	(224)
Cash inflow from additional debt		**1,513**	256
Cash outflow from payment of capital element of finance leases		**(20)**	(383)
Cash outflow from repayment of other debt		**(175)**	(107)
Net cash flow from increase/(decrease) in debt		**1,318**	(234)
Realised net foreign exchange loss on cash settlement of derivative contracts		**(117)**	(8)
Equity dividends paid		**(500)**	(417)
Net cash flow from continuing financing activities		**2,603**	(863)
Net cash flow from discontinued financing activities		**–**	(25)
Net cash flow from financing activities		**2,603**	(888)
Net increase in cash and cash equivalents		**1,778**	505
Cash and cash equivalents at 1 January (ii)		**1,100**	592
Effect of foreign exchange rate changes		**26**	3
Cash and cash equivalents at 31 December (ii)	23	**2,904**	1,100

(i) On 15 December 2008 the Group raised £2,164 million of proceeds, net of £65 million of issue costs through a Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.
(ii) Cash and cash equivalents are stated net of overdrafts of £35 million (2007: £30 million).

The notes on pages 62 to 134 form part of these Financial Statements.

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 43. 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 34.

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 financial assets, 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 2008

In 2008 an amendment to IAS 39, Financial Instruments: Recognition and Measurement and IFRS 7, Financial Instruments: Disclosures was issued. The amendment was endorsed by the EU on 15 October 2008. The amendment permits entities to reclassify certain financial assets held for trading to either the held to maturity, loans and receivables or available-for-sale categories. The amendment also allows transfers of certain financial assets from available-for-sale to loans and receivables. The adoption of the amendment has had no impact on the Financial Statements of the Group.

Three interpretations issued by the International Financial Reporting Interpretations Committee are effective for the current period. These are IFRIC 11, IFRS 2 – Group and Treasury Share Transactions, IFRIC 12 Service Concession Arrangements and IFRIC 14, IAS 19 – The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction. The adoption of these interpretations has not led to any changes in the Group's accounting policies and has had no impact on the Financial Statements of the Group.

(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 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 will adopt IAS 23 (Amended) from 1 January 2009, which will require a change to the Group's existing accounting policy, where such costs are immediately expensed. The Group will adopt IAS 23 (Amended) retrospectively and apply a commencement date of 1 January 2008 for qualifying projects subject to borrowing cost capitalisation. Based on current investment plans, the estimated impact of adopting IAS 23 (Amended) in 2009 would be to capitalise approximately £30 million of borrowing costs directly attributable to the acquisition, construction and production of qualifying assets, resulting in an increase to the net book value of property, plant and equipment by approximately £30 million and a reduction to interest expense by approximately £30 million for the year ended 31 December 2009. The impact on comparatives would be an increase in the net book value of property, plant and equipment for borrowing costs capitalised and a reduction to interest expense of approximately £10 million;
- 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 adopt IFRS 8 with effect from 1 January 2009. The impact of adopting IFRS 8 on the Group is under assessment;
- 'Improvements to IFRSs' contains amendments to various existing standards. The amendments are effective, in most cases, from 1 January 2009, or otherwise for annual periods beginning on or after 1 July 2009. The impact of adopting 'Improvements to IFRSs' will result in the Group reclassifying certain derivative financial assets and certain derivative financial liabilities from current to non-current in the Group's Balance Sheet with effect from 1 January 2009;
- IFRS 3 (Revised), Business Combinations, effective for annual periods beginning on or after 1 July 2009 subject to EU endorsement. The revised standard continues to apply the acquisition method to business combinations with some significant changes. For example, all payments to purchase a business are to be recorded at fair value at acquisition date, with contingent payments classified as debt subsequently re-measured through the income statement. All acquisition-related costs should be expensed. There is a choice on an acquisition-by-acquisition basis to measure the non-controlling interest in

the acquiree at either fair value or at the non-controlling interest's proportionate share of the acquiree's net assets. The Group will adopt IFRS 3 (Revised) prospectively to all business combinations from 1 January 2010, subject to EU endorsement;

- IAS 27 (Revised), Consolidated and Separate Financial Statements, effective for annual periods beginning on or after 1 July 2009, subject to EU endorsement. The revised standard requires the effects of all transactions with non-controlling interests to be recorded in equity if there is no change in control and these transactions will no longer result in goodwill or gains and losses. The revised standard also specifies the accounting when control is lost. Any remaining interest in the entity is re-measured to fair value, and a gain or loss is recognised in profit or loss. The Group will apply IAS 27 (Revised) prospectively from 1 January 2010, subject to EU endorsement; and
- IFRIC 18, Transfers of Assets from Customers, issued on 29 January 2009, subject to EU endorsement. This interpretation clarifies the accounting for agreements in which an entity receives from a customer an item of property, plant and equipment that the entity must use either to connect the customer to a network or to provide the customer with ongoing access to a supply of goods or services, such as a supply of electricity or gas. It also applies to agreements in which an entity receives cash from a customer which must be used to acquire or construct the item of property, plant and equipment in order to connect the customer to a network or provide the customer with ongoing access to a supply of goods or services. IFRIC 18 requires entities to apply the interpretation prospectively to transfers of assets from customers received on or after 1 July 2009. The impact to the Group of adopting IFRIC 18 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 (Revised), Presentation of Financial Statements, effective from 1 January 2009;
- IAS 32 (Amendment), Financial Instruments: Presentation and IAS 1 (Amendment), Presentation of Financial Statements – Puttable financial instruments and obligations arising on liquidation, effective from 1 January 2009, subject to EU endorsement;
- IFRS 2 (Amendment), Share Based Payment – Vesting Conditions and Cancellations, effective from 1 January 2009;
- IFRIC 13, Customer Loyalty Programmes, effective for annual periods beginning on or after 1 July 2008;
- IFRIC 15, Agreements for the Construction of Real Estate, effective from 1 January 2009, subject to EU endorsement;
- IFRIC 16, Hedges of a Net Investment in a Foreign Operation, effective for annual periods beginning on or after 1 October 2008, subject to EU endorsement;
- IFRIC 17, Distributions of Non-cash Assets to Owners, effective for annual periods beginning on or after 1 July 2009, subject to EU endorsement;
- IFRS 1 (Amendment), First-time Adoption of IFRS, effective from 1 January 2009, subject to EU endorsement; and
- IAS 39 (Amendment), Financial Instruments: Recognition and Measurement – Eligible Hedged Items, effective for annual periods beginning on or after 1 July 2009, subject to EU endorsement.

(c) Changes of accounting presentation

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

- Centrica Storage enters into gas sales and gas purchases as part of its normal trading activity to optimise the performance of the storage facility. Sales and purchases relating to this optimisation activity are presented net within revenue. Previously the Group presented such activity gross within revenue and cost of sales with sales reported as revenue and purchases reported as cost of sales. The Directors consider the change of presentation better reflects the nature of this activity. The impact of the change of accounting presentation is to reduce Group revenue and cost of sales by £263 million in 2008. The impact on comparatives is to reduce Group revenue and cost of sales by £70 million.

(d) 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. 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 believes 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 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.

Notes to the Financial Statements continued

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. Gas purchases and gas sales entered into to optimise the performance of the gas storage facilities are presented net within revenue.

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. Gas purchases and gas sales entered into to optimise the performance of gas production facilities are presented net within revenue.

Power generation: Revenue is recognised on the basis of power supplied during the period. Power and gas purchases and power and gas sales entered into to optimise the performance of power generation facilities are presented net within revenue.

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.

Carbon Emissions Reduction Target programme (CERT)

UK licensed energy suppliers are set a carbon emission reduction target by the Government which is proportional to the size of their customer base. The current CERT programme runs from April 2008 to March 2011. The target is subject to an annual adjustment throughout the programme period to take account of changes to a UK licensed energy supplier's customer base. Energy suppliers can meet the target through expenditure on qualifying projects which give rise to carbon savings. The carbon savings can be transferred between energy suppliers. The Group charges the costs of the programme to cost of sales and capitalises costs incurred in deriving carbon savings in excess of the annual target as inventory which is valued at the lower of cost or net realisable value and which may be used to meet the carbon emissions reduction target in subsequent periods or be transferred to third parties. The inventory is carried on a first-in, first-out basis. The carbon emission reduction target for the programme period is allocated to reporting periods on a straight-line basis as adjusted by the annual determination process.

Employee share schemes

The Group operates a number of employee share schemes, detailed 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, RSS and ESPP	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 translated 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 or partial 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 translation of the opening net assets and the results are transferred to the Group's foreign currency translation reserve, a separate component of equity, and are reported in the Statement of 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.

Notes to the Financial Statements continued

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, 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 40 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 reassessed 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.

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. The present value of the defined benefit obligation/asset is determined by discounting the estimated future cash outflows using interest rates of high-quality corporate bonds that are denominated in the currency in which the benefits are paid, and that have terms of maturity approximating to the terms of the related pension liability.

Payments to defined contribution retirement benefit schemes are charged as an operating expense as they fall due.

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 arise 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 were 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) Available-for-sale 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 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.

At each balance sheet date the Group assesses whether there is objective evidence that available-for-sale financial assets are impaired. If any such evidence exists cumulative losses recognised in equity are removed from equity and recognised in profit and loss. The cumulative loss removed from equity represents the difference between the acquisition cost and current fair value, less any impairment loss on that financial asset previously recognised in profit or loss.

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.

Notes to the Financial Statements continued

(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.

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 41 to 42 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 reassessed 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).

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

Petroleum revenue tax (PRT)

The definitions of an income tax in IAS 12, Income Taxes, have led management to judge that PRT should be treated consistently with other 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.

The Consumers' Waterheater Income Fund

The Group 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 2006 the Trustees of the Fund appointed an independent Chief Executive Officer. The activities undertaken by the Fund started to change following this appointment. In 2007 the Trustees of the Fund sought further changes in the conduct of the Fund. 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 represented 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 judged that the Fund's activities were no longer predetermined such that its activities were being conducted on behalf of Centrica, and thus the Fund ceased to represent a subsidiary of the Centrica Group.

The Group 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 prior year have been presented as a discontinued operation distinct from continuing operations within the Group Income Statement.

(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 comprises both billed and unbilled revenue. It is estimated through the billing systems, using historical consumption patterns, on a customer by customer basis, taking into account weather patterns and the differences between actual meter reads being returned and system estimates. Actual meter reads continue to be compared to system estimates between the balance sheet date and the finalisation of the accounts. An assessment is also made of any factors that are likely to materially affect the ultimate economic benefits which will flow to the Group, including bill cancellation and re-bill rates. To the extent that the economic benefits are not expected to flow to the Group, the value of that 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 note 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 liquids 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 143.

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 2010 and 2062, with the substantial majority of the costs expected to be paid between 2019 and 2030.

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 in accordance with the Group's accounting policy described in note 2. This requires the determination of the recoverable amount of the cash-generating units to which goodwill and indefinite lived intangibles are allocated. The recoverable amounts are determined by either estimating the value in use of those cash-generating units or in the case of the Centrica Energy – Gas production and development cash-generating unit determining the fair value less costs to sell of the cash-generating unit. Value in use calculations requires the Group to make an estimate of the expected future cash flows to be derived from the cash-generating units and to choose a suitable discount rate in order to calculate the present value of those cash flows. The fair value less costs to sell methodology is deemed more appropriate for the Centrica Energy – Gas production and development cash-generating unit as it is based on post-tax cash flows arising from each field within the cash-generating unit, which is consistent with the approach taken by management in determining the economic value of the underlying assets. Fair value less costs to sell is determined by discounting the post-tax cash flows expected to be generated by the gas production and development assets within the Centrica Energy – Gas production and development cash-generating unit, net of associated selling costs, and takes into account assumptions market participants would use in estimating fair value. Further detail on the assumptions used in determining the value in use and fair value less costs to sell calculations is provided in note 16.

An impairment charge of £45 million arose on the European Energy – Oxxio cash-generating unit during the course of 2008 resulting in the carrying amount of goodwill being written down to its recoverable amount. Further detail on the impairment is provided in note 16.

Impairment of power generation and upstream gas assets

Power generation and upstream gas assets are assessed for indicators of impairment at each reporting date in accordance with the Group's accounting policies as described in note 2. If an indicator of impairment exists an assessment of the recoverable amount of the asset is required to be made. Indicators of impairment for these assets may include, but are not limited to, the following:

- Reductions in reserve estimates or profiles of production;
- Declines in long-term commodity prices;
- Increases in capital expenditure or acceleration of known capital expenditure;
- Significant unplanned outages or problems with operational performance; and
- Changes in regulatory or tax environments.

The recoverable amount of power generation and upstream gas assets is usually assessed with reference to each individual asset's value in use. The value in use is based on the pre-tax cash flows expected to be generated by the asset and is dependent on views of forecast generation/production, forecast commodity prices (using market prices where available and internal estimates for the remainder of the period) and the timing and extent of capital expenditure.

For gas fired power stations, which have a high degree of production flexibility, the value in use calculation also includes a scenario based statistical assessment of the additional value which can be generated from optimising production to take advantage of volatile forward prices. Pre-tax cash flows for the first three years are based on the Group's internal Board-approved three-year business plans and thereafter are estimated on a consistent basis to reflect cash flows up to the date of cessation of operation of the asset. Pre-tax cash flows are discounted using an appropriate pre-tax discount rate which is derived from the Group's weighted average cost of capital. The carrying values of the Group's power generation and upstream gas assets are included within note 17.

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 41 to 42.

During 2008, there was significant volatility in commodity prices and a continuing shortage of available credit in the market. In addition, many of the markets in which the Group operates are experiencing a slowing of growth or, in some cases, economic contraction. As a result of these external market factors, the Group is encountering an increase in commodity price risk, credit risk and liquidity risk compared with that experienced at the end of 2007. The Group continues to manage these risks in accordance with its financial risk management processes and did not incur any additional significant cash costs as a result of the increased commodity, credit or liquidity risk experienced in 2008.

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 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 is carried out by a central Group Treasury function in accordance with the Group's financing and treasury policy, as approved by the Board. The credit risks associated with commodity trading and treasury positions are managed in accordance with the Group's counterparty credit policy. Downstream credit risk management is carried out in accordance with individual 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, equity 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 activities to commodity price risk according to IFRS 7, Financial Instruments: Disclosures. 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, only those energy contracts within the scope of IAS 39 are within the scope of the IFRS 7 disclosure requirements.

4. FINANCIAL RISK MANAGEMENT CONTINUED

The increase in commodity prices in the six months ended 30 June 2008 resulted in significant mark-to-market gains on certain energy procurement contracts where the purchase price had been locked in by contract. Commodity prices have since fallen from their levels at 30 June 2008, resulting in significant mark-to-market losses for the year on contracts locked-in during the year at the higher prices. The net loss of £1,415 million (2007: gain of £235 million) on the re-measurement of energy contracts largely represents unrealised mark-to-market loss created by gas and power purchase contracts which are priced above the current wholesale market value of energy. This loss is calculated with reference to forward energy prices and therefore the extent of the economic loss arising over the life of these contracts is uncertain and is entirely dependent upon the level of future wholesale energy prices. Generally, subject to short-term balancing, the ultimate net charge to cost of sales will be consistent with the price of energy agreed in these contracts and the fair value adjustments will reverse as the energy is supplied over the life of the contract.

The carrying value of energy contracts used in energy procurement and downstream activities at 31 December 2008 is disclosed in note 21. 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).

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 2008 was £1 million (2007: £9 million). The carrying value of energy contracts used in proprietary energy trading activities at 31 December 2008 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, New Zealand 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 2008, there were no material unhedged non-functional currency monetary assets or liabilities, firm commitments or probable forecast transactions (2007: £nil), other than foreign currency borrowings used to hedge translational exposures.

4. FINANCIAL RISK MANAGEMENT CONTINUED

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 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 and interest rates) 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 2008 assuming that a reasonably possible change in the relevant risk variable had occurred at 31 December 2008 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. Reasonably possible changes in market variables used in the sensitivity analysis are based on implied volatilities, where available, or historical data for energy prices and foreign exchange rates. Reasonably possible changes in interest rates are based on management judgement and historical experience.

The sensitivity analysis has been prepared based on 31 December 2008 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 2008 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 includes 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 and foreign currency 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).

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	2008 Base price (i)	2008 Reasonably possible change in variable	2007 Base price (i)	2007 Reasonably possible change in variable
UK gas (p/therm)	**56**	**+/-14**	51	+/-12
UK power (£/MWh)	**53**	**+/-9**	52	+/-11
UK coal (US$/tonne)	**93**	**+/-24**	101	+/-15
UK emissions (€/tonne)	**16**	**+/-4**	24	+/-5
UK oil (US$/bbl)	**58**	**+/-15**	88	+/-14
North American gas (p/therm)	**48**	**+/-11**	38	+/-4
North American power (£/MWh)	**41**	**+/-6**	28	+/-5
European power (£/MWh)	**61**	**+/-9**	–	–

(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)	2008 Impact on profit £m	2008 Impact on equity £m	2007 Impact on profit £m	2007 Impact on equity £m
UK energy prices (combined) – increase/decrease	**326/(322)**	**90/(90)**	34/(34)	56/(56)
North American energy prices (combined) – increase/decrease	**25/(25)**	**27/(27)**	103/(103)	54/(54)
European energy prices (combined) – increase/decrease	**44/(44)**	**–/–**	–/–	–/–

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)	2008 Reasonably possible change in variable %	2008 Impact on profit £m	2008 Impact on equity £m	2007 Reasonably possible change in variable %	2007 Impact on profit £m	2007 Impact on equity £m
UK interest rates	**+/-1.00**	**16/(16)**	**19/(23)**	+/-0.50	5/(5)	(4)/4
US interest rates	**+/-1.00**	**(2)/2**	**(12)/14**	+/-0.50	–/–	(2)/2
Canadian interest rates	**+/-1.00**	**–/–**	**–/–**	+/-0.50	(2)/2	–/–
Euro interest rates	**+/-1.00**	**3/(3)**	**–/–**	+/-0.50	–/–	–/–
Japanese interest rates	**+/-1.00**	**–/–**	**(17)/23**	+/-0.50	–/–	(1)/1
New Zealand interest rates	**+/-1.00**	**(2)/2**	**–/–**	+/-0.50	(1)/1	–/–

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:

Foreign exchange rates and incremental profit/(loss)	2008 Reasonably possible change in variable %	2008 Impact on profit £m	2008 Impact on equity £m	2007 Reasonably possible change in variable %	2007 Impact on profit £m	2007 Impact on equity £m
US dollar	**+/-10**	**(46)/45**	**(12)/12**	+/-10	(32)/28	(14)/12
Canadian dollar	**+/-10**	**(3)/1**	**(31)/28**	+/-10	(3)/1	(12)/10
Euro	**+/-10**	**3/(2)**	**(20)/17**	+/-10	1/(1)	(18)/17
Japanese yen	**+/-10**	**–/–**	**3/(2)**	+/-10	–/–	1/–
New Zealand dollar	**+/-10**	**(10)/10**	**–/–**	+/-10	–/–	–/–
Norwegian krone	**+/-10**	**–/–**	**(4)/3**	+/-10	2/(2)	–/–

4. FINANCIAL RISK MANAGEMENT CONTINUED

(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. During 2008, there has been a continuing shortage of available credit in the market. In addition, many of the markets in which the Group operates are experiencing a slowing of growth or, in some cases, economic contraction. As a result of these external market factors, the Group is encountering an increase in credit risk compared with that experienced at the end of 2007. The Group continues to manage credit risk in accordance with its financial risk management processes and has not incurred any additional significant credit losses as a result of the increased credit risk.

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.

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 and going concern

Liquidity risk is the risk that the Group is unable to meet its financial obligations as they fall due. The Group can incur significant movements in its liquidity position due particularly to the seasonal nature of its business and margin cash arrangements associated with certain wholesale commodity contracts.

The Group's liquidity position has been particularly volatile during 2008 as significant volatility in commodity prices has seen large increases in cash required to fund working capital and margin cash balances. At 31 December 2008, the Group was holding £43 million (2007: £93 million) of cash as collateral against counterparty balances, and had pledged £669 million (2007: £118 million) of cash as collateral, principally under margin calls to cover exposure to mark-to-market positions on derivative contracts representing a net cash outflow during the year of £556 million (2007: £2 million inflow), write-offs of pledged balances of £22 million (2007: £nil), acquisition of cash collateral balances held of £33 million (2007: £nil) and exchange adjustments of £100 million (2007: £5 million). Generally, cash paid or received as collateral is interest-bearing and is free from any restriction over its use by the holder. To mitigate this risk the Group holds cash on deposit and maintains significant committed facilities.

The Group closely monitors, and has a number of treasury policies to manage its liquidity risk. Cash forecasts identifying the Group's liquidity requirements are produced regularly and are stress-tested for different scenarios including, but not limited to, reasonably possible increases or decreases in commodity prices and the potential cash implications of a ratings downgrade. The Group seeks to ensure that sufficient financial headroom exists for at least a 12-month period to safeguard the Group's ability to continue as a going concern. It is the Group's policy to maintain committed facilities of at least £1,200 million less available surplus cash resources, to raise at least 75% of its net debt (excluding non-recourse debt) over £200 million in the long-term debt market and to maintain an average term to maturity in the recourse long-term debt portfolio greater than five years.

4. FINANCIAL RISK MANAGEMENT CONTINUED

At 31 December 2008, the Group held £2,939 million (2007: £1,130 million) of cash and cash equivalents, had undrawn committed bank borrowing facilities of £1,350 million (2007: £1,300 million), plus a committed letter of credit facility for Canadian $200 million (2007: C$nil) made available to the Direct Energy business in North America of which Canadian $146 million was drawn at 31 December 2008 (2007: C$nil), 367% (2007: 321%) of the Group's net debt over £200 million has been raised in the long-term debt market and the average term to maturity of the long-term debt portfolio was 9.3 years (2007: 7.1 years).

The relatively high level of available cash resources and undrawn committed bank borrowing facilities has enabled the Directors to conclude that the Group has sufficient headroom to continue as a going concern. The statement of going concern is included in the Directors' Report – Governance, on page 42.

The Group's liquidity position at 31 December 2008 was significantly improved by the proceeds of the Rights Issue which completed in December 2008. The Rights Issue was undertaken in the expectation of acquiring a 25% stake in Lake Acquisitions Limited, the owner of the British Energy Group plc, from Electricité de France S.A. The Group will reassess its liquidity position before committing to any acquisition and would seek to finance any transaction with the Rights Issue proceeds, additional debt and, possibly, the sale of certain assets.

Maturities of derivative financial liabilities, trade and other payables, bank borrowings and provisions are provided in notes 21, 24, 25 and 27, respectively. Details of commitments and contingencies are provided in note 36 and details of undrawn committed bank borrowing facilities are provided in note 25.

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 2008, the Group's long-term credit rating was A3 stable outlook for Moody's Investor Services Inc. (2007: A3 stable outlook) and A negative outlook for Standard & Poor's Rating Services (2007: A negative outlook).

The Group monitors capital, using a medium term view of three to five 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. 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.

During the year, the Group raised proceeds of approximately £2,164 million, net of issue costs of approximately £65 million, through a three for eight Rights Issue of new ordinary shares at 160 pence per share, representing a bonus to existing shareholders of 0.1233 ordinary shares per ordinary share held based on the closing share price of 267.75 pence per ordinary share on 21 November 2008, the last day the shares traded cum-rights. Centrica and Electricité de France S.A. (EDF) announced that they were in discussions in relation to an option for Centrica to acquire a 25% interest in British Energy Group plc. Centrica and EDF continue these discussions. Centrica would seek to finance any transaction with the Rights Issue proceeds, additional debt and, possibly, the sale of certain assets. If Centrica does not acquire an interest in British Energy Group, Centrica would evaluate the use of funds for other acquisition opportunities that meet its vertical integration objective, for general corporate purposes or for returns to shareholders with a view to maintaining an appropriate capital structure and maximising long-term shareholder value. On 13 January 2009, Standard & Poor's Rating Services placed the Group's long-term credit rating on CreditWatch with negative implications reflecting the increased likelihood of the Group completing this transaction and the impact on the financial risk of the Group. Standard & Poor's Rating Services has stated that any downgrade of the Group's credit rating was likely to be limited to one notch.

Notes to the Financial Statements continued

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 34.

Year ended 31 December	2008			2007 (restated) (iv)		
(a) Revenue	Gross segment revenue £m	Less inter-segment revenue (i),(ii),(iii) £m	Group revenue £m	Gross segment revenue £m	Less inter-segment revenue (i),(ii),(iii) £m	Group revenue £m
Continuing operations:						
British Gas Residential	**7,769**	**–**	**7,769**	6,457	–	6,457
British Gas Business	**3,063**	**–**	**3,063**	2,431	–	2,431
British Gas Services	**1,349**	**–**	**1,349**	1,279	–	1,279
British Gas	**12,181**	**–**	**12,181**	10,167	–	10,167
Gas production and development (i)	**1,784**	**(1,318)**	**466**	923	(624)	299
Power generation (i)	**1,264**	**(595)**	**669**	880	(578)	302
Industrial and commercial (ii)	**1,522**	**(486)**	**1,036**	838	–	838
Accord energy trading (iii)	**61**	**(12)**	**49**	24	(12)	12
Centrica Energy	**4,631**	**(2,411)**	**2,220**	2,665	(1,214)	1,451
Centrica Storage (i),(iv)	**280**	**(59)**	**221**	327	(57)	270
Direct Energy	**5,824**	**–**	**5,824**	3,992	–	3,992
European Energy (i)	**890**	**(1)**	**889**	395	(3)	392
Other operations (v)	**10**	**–**	**10**	–	–	–
	23,816	**(2,471)**	**21,345**	17,546	(1,274)	16,272
Discontinued operations:						
The Consumers' Waterheater Income Fund	**–**	**–**	**–**	42	–	42
	–	**–**	**–**	42	–	42

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

Year ended 31 December	2008 £m	2007 (restated) (iv) £m
Sale of goods (iv)	**19,575**	14,551
Rendering of services	**1,729**	1,693
Other income	**41**	28
Group revenue	**21,345**	16,272

(i) Inter-segment revenue reflects the level of revenue generated on sales to other Group segments on an arm's length basis. During the second half of 2008, Gas production and development began to sell gas downstream at forward market prices. Prior to this, Gas production and development sold all gas produced at month ahead prices. This change resulted in an additional £54 million of net revenue being reported in Gas production and development in 2008 than would have been reported had Gas production and development continued to sell gas downstream at month ahead prices.
(ii) Inter-segment revenue in the Industrial and commercial segment reflects the sale of upstream gas produced or procured to other Group segments on an arm's length basis. Prior to 2008, the Group's downstream businesses procured gas directly from Gas production and development or external counterparties.
(iii) 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.
(iv) Gross segment revenue, inter-segment revenue and Group revenue have been restated to report gas sales revenue of Centrica Storage net of cost of sales to better reflect the nature of the transactions as explained in note 2.
(v) Other operations comprise British Gas New Energy, Group Treasury, Group Property, Information Services and other shared services.

6. SEGMENTAL ANALYSIS CONTINUED

Year ended 31 December	Operating profit/(loss) before exceptional items and certain re-measurements		Exceptional items (note 8)		Certain re-measurements (note 8)		Operating profit/(loss) after exceptional items and certain re-measurements	
(b) Operating profit	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Continuing operations:								
British Gas Residential	**379**	571	**–**	–	**(787)**	39	**(408)**	610
British Gas Business	**143**	120	**–**	–	**(233)**	317	**(90)**	437
British Gas Services	**195**	151	**–**	–	**–**	–	**195**	151
British Gas	**717**	842	**–**	–	**(1,020)**	356	**(303)**	1,198
Gas production and development [(i)]	**1,164**	429	**–**	–	**55**	(16)	**1,219**	413
Power generation	**7**	46	**–**	–	**(8)**	(43)	**(1)**	3
Industrial and commercial	**(329)**	179	**–**	–	**104**	(95)	**(225)**	84
Accord energy trading	**37**	9	**–**	–	**(1)**	(3)	**36**	6
Centrica Energy	**879**	663	**–**	–	**150**	(157)	**1,029**	506
Centrica Storage	**195**	240	**–**	–	**7**	(8)	**202**	232
Direct Energy	**215**	187	**–**	–	**(465)**	53	**(250)**	240
European Energy [(ii)]	**(56)**	17	**(67)**	–	**(87)**	(9)	**(210)**	8
Other operations [(iii)]	**(8)**	–	**–**	–	**–**	–	**(8)**	–
	1,942	1,949	**(67)**	–	**(1,415)**	235	**460**	2,184
Discontinued operations:								
The Consumers' Waterheater Income Fund	**–**	39	**–**	227	**–**	–	**–**	266

Year ended 31 December	Share of results of joint ventures and associates net of interest and taxation		Depreciation of property, plant and equipment		Amortisation, write-downs and impairments of intangibles	
(c) Included within operating profit	**2008 £m**	2007 £m	**2008 £m**	2007 £m	**2008 £m**	2007 £m
Continuing operations:						
British Gas Residential	**–**	–	**10**	16	**26**	27
British Gas Business	**–**	–	**3**	3	**8**	19
British Gas Services	**–**	–	**13**	13	**5**	4
British Gas	**–**	–	**26**	32	**39**	50
Gas production and development	**–**	–	**280**	250	**21**	8
Power generation	**9**	4	**101**	93	**31**	1
Industrial and commercial	**–**	–	**1**	1	**2**	–
Accord energy trading	**–**	–	**–**	–	**–**	–
Centrica Energy	**9**	4	**382**	344	**54**	9
Centrica Storage	**–**	–	**22**	24	**–**	–
Direct Energy	**–**	–	**75**	62	**14**	15
European Energy	**3**	1	**2**	2	**12**	10
Other operations [(iii)]	**–**	–	**8**	9	**10**	8
	12	5	**515**	473	**129**	92
Discontinued operations:						
The Consumers' Waterheater Income Fund	**–**	–	**–**	21	**–**	1

(i) During the second half of 2008, Gas production and development began to sell gas downstream at forward market prices. Prior to this, Gas production and development sold all gas produced at month ahead prices. This change resulted in an additional £54 million of operating profit being reported in Gas production and development in 2008 than would have been reported had Gas production and development continued to sell gas downstream at month ahead prices.

(ii) During 2008, exceptional charges of £67 million were incurred in the European Energy segment, including a £45 million impairment of the Oxxio goodwill, explained in note 16, and a £22 million impairment of a receivable balance in Oxxio relating to historic overpayments of regulatory energy revenue tax, reflecting the reduced likelihood of realising the balance in the future.

(iii) Other operations comprise British Gas New Energy, Group Treasury, Group Property, Information Services and other shared services. 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.

6. SEGMENTAL ANALYSIS CONTINUED

(d) Assets and liabilities

31 December	Segment assets 2008 £m	Segment assets 2007 £m	Segment liabilities 2008 £m	Segment liabilities 2007 £m	Net segment assets/(liabilities) 2008 £m	Net segment assets/(liabilities) 2007 £m	Average capital employed Year ended 31 December (iii) 2008 £m	Average capital employed Year ended 31 December (iii) 2007 £m
British Gas Residential (i)	**2,281**	1,035	**(2,907)**	(1,063)	**(626)**	(28)	**318**	400
British Gas Business (i)	**1,129**	817	**(852)**	(430)	**277**	387	**506**	418
British Gas Services	**239**	258	**(149)**	(167)	**90**	91	**75**	67
British Gas	**3,649**	2,110	**(3,908)**	(1,660)	**(259)**	450	**899**	885
Gas production and development	**1,975**	1,576	**(747)**	(480)	**1,228**	1,096	**731**	678
Power generation	**2,135**	2,173	**(88)**	(272)	**2,047**	1,901	**1,545**	1,422
Industrial and commercial (i)	**592**	1,532	**(703)**	(1,889)	**(111)**	(357)	**(165)**	(80)
Accord energy trading	**3,765**	1,243	**(3,560)**	(1,377)	**205**	(134)	**(254)**	34
Centrica Energy	**8,467**	6,524	**(5,098)**	(4,018)	**3,369**	2,506	**1,857**	2,054
Centrica Storage	**688**	503	**(272)**	(189)	**416**	314	**344**	350
Direct Energy	**3,994**	2,560	**(2,043)**	(993)	**1,951**	1,567	**1,910**	1,844
European Energy	**742**	432	**(421)**	(113)	**321**	319	**391**	292
Other operations (ii)	**317**	99	**(541)**	(295)	**(224)**	(196)	**(93)**	(106)
	17,857	12,228	**(12,283)**	(7,268)	**5,574**	4,960	**5,308**	5,319
Deferred tax assets/(liabilities)	**311**	27	**(448)**	(596)	**(137)**	(569)		
Current tax assets/(liabilities)	**39**	40	**(365)**	(281)	**(326)**	(241)		
Short-term deposits and other financial assets	**2,950**	1,166	**–**	–	**2,950**	1,166		
Bank overdrafts and loans	**–**	–	**(3,548)**	(2,014)	**(3,548)**	(2,014)		
Retirement benefit assets/(obligations)	**73**	152	**(186)**	(55)	**(113)**	97		
Other	**4**	7	**(18)**	(24)	**(14)**	(17)		
Non-operating assets/(liabilities)	**3,377**	1,392	**(4,565)**	(2,970)	**(1,188)**	(1,578)		
	21,234	13,620	**(16,848)**	(10,238)	**4,386**	3,382		
Less inter-segment (receivables)/payables	**(2,887)**	(1,765)	**2,887**	1,765	**–**	–		
	18,347	11,855	**(13,961)**	(8,473)	**4,386**	3,382		

(i) 2008 segment assets include the allocation of mark-to-market assets to British Gas Residential of £824 million and mark-to-market liabilities to British Gas Residential of £1,643 million and British Gas Business of £291 million from Industrial and commercial. In 2007, mark-to-market assets and liabilities were retained in Industrial and commercial.
(ii) Other operations comprise assets and liabilities of British Gas New Energy, Group Treasury, Group Property, Information Services, GF One Limited, GF Two Limited and other shared services.
(iii) 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:

	2008 £m	2007 £m
Net segment assets at 31 December	**5,574**	4,960
Add back/(deduct):		
Net derivative financial liabilities	**2,174**	429
Net power generation assets under construction and gas and storage assets under development	**(815)**	(563)
Cash at bank, in transit and in hand	**(87)**	(53)
Effect of averaging month-end balances	**(1,538)**	546
Average capital employed for year ended 31 December	**5,308**	5,319

6. SEGMENTAL ANALYSIS CONTINUED

Year ended 31 December (e) Capital expenditure	Capital expenditure on property, plant and equipment (note 17) 2008 £m	2007 £m	Capital expenditure on intangible assets other than goodwill (note 15) (ii) 2008 £m	2007 £m
British Gas Residential	15	3	13	2
British Gas Business	1	–	6	6
British Gas Services	16	16	–	3
British Gas	32	19	19	11
Gas production and development	169	117	12	15
Power generation	299	344	264	104
Industrial and commercial	–	7	4	2
Accord energy trading	–	–	–	–
Centrica Energy	468	468	280	121
Centrica Storage	23	19	2	1
Direct Energy	92	99	21	29
European Energy	9	12	15	10
Other operations (i)	7	11	2	9
Additions	631	628	339	181
Decrease in prepayments related to capital expenditure	(24)	(39)	–	–
Capital expenditure of discontinued operations	–	(26)	–	–
Decrease/(increase) in trade payables related to capital expenditure	19	–	(155)	4
Net cash outflow	626	563	184	185

(i) Other operations comprise British Gas New Energy, Group Treasury, Group Property, Information Services and other shared services.
(ii) See note 35 for additions to goodwill.

(ii) Secondary reporting format – geographical segments

The Group operates in three main geographical areas:

Year ended 31 December	Revenue (based on location of customer) 2008 £m	2007 (restated) (i) £m	Total assets (based on location of assets) At 31 December 2008 £m	2007 £m	Capital expenditure on property, plant and equipment (note 17) (based on location of assets) 2008 £m	2007 £m	Capital expenditure on intangible assets other than goodwill (note 15) (based on location of assets) (ii) 2008 £m	2007 £m
Continuing operations:								
UK	14,612	11,884	13,076	8,823	529	516	295	134
North America	5,824	3,992	4,051	2,576	92	99	21	29
Rest of world	909	396	1,220	456	10	13	23	18
	21,345	16,272	18,347	11,855	631	628	339	181

(i) Restated to reflect gas sales revenue of Centrica Storage net of cost of sales to better reflect the nature of the transactions as explained in note 2.
(ii) See note 35 for additions to goodwill.

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7. COSTS OF CONTINUING OPERATIONS

Analysis of costs by nature	2008 £m	2007 (restated) (i) £m
Transportation, distribution and metering costs	**(3,000)**	(2,775)
Commodity costs	**(12,240)**	(7,670)
Depreciation, amortisation and write-downs	**(451)**	(415)
Employee costs	**(451)**	(415)
Other costs relating to energy consumption and provision of services	**(997)**	(872)
Total cost of sales	**(17,139)**	(12,147)
Depreciation, amortisation and write-downs	**(193)**	(150)
Employee costs	**(922)**	(901)
Loss on disposal of property, plant and equipment and other intangible assets	**–**	(7)
Profit on disposal of businesses	**–**	2
Impairment of trade receivables (note 20)	**(237)**	(184)
Foreign exchange gains	**1**	–
Other operating costs	**(929)**	(950)
Total operating costs before exceptional items	**(2,280)**	(2,190)
Exceptional items (note 8)	**(67)**	–
Total operating costs	**(2,347)**	(2,190)

(i) Cost of sales has been restated to report gas sales revenue of Centrica Storage net of cost of sales to better reflect the nature of the transactions as explained in note 2.

Auditors' remuneration	2008 £m	2007 £m
Fees payable to the Company's auditors for the audit of the Company's annual accounts and Group consolidation	**2.2**	2.2
The auditing of other accounts within the Group pursuant to legislation (including that of countries and territories outside the UK) (i)	**1.3**	1.2
Total fees related to audit of parent and subsidiary entities	**3.5**	3.4
Fees payable to the Company's auditors and its associates for other services:		
Other services pursuant to legislation (i)	**0.9**	0.5
Services related to information technology	**0.2**	–
Services related to corporate finance transactions entered into or proposed to be entered into by or on behalf of the company or any of its associates	**0.4**	–
All other services	**0.8**	0.5
	5.8	4.4
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.

8. EXCEPTIONAL ITEMS AND CERTAIN RE-MEASUREMENTS

(a) Exceptional items (note 2)	2008 £m	2007 £m
Continuing operations:		
Impairment of Oxxio goodwill and other assets (i)	(67)	–
Discontinued operations:		
Profit on disposal of The Consumers' Waterheater Income Fund (ii)	–	227

(i) During 2008, exceptional charges of £67 million were incurred in the European Energy segment, including a £45 million impairment of the Oxxio goodwill, explained in note 16, and a £22 million impairment of a receivable balance in Oxxio relating to historic overpayments of regulatory energy revenue tax, reflecting the reduced likelihood of realising the balance in the future.
(ii) The Group deconsolidated the Fund with effect from 1 December 2007 recognising an exceptional profit on disposal amounting to £227 million in 2007.

(b) Certain re-measurements (note 2)	2008 £m	2007 £m
Certain re-measurements recognised in relation to energy contracts		
Net gains arising on delivery of contracts (i)	10	352
Net losses arising on market price movements and new contracts (ii)	(1,417)	(95)
Net losses arising on positions in relation to cross-border transportation or capacity contracts (iii)	(4)	(13)
Net re-measurement of energy contracts included within gross profit	(1,411)	244
Net losses arising on re-measurement of joint ventures' energy contracts (iv)	(4)	(9)
Net re-measurement included within Group operating profit	(1,415)	235
Taxation on certain re-measurements	434	(60)
Net re-measurement after taxation	(981)	175
Discontinued operations:		
Fair value losses arising on re-measurement of the publicly traded units of The Consumers' Waterheater Income Fund	–	(19)
Total certain re-measurements	(981)	156

(i) As energy is delivered or consumed from previously contracted positions, the related fair value recognised in the opening balance sheet (representing the discounted 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 certain re-measurements relating to the energy procurement activities of joint ventures.

9. DIRECTORS AND EMPLOYEES

(a) Employee costs	2008 £m	2007 £m
Wages and salaries	1,147	1,078
Social security costs	88	88
Other pension and retirement benefits costs	109	123
Share scheme costs	35	31
	1,379	1,320
Capitalised employee costs	(6)	(4)
Employee costs recognised in the Group Income Statement	1,373	1,316

Details of Directors' remuneration, share-based payments and pension entitlements in the Remuneration Report on pages 44 to 55 form part of these Financial Statements. Details of employee share-based payments are given in note 33. Details of the remuneration of key management personnel are given in note 37.

9. DIRECTORS AND EMPLOYEES CONTINUED

(b) Average number of employees during the year

	2008 Number	2007 Number
British Gas Residential	**8,077**	9,227
British Gas Business	**2,065**	2,008
British Gas Services	**15,412**	15,186
Centrica Energy	**1,152**	1,053
Centrica Storage	**199**	191
Direct Energy	**4,991**	4,839
European Energy	**253**	214
Other operations	**668**	1,190
	32,817	33,908
UK	**27,538**	28,829
North America	**4,991**	4,839
Rest of world	**288**	240
	32,817	33,908

10. NET INTEREST

	2008 Interest expense £m	2008 Interest income £m	2008 Total £m	2007 Interest expense £m	2007 Interest income £m	2007 Total £m
Continuing operations						
Cost of servicing net debt						
Interest income	**–**	**106**	**106**	–	95	95
Interest expense on bank loans and overdrafts	**(128)**	**–**	**(128)**	(109)	–	(109)
Interest expense on finance leases (i)	**(23)**	**–**	**(23)**	(87)	–	(87)
	(151)	**106**	**(45)**	(196)	95	(101)
(Losses)/gains on revaluation						
(Losses)/gains on fair value hedges	**(82)**	**81**	**(1)**	(6)	5	(1)
Fair value (losses)/gains on other derivatives (ii)	**(396)**	**47**	**(349)**	(89)	24	(65)
Net foreign exchange translation of monetary assets and liabilities (iii)	**–**	**345**	**345**	–	58	58
	(478)	**473**	**(5)**	(95)	87	(8)
Other interest						
Notional interest arising on discounted items	**(20)**	**59**	**39**	(20)	55	35
Interest on cash collateral balances	**(20)**	**5**	**(15)**	(1)	6	5
Interest on supplier early payment arrangements	**–**	**15**	**15**	–	15	15
Other interest (iv)	**–**	**–**	**–**	(19)	–	(19)
	(40)	**79**	**39**	(40)	76	36
Interest (expense)/income	**(669)**	**658**	**(11)**	(331)	258	(73)

(i) 2007 includes £40 million of net interest expense incurred on termination of the Humber finance lease.
(ii) Primarily reflects changes in the fair value of derivatives used to hedge the foreign exchange exposure associated with inter-company loans denominated in foreign currencies.
(iii) Primarily reflects foreign exchange gains on inter-company loans denominated in foreign currencies.
(iv) In 2007 the Group reached an 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	2008 Results for the year before exceptional items and certain re-measurements £m	2008 Exceptional items and certain re-measurements £m	2008 Results for the year £m	2007 Results for the year before exceptional items and certain re-measurements £m	2007 Exceptional items and certain re-measurements £m	2007 Results for the year £m
The tax charge comprises:						
Current tax						
UK corporation tax	**398**	**5**	**403**	309	–	309
UK petroleum revenue tax	**517**	**–**	**517**	200	–	200
Foreign tax	**24**	**2**	**26**	48	2	50
Adjustments in respect of prior years	**(20)**	**–**	**(20)**	4	–	4
Total current tax	**919**	**7**	**926**	561	2	563
Deferred tax						
Current year (i)	**165**	**(236)**	**(71)**	253	53	306
Adjustments in respect of prior years	**(8)**	**–**	**(8)**	(19)	–	(19)
Change in tax rates (ii)	**(1)**	**–**	**(1)**	(9)	–	(9)
UK petroleum revenue tax	**(52)**	**–**	**(52)**	(32)	–	(32)
Foreign deferred tax	**4**	**(205)**	**(201)**	(1)	5	4
Total deferred tax	**108**	**(441)**	**(333)**	192	58	250
Total tax on profit from continuing operations	**1,027**	**(434)**	**593**	753	60	813

(i) The Finance Act 2008 changed the rules concerning loss relief on decommissioning costs and, as a result of this change, the current year deferred tax charge is stated net of a £55 million credit in respect of previously unrecognised deferred tax assets.
(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 and a further credit of £1 million in 2008. 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 2008 was £nil (2007: charge of £3 million).

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 was 28.5% for 2008 (2007: 30%). Additional charges of 21.5% (2007: 20%) are applicable on the Group's UK upstream profits. Taxation for other jurisdictions is calculated at the rates prevailing in those respective jurisdictions.

(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:

	2008 Results for the year before exceptional items and certain re-measurements £m	2008 Exceptional items and certain re-measurements £m	2008 Results for the year £m	2007 Results for the year before exceptional items and certain re-measurements £m	2007 Exceptional items and certain re-measurements £m	2007 Results for the year £m
Profit from continuing operations before tax	**1,931**	**(1,482)**	**449**	1,876	235	2,111
Less: share of profits in joint ventures and associates, net of interest and taxation	**(16)**	**4**	**(12)**	(14)	9	(5)
Group profit from continuing operations before tax	**1,915**	**(1,478)**	**437**	1,862	244	2,106
Tax on profit from continuing operations at standard UK corporation tax rate of 28.5% (2007: 30%)	**546**	**(421)**	**125**	559	73	632
Effects of:						
Net expenses not deductible for tax purposes	**48**	**13**	**61**	11	–	11
Adjustments in respect of prior years	**(28)**	**–**	**(28)**	(15)	(15)	(30)
Movement in unrecognised deferred tax assets (i)	**(31)**	**6**	**(25)**	16	–	16
UK petroleum revenue tax rates	**335**	**–**	**335**	118	–	118
Overseas tax rates	**(8)**	**(46)**	**(54)**	8	5	13
Additional charges applicable to upstream profits	**166**	**10**	**176**	65	(3)	62
Changes to tax rates	**(1)**	**4**	**3**	(9)	–	(9)
Taxation on profit from continuing operations	**1,027**	**(434)**	**593**	753	60	813

(i) The movement in unrecognised deferred tax assets includes the recognition in 2008 of £55 million of deferred tax assets relating to certain decommissioning provisions, following changes to UK tax law, and non-recognition of losses in certain overseas subsidiaries.

11. TAXATION CONTINUED

(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 current UK statutory rate of 28% (2007: 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

	2008 £m	2007 £m
Prior year final dividend of 8.59 pence (2007: 7.12 pence) per ordinary share	**356**	294
Interim dividend of 3.47 pence (2007: 2.98 pence) per ordinary share	**144**	123
	500	417

The prior year final dividend was paid on 11 June 2008 (2007: 13 June). The interim dividend was paid on 12 November 2008 (2007: 14 November). The prior year final dividend of 9.65 pence (2007: 8.00 pence) per ordinary share and interim dividend of 3.90 pence (2007: 3.35 pence) per ordinary share have been adjusted to reflect the bonus element of the Rights Issue in the table above. Details of the Rights Issue are provided in notes 5, 29 and 30.

The Directors propose a final dividend of 8.73 pence per ordinary share (totalling £446 million) for the year ended 31 December 2008. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 11 May 2009. 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 2009.

13. EARNINGS PER ORDINARY SHARE

Basic earnings per ordinary share has been calculated by dividing the loss attributable to equity holders of the Company for the year of £145 million (2007: earnings of £1,505 million) by the weighted average number of ordinary shares in issue during the year of 4,198 million (2007: 4,126 million). The weighted average number of ordinary shares outstanding and the dilutive impact for both periods presented has been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30. 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:

	2008		2007 (restated) (i)	
(a) Continuing and discontinued operations	£m	Pence per ordinary share	£m	Pence per ordinary share
(Loss)/earnings – basic	**(145)**	**(3.5)**	1,505	36.5
Net exceptional items after tax (notes 2 and 8)	**67**	**1.6**	(227)	(5.5)
Certain re-measurement losses and (gains) after tax (notes 2 and 8)	**981**	**23.4**	(156)	(3.8)
Earnings – adjusted basic	**903**	**21.5**	1,122	27.2
(Loss)/earnings – diluted	**(145)**	**(3.5)**	1,505	35.9
Earnings – adjusted diluted	**903**	**21.3**	1,122	26.7

	2008		2007 (restated) (i)	
(b) Continuing operations	£m	Pence per ordinary share	£m	Pence per ordinary share
(Loss)/earnings – basic	**(145)**	**(3.5)**	1,296	31.4
Net exceptional items after tax (notes 2 and 8)	**67**	**1.6**	–	–
Certain re-measurement losses and (gains) after tax (notes 2 and 8)	**981**	**23.4**	(175)	(4.2)
Earnings – adjusted basic	**903**	**21.5**	1,121	27.2
(Loss)/earnings – diluted	**(145)**	**(3.5)**	1,296	30.9
Earnings – adjusted diluted	**903**	**21.3**	1,121	26.7

(i) Restated to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

13. EARNINGS PER ORDINARY SHARE CONTINUED

(c) Discontinued operations	2008 £m	2008 Pence per ordinary share	2007 (restated) (i) £m	2007 (restated) (i) Pence per ordinary share
Earnings – basic	–	–	209	5.1
Earnings – diluted	–	–	209	5.0

(i) Restated to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

Certain re-measurements (notes 2 and 8) included within operating profit comprise re-measurements arising on 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 in 2007 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.

In addition to basic and adjusted basic 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 2008 or 2007, however the weighted average number of shares used as the denominator is adjusted for potentially dilutive ordinary shares. In 2008, no outstanding awards or options are considered to be potentially dilutive for diluted earnings per ordinary share, because doing so would decrease the loss per ordinary share. However, potentially dilutive ordinary shares were taken into account when calculating adjusted diluted earnings per ordinary share.

	2008 million shares	2007 (restated) (i) million shares
Weighted average number of shares used in the calculation of basic earnings per ordinary share	4,198	4,126
Dilutive impact of share-based payment schemes	35	71
Weighted average number of shares used in the calculation of diluted earnings per ordinary share	4,233	4,197

(i) Restated to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

14. GOODWILL

	2008 £m	2007 £m
Cost and net book value		
1 January	1,074	1,055
Acquisitions (note 35)	269	58
Adjustments to provisional fair values of acquisitions completed in previous year	2	–
Impairment (note 16)	(45)	–
Disposals	–	(124)
Exchange adjustments	210	85
31 December	1,510	1,074

Analysis of goodwill at 31 December by acquisition	2008 £m	2007 £m
Direct Energy	369	335
Energy America	31	23
Enron Direct/Electricity Direct	133	133
Enbridge Services	87	79
CPL/WTU	253	186
ATCO	51	46
Dyno-Rod	17	17
Residential Services Group	92	67
Oxxio	69	90
Newfield	57	55
Strategic Energy	104	–
Caythorpe	33	–
Heimdal	151	–
Other	63	43
	1,510	1,074

Notes to the Financial Statements continued

15. OTHER INTANGIBLE ASSETS

	Application software £m	Emissions allowances and renewable obligation certificates £m	Brands (i) £m	Customer relationships £m	Consents £m	Exploration and evaluation expenditure £m	Other £m	**Total £m**
Cost								
1 January 2008	447	53	57	72	29	41	44	**743**
Additions – acquired from a third party	57	249	–	14	–	16	1	**337**
Additions – internally generated	2	–	–	–	–	–	–	**2**
Acquisitions (note 35)	–	–	2	20	–	54	–	**76**
Disposals	–	(9)	–	(18)	–	–	–	**(27)**
Surrenders	–	(100)	–	–	–	–	–	**(100)**
Write-downs recognised in income (ii)	–	–	–	–	–	(22)	–	**(22)**
Exchange adjustments	15	–	–	20	–	8	1	**44**
31 December 2008	**521**	**193**	**59**	**108**	**29**	**97**	**46**	**1,053**
Aggregate amortisation and impairment								
1 January 2008	214	–	–	32	–	–	32	**278**
Amortisation	58	–	–	14	2	–	2	**76**
Impairment recognised in income (iii)	–	31	–	–	–	–	–	**31**
Disposals	–	–	–	(18)	–	–	–	**(18)**
Exchange adjustments	6	–	–	9	–	–	–	**15**
31 December 2008	**278**	**31**	**–**	**37**	**2**	**–**	**34**	**382**
Net book value at 31 December 2008	**243**	**162**	**59**	**71**	**27**	**97**	**12**	**671**

	Application software £m	Renewable obligation certificates £m	Brands (i) £m	Customer relationships £m	Consents £m	Exploration and evaluation expenditure £m	Other £m	Total £m
Cost								
1 January 2007	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	–	–	–	10	–	12	–	22
Disposals of subsidiaries	–	–	–	(9)	–	–	(1)	(10)
Disposals	(11)	–	–	–	–	–	–	(11)
Exploration and evaluation expenditure transferred to producing assets	–	–	–	–	–	(17)	–	(17)
Surrenders	–	(72)	–	–	–	–	–	(72)
Write-downs recognised in income	–	–	–	–	–	(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
Amortisation	53	–	–	10	–	–	17	80
Disposals of subsidiaries	–	–	–	(1)	–	–	–	(1)
Disposals	(6)	–	–	–	–	–	–	(6)
Exchange adjustments	7	–	–	3	–	–	–	10
31 December 2007	214	–	–	32	–	–	32	278
Net book value at 31 December 2007	233	53	57	40	29	41	12	465

(i) Brands include £57 million associated with 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) A £21 million write-down of exploration and evaluation expenditure was recognised in Gas production and development, and a £1 million write-down was recognised in the Direct Energy segment, in operating costs to reflect a reduction in the recoverable amount of certain assets to £nil, related to projects that are not commercially viable.

(iii) A £31 million impairment of emissions allowances was recognised in the Power generation segment, within cost of sales, to reflect a reduction in fair value (less costs to sell) as a result of a decrease in market prices, that was partially offset by a reduction in the obligation related to emission allowances of £30m.

16. IMPAIRMENT TESTING OF GOODWILL AND INTANGIBLES WITH INDEFINITE USEFUL LIVES

(a) Carrying amount of goodwill and intangible assets with indefinite useful lives allocated to cash-generating units

Goodwill acquired through business combinations and indefinite lived intangible assets have been allocated for impairment testing purposes to individual cash-generating units each representing the lowest level within the Group at which the goodwill or indefinite lived intangible asset is monitored for internal management purposes as follows:

Cash-generating unit	Principal acquisitions to which goodwill and intangibles with indefinite useful lives relates	2008 Carrying amount of goodwill £m	2008 Carrying amount of indefinite lived intangible asset £m	2008 Total £m	2007 Carrying amount of goodwill £m	2007 Carrying amount of indefinite lived intangible asset £m	2007 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
Centrica Energy – Gas production and development	Newfield/Heimdal	**208**	**–**	**208**	55	–	55
Direct Energy – Mass markets energy (i)	Direct Energy/ATCO/CPL/WTU (ii)	**612**	**–**	**612**	506	–	506
Direct Energy – Commercial and industrial energy (i)	Direct Energy/ATCO/Strategic Energy (ii)	**196**	**–**	**196**	83	–	83
Direct Energy – Home and business services (i)	Enbridge Services/Residential Services Group (ii)	**200**	**–**	**200**	158	–	158
European Energy – Oxxio	Oxxio	**69**	**–**	**69**	90	–	90
Other (iii)	Various (iii)	**75**	**–**	**75**	32	–	32
		1,510	**57**	**1,567**	1,074	57	1,131

(i) During the year, the aggregation of assets in determining the cash-generating units for Direct Energy changed in line with the restructuring of the business into four pan-North American lines of business. Direct Energy – Mass markets energy combines Canada mass markets, US North mass markets, Texas Direct mass markets and Texas residential energy, Direct Energy – Commercial and industrial energy combines Canada commercial and industrial, US North commercial and industrial and Texas commercial and industrial, and Direct Energy – Home and business services combines Canada home services, US home services, Canada business services and US business services. Comparative figures have been restated to reflect the change in the allocation of goodwill to cash-generating units.

(ii) Carrying amount of goodwill also contains goodwill from other Direct Energy acquisitions which are not significant compared with the aggregate carrying value of goodwill reported within the cash-generating unit.

(iii) 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.

(b) Basis on which recoverable amount has been determined

Value in use calculations have been used to determine recoverable amounts for all of the goodwill and indefinite lived intangible asset balances noted above, with the exception of the impairment test for the Centrica Energy – Gas production and development cash-generating unit, where fair value less costs to sell has been used as the basis for determining recoverable amount.

(i) Value in use

The value in use calculations use cash flow projections based on the Group's internal Board-approved three-year business plans. The Group's business plans are based on past experience and adjusted to reflect market trends, economic conditions, key risks, the implementation of strategic objectives and changes in commodity prices, as appropriate. Commodity prices used in the planning process are based in part on observable market data and in part on internal estimates. The extent to which the commodity prices used in the business plans are based on observable market data is determined by the extent to which the market for the underlying commodity is judged to be active. Note 28 provides additional detail on the active period of each of the commodity markets in which the Group operates.

Cash flows beyond the three-year plan period have been extrapolated using growth rates in line with historic long-term growth rates in the market where the cash-generating unit operates.

Cash flows are discounted using a discount rate specific to each cash-generating unit to determine the cash-generating unit's value in use, which is then deemed to be its recoverable amount. The recoverable amount is compared to the carrying value of each cash-generating unit's net assets to determine whether the carrying values of any of the Group's goodwill or indefinite lived intangible asset balances are greater than their corresponding recoverable amounts.

Notes to the Financial Statements continued

16. IMPAIRMENT TESTING OF GOODWILL AND INTANGIBLES WITH INDEFINITE USEFUL LIVES CONTINUED

(ii) Fair value less costs to sell

Fair value less costs to sell is used as the basis for determining the recoverable amount of goodwill allocated to Centrica Energy – Gas production and development. This methodology is deemed to be more appropriate because it is based on the post-tax cash flows arising from each field within Centrica Energy – Gas production and development, which is consistent with the approach taken by management to evaluate the economic value of the underlying assets.

Fair value less costs to sell is determined by discounting the post-tax cash flows expected to be generated by the gas production and development assets within Centrica Energy – Gas production and development, net of associated selling costs, taking into account those assumptions that market participants would use in estimating fair value. Post-tax cash flows are derived from projected production profiles of each field within Centrica Energy – Gas production and development, taking into account forward prices for gas and liquids over the relevant period. Where forward market prices are not available, prices are determined based on internal model inputs. Note 28 provides additional detail on the active period of each of the commodity markets in which the Group operates.

The date of cessation of production depends on the interaction of a number of variables, such as the recoverable quantities of hydrocarbons, the production costs, the contractual duration of the licence area and the selling price of the gas and liquids produced. As each field has specific reservoir characteristics and economic circumstances, the post-tax cash flows for each field are computed using individual economic models and key assumptions as determined by management. Post-tax cash flows used in the fair value less costs to sell calculation for the first three years are based on the Group's internal Board-approved three-year business plans and, thereafter, are forecast on a consistent basis. The future post-tax cash flows are discounted using a post-tax nominal discount rate of 8.5% to determine the fair value less costs to sell of Centrica Energy – Gas production and development. Fair value less costs to sell is compared to the carrying value of the Centrica Energy – Gas production and development cash-generating unit to determine whether goodwill is impaired. The discount rate used in the fair value less costs to sell calculation is determined in the same manner as the discount rates used in the value in use calculations described below, with the exception of the adjustment required to determine an equivalent pre-tax discount rate that is not required for the fair value less costs to sell calculation.

(c) Key rates used in value in use calculations

(i) Growth rate to perpetuity

Long-term growth rates are determined using a blend of publicly available historical data and long-term growth rate forecasts published by external analysts.

(ii) Discount rates

The Group uses surrogates in an attempt to estimate a market assessment of the time value of money and the risks inherent in the Group's business plans in order to discount the forecast cash flows of each of the Group's cash-generating units. Discount rates are derived from the Group's weighted average cost of capital by replacing the Group's beta with the betas of companies comparable to each of the Group's cash-generating units to estimate a cash-generating unit specific weighted average cost of capital. Each cash-generating unit's specific weighted average cost of capital is then adjusted to reflect the impact of tax in order to calculate an equivalent pre-tax discount rate.

Long-term growth rates used in the value in use calculations for each of the Group's cash-generating units are provided in the table below together with pre-tax discount rates.

	British Gas Business	British Gas Services – Dyno-Rod	Direct Energy – Mass markets energy	Direct Energy – Commercial and industrial energy	Direct Energy – Home and business services	European Energy – Oxxio
Growth rate to perpetuity	2.0%	2.5%	1.5%	2.0%	2.0%	2.0%
Pre-tax discount rate	9.3%	9.9%	9.3%	9.3%	9.3%	10.9%

(iii) Inflation rates

Inflation rates used in the three-year business plan were based on a blend of a number of publicly available inflation forecasts available in the UK, Europe, Canada and the US. Inflation rates used for the value in use calculations were as follows: UK and Europe – 2.5% in 2009 and 2% in 2010 and 2011, Canada – 2.3% in 2009 and 2% in 2010 and 2011 and the US – 2.9% in 2009 and 2% in 2010 and 2011.

16. IMPAIRMENT TESTING OF GOODWILL AND INTANGIBLES WITH INDEFINITE USEFUL LIVES CONTINUED

(d) Key assumptions used and summary of results

(i) British Gas Business

Key assumptions

- Gross margin percentage: based on contractual terms for customers on existing contracts and achieved gross margin percentages in the period leading up to approval of the business plan for new and renewal customers adjusted to reflect current market conditions and higher expected transportation costs.
- Revenues: 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 and recent customer acquisitions, with prices based on forward market curves for both gas and electricity.
- Operating costs: based on a projection of headcount in line with expected activity and salary increases based on inflation expectations, with a slight increase in the provision for credit losses experienced historically to reflect the current economic environment in the UK.

Summary of results

The recoverable amount of the British Gas Business cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill to be equal to or less than the carrying amount.

(ii) British Gas Services – Dyno-Rod

Key assumptions

- Gross margin percentage: based on achieved gross margins in the period leading up to approval of the business plan.
- Revenues: based on revenue levels achieved in the period leading up to approval of the business plan adjusted for the impact of increased marketing spend and the targeting of key accounts with individual sales staff, with a slight reduction in growth rates to reflect the current economic environment in the UK.
- Operating costs: based on a projection of headcount in line with expected activity and salary increases based on inflation expectations.

Summary of results

The recoverable amount of the British Gas Services – Dyno-Rod cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill or indefinite lived intangible asset to be equal to or less than their carrying amounts.

(iii) Centrica Energy – Gas production and development

Key assumptions

- Cash inflows: based on forward market prices for gas and oil for the active period of the market and internal model inputs thereafter, with reserve volumes and production profiles based on internal management estimates.
- Cash outflows: based on planned capital expenditure and the estimated future costs of abandonment.
- Taxation: based on tax rates expected to be in effect at the point of the forecast cash flow.

Summary of results

The recoverable amount of the Centrica Energy – Gas production and development cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill to be equal to or less than the carrying amount.

(iv) Direct Energy – Mass markets energy

Key assumptions

- Gross margin percentage: based on contractual terms for customers on existing contracts and achieved gross margin percentages in the period leading up to approval of the business plan for new and renewal customers, adjusted to reflect competitor data, where available. Where applicable, regulated gross margin percentages are based on the gross margin percentages included in regulatory applications submitted to the Alberta Utilities Commission in Canada.
- Revenues: based on average market share by individual market sector achieved in the period immediately prior to the approval of the business plan, adjusted for expectations of growth or decline based on individual jurisdiction to reflect regulatory or competitive differences, including customer propensity to switch, and contractual prices, with non-contractual prices based on forward market gas and power curves in Canada and the US.
- Operating costs: based on a projection of headcount in line with expected activity and salary increases based on inflation expectations, with a slight increase in the provision for credit losses experienced historically to reflect the current negative economic environment in the US, and, to a lesser extent, Canada.

16. IMPAIRMENT TESTING OF GOODWILL AND INTANGIBLES WITH INDEFINITE USEFUL LIVES CONTINUED

Summary of results

The recoverable amount of the Direct Energy – Mass markets energy cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill to be equal to or less than the carrying amount.

(v) Direct Energy – Commercial and industrial energy

Key assumptions

- Gross margin percentage: based on achieved gross margin percentages in the period leading up to approval of the business plan, increased to reflect an expected easing of competitive pressure throughout the plan period and decreased to reflect the current negative economic environment in the US, and, to a lesser extent, Canada.
- Revenues: based on historical growth trends and planned sales activities by individual market sector with an adjustment to reflect an increase in volumes driven by the acquisition of Strategic Energy as explained in note 35. Prices are based on forward market curves for gas and electricity in Canada and the US.
- Operating costs: based on expected increases in existing cost base to reflect increased activity as a slightly declining percentage of gross margins to reflect expected synergies associated with the acquisition of Strategic Energy as explained in note 35.

Summary of results

The recoverable amount of the Direct Energy – Commercial and industrial energy cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill to be equal to or less than the carrying amount.

(vi) Direct Energy – Home and business services

Key assumptions

- Gross margin percentage: based on gross margin percentages achieved in the period leading up to approval of the business plan, adjusted to reflect the current economic conditions and housing decline in North America.
- Revenues: based on historical growth trends by individual market sector adjusted for new product offerings and continued penetration into new markets.
- Operating costs: based on projected headcount and inflationary increases.

Summary of results

The recoverable amount of the Direct Energy – Home and business services cash-generating unit exceeded its carrying value at the impairment test date. Reasonably possible changes in the key assumptions listed above would not cause the recoverable amount of the goodwill to be equal to or less than the carrying amount.

(vii) European Energy – Oxxio

Key assumptions

- Gross margin percentage: based on the gross margin percentages achieved in the period leading up to approval of the business plan, adjusted to reflect the increase in levels of competition currently being experienced in The Netherlands.
- Revenues: based on customer account growth achieved in the period leading up to approval of the business plan, adjusted downward to reflect the impact of the recent increases in competition, with prices reflecting forward market curves for gas and electricity.
- Operating costs: based on projected headcount and inflationary increases adjusted to reflect recently implemented cost improvement programmes and an increase in web enabled customer solutions.

Summary of results

The recoverable amount of the European Energy – Oxxio cash-generating unit was below its carrying value by £45 million at the impairment test date and accordingly an impairment loss of this amount has been recognised in the Income Statement for the year ended 31 December 2008 within exceptional operating costs. The impairment loss arose due to a mixture of more competitive markets and lower margins in the forecast period due to procurement issues that arose during 2008 with the increased volatility in energy markets. The European Energy – Oxxio value in use calculation was based on a discount rate of 10.9% (2007: 10.7%), and assumed an average gross margin percentage of 9.0% over the three years with closing customer numbers of approximately 750,000 in all three years. At 31 December 2008, the carrying value of the European Energy – Oxxio cash-generating unit was equal to its recoverable amount. As a result, a reasonably possible decrease in gross margin percentage or customer numbers, below the levels used in the value in use calculation above, would potentially result in the recoverable amount of the European Energy – Oxxio cash-generating unit falling below its carrying value, triggering a further impairment loss. If, for example, the value in use calculation assumed gross margin percentages 0.5ppts lower, than those used, a further goodwill impairment loss of approximately £32 million would have been recorded, while a 5% reduction in customer numbers would have resulted in an additional goodwill impairment loss of approximately £23 million.

17. PROPERTY, PLANT AND EQUIPMENT

	Land and buildings (i) £m	Plant, equipment and vehicles (ii) £m	Power generation (ii),(iii) £m	Gas storage and production (ii),(iii),(iv) £m	**Total £m**
Cost					
1 January 2008	39	288	2,076	5,433	**7,836**
Additions	–	115	312	204	**631**
Acquisitions (note 35)	–	4	–	342	**346**
Disposals	(18)	(8)	(8)	–	**(34)**
Revisions and additions to decommissioning liability (note 27)	–	–	16	165	**181**
Exchange adjustments	1	25	87	81	**194**
31 December 2008	**22**	**424**	**2,483**	**6,225**	**9,154**
Aggregate depreciation and impairment					
1 January 2008	17	121	305	3,483	**3,926**
Charge for the year	1	46	117	351	**515**
Disposals	(8)	(8)	(7)	–	**(23)**
Exchange adjustments	–	8	19	29	**56**
31 December 2008	**10**	**167**	**434**	**3,863**	**4,474**
Net book value at 31 December 2008	**12**	**257**	**2,049**	**2,362**	**4,680**

	Land and buildings (i) £m	Plant, equipment and vehicles (ii) £m	Power generation (ii),(iii) £m	Gas storage and production (ii),(iii),(iv) £m	Total £m
Cost					
1 January 2007	38	648	1,732	4,860	7,278
Additions	–	76	386	166	628
Exploration and evaluation expenditure transferred to producing assets	–	–	–	17	17
Acquisitions	–	10	–	244	254
Disposals of subsidiaries	–	(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	16	222	244	3,141	3,623
Charge for the year	1	75	107	311	494
Disposals of subsidiaries	–	(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 at 31 December 2007	22	167	1,771	1,950	3,910

Notes to the Financial Statements continued

17. PROPERTY, PLANT AND EQUIPMENT CONTINUED

(i) The net book value of land and buildings comprises the following:	2008 £m	2007 £m
Freeholds	**5**	14
Long leaseholds	**1**	1
Short leaseholds	**6**	7
	12	22

(ii) Assets in the course of construction are included within the following categories of property, plant and equipment:	2008 £m	2007 £m
Plant, equipment and vehicles	**33**	7
Power generation	**697**	393
Gas storage and production	**186**	202
	916	602

	2008			2007		
(iii) Assets held under finance leases included in totals above	Power generation £m	Gas storage and production £m	Total £m	Power generation £m	Gas storage and production £m	Total £m
Cost at 1 January	**469**	**415**	**884**	882	415	1,297
Additions	**–**	**–**	**–**	4	–	4
Transferred out of assets held under finance leases [v]	**–**	**–**	**–**	(417)	–	(417)
Cost at 31 December	**469**	**415**	**884**	469	415	884
Aggregate depreciation at 1 January	**90**	**352**	**442**	89	344	433
Charge for the year	**28**	**8**	**36**	60	8	68
Transferred out of assets held under finance leases [v]	**–**	**–**	**–**	(59)	–	(59)
Aggregate depreciation at 31 December	**118**	**360**	**478**	90	352	442
Net book value at 31 December	**351**	**55**	**406**	379	63	442

(iv) The net book value of decommissioning costs included within gas storage and production assets was £413 million (2007: £209 million).
(v) Relates to the Humber Power Station that was the subject of a finance lease that was terminated in 2007.

The net book value of assets to which title was restricted (Spalding finance lease asset) at 31 December 2008 was £351 million (2007: £379 million).

18. INTERESTS IN JOINT VENTURES AND ASSOCIATES

	Investments in joint ventures and associates			
(a) Interest in joint ventures and associates	Investments £m	Goodwill £m	Shareholder loans £m	Total £m
1 January 2008	192	30	63	**285**
Decrease in shareholder loans	–	–	(19)	**(19)**
Share of profits for the year	12	–	–	**12**
Exchange adjustments	52	–	–	**52**
31 December 2008	**256**	**30**	**44**	**330**

18. INTERESTS IN JOINT VENTURES AND ASSOCIATES CONTINUED

	Investments in joint ventures and associates			
	Investments £m	Goodwill £m	Shareholder loans £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

(b) Share of joint ventures' assets and liabilities

The Group's share of joint ventures' gross assets and gross liabilities at 31 December 2008 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).

					2008	2007
	Braes of Doune Wind Farm (Scotland) Limited £m	Barrow Offshore Wind Limited £m	Segebel SA £m	Other (i) £m	**Total £m**	Total £m
Share of current assets	12	7	185	–	**204**	100
Share of non-current assets	39	64	309	–	**412**	350
	51	71	494	–	**616**	450
Share of current liabilities	(24)	(1)	(148)	–	**(173)**	(78)
Share of non-current liabilities	(18)	(24)	(114)	(1)	**(157)**	(150)
	(42)	(25)	(262)	(1)	**(330)**	(228)
Share of net assets of joint ventures and associates	9	46	232	(1)	**286**	222
Shareholder loans	32	10	–	2	**44**	63
Interests in joint ventures and associates	41	56	232	1	**330**	285
Net (debt)/cash included in share of net assets	(36)	(15)	42	(2)	**(11)**	(35)

(i) Other includes the Group's interest in Coots (CO_2 pipeline construction). The Group's interest in Coots is not significant relative to the Group's interests in joint ventures in aggregate.

(c) Share of profits/(losses) in joint ventures and associates

					2008	2007
	Braes of Doune Wind Farm (Scotland) Limited £m	Barrow Offshore Wind Limited £m	Segebel SA £m	Other (i) £m	**Total £m**	Total £m
Income	10	11	496	–	**517**	386
Expenses	(3)	(5)	(495)	–	**(503)**	(379)
	7	6	1	–	**14**	7
Interest	–	(1)	1	–	**–**	–
Tax	(2)	(1)	1	–	**(2)**	(2)
Share of post-tax results of joint ventures and associates	5	4	3	–	**12**	5

(i) Other includes the Group's interest in Coots (CO_2 pipeline construction). The Group's interest in Coots is not significant relative to the Group's interests in joint ventures in aggregate.

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. The Group's share of the investment in and results of Segebel SA are included within the European Energy segment.

Notes to the Financial Statements continued

19. INVENTORIES

	2008 £m	2007 £m
Gas in storage and transportation	**223**	134
Other raw materials and consumables	**93**	84
Finished goods and goods for resale	**96**	23
	412	241

There are no inventories which are carried at fair value less cost to sell (2007: £nil). The Group consumed £515 million of inventories (2007: £488 million) during the year. Write-downs of inventory of £23 million (2007: £nil) were recognised in gross profit during the year to reflect the impact of a reduction in the forward market price of gas on the net realisable value of gas in storage and transportation, with £10 million recognised in Direct Energy, £8 million recognised in Centrica Energy and £5 million recognised in Centrica Storage.

20. TRADE AND OTHER RECEIVABLES

	2008		2007	
	Current £m	Non-current £m	Current £m	Non-current £m
Financial assets:				
Trade receivables	**2,142**	**25**	1,405	22
Accrued energy income	**2,480**	**–**	1,678	–
Cash collateral pledged	**669**	**–**	118	–
Other receivables	**330**	**9**	435	11
	5,621	**34**	3,636	33
Less: Provision for credit losses	**(541)**	**–**	(431)	–
	5,080	**34**	3,205	33
Non-financial assets:				
Prepayments and other receivables	**255**	**–**	218	–
	5,335	**34**	3,423	33

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:

	2008		2007	
	Current £m	Non-current £m	Current £m	Non-current £m
Financial assets by class:				
Residential customers	**2,217**	**25**	1,960	23
Business customers	**1,651**	**9**	802	9
Treasury, trading and energy procurement counterparties	**1,753**	**–**	874	1
	5,621	**34**	3,636	33
Less: Provision for credit losses	**(541)**	**–**	(431)	–
	5,080	**34**	3,205	33

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:

	2008			2007		
Days past due	Residential customers £m	Business customers £m	Treasury, trading and energy procurement counterparties £m	Residential customers £m	Business customers £m	Treasury, trading and energy procurement counterparties £m
Less than 30 days	**299**	**123**	**5**	276	55	–
30–89 days	**127**	**141**	**2**	174	41	–
Less than 90 days	**426**	**264**	**7**	450	96	–
90–182 days	**89**	**34**	**–**	91	47	–
183–365 days	**109**	**51**	**5**	98	37	–
Greater than 365 days	**126**	**17**	**5**	62	17	–
	750	**366**	**17**	701	197	–

20. TRADE AND OTHER RECEIVABLES CONTINUED

At 31 December 2008 there were £107 million (2007: £87 million) of receivables, net of provisions for credit losses, from residential customers and £25 million (2007: £nil) from treasury, trading and energy procurement counterparties that were considered to be individually impaired. There were no individually impaired receivables, net of provisions for credit losses, from business customers. 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:

2008	Residential customers £m	Business customers £m	Treasury, trading and energy procurement counterparties £m	**Total £m**
1 January	(350)	(81)	–	**(431)**
Impairment of trade receivables	(141)	(85)	(11)	**(237)**
Receivables written off	118	38	–	**156**
Exchange adjustments	(26)	(3)	–	**(29)**
31 December	**(399)**	**(131)**	**(11)**	**(541)**

2007	Residential customers £m	Business customers £m	Treasury, trading and energy procurement counterparties £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)

The charge for the impairment of trade receivables is stated net of credits for the release of specific provisions made in previous years, relating mainly to residential customers in the UK, which are no longer required. At 31 December 2008 the Group held £23 million (2007: £36 million) of customer deposits for the purposes of mitigating the credit risk associated with receivables from residential and business customers. 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
2008	**1,753**	3	478	891	260	14	107
2007	875	7	189	277	129	26	247

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 counterparty credit policy 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:

	2008 £m	2007 £m
Derivative financial instruments – held for proprietary energy trading		
Derivative financial instruments – held for trading under IAS 39		
Energy derivatives – assets	**119**	44
Energy derivatives – liabilities	**(6)**	(52)
	113	(8)
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	**1,299**	789
Energy derivatives – liabilities	**(3,228)**	(1,100)
Interest rate derivatives – assets	**2**	2
Interest rate derivatives – liabilities	**(19)**	(5)
Foreign exchange derivatives – assets	**200**	19
Foreign exchange derivatives – liabilities	**(295)**	(80)
	(2,041)	(375)
Energy contracts designated at fair value through profit and loss		
Energy derivatives – assets	**109**	9
Energy derivatives – liabilities	**(95)**	(86)
	14	(77)
Derivative financial instruments in hedge accounting relationships		
Energy derivatives – assets	**24**	123
Energy derivatives – liabilities	**(365)**	(68)
Interest rate derivatives – assets	**62**	–
Interest rate derivatives – liabilities	**(4)**	(7)
Foreign exchange derivatives – assets	**100**	–
Foreign exchange derivatives – liabilities	**(77)**	(17)
	(260)	31
Net total	**(2,174)**	(429)

The net total reconciles to the Balance Sheet as follows:

	2008 £m	2007 £m
Derivative financial instruments – non-current assets	**195**	72
Derivative financial instruments – current assets	**1,720**	914
	1,915	986
Derivative financial instruments – current liabilities	**(3,932)**	(1,404)
Derivative financial instruments – non-current liabilities	**(157)**	(11)
	(4,089)	(1,415)
Net total	**(2,174)**	(429)

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

	2008 £m	2007 £m
Short-term forward market purchases and sales of gas and electricity:		
UK and Europe	**(748)**	107
North America	**(814)**	(80)
Structured gas purchase contracts	**(28)**	250
Structured gas sales contracts	**(450)**	(553)
Other	**(103)**	(65)
Net total	**(2,143)**	(341)

21. DERIVATIVE FINANCIAL INSTRUMENTS CONTINUED

Net (losses)/gains on derivative financial instruments due to re-measurement	2008 Income Statement £m	2008 Equity £m	2007 Income Statement £m	2007 Equity £m
Financial assets and liabilities measured at fair value through profit and loss:				
Derivative financial instruments – held for proprietary energy trading	**117**	**–**	(5)	–
Derivative financial instruments – held for trading under IAS 39	**(1,621)**	**–**	230	–
Energy contracts designated at fair value through profit and loss	**(16)**	**–**	(35)	–
Derivative financial instruments in hedge accounting relationships	**82**	**(360)**	3	535
	(1,438)	**(360)**	193	535

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
2008	**1,915**	–	294	1,326	128	9	158
2007	986	–	372	272	51	–	291

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. Details of collateral balances held at 31 December 2008 are provided in note 4.

Maturity profiles of derivative financial instruments – liabilities

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	2008 £m	2007 £m
Less than one year	**(456)**	(128)
One to five years	**(148)**	(53)
More than five years	**–**	(2)
	(604)	(183)

Interest rate derivatives that will be settled on a net basis	2008 £m	2007 £m
Less than one year	**(18)**	(9)
One to five years	**(7)**	(4)
More than five years	**–**	(1)
	(25)	(14)

Notes to the Financial Statements continued

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	2008 £m	2007 £m
Less than one year	**(20,426)**	(12,076)
One to five years	**(21,538)**	(17,559)
More than five years	**(8,095)**	(6,719)
	(50,059)	(36,354)

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:

	2008		2007	
Foreign exchange derivatives that will be settled on a gross basis	Outflow £m	Inflow £m	Outflow £m	Inflow £m
Less than one year	**(4,394)**	**4,227**	(1,898)	1,851
One to five years	**(487)**	**528**	(811)	785
More than five years	**(150)**	**137**	(130)	112
	(5,031)	**4,892**	(2,839)	2,748

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:

	2008		2007	
	Assets £m	Liabilities £m	Assets £m	Liabilities £m
Fair value hedges	**72**	**–**	–	9
Cash flow hedges	**96**	**369**	123	67
Net investment hedges:				
Primary financial instruments	**–**	**225**	–	74
Derivative financial instruments	**18**	**77**	–	16

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 as income within net interest expense.

22. HEDGE ACCOUNTING CONTINUED

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

Gains/(losses)	2008 £m	2007 £m
On hedging instruments	81	5
On hedged items attributable to the hedged risk	(82)	(6)
	(1)	(1)

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 2008, the Group recognised a £4 million loss (2007: £nil) 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 2008, the Group did not recognise any gains or losses due to net investment hedge ineffectiveness (2007: £nil).

23. CASH AND CASH EQUIVALENTS

	2008 £m	2007 £m
Cash at bank, in transit and in hand	87	53
Short-term deposits	2,852	1,077
Cash and cash equivalents	2,939	1,130

Cash and cash equivalents includes £34 million (2007: £40 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
2008	**2,939**	1,488	751	692	8
2007	1,130	246	783	95	6

Credit risk associated with cash and cash equivalents is managed in accordance with the Group's counterparty credit policy as described in note 4.

Notes to the Financial Statements continued

24. TRADE AND OTHER PAYABLES

	2008 Current £m	2008 Non-current £m	2007 Current £m	2007 Non-current £m
Financial liabilities:				
Trade payables	**1,384**	**–**	925	–
Cash collateral received	**43**	**–**	93	–
Other payables	**559**	**4**	663	14
Accruals				
Commodity costs	**1,244**	**–**	736	–
Transportation, distribution and metering costs	**70**	**–**	104	–
Operating and other accruals	**494**	**–**	572	–
	1,808	**–**	1,412	–
	3,794	**4**	3,093	14
Non-financial liabilities:				
Other payables and accruals	**381**	**60**	131	2
Deferred income	**189**	**3**	147	4
	4,364	**67**	3,371	20

Maturity analysis of financial liabilities within trade and other payables on an undiscounted basis	2008 £m	2007 £m
Less than 90 days	**3,683**	2,908
90–182 days	**35**	24
183–365 days	**76**	161
	3,794	3,093
Greater than 365 days	**4**	14
	3,798	3,107

25. BANK OVERDRAFTS, LOANS AND OTHER BORROWINGS

	Interest rate %	Principal m	2008 Current £m	2008 Non-current £m	2008 Total £m	2007 Current £m	2007 Non-current £m	2007 Total £m
Bank overdrafts and loans			**52**	**429**	**481**	70	277	347
Bonds (by maturity date)								
25 July 2008	3.500	€75	**–**	**–**	**–**	57	–	57
8 September 2008	Floating	€100	**–**	**–**	**–**	74	–	74
9 March 2009	4.129	£250	**253**	**–**	**253**	–	253	253
2 November 2012	6.103	£400	**–**	**416**	**416**	–	400	400
27 February 2013	1.045	¥3,000	**–**	**23**	**23**	–	13	13
9 December 2013 (i)	7.307	€750	**–**	**718**	**718**	–	–	–
24 October 2016	5.706	£300	**–**	**316**	**316**	–	300	300
19 September 2018 (ii)	7.100	£300	**–**	**340**	**340**	–	–	–
4 September 2026	Floating (iii)	£150	**–**	**153**	**153**	–	153	153
19 September 2033 (ii)	7.250	£450	**–**	**447**	**447**	–	–	–
			253	**2,413**	**2,666**	131	1,119	1,250
Commercial paper			**4**	**–**	**4**	–	–	–
Obligations under finance leases			**21**	**376**	**397**	20	397	417
			330	**3,218**	**3,548**	221	1,793	2,014

(i) Issued on 9 December 2008.
(ii) Issued on 19 September 2008.
(iii) Capped at 6.854%.

25. BANK OVERDRAFTS, LOANS AND OTHER BORROWINGS CONTINUED

Future finance lease commitments:	Minimum lease payments 2008 £m	Capital element of lease payments 2008 £m	Minimum lease payments 2007 £m	Capital element of lease payments 2007 £m
Amounts payable:				
Within one year	**44**	**21**	43	20
Between one and five years	**181**	**107**	179	98
After five years	**330**	**269**	376	299
	555	**397**	598	417
Less future finance charges	**(158)**		(181)	
Present value of lease obligations	**397**		417	

Maturity profile of the Group's borrowings including interest and principal:	2008 £m	2007 £m
Within one year (i)	**454**	322
Between one and five years	**1,797**	1,198
After five years	**2,189**	1,215
	4,440	2,735
Interest payments	**(892)**	(721)
	3,548	2,014

(i) Borrowings include amounts repayable on demand of £35 million (2007: £30 million).

At 31 December 2008, the Group had undrawn committed bank borrowing facilities of £1,350 million (2007: £1,300 million), of which £300 million matures in 2010, with the remaining £1,050 million maturing in 2012, plus a committed letter of credit facility for Canadian $200 million (2007: £nil) maturing in 2012, of which Canadian $146 million was drawn at 31 December 2008.

	2008			2007		
Currency composition of the Group's borrowings:	Before impact of foreign currency derivatives £m	Impact of foreign currency derivatives (i) £m	After impact of foreign currency derivatives £m	Before impact of foreign currency derivatives £m	Impact of foreign currency derivatives (i) £m	After impact of foreign currency derivatives £m
Pounds sterling	**2,509**	**(2,346)**	**163**	1,731	(1,188)	543
Euros	**718**	**(37)**	**681**	131	163	294
New Zealand dollars	**122**	**(120)**	**2**	27	(27)	–
US dollars	**98**	**1,261**	**1,359**	56	480	536
Japanese yen	**85**	**(85)**	**–**	42	(42)	–
Canadian dollars	**16**	**1,067**	**1,083**	27	614	641
Norwegian kroner	**–**	**260**	**260**	–	–	–
	3,548	**–**	**3,548**	2,014	–	2,014

(i) Includes the impact of hedges of net investments in foreign operations and foreign currency denominated inter-company loans.

Interest rate exposure by earlier of contractual re-pricing and maturity date:	Average effective interest rate %	Total £m	Within one year £m	One to five years £m	More than five years £m
2008					
Bank overdrafts and loans	**5.6**	**481**	**207**	**14**	**260**
Bonds	**6.2**	**2,666**	**406**	**1,157**	**1,103**
Commercial paper	**4.5**	**4**	**4**	**–**	**–**
Obligations under finance leases	**5.8**	**397**	**–**	**–**	**397**
	6.1	**3,548**	**617**	**1,171**	**1,760**
Impact of interest rate derivatives	**0.4**	**–**	**1,156**	**(658)**	**(498)**
	6.5	**3,548**	**1,773**	**513**	**1,262**
2007					
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
	5.5	2,014	536	770	708
Impact of interest rate derivatives	0.5	–	627	(464)	(163)
	6.0	2,014	1,163	306	545

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 periods:

	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 2007	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	–	–	–	–	75	–	–	173	**248**
Acquisition of subsidiary	–	–	–	–	–	127	(81)	–	**46**
Exchange and other adjustments	–	–	–	–	–	–	7	3	**10**
31 December 2007	167	(84)	(86)	43	28	807	(201)	(105)	**569**
Changes to tax rates	–	–	–	–	–	(1)	–	–	**(1)**
Charge/(credit) to income	42	(21)	(94)	47	53	63	19	(441)	**(332)**
Credit to equity [(i)]	–	–	–	–	(111)	–	–	(97)	**(208)**
Acquisition of subsidiary (note 35)	–	–	–	–	–	148	(1)	–	**147**
Exchange and other adjustments	–	–	–	–	–	19	(10)	(47)	**(38)**
31 December 2008	**209**	**(105)**	**(180)**	**90**	**(30)**	**1,036**	**(193)**	**(690)**	**137**

(i) The credit to equity for retirement benefit obligations and other provisions includes a credit of £nil (2007: 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:

	2008 £m	2007 £m
Deferred tax liabilities	**448**	596
Deferred tax assets	**(311)**	(27)
	137	569

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

	2008 £m	2007 £m
Deferred tax assets crystallising within one year	**(423)**	(124)
Deferred tax assets crystallising after one year	**(890)**	(502)
	(1,313)	(626)
Offset against deferred tax liabilities	**1,002**	599
Net deferred tax assets	**(311)**	(27)
Deferred tax liabilities crystallising within one year	**58**	113
Deferred tax liabilities crystallising after one year	**1,392**	1,082
	1,450	1,195
Offset against deferred tax assets	**(1,002)**	(599)
Net deferred tax liabilities	**448**	596

At the balance sheet date the Group had certain deductible temporary differences of £178 million (2007: £376 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 £76 million (2007: £62 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 (2007: £3 million), which has been provided for.

Current tax assets of £39 million (2007: £40 million) include £20 million (2007: £20 million) of recoverable petroleum revenue tax.

27. PROVISIONS FOR OTHER LIABILITIES AND CHARGES

Current provisions for other liabilities and charges

	1 January 2008 £m	Charged in the year £m	Unused and reversed in the year £m	Revisions and additions £m	Transferred (to)/from non-current £m	Utilised £m	Exchange adjustments £m	31 December 2008 £m
Restructuring costs (i)	37	9	(6)	–	2	(20)	–	22
Decommissioning costs (ii)	3	3	–	–	(7)	–	1	–
Sales contract loss provision (iii)	2	–	–	–	–	(2)	–	–
Renegotiation provisions (iv)	84	–	–	–	(20)	(64)	–	–
Other (v)	14	–	(3)	–	1	(5)	–	7
	140	12	(9)	–	(24)	(91)	1	29

Non-current provisions for other liabilities and charges

	1 January 2008 £m	Acquisitions and disposals £m	Charged in the year £m	Unused and reversed in the year £m	Revisions and additions £m	Transferred (to)/from current £m	Exchange adjustments £m	31 December 2008 £m
Restructuring costs (i)	32	–	4	–	–	(2)	–	34
Decommissioning costs (ii)	511	47	17	–	181	7	6	769
Renegotiation provisions (iv)	7	–	–	–	–	20	–	27
Other (v)	31	–	6	(1)	–	(1)	–	35
	581	47	27	(1)	181	24	6	865

Financial and non-financial liabilities within provisions for other liabilities and charges

	2008 Current £m	2008 Non-current £m	2007 Current £m	2007 Non-current £m
Financial liabilities:				
Restructuring costs (i)	20	34	35	31
Renegotiation provisions (iv)	–	27	84	7
Other (v)	7	18	7	5
	27	79	126	43
Non-financial liabilities:				
Restructuring costs (i)	2	–	2	1
Decommissioning costs (ii)	–	769	3	511
Sales contract loss provision (iii)	–	–	2	–
Other (v)	–	17	7	26
	2	786	14	538
	29	865	140	581

Maturity analysis for financial liabilities within provisions for other liabilities and charges on an undiscounted basis

	2008 £m	2007 £m
Within one year	27	126
Between one and two years	19	13
Between two and five years	53	16
After five years	7	16
	106	171

(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 £50 million (2007: £51 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 2009 and 2022.

(ii) 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 2010 and 2062, with the substantial majority of the provision being utilised between 2015 and 2030. The charge to income includes £20 million of notional interest (2007: £13 million).

(iii) 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.

(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, most of which was settled in 2008, based on the reserves in a group of third-party fields. The charge for the year includes £nil of notional interest (2007: £6 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 266.00 pence at 31 December 2008 (2007: 319.21 pence after adjusting for the bonus element of the Rights Issue) and is expected to be utilised between 2009 and 2014.

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:

		2008		2007	
Financial assets	Notes	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Loans and receivables:					
Trade and other receivables, net of provisions	20	5,114	5,114	3,238	3,238
Cash and cash equivalents	23	2,939	2,939	1,130	1,130
		8,053	8,053	4,368	4,368
Financial assets measured at fair value through profit and loss:					
Derivative financial instruments	21	1,915	1,915	986	986
Available-for-sale financial assets:					
Debt		89	89	79	79
Equity		9	9	10	10
		98	98	89	89

		2008		2007	
Financial liabilities	Notes	Carrying value £m	Fair value £m	Carrying value £m	Fair value £m
Financial liabilities measured at amortised cost:					
Trade and other payables	24	(3,798)	(3,798)	(3,107)	(3,107)
Bank overdrafts, loans and other borrowings					
Bank overdrafts and loans	25	(481)	(535)	(347)	(338)
Bonds	25	(2,666)	(2,660)	(1,250)	(1,246)
Commercial paper		(4)	(4)	–	–
Obligations under finance leases	25	(397)	(397)	(417)	(417)
Provisions	27	(106)	(106)	(169)	(169)
		(7,452)	(7,500)	(5,290)	(5,277)
Financial liabilities at fair value through profit and loss:					
Derivative financial instruments	21	(4,089)	(4,089)	(1,415)	(1,415)

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 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.

28. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

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 for the purposes of accounting as follows:

Active period of markets	Gas	Power	Coal	Emissions	Oil
UK (years)	2	2	3	2-4	3
North America (years)	5	5	n/a	n/a	n/a
Europe (years)	n/a	Up to 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 3% (2007: 6%). 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 3% (2007: 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 2008 is a £272 million liability (2007: £322 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 2008 amounted to a gain of £17 million (2007: loss of £100 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:

Energy price	2008 Reasonably possible change in variable	2007 Reasonably possible change in variable
UK gas (p/therm)	+/-14	+/-12
UK power (£/MWh)	+/-10	+/-11
UK coal (US$/tonne)	+/-25	+/-15
UK emissions (€/tonne)	+/-4	+/-6
UK oil (US$/bbl)	+/-15	+/-14

Increase/(decrease) in fair value	2008 £m	2007 £m
UK energy prices – increase/decrease	179/(175)	85/(100)

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.

Notes to the Financial Statements continued

28. FAIR VALUE OF FINANCIAL INSTRUMENTS CONTINUED

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 losses/(gains)	2008 £m	2007 £m
1 January	(166)	(62)
Net losses/(gains) deferred on new transactions	128	(103)
Recognised in the Income Statement during the period	89	(1)
31 December	51	(166)

29. CALLED UP SHARE CAPITAL

	2008 £m	2007 £m
Authorised share capital of the Company		
7,000,000,000 ordinary shares of $6^{14}/_{81}$p each (2007: 4,455,000,000 ordinary shares of $6^{14}/_{81}$p each) (i)	432	275
100,000 cumulative redeemable preference shares of £1 each	–	–
Allotted and fully paid share capital of the Company		
5,107,658,569 ordinary shares of $6^{14}/_{81}$p each (2007: 3,679,980,311 ordinary shares of $6^{14}/_{81}$p each)	315	227

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

	2008 Number	2007 Number
1 January	3,679,980,311	3,662,721,068
Rights Issue (ii)	1,392,789,173	–
Issued under employee share schemes (iii)	34,889,085	17,259,243
31 December	5,107,658,569	3,679,980,311

(i) At a General Meeting of the Company held on 21 November 2008, the authorised share capital of the Company was increased from £275 million to £432 million by the creation of 2,545,000,000 ordinary shares of a nominal value of $6^{14}/_{81}$ pence each, forming a single class with the existing ordinary shares.
(ii) On 31 October 2008, the Company announced a Rights Issue, which was approved by shareholders on 21 November 2008, on the basis of three new ordinary shares for every eight ordinary shares held at 160 pence per share, all with a nominal value of $6^{14}/_{81}$ pence each. The Company raised proceeds of approximately £2,164 million, net of issue costs of approximately £65 million. The last day for acceptance was 12 December 2008 and dealing in new ordinary shares fully paid commenced on the London Stock Exchange on 15 December 2008.
(iii) Ordinary shares were allotted and issued to satisfy the exercise of share options, share incentive schemes, the Direct Energy Employee Share Purchase Plan and the matching element of the Share Incentive Plan as follows:

	2008	2007
Number	34,889,085	17,259,243
Nominal value (£m)	2.2	1.1
Consideration (£m) (net of issue costs of £nil (2007: £nil))	38	22

The closing price of one Centrica ordinary share on 31 December 2008 was 266.00 pence (2007: 319.21 pence after adjusting for the bonus element of the Rights Issue).

Centrica employee share ownership trusts purchase Centrica ordinary shares from the open market and receive newly issued shares to satisfy future obligations of certain employee share schemes. During the year, the trusts purchased 1.0 million shares (2007: 0.6 million), received 6.5 million newly allotted shares (2007: 5.3 million) and released 4.5 million shares (2007: 5.3 million shares) to employees on vesting. At 31 December 2008, the trusts held 3.6 million shares (2007: 0.6 million shares) at a carrying amount of £10 million (2007: £2 million). Until such time as the Company's own shares held by these trusts vest unconditionally, the amount paid for those shares, or the value they were issued at, are held as treasury shares and are deducted from shareholders' equity. The number of ordinary shares held in trust for both periods presented has been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5 and 30.

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 2008	227	685	467	16	1,928	**3,323**	59	**3,382**
Exchange differences on translation of foreign operations	–	–	–	–	(29)	**(29)**	–	**(29)**
Actuarial losses on pensions (note 34)	–	–	–	–	(399)	**(399)**	–	**(399)**
Losses on revaluation of available-for-sale assets	–	–	–	–	(19)	**(19)**	–	**(19)**
Cash flow hedges:								
Net fair value losses	–	–	–	–	(318)	**(318)**	–	**(318)**
Transfers to Income Statement	–	–	–	–	(30)	**(30)**	–	**(30)**
Transfers to Balance Sheet	–	–	–	–	1	**1**	–	**1**
Rights Issue	86	–	2,078	–	–	**2,164**	–	**2,164**
Transfer	–	–	(2,078)	–	2,078	**–**	–	**–**
Tax on above items	–	–	–	–	208	**208**	–	**208**
	313	685	467	16	3,420	**4,901**	59	**4,960**
Loss for the year	–	–	–	–	(145)	**(145)**	1	**(144)**
Employee share schemes:								
Increase in treasury shares	–	–	–	–	(9)	**(9)**	–	**(9)**
Share issue	2	44	–	–	–	**46**	–	**46**
Exercise of awards	–	–	–	–	(7)	**(7)**	–	**(7)**
Value of services provided	–	–	–	–	40	**40**	–	**40**
Dividends	–	–	–	–	(500)	**(500)**	–	**(500)**
31 December 2008	**315**	**729**	**467**	**16**	**2,799**	**4,326**	**60**	**4,386**

Other reserves

	Revaluation reserve £m	Foreign currency translation reserve £m	Cash flow hedging reserve £m	Treasury shares £m	Share-based payments reserve £m	Other £m	Total other reserves £m
				Profit and loss reserve			
1 January 2008	10	(14)	51	(2)	51	1,832	**1,928**
Exchange differences on translation of foreign operations	–	(10)	(19)	–	–	–	**(29)**
Actuarial losses on pensions (note 34)	–	–	–	–	–	(399)	**(399)**
Losses on revaluation of available-for-sale assets	–	–	–	–	–	(19)	**(19)**
Cash flow hedges:							
Net fair value losses	–	–	(318)	–	–	–	**(318)**
Transfers to Income Statement	–	–	(30)	–	–	–	**(30)**
Transfers to Balance Sheet	–	–	1	–	–	–	**1**
Rights Issue Transfer	–	–	–	–	–	2,078	**2,078**
Tax on above items	–	–	97	–	–	111	**208**
	10	(24)	(218)	(2)	51	3,603	**3,420**
Loss for the year	–	–	–	–	–	(145)	**(145)**
Employee share schemes:							
Increase in treasury shares	–	–	–	(9)	–	–	**(9)**
Exercise of awards	–	–	–	1	(25)	17	**(7)**
Value of services provided	–	–	–	–	40	–	**40**
Dividends	–	–	–	–	–	(500)	**(500)**
31 December 2008	**10**	**(24)**	**(218)**	**(10)**	**66**	**2,975**	**2,799**

30. RESERVES CONTINUED

	Attributable to equity holders of the Company							
	Share capital £m	Share premium £m	Merger reserve £m	Capital redemption reserve £m	Other reserves £m	Total £m	Minority interest £m	Total equity £m
1 January 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 pensions	–	–	–	–	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 above items	–	–	–	–	(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:								
Increase in 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: Treasury shares £m	Profit and loss reserve: Share-based payments reserve £m	Profit and loss reserve: Other £m	Total other reserves £m
1 January 2007	10	(26)	(326)	–	38	523	219
Exchange differences on translation of foreign operations	–	16	(1)	–	–	–	15
Exchange differences transferred to Income Statement	–	(4)	–	–	–	–	(4)
Actuarial gains on pensions	–	–	–	–	–	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 above items	–	–	(173)	–	–	(75)	(248)
	10	(14)	51	–	38	733	818
Profit for the year	–	–	–	–	–	1,505	1,505
Employee share schemes:							
Increase in treasury shares	–	–	–	(2)	–	–	(2)
Exercise of awards	–	–	–	–	(18)	11	(7)
Value of services provided	–	–	–	–	31	–	31
Dividends	–	–	–	–	–	(417)	(417)
31 December 2007	10	(14)	51	(2)	51	1,832	1,928

30. RESERVES CONTINUED

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.

On 15 December 2008, a Rights Issue was completed and 1,392,789,173 new ordinary shares with an aggregate nominal value of approximately £86 million were issued for cash consideration of £2,164 million, net of issue costs of £65 million. The Rights Issue was effected through a structure which resulted in a merger reserve arising under section 131 of the Companies Act 1985. Centrica plc issued shares in exchange for shares in Centrica CB Limited, which subsequently redeemed its no par value redeemable preference shares for cash. Following the receipt of the cash proceeds through the structure, the excess of the net proceeds received over the nominal value of the share capital issued has been transferred from the merger reserve to other profit and loss reserves.

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.

Revaluation reserve

During 2005, the revaluation of the Group's existing interest in Centrica SHB 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 £175 million (2007: £48 million) on net investments in overseas undertakings have been offset in reserves against exchange losses of £185 million (2007: £32 million) 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	2008 £m	2007 £m
Gross profit	30	(391)
Net interest expense	–	9
	30	(382)

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:

	2008 £m	2007 £m
Within one year	(147)	17
Between one and five years	(79)	34
After five years	8	–
	(218)	51

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.

30. RESERVES CONTINUED

Profit and loss reserve

Treasury shares reserve reflects the cost of shares in the Company held in share-based payment plans to meet future obligations to deliver shares to employees on vesting.

Cumulative actuarial gains arising on defined benefit pension schemes recognised in the profit and loss reserve amounted to £324 million (2007: £723 million). Cumulative losses of £16 million (2007: gains of £3 million) on available-for-sale financial assets were included within the profit and loss reserve.

Aggregate tax taken directly to reserves amounted to a credit of £208 million (2007: £248 million charge), of which a credit of £111 million relates to deferred tax arising on actuarial losses on the Group's defined benefit schemes (2007: £75 million charge), and a credit of £97 million relates to deferred tax arising on gains and losses on available-for-sale investments and cash flow hedges (2007: £173 million charge).

The share-based payments reserve reflects the obligation to deliver shares to employees under the Group's share schemes in return for services provided.

31. MINORITY INTERESTS

	2008 £m	2007 £m
At 1 January	**59**	57
Profit on ordinary activities after taxation	**1**	2
At 31 December	**60**	59

Minority interests at 31 December 2008 relate primarily to a 30% economic interest (2007: 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

(a) Reconciliation of Group operating profit to net cash flow from operating activities

	2008 £m	2007 £m
Continuing operations		
Group operating profit including share of result of joint ventures and associates	460	2,184
Less share of profits of joint ventures and associates	(12)	(5)
Group operating profit before share of profits of joint ventures and associates	448	2,179
Add back/(deduct):		
Amortisation and write-down of intangible assets and impairment of goodwill	174	92
Depreciation of property, plant and equipment	515	473
Employee share scheme costs	35	29
Profit on sale of businesses	–	(2)
Loss on sale of property, plant and equipment and other intangible assets	–	7
Movement in provisions	(141)	(66)
Re-measurement of energy contracts (i)	1,369	(218)
Unrealised foreign exchange gains on operating cash and cash equivalents	(3)	–
Operating cash flows before movements in working capital	2,397	2,494
(Increase)/decrease in inventories	(143)	38
(Increase)/decrease in trade and other receivables (ii)	(1,377)	181
Increase in trade and other payables (ii)	425	44
Cash generated from continuing operations	1,302	2,757
Income taxes paid	(374)	(341)
Net petroleum revenue tax paid	(533)	(60)
Interest received	23	27
Interest paid	(47)	(3)
Payments relating to exceptional charges	(74)	(90)
Net cash flow from continuing operating activities	297	2,290
Discontinued operations		
Group operating profit before share of joint ventures and associates	–	266
Add back/(deduct):		
Amortisation of intangible assets	–	1
Depreciation of property, plant and equipment	–	21
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
Decrease in receivables	–	1
Net cash flow from discontinued operating activities	–	67
Net cash flow from operating activities	297	2,357

(i) Adds back/(deducts) unrealised losses/(profits) arising from re-measurement of energy contracts, including those related to proprietary trading activities.
(ii) Includes net outflow of £556 million of cash collateral in 2008 (2007: inflow of £2 million).

Notes to the Financial Statements continued

32. NOTES TO THE GROUP CASH FLOW STATEMENT CONTINUED

(b) Net debt

	2008 £m	2007 £m
Current borrowings (note 25) (i)	**(295)**	(191)
Non-current borrowings (note 25)	**(3,218)**	(1,793)
Less:		
Cash and cash equivalents (i)	**2,904**	1,100
Current available-for-sale financial assets	**63**	50
Non-current available-for-sale financial assets	**35**	39
	(511)	(795)

(i) Overdrafts of £35 million (2007: £30 million) are excluded from current borrowings and are included net within cash and cash equivalents.

(c) Reconciliation of net increase in cash and cash equivalents to movement in net debt

	2008 £m	2007 £m
Net increase in cash and cash equivalents	**1,778**	505
Add back/(deduct):		
Net purchase of available-for-sale financial assets	**22**	2
Cash inflow from additional debt	**(1,513)**	(256)
Cash outflow from payment of capital element of finance leases	**20**	383
Cash outflow from repayment of other debt	**175**	107
	482	741
Revaluation of:		
Available-for-sale financial assets	**(19)**	1
Loans and other borrowings	**(82)**	(6)
	381	736
(Increase)/decrease in interest payable on loans and other borrowings	**(9)**	11
Acquisitions	**(19)**	–
Exchange adjustments	**(72)**	(17)
Other non-cash movements	**3**	2
Movement in net debt	**284**	732
Net debt at 1 January	**(795)**	(1,527)
Net debt at end of period	**(511)**	(795)

(d) Relationship between current tax charge and taxes paid

	UK £m	North America £m	Other £m	2008 £m	2007 £m
Current tax charge:					
Corporation tax charge	383	49	(23)	**409**	363
Petroleum revenue tax	517	–	–	**517**	200
	900	**49**	**(23)**	**926**	563
Taxes paid:					
Corporation tax charge	343	35	(4)	**374**	341
Petroleum revenue tax	533	–	–	**533**	60
	876	**35**	**(4)**	**907**	401

Differences between current tax charged and taxes paid arose principally due to the following factors:

- UK corporation tax is paid, based on estimated profits, partly during the year and partly in the following year. Fluctuations in profits from year to year may therefore give rise to divergence between the charge for the current year and taxes paid; and
- Petroleum revenue tax payments are based on income realised in the preceding period, with subsequent adjustments to reflect actual profits. Variations in production from period to period may therefore lead to temporary differences between tax charged and tax paid.

33. SHARE-BASED PAYMENTS

Employee share schemes are designed to encourage participants to align their objectives with those of shareholders. Centrica operates eight main employee share schemes: the Deferred and Matching Share Scheme (DMSS), the Executive Share Option Scheme (ESOS), the Long Term Incentive Scheme (LTIS), Sharesave, the Share Award Scheme (SAS), the Restricted Share Scheme (RSS), the Share Incentive Plan (SIP) and the Direct Energy Employee Share Purchase Plan (ESPP).

On 15 December 2008 the Company raised proceeds of £2,164 million, net of issue costs of £65 million, through a Rights Issue as explained in notes 5, 29 and 30. The number of shares allocated to employees under the Group's share schemes has been adjusted to reflect the bonus element of the Rights Issue. The terms of the Group's employee share schemes were adjusted such that participants of the various plans were no better or worse off as a result of the Rights Issue. Consequently, no additional expense was or will be recognised as a result of changes to the Group's employee share schemes. Details of the adjustments made to the terms of the Group's employee share schemes as a result of the Rights Issue are provided in sections (b) and (c) below.

(a) Summary of share-based payment plans and movements in the number of shares and options outstanding

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. The fair value of the award reflects the market value of the shares at the grant date. The scheme comprises three separate elements:

(i) Deferred shares

The scheme requires participants to defer 20% of their annual pre-tax 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 (except where permitted by the rules of the scheme). 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.

(ii) 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 after-tax bonus for the year. This 50% limit includes the amount automatically deferred each year pre-tax. 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 and thus the shares do not attract an IFRS 2 charge. Subsequent to the bonus year, the shares are held in trust over the three-year performance period and will vest unconditionally. Participants can withdraw the investment shares unconditionally at any point throughout the vesting period, although the related matching shares will be forfeited. The shares are eligible to receive dividends.

(iii) 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 Group's 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 more. The number of investment 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 conditions 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 who leaves prior to the vesting date will forfeit their right to the shares (except where permitted by the rules of the scheme).

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. Details of the fair values of awards granted and related assumptions are included in section (c) below.

33. SHARE-BASED PAYMENTS CONTINUED

A reconciliation of movements in allocations of deferred and matching shares actually made is shown below:

	2008 Number (i)	2007 Number (i)
Outstanding at start of period	**3,393,500**	–
Granted	**3,425,689**	3,453,802
Forfeited	**(254,794)**	(60,302)
Outstanding at end of period	**6,564,395**	3,393,500
Vested at end of period	**–**	–

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

There were no shares released during the period or in 2007.

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. Awards under the ESOS are generally reserved for employees within the senior executive group. Options granted under the ESOS will become exercisable in full on the third anniversary of the date of grant, subject to the growth in earnings per share over that period exceeding RPI growth by 18 percent or more. The number of options becoming exercisable is determined on a straight-line basis between 40% and 100% if EPS growth exceeds RPI growth by between nine and 18 percent. Options granted up to March 2004 permitted retesting of EPS growth annually for a further two years. The exercise of options is subject to continued employment within the Group (except where permitted by the rules of the scheme). 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. Details of the fair values of awards granted and related assumptions are included in section (b) below. A reconciliation of option movements is as follows:

	2008		2007	
	Number (i)	Weighted average exercise price (i)	Number (i)	Weighted average exercise price (i)
Outstanding at start of period	**21,953,085**	**£2.07**	27,062,070	£2.07
Granted (ii)	**336,012**	**£2.56**	–	–
Exercised	**(3,199,991)**	**£1.94**	(2,880,618)	£1.97
Forfeited	**(1,102,971)**	**£2.25**	(2,228,367)	£2.20
Outstanding at end of period	**17,986,135**	**£2.09**	21,953,085	£2.07
Exercisable at end of period	**13,031,276**	**£1.92**	9,879,752	£1.81

(i) Movements in allocations prior to 14 November 2008 and the corresponding weighted average exercise price have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.
(ii) Options granted in 2008 relate to a special grant of options that vested and become exercisable immediately.

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

2008				2007			
Range of exercise prices (i)	Weighted average exercise price (i)	Number of shares (i)	Average remaining contractual life Years	Range of exercise prices (i)	Weighted average exercise price (i)	Number of shares (i)	Average remaining contractual life Years
£1.30–£1.39	**£1.31**	**2,313,157**	**4.2**	£1.30–£1.39	£1.31	2,984,952	5.3
£1.90–£1.99	**£1.99**	**2,264,509**	**5.2**	£1.90–£1.99	£1.99	3,075,259	6.3
£2.00–£2.09	**£2.03**	**6,576,689**	**5.3**	£2.00–£2.09	£2.03	8,388,293	6.4
£2.10–£2.19	**£2.14**	**1,357,308**	**2.6**	£2.10–£2.19	£2.14	1,454,838	3.6
£2.20–£2.29	**£2.23**	**183,601**	**6.7**	£2.20–£2.29	£2.23	248,997	7.8
£2.50–£2.59	**£2.54**	**5,290,871**	**7.4**	£2.50–£2.59	£2.54	5,800,746	8.3
	£2.09	**17,986,135**	**5.6**		£2.07	21,953,085	6.5

(i) Exercise prices and the number of shares in each range have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For options exercised during the period, the weighted average share price adjusted to reflect the bonus element of the Rights Issue was £2.81 (2007: £3.44).

33. SHARE-BASED PAYMENTS CONTINUED

LTIS

Under the LTIS, allocations of shares in Centrica plc 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, however release of shares is subject to continued employment within the Group at the date of release (except where permitted by the rules of the scheme). 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 determined on a straight-line basis 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. For shares that vest on awards made from 2006 (for both TSR and EPS portions), additional shares are awarded or a cash payment is made to reflect dividends that would have been paid on the allocations during the performance period. The fair value of the awards is therefore considered to be the market value at the grant date. The likelihood of achieving the performance conditions is taken into account in calculating the number of awards expected to vest. Details of the fair values of awards granted and related assumptions are included in section (c) below. A reconciliation of movements in allocations is as follows:

	2008 Number (i)	2007 Number (i)
Outstanding at start of period	**22,272,975**	23,580,460
Granted	**13,026,508**	7,266,456
Released	**(3,882,647)**	(5,230,265)
Forfeited – performance related	**(2,649,148)**	(64,390)
Forfeited – non-performance related	**(2,270,544)**	(3,279,286)
Outstanding at end of period	**26,497,144**	22,272,975
Vested at end of period	**264,143**	39,499

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For shares released during the period, the weighted average share price adjusted to reflect the bonus element of the Rights Issue was £2.72 (2007: £3.48).

Sharesave

Under Sharesave, the Board may grant options over shares in Centrica plc to all UK-based employees of the Group. To date, the Board has approved the grant of options with a fixed exercise price equal to 80% of the average market price of the shares for the three days prior to invitation which is three to four weeks prior to the grant date. Employees pay a fixed amount from salary into a savings account each month, and may elect to save over three or five years. At the end of the savings period, employees have six months in which to exercise their options using the funds saved. If employees decide not to exercise their options, they may withdraw the funds saved, and the options expire. Exercise of options is subject to continued employment within the Group (except where permitted by rules of the scheme). Details of the fair values of awards granted and related assumptions are included in section (b) below. A reconciliation of movements in allocations is as follows:

	2008		2007	
	Number (i)	Weighted average exercise price (i)	Number (i)	Weighted average exercise price (i)
Outstanding at start of period	**57,663,048**	**£1.58**	62,120,635	£1.41
Granted	**15,823,636**	**£2.27**	10,477,514	£2.59
Exercised	**(30,637,590)**	**£1.08**	(10,823,787)	£1.46
Forfeited	**(4,603,041)**	**£1.76**	(4,105,305)	£1.86
Expired	**(59,488)**	**£1.28**	(6,009)	£1.58
Outstanding at end of period	**38,186,565**	**£2.20**	57,663,048	£1.58
Exercisable at end of period	**144,015**	**£1.13**	75,456	£1.61

(i) Movements in allocations prior to 14 November 2008 and the corresponding weighted average exercise price have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

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:

2008 Range of exercise prices (i)	2008 Weighted average exercise price (i)	2008 Number of shares (i)	2008 Average remaining contractual life Years	2007 Range of exercise prices (i)	2007 Weighted average exercise price (i)	2007 Number of shares (i)	2007 Average remaining contractual life Years
£0.90–£0.99	**£0.95**	**109,440**	**–**	£0.90–£0.99	£0.95	26,249,916	0.9
£1.50–£1.59	**–**	**–**	**–**	£1.50–£1.59	£1.58	27,833	–
£1.60–£1.69	**£1.66**	**5,731,196**	**0.9**	£1.60–£1.69	£1.66	10,654,356	1.8
£1.70–£1.79	**–**	**–**	**–**	£1.70–£1.79	£1.70	793	–
£2.10–£2.19	**£2.12**	**9,801,088**	**2.3**	£2.10–£2.19	£2.12	11,011,582	2.5
£2.20–£2.29	**£2.27**	**14,930,249**	**4.3**	–	–	–	–
£2.50–£2.59	**£2.59**	**7,614,592**	**3.3**	£2.50–£2.59	£2.59	9,718,568	3.6
	£2.20	**38,186,565**	**3.0**		£1.58	57,663,048	1.9

(i) Exercise prices and the number of shares in each range have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For options exercised during the period, the weighted average share price at the date of exercise adjusted to reflect the bonus element of the Rights Issue was £2.64 (2007: £3.36).

SAS

Under the SAS, allocations of shares in Centrica plc are made to selected employees at middle management levels, based on recommendation by the Chief Executive and the Group Human Resources Director. 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 within the Group (except where permitted by the rules of the scheme) in two stages – half of the award vesting after two years, the other half vesting after three years. On vesting, additional shares are awarded or a cash payment is made to reflect dividends that would have been paid on the allocations during the vesting period. The fair value is therefore considered to be the market value at date of grant. Details of the fair values of awards granted and related assumptions are included in section (c) below. A reconciliation of movements in the allocations is as follows:

	2008 Number (i)	2007 Number (i)
Outstanding at start of period	**2,768,440**	1,645,338
Granted	**1,787,004**	1,314,198
Released	**(685,573)**	(25,593)
Forfeited	**(263,338)**	(165,503)
Outstanding at end of period	**3,606,533**	2,768,440
Vested at end of period	**–**	–

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For shares released during the period, the weighted average share price at the date of release adjusted to reflect the bonus element of the Rights Issue was £2.71 (2007: £3.34).

RSS

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 Human Resources Director. Neither the Executive Directors nor the next tier of executive management are eligible to participate. There is no contractual eligibility for RSS 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 within the Group (except where permitted by the rules of the scheme) in one or two stages dependent on the individual awards. On vesting, additional shares are awarded or a cash payment is made to reflect dividends that would have been paid on the allocations during the vesting period. The fair value is therefore considered to be the market value at date of grant. Details of the fair values of awards granted and related assumptions are included in section (c) below.

33. SHARE-BASED PAYMENTS CONTINUED

A reconciliation of movements in the allocations is as follows:

	2008 Number (i)	2007 Number (i)
Outstanding at start of period	**408,597**	–
Granted	**32,795**	408,597
Released	**(40,684)**	–
Outstanding at end of period	**400,708**	408,597
Vested at end of period	**–**	–

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For shares released during the period, the weighted average share price at the date of release adjusted to reflect the bonus element of the Rights Issue was £2.69 (2007: £nil).

SIP

Under SIP, employees in the UK may purchase 'partnership shares' through monthly salary deductions. The Company then awards one 'matching share' for every two purchased, up to a maximum of 20 matching shares per employee per month (since increased to 22 matching shares from 2009 to reflect the bonus element of the Rights Issue). Both partnership shares and matching shares are held in a trust. 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 (except where permitted by the rules of the scheme). Matching shares are valued at the market price at the grant date. Details of the fair values of awards granted and related assumptions are included in section (c) below.

A reconciliation of matching shares held in trust is as follows:

	2008 Number (i)	2007 Number (i)
Unvested at start of period	**2,873,180**	2,642,434
Granted	**730,122**	669,188
Released	**(182,117)**	(308,529)
Forfeited	**(133,070)**	(129,913)
Unvested at end of period	**3,288,115**	2,873,180

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For shares released during the period, the weighted average share price at the date of release adjusted to reflect the bonus element of the Rights Issue was £2.77 (2007: £3.33).

ESPP

Under the ESPP, employees in North America may purchase 'partnership shares' through salary deductions. The Company then awards 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 (except where permitted by the rules of the scheme). Matching shares are valued at the market price at the grant date. Details of the fair values of awards granted and related assumptions are included in section (c) below.

A reconciliation of matching shares granted is shown below:

	2008 Number (i)	2007 Number (i)
Unvested at start of period	**383,230**	386,776
Granted	**287,300**	209,959
Released	**(151,024)**	(175,687)
Forfeited	**(43,418)**	(37,818)
Unvested at end of period	**476,088**	383,230

(i) Movements in allocations prior to 14 November 2008 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

For shares released during the period, the weighted average share price at the date of release adjusted to reflect the bonus element of the Rights Issue was £2.75 (2007: £3.30).

Notes to the Financial Statements continued

33. SHARE-BASED PAYMENTS CONTINUED

(b) Fair values and associated details of options granted

	Sharesave		ESOS	
	2008	2007	**2008**	2007
Number of options originally granted	**14,168,889**	9,326,314	**299,130**	–
Number of options originally granted adjusted for Rights Issue (i)	**15,823,636**	10,477,514	**336,012**	–
Weighted average fair value at grant date	**£0.73**	£1.19	**£0.68**	–
Weighted average fair value at grant date adjusted for Rights Issue (i)	**£0.65**	£1.06	**£0.60**	–
Weighted average share price at grant date	**£3.05**	£3.91	**£3.27**	–
Weighted average share price at grant date adjusted for Rights Issue (i)	**£2.71**	£3.48	**£2.91**	–
Weighted average exercise price at grant date	**£2.55**	£2.91	**£2.88**	–
Weighted average exercise price adjusted for Rights Issue (i)	**£2.27**	£2.59	**£2.56**	–
Expected volatility (ii)	**23%**	23%	**23%**	–
Contractual option life	**4.4 years**	4.2 years	**10 years**	–
Expected life	**4.1 years**	3.7 years	**5 years**	–
Vesting period	**4.1 years**	3.7 years	**–**	–
Expected dividend yield	**3.50%**	3.70%	**4.20%**	–
Risk-free interest rate (iii)	**4.08%**	5.33%	**4.30%**	–
Expected forfeitures	**32%**	30%	**0%**	–

(c) Fair values and associated details of shares granted

2008	DMSS	LTIS	SAS	RSS	SIP	ESPP
Number of equity instruments at grant date	**3,030,836**	**11,595,241**	**1,590,660**	**32,795**	**691,019**	**274,217**
Number of equity instruments at grant date adjusted for Rights Issue (i)	**3,404,949**	**13,026,508**	**1,787,004**	**32,795**	**730,122**	**287,300**
Weighted average fair value at grant date	**£2.95**	**£2.24**	**£3.05**	**£2.47**	**£3.02**	**£3.33**
Weighted average fair value at grant date adjusted for Rights Issue (i)	**£2.63**	**£2.00**	**£2.71**	**£2.47**	**£2.69**	**£2.96**
Expected performance lapses	**0%**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Expected dividend yield	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**	**n/a**
Vesting period	**4 years**	**3 years**	**2.5 years**	**3 years**	**3 years**	**2 years**
Expected volatility (ii)	**n/a**	**22%**	**n/a**	**n/a**	**n/a**	**n/a**
Expected forfeitures	**25%**	**25%**	**20%**	**25%**	**0%**	**20%**
Risk-free rate (iii)	**n/a**	**4.05%**	**n/a**	**n/a**	**n/a**	**n/a**
Average volatility of FTSE 100	**n/a**	**27%**	**n/a**	**n/a**	**n/a**	**n/a**
Average cross-correlation of FTSE 100 (iv)	**n/a**	**30%**	**n/a**	**n/a**	**n/a**	**n/a**

2007	DMSS	LTIS	SAS	RSS	SIP	ESPP
Number of equity instruments at grant date	3,049,297	6,468,066	1,169,803	363,703	633,348	200,398
Number of equity instruments at grant date adjusted for Rights Issue (i)	3,425,689	7,266,456	1,314,198	408,597	669,188	209,959
Weighted average fair value at grant date	£2.93	£3.08	£3.91	£3.86	£3.72	£3.69
Weighted average fair value at grant date adjusted for Rights Issue (i)	£2.61	£2.74	£3.48	£3.44	£3.31	£3.28
Expected performance lapses	0%	n/a	n/a	n/a	n/a	n/a
Expected dividend yield	n/a	n/a	n/a	n/a	n/a	n/a
Vesting period	4 years	3 years	2.5 years	2.4 years	3 years	2 years
Expected volatility (ii)	n/a	21%	n/a	n/a	n/a	n/a
Expected forfeitures	25%	20%	20%	19%	0%	20%
Risk-free rate (iii)	n/a	5.40%	n/a	n/a	n/a	n/a
Average volatility of FTSE 100	n/a	30%	n/a	n/a	n/a	n/a
Average cross-correlation of FTSE 100 (iv)	n/a	20%	n/a	n/a	n/a	n/a

(i) Adjusted to take account of the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.
(ii) The expected volatility is based on historical volatility over the last three years.
(iii) The risk-free rate of return is the yield on zero-coupon UK government bonds of a term consistent with the expected option life.
(iv) 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.

34. PENSIONS

Pension schemes

A substantial majority of the Group's UK employees at 31 December 2008 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 also has a career average salary section which was closed to new members with effect from 1 July 2008 and replaced by a defined contribution section which is open to new members. 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) under a defined benefit scheme.

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 2008 and the Direct Energy Marketing Limited pension plan at 14 June 2008. These have been updated to 31 December 2008 for the purposes of meeting the requirements of IAS 19. Investments have been valued, for this purpose, at market value.

Governance

The UK schemes are managed by trustee companies where boards consist of both company nominated and member nominated directors. Each UK scheme holds units in the Centrica Combined Common Investment Fund (CCCIF), which holds the combined assets of the participating schemes. The method of allocation of units is set out in the Trust Deed of the CCCIF. The trustee of the CCCIF is a company, Centrica Combined Common Investment Fund Limited (CCCIF Limited) which was incorporated on 23 September 2002. The trustee of the CCCIF may be appointed or removed by the participant schemes. The board of CCCIF Limited comprises six directors, of which three are appointed by Centrica plc (including the chairman and one independent director) and a director is appointed by each of the participating schemes. No direct investments are made in securities issued by Centrica plc or any of its subsidiaries, property leased to or owned by Centrica plc or any of its subsidiaries or securities of any fund manager or any of their associated companies.

Under the terms of the Pensions Act 2004, the Company and each trustee board must agree the funding rate for its defined benefit pension scheme and a recovery plan to fund any deficit against the scheme specific statutory funding objective. This approach was first adopted for the triennial valuations completed at 31 March 2006 and will again be reflected in the valuations due to be completed at 31 March 2009.

In addition, the Group has a commitment to provide contributions to defined contribution schemes for certain employees in the UK and North America who are not members of one of the Group's defined benefit pension schemes.

Major assumptions used for the actuarial valuation	31 December 2008 %	31 December 2007 %
Rate of increase in employee earnings	**4.30**	4.40
Rate of increase in pensions in payment and deferred pensions	**3.30**	3.40
Discount rate	**6.70**	5.80
Inflation assumption	**3.30**	3.40

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:

	2008		2007	
Life expectancy at age 65 for a member:	Male Years	Female Years	Male Years	Female Years
Currently aged 65	**20.4**	**21.8**	20.2	21.8
Currently aged 45	**21.6**	**22.9**	21.4	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.

34. PENSIONS CONTINUED

Impact of changing material assumptions	2008 Increase/ decrease in assumption	2008 Indicative effect on scheme liabilities %	2007 Increase/ decrease in assumption	2007 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

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:

	2008 Expected rate of return per annum %	2008 Valuation £m	2007 Expected rate of return per annum %	2007 Valuation £m
UK equities	**8.5**	**884**	8.1	1,549
Non-UK equities	**8.5**	**996**	8.1	931
Fixed-interest bonds	**6.3**	**404**	5.8	412
Index-linked bonds	**4.3**	**258**	4.5	351
Property	**7.2**	**55**	6.8	50
Cash and other assets	**4.1**	**45**	5.4	34
Total fair value of plan assets	**7.7**	**2,642**	7.4	3,327
Present value of defined benefit obligation		**(2,755)**		(3,230)
Net (liability)/asset recognised in the Balance Sheet		**(113)**		97
Associated deferred tax asset/(liability) recognised in the Balance Sheet		**30**		(28)
Net pension (liability)/asset		**(83)**		69
Net (liability)/asset recognised in the Balance Sheet comprises:				
Surpluses		**73**		152
Deficits		**(186)**		(55)
		(113)		97

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 less costs of administering the plan and taxes paid by the plan itself. 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 £24 million (2007: £31 million) relating to unfunded pension arrangements. Included within non-current available-for-sale financial assets are £26 million (2007: £30 million) of investments, held by the Law Debenture Trust on behalf of the Company, as security in respect of the Centrica Unapproved Pension Scheme.

The Company has agreed with the trustees of the Centrica Pension Scheme and the Centrica Management Pension Scheme that it will provide collateral equal to the 31 December IAS 19 deficits two months after the relevant financial year or make additional contributions. At 31 December 2008, the IAS 19 net deficit on these two schemes totalled £94 million. The agreements provide that a charge over assets or letters of credit from a bank with a minimum credit rating of AA will be acceptable collateral for the trustees.

34. PENSIONS CONTINUED

Analysis of the amount charged to operating profit

	2008 £m	2007 £m
Current service cost	**106**	127
Past service credit	**(3)**	–
Loss on curtailment	**6**	–
Net charge to operating profit	**109**	127

Analysis of the amount credited to notional interest

	2008 £m	2007 £m
Expected return on pension scheme assets	**249**	221
Interest on pension scheme liabilities	**(190)**	(166)
Net credit to notional interest income	**59**	55

Analysis of the actuarial (loss)/gain recognised in the Statement of Recognised Income and Expense

	2008 £m	2007 £m
Actual return less expected return on pension scheme assets	**(1,121)**	(38)
Experience gains and losses arising on the scheme liabilities	**–**	(16)
Changes in assumptions underlying the present value of the schemes' liabilities	**722**	338
Actuarial (loss)/gain to be recognised in the Statement of Recognised Income and Expense before adjustment for tax	**(399)**	284
Cumulative actuarial gains recognised in reserves at 1 January	**723**	439
Cumulative actuarial gains recognised in reserves at 31 December	**324**	723

Five year history of (deficit)/surplus

	2008 £m	2007 £m	2006 £m	2005 £m	2004 £m
Plan assets	**2,642**	3,327	2,988	2,570	2,041
Defined benefit obligation	**(2,755)**	(3,230)	(3,284)	(3,390)	(2,760)
(Deficit)/surplus	**(113)**	97	(296)	(820)	(719)

Five year history of experience gains and losses

	2008	2007	2006	2005	2004
Difference between the expected and actual return on scheme assets:					
Amount (£m)	**(1,121)**	(38)	95	307	64
Percentage of scheme assets	**42.4%**	1.1%	3.2%	11.9%	3.1%
Experience gains and losses on scheme liabilities:					
Amount (£m)	**–**	(16)	145	21	134
Percentage of the present value of scheme liabilities	**–**	0.5%	4.4%	0.6%	4.9%
Total actuarial (loss)/gain recognised in the Statement of Recognised Income and Expense:					
Amount (£m)	**(399)**	284	475	(126)	90
Percentage of the present value of scheme liabilities	**14.5%**	8.8%	14.5%	3.7%	3.3%

Movement in the defined benefit obligation during the year

	2008 £m	2007 £m
1 January	**3,230**	3,284
Current service cost	**106**	127
Past service credit	**(3)**	–
Loss on curtailment	**6**	36
Interest on scheme liabilities	**190**	166
Plan participants' contributions	**26**	25
Benefits paid from schemes	**(79)**	(87)
Benefits paid by company	**(1)**	(1)
Actuarial gain	**(722)**	(322)
Acquisitions	**–**	2
Exchange adjustments	**2**	–
31 December	**2,755**	3,230

34. PENSIONS CONTINUED

Movement in plan assets during the year	2008 £m	2007 £m
1 January	**3,327**	2,988
Movements in the year:		
Expected return on scheme assets	**249**	221
Actuarial loss	**(1,121)**	(38)
Employer contributions [i]	**243**	218
Plan participants' contributions	**26**	25
Benefits paid from schemes	**(79)**	(87)
Pension Protection Fund Levy paid	**(3)**	–
31 December	**2,642**	3,327

(i) Includes £58 million (2007: £42 million) related to exceptional charges recorded in prior years.

Agreed future employer contribution rates (pensionable salary and % of pensionable salary) for the three main defined benefit schemes	2008 £m	2008 %
Centrica Pension Scheme – Final salary section	**7**	**22.4**
Centrica Pension Scheme – CRIS section	**92**	**10.9**
Centrica Engineers' Pension Scheme – Final salary section	**170**	**23.0**
Centrica Engineers' Pension Scheme – CERIS section	**48**	**12.5**
Centrica Management Pension Scheme	**70**	**22.6**
Centrica Management Pension Scheme – 2008 section	**124**	**20.4**

35. BUSINESS COMBINATIONS

During the year, the Group acquired 100% of the outstanding common shares of Rockyview Energy Inc. (Rockyview Energy), 100% of the membership interests of Strategic Energy LLC (Strategic Energy), a subsidiary of Great Plains Energy Inc., 100% of the Canadian assets of TransGlobe Energy Corp. (TransGlobe Energy), 100% of the share capital of Caythorpe Gas Storage Ltd (Caythorpe) and interests in a number of non-operated gas and oil assets in Norway (Heimdal assets). Other smaller acquisitions are described in section (f).

The purchase method of accounting was adopted in all cases. The assets and liabilities acquired and their fair values are shown below. The residual excess of cash consideration over the net assets acquired on each acquisition is recognised as goodwill in the Financial Statements. Unless otherwise stated, the fair values disclosed are provisional because the Directors have not yet reached a final determination on all aspects of the fair value exercise.

(a) Rockyview Energy

On 14 January 2008 the Group acquired 88.4% of the outstanding common shares of publicly traded oil and gas company Rockyview Energy for cash consideration of C$70 million (£35 million) and the remaining 11.6% of the outstanding common shares of Rockyview Energy by 19 February 2008 in a series of transactions for additional cash consideration of C$9 million (£5 million). In addition, borrowings with a fair value of C$38 million (£19 million) as assumed by the Group as part of the acquisition have been reflected in the opening balance sheet of the acquiree. The acquired business contributed a profit after tax of £7 million to the Group for the period from 14 January 2008 to 31 December 2008. The book values of the assets and liabilities have been adjusted to align with the fair values of the 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 and evaluation assets, and the producing oil and gas field assets. Other adjustments were made in respect of the recognition of decommissioning provisions at fair value and deferred tax relating to the fair value adjustments. During the year, the Directors reached a final determination on all aspects of the fair value exercise. No material adjustments have been made to the fair values disclosed in the 2008 interim Financial Statements.

(b) TransGlobe Energy

On 1 May 2008 the Group acquired 100% of the assets of TransGlobe Energy for cash consideration of C$51 million (£26 million). TransGlobe Energy is a publicly-traded oil and gas producer based in Calgary, Canada. The acquired business contributed a profit after tax of £1 million to the Group for the period from 1 May 2008 to 31 December 2008. The book values of the assets and liabilities have been adjusted to align with the fair values of the assets and liabilities acquired. Adjustments have been made to property, plant and equipment and to other intangible assets to recognise the producing oil and gas field assets and the exploration and evaluation assets at their respective fair values.

35. BUSINESS COMBINATIONS CONTINUED

(c) Strategic Energy

On 2 June 2008 the Group acquired 100% of the membership interests of Strategic Energy, a subsidiary of Great Plains Energy Inc., for cash consideration of US$309 million (£157 million). Strategic Energy is a US electricity supplier serving non-residential customers in eleven states within the US. The acquired business contributed a profit after tax of £9 million to the Group for the period from 2 June 2008 to 31 December 2008. The book values of the assets and liabilities have been adjusted to align with the fair values of the assets and liabilities acquired. Adjustments have been made in respect of other intangible assets, primarily to recognise contractual customer relationships and the acquired Strategic Energy brand, to trade and other payables in order to recognise acquired customer contracts priced below the market rate at the date of acquisition and to trade and other receivables in order to recognise acquired wholesale energy contracts at fair value. Goodwill of £77 million has arisen principally in relation to expected synergies.

Revisions to the fair values disclosed in the 2008 interim Financial Statements were made in respect of other intangible assets (£5 million increase) to reflect updated assumptions and estimates within the intangible assets valuation models, to trade and other receivables in order to reflect updated assumptions on the valuation of in-the-money energy procurement contracts (£4 million decrease), and to trade and other payables (£9 million increase) in order to recognise a legal liability and to reflect updated assumptions on the valuation of out-of-the-money sales contracts. In addition, the acquired in-the-money energy procurement contracts were re-classified from trade and other receivables to derivative financial instruments. These revisions resulted in an overall reduction in acquired net assets of £8 million, with a corresponding increase in goodwill.

(d) Caythorpe

On 8 September 2008 the Group acquired 100% of the share capital of Caythorpe and related assets for cash consideration of £71 million. Caythorpe owns a substantially depleted onshore gas field in the UK, together with planning permission and licences for conversion to an onshore gas storage facility. The acquired business did not generate any profit or incur any loss from 8 September 2008 to 31 December 2008. The book values of the assets and liabilities have been adjusted to align with the fair values of the assets and liabilities acquired. Adjustments have been made in respect of other intangible assets and property, plant and equipment in order to recognise the reservoir and related assets at their fair value, as well as the corresponding deferred tax liability, and to provisions for other liabilities and charges in order to recognise a decommissioning provision in respect of the existing site. Goodwill of £33 million has arisen due to the unique positioning of the acquired business, expected synergies from operating Caythorpe as part of a portfolio of storage assets and the recognition of deferred tax as a result of the fair values of the assets and liabilities acquired differing from their tax bases.

(e) Heimdal assets

On 31 October 2008 the Group acquired interests in a number of non-operated gas and oil assets in Norway, collectively the Heimdal assets, for cash consideration of US$312 million (£194 million). A net amount of £5 million, which has been reflected as a reduction to the consideration amount, was due at 31 October 2008 from the vendor. The net amount of £5 million comprised an amount receivable from the vendor of £10 million in respect of an adjustment for gas and oil produced and sold prior to the completion date and an amount payable to the vendor of £5 million in respect of deferred consideration. As at 31 December 2008, the amount receivable from the vendor was fully settled. The £5 million payable to the vendor was settled subsequent to the year end. The US dollar consideration amount was hedged between the date the sale and purchase agreement was signed (8 July 2008) and the date the transaction completed (31 October 2008). This resulted in a foreign exchange gain of £32 million being realised by the Group, which hedged the cash consideration on the acquisition.

The Heimdal assets comprise a combination of non-operating interests in producing fields, potential development projects and exploration opportunities. The acquired business contributed a profit after tax of £3 million from 31 October 2008 to 31 December 2008. The assets and liabilities acquired have been recognised at their respective fair values. The Group does not have access to the vendor's books and records which would include the assets and liabilities of the Heimdal assets at their pre-acquisition net book values and, hence, it is impracticable to disclose the carrying amounts on this basis. Goodwill of £142 million has arisen principally in relation to the recognition of deferred tax as a result of the fair values of the assets and liabilities acquired differing from their tax bases.

Notes to the Financial Statements continued

35. BUSINESS COMBINATIONS CONTINUED

North American business combinations

	Rockyview Energy		TransGlobe Energy		Strategic Energy		Total
	IFRS carrying values pre-acquisition £m	Fair value £m	IFRS carrying values pre-acquisition £m	Fair value £m	IFRS carrying values pre-acquisition £m	Fair value £m	Fair value £m
Other intangible assets	7	11	–	3	–	11	25
Property, plant and equipment	48	53	30	25	3	3	81
Trade and other receivables: current	6	6	–	–	146	146	152
Trade and other receivables: non-current	–	–	–	–	2	2	2
Derivative financial instruments: current	–	–	–	–	111	72	72
Derivative financial instruments: non-current	–	–	–	–	83	61	61
Cash and cash equivalents	–	–	–	–	77	77	77
Trade and other payables: current	(5)	(5)	–	–	(162)	(235)	(240)
Trade and other payables: non-current	–	–	–	–	–	(57)	(57)
Bank loans	(19)	(19)	–	–	–	–	(19)
Provisions for other liabilities and charges	(2)	(5)	(1)	(1)	–	–	(6)
Deferred tax liabilities	(4)	(1)	(1)	(1)	–	–	(2)
Net assets acquired	31	40	28	26	260	80	146
Goodwill		–		–		77	77
Cash consideration		**40**		**26**		**157**	**223**

UK and European business combinations

	Caythorpe		Heimdal assets (i)	Total
	IFRS carrying values pre-acquisition £m	Fair value £m	Fair value £m	Fair value £m
Other intangible assets	5	–	40	40
Property, plant and equipment	–	58	206	264
Trade and other receivables: current	–	–	7	7
Trade and other payables: current	–	–	(53)	(53)
Trade and other payables: non-current	–	–	(14)	(14)
Provisions for other liabilities and charges	–	(5)	(36)	(41)
Deferred tax liabilities	–	(15)	(130)	(145)
Net assets acquired	5	38	20	58
Goodwill		33	142	175
Gain on foreign exchange hedging instrument		–	32	32
Cash consideration		**71**	**194**	**265**

(i) The Group does not have access to the vendor's books and records which would include the Heimdal assets at their pre-acquisition net book values and, hence, it is impracticable to disclose the carrying amounts on this basis.

(f) Other acquisitions

The Group also acquired the assets and certain liabilities of Chilltrol Inc. on 29 February 2008 (consideration £4 million, goodwill £3 million), the assets and certain liabilities of Airco Mechanical Ltd and a number of related companies on 22 July 2008 (consideration £7 million, goodwill £4 million), Solar Technologies Group Ltd on 25 September 2008 (consideration £2 million, goodwill £2 million), BMSi Ltd on 14 October 2008 (consideration £10 million, which includes contingent consideration of £3 million, goodwill £6 million) and Semplice Energy Ltd on 20 October 2008 (consideration £1 million, goodwill £2 million). The acquired businesses contributed a profit after tax of £1 million to the Group from their respective dates of acquisition up to 31 December 2008.

The pro forma consolidated results of the Group, as if the 2008 acquisitions had been made at the beginning of the period, include revenue from continuing operations of £21,926 million (compared to reported Group revenue of £21,345 million) and an after tax loss of £143 million (compared to reported loss of £144 million). In determining these pro forma consolidated results, an estimate of the pre-acquisition results relating to the Heimdal assets has not been included as the lack of access to the vendor's books and records makes such an estimate impracticable. 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 2008 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.

36. COMMITMENTS AND CONTINGENCIES

(a) Commitments

Commitments in relation to the acquisition of property, plant and equipment	2008 £m	2007 £m
Construction of a power station at Langage	**64**	201
Construction of Lynn and Inner Dowsing wind farms	**5**	114
Redevelopment of Statfjord gas field	**62**	83
Other gas field developments	**60**	–
Other	**79**	69
	270	467

Commitments in relation to the acquisition of intangible assets	2008 £m	2007 £m
Renewable obligation certificates	**1,058**	1,075
Carbon emissions certificates	**399**	224
Certified emission reduction certificates	**139**	99
Other	**83**	49
	1,679	1,447

Commitments in relation to other contracts	2008 £m	2007 £m
Liquefied natural gas capacity	**783**	754
Transportation capacity	**829**	445
Outsourcing of services	**216**	167
Other	**355**	110
	2,183	1,476

Commitments in relation to commodity purchase contracts	2008 £m	2007 £m
Within one year	**15,202**	8,400
Between one and five years	**23,267**	18,100
After five years	**11,210**	9,100
	49,679	35,600

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.

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.

Notes to the Financial Statements continued

36. COMMITMENTS AND CONTINGENCIES CONTINUED

(b) Decommissioning costs

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

	2008 £m	2007 £m
Within one year	**126**	88
Between one and five years	**230**	165
After five years	**142**	146
	498	399

	2008 £m	2007 £m
The total of future minimum sub-lease payments expected to be received under non-cancellable operating sub-leases at 31 December	**14**	8
Lease and sub-lease payments recognised as an expense in the year were as follows:		
Minimum lease payments	**77**	60
Contingent rents – renewables (i)	**116**	48
Contingent rents – other	**3**	–

(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 (2007: £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 material 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.

37. RELATED PARTY TRANSACTIONS

During the year, the Group entered into the following transactions with related parties who are not members of the Group:

	2008			2007		
	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	**–**	**12**	**1**	–	14	2
Braes of Doune Wind Farm (Scotland) Limited	**–**	**13**	**–**	–	10	–
The Consumers' Waterheater Income Fund	**78**	**–**	**2**	72	–	2
	78	**25**	**3**	72	24	4

37. RELATED PARTY TRANSACTIONS CONTINUED

Balances outstanding with related parties at 31 December were as follows:

	2008			2007		
	Amounts owed from related parties £m	Amounts owed to related parties £m	Provision for bad or doubtful debt relating to amounts owed from related parties £m	Amounts owed from related parties £m	Amounts owed to related parties £m	Provision for bad or doubtful debt relating to amounts owed from related parties £m
Barrow Offshore Wind Limited	16	4	–	26	4	–
Braes of Doune Wind Farm (Scotland) Limited	32	8	–	38	4	–
The Consumers' Waterheater Income Fund	5	–	–	3	–	–
	53	12	–	67	8	–

Barrow Offshore Wind Limited and Braes of Doune Wind Farm (Scotland) Limited are both joint ventures of the Group.

The Consumers' Waterheater Income Fund (Fund) was deconsolidated with effect from 1 December 2007. The transactions disclosed in the tables above reflect all transactions entered into with the Fund for the full period disclosed. The Fund is a related party of the Group due to the significance of the contractual arrangements in place between the Fund and the Group to the operations of the Fund.

Remuneration of key management personnel	2008 £m	2007 £m
Short-term benefits	10	8
Post-employment benefits	1	3
Share-based payments	6	5
	17	16

Key management personnel comprise members of the Board and Executive Committee, a total of 15 individuals at 31 December 2008 (2007:15). 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.

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 biennial 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 £8 million (2007: £7 million). The contracts are not exposed to any interest rate risk or significant credit risk and do not contain any embedded derivatives.

The claims notified during the year were £291 million (2007: £269 million) and were exactly matched by expenses related to fixed-fee service contracts. All claims are settled immediately and in full.

	2008 £m	2007 £m
Total revenue	**944**	885
Expenses relating to fixed-fee service contracts	**754**	727
Deferred income	**27**	34

39. EVENTS AFTER THE BALANCE SHEET DATE

The Directors propose a final dividend of 8.73 pence per ordinary share (totalling £446 million) for the year ended 31 December 2008. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 11 May 2009. 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 2009.

On 20 January 2009, the Group acquired 50% of the issued share capital of Segebel SA for total consideration of €590 million (£547 million), including deferred consideration of €70 million (£65 million) and transaction costs of €5 million (£5 million), bringing the Group's total ownership interest in Segebel SA to 100%. The transaction results in the Group acquiring a controlling interest in Segebel SA, which will result in it being consolidated as a subsidiary. Segebel SA holds a controlling stake of 51% in SPE SA, a Belgian energy company. As such, this transaction also results in the Group obtaining a controlling interest in SPE SA.

39. EVENTS AFTER THE BALANCE SHEET DATE CONTINUED

The provisional fair values of the consolidated assets and liabilities of Segebel SA, including 100% of the assets and liabilities of SPE SA, as at the acquisition date are disclosed below. These values are provisional because the Directors have not yet reached a final determination on all aspects of the fair value exercise. In order to calculate goodwill arising from the acquisition, the minority interests in SPE SA (49%) are eliminated from the consolidated net assets in order to present the net assets attributable to Segebel SA, of which the Group has acquired 50%.

In addition to the provisional estimate of £229 million of goodwill to be recognised as part of this transaction, the Group also holds previously recognised goodwill of £26 million arising from the acquisition of the initial 50% stake in Segebel SA in September 2005.

Goodwill of £229 million arises principally in relation to incremental benefits expected to arise from the Pax Electrica II arrangements, as well as the recognition of deferred tax on the fair value adjustments.

	IFRS carrying values pre-acquisition £m	Fair value £m
Other intangible assets	203	576
Property, plant and equipment	343	940
Deferred tax assets	22	–
Retirement benefit assets	5	5
Trade and other receivables: current	406	532
Trade and other receivables: non-current	43	175
Inventories	32	33
Cash and cash equivalents	134	134
Net derivative financial instruments: current	(65)	(65)
Trade and other payables: current	(356)	(465)
Trade and other payables: non-current	–	(78)
Bank overdrafts, loans and other borrowings: current	(14)	(14)
Bank loans and other borrowings: non-current	(88)	(89)
Provisions for other liabilities and charges: current	–	(6)
Provisions for other liabilities and charges: non-current	(78)	(78)
Deferred tax liabilities	–	(329)
Retirement benefit obligations	(22)	(22)
Net assets (100%)	565	1,249
Minority interest in SPE SA		(612)
Net assets attributable to Segebel SA shareholders (51%)		637
Net assets acquired (50%)		318
Goodwill		229
Total consideration		**547**
Consideration comprises:		
Deferred consideration		**65**
Cash consideration		**482**

On 30 June 2008, an agreement was entered into to transfer the active members of the Centrica Pension Scheme to the Centrica Management Pension Scheme with an effective date of 1 January 2009. Liabilities and assets will accordingly be transferred with effect from this date. There will be no tax effect arising on the transfer. The Group has paid an additional £30 million to the Centrica Management Pension Scheme in December 2008 in relation to the transfer and will be paying a further amount of up to £79 million plus interest to that scheme. In addition, the Group has agreed to provide security to the Centrica Management Pension Scheme in the form of a charge on assets and/or letters of credit of up to £70 million in relation to the transfer.

40. PRINCIPAL UNDERTAKINGS

31 December 2008	Country of incorporation/formation	% 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 Insurance Limited	England	100	Insurance provision
British Gas Services Limited	England	100	Servicing and installation of gas heating systems
British Gas Trading Limited	England	100	Energy supply
Caythorpe Gas Storage Limited	England	100	Gas storage
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 Renewable Holdings Limited	England	100	Renewable energy holding company
Centrica Resources Limited	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
CPL Retail Energy LP	USA	100	Energy supply
DER Development No. 10 Limited	Canada	100	Gas production
DER Partnership 2	Canada	100	Gas production
Direct Energy LP	USA	100	Energy supply
Direct Energy Business LLC	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
Rockyview Energy Inc	Canada	100	Gas and oil production
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	Power generation
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.

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 2008 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 2008.

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 At a Glance, Financial Highlights, the Chairman's Statement, the Directors' Report, the unaudited part of the Directors' Remuneration 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 2008;
- 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

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
London
26 February 2009

Company Balance Sheet

31 December	Notes	2008 £m	2007 £m
Fixed assets			
Tangible fixed assets	iii	**35**	43
Investments in subsidiary undertakings	iv	**2,091**	2,080
		2,126	2,123
Current assets			
Debtors	v	**8,162**	5,571
Current asset investments	vi	**2,842**	1,066
Cash at bank and in hand		**–**	1
		11,004	6,638
Creditors (amounts falling due within one year)			
Borrowings	vii	**(297)**	(167)
Other creditors	viii	**(4,970)**	(3,830)
		(5,267)	(3,997)
Net current assets		**5,737**	2,641
Total assets less current liabilities		**7,863**	4,764
Creditors (amounts falling due after more than one year)			
Borrowings	vii	**(2,835)**	(1,378)
Other creditors	viii	**(4)**	–
		(2,839)	(1,378)
Provisions for liabilities and charges	ix	**(17)**	(13)
Net assets		**5,007**	3,373
Capital and reserves – equity interests			
Called up share capital	29	**315**	227
Share premium account	x	**729**	685
Capital redemption reserve	x	**16**	16
Other reserves	x	**3,947**	2,445
Shareholders' funds	xi	**5,007**	3,373

The Financial Statements on pages 136 to 142 were approved and authorised for issue by the Board of Directors on 26 February 2009 and were signed on its behalf by:

Sam Laidlaw
Chief Executive

Nick Luff
Group Finance Director

The notes on pages 137 to 142 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 loss after tax for the year ended 31 December 2008 was £93 million (2007: £5 million profit).

Employee share schemes
The Group has a number of employee share schemes, detailed 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. The issue of share incentives by the Company to employees of its subsidiaries represents additional capital contributions. An addition to the Company's investment in subsidiary undertakings is reported with a corresponding increase in shareholders' funds. The addition to the Company's investment in subsidiary undertakings is reduced on the issue of share incentives as these are recharged to the subsidiaries.

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, RSS and ESPP	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 of up to 10 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, 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 and borrowings

The Company's accounting policies for financial instruments and borrowings 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 41 to 42 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 the notes 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 £42 million (2007: £74 million), social security costs of £4 million (2007: £7 million), share scheme costs of £8 million (2007: £8 million) and other pension and retirement benefit costs of £27 million (2007: £17 million).

Details of Directors' remuneration, share-based payments and pension entitlements in the Remuneration Report on pages 44 to 55 form part of these Financial Statements. Details of employee share-based payments are given 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 631 (2007: 1,174), whom were primarily employed in the UK.

III. TANGIBLE FIXED ASSETS

	Plant, equipment and vehicles £m
Cost	
1 January 2008	79
Additions	5
31 December 2008	84
Depreciation and amortisation	
1 January 2008	36
Charge for the year	13
31 December 2008	49
Net book value	
31 December 2008	35
31 December 2007	43

IV. INVESTMENTS IN SUBSIDIARY UNDERTAKINGS

	Investments in subsidiaries' shares £m
Cost	
1 January 2008	2,080
Additions and disposals (i)	11
31 December 2008	2,091

(i) Additions and disposals represent the net change in shares to be issued under employee share schemes in Group undertakings.

V. DEBTORS

	2008			2007		
	Due within one year £m	Due after more than one year £m	Total £m	Due within one year £m	Due after more than one year £m	Total £m
Amounts owed by Group undertakings	7,933	–	7,933	5,545	–	5,545
Derivative financial instruments (i)	60	138	198	11	–	11
Other debtors	18	–	18	4	–	4
Prepayments and other accrued income	13	–	13	11	–	11
	8,024	138	8,162	5,571	–	5,571

(i) Derivative financial instruments comprise foreign currency derivatives held for trading of £40 million (2007: £9 million), interest rate derivatives held for trading of £2 million (2007: £2 million), interest rate derivatives held for hedging of £62 million (2007: £nil) and foreign currency derivatives held for hedging of £94 million (2007: £nil). The fair value of these derivatives is equivalent to the carrying value.

Notes to the Company Balance Sheet continued

VI. CURRENT ASSET INVESTMENTS

	2008 £m	2007 £m
Money market investments	**2,842**	1,066

£26 million (2007: £30 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

	2008		2007	
Amounts falling due	Within one year £m	After one year £m	Within one year £m	After one year £m
Bank loans and overdrafts	**40**	**422**	36	259
Bonds	**253**	**2,413**	131	1,119
Commercial paper	**4**	**–**	–	–
	297	**2,835**	167	1,378

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 are provided in note 25 to the Group Financial Statements.

VIII. OTHER CREDITORS

	2008		2007	
	Due within one year £m	Due after more than one year £m	Due within one year £m	Due after more than one year £m
Trade creditors	**17**	**–**	19	–
Amounts owed to Group undertakings	**4,597**	**–**	3,671	–
Derivative financial instruments (i)	**309**	**4**	68	–
Taxation and social security	**1**	**–**	2	–
Accruals and deferred income	**46**	**–**	70	–
	4,970	**4**	3,830	–

(i) Derivative financial instruments comprise foreign currency derivatives held for trading of £213 million (2007: £39 million), interest rate derivatives held for trading of £19 million (2007: £5 million) interest rate derivatives held for hedging of £4 million (2007: £7 million) and foreign currency derivatives held for hedging of £77 million (2007: £17 million). The fair value of these derivatives is equivalent to the carrying value.

IX. PROVISIONS FOR LIABILITIES AND CHARGES

	1 January 2008 £m	Profit and loss charge £m	Utilised in the year £m	Unused and released £m	31 December 2008 £m
Other provisions	13	1	(3)	(1)	**10**
Deferred tax	–	7	–	–	**7**
	13	8	(3)	(1)	**17**

Potential unrecognised deferred corporation tax assets amounted to £6 million (2007: £14 million), primarily relating to unused tax losses. The Company does not expect to be able to utilise these losses within the foreseeable future.

Other provisions principally represent estimated liabilities for contractual settlements and National Insurance in respect of employee share scheme liabilities. The National Insurance provision was based on a share price of 266.00 pence at 31 December 2008 (2007: 319.21 pence adjusted for the Rights Issue). The majority of the amounts are expected to be utilised between 2009 and 2011.

X. RESERVES

	Share premium account £m	Merger reserve £m	Capital redemption reserve £m	Cash flow hedging reserve £m	Profit and loss reserve £m	**Total £m**
1 January 2008	685	–	16	4	2,441	**3,146**
Loss for the year (i)	–	–	–	–	(93)	**(93)**
Gains on revaluation of cash flow hedges	–	–	–	17	–	**17**
Deferred tax on revaluation gains	–	–	–	(7)	–	**(7)**
Dividends	–	–	–	–	(500)	**(500)**
Employee share schemes:						
Increase in treasury shares	–	–	–	–	(9)	**(9)**
Value of services provided	–	–	–	–	40	**40**
Exercise of awards	–	–	–	–	(24)	**(24)**
Rights Issue (ii)	–	2,078	–	–	–	**2,078**
Transfer (ii)	–	(2,078)	–	–	2,078	**–**
Share issue	44	–	–	–	–	**44**
31 December 2008	729	–	16	14	3,933	**4,692**

(i) As permitted by section 230(3) of the Companies Act 1985, no profit and loss account is presented. The Company's loss for the year was £93 million (2007: profit of £5 million) before dividends paid of £500 million (2007: £417 million).
(ii) Details of the Rights Issue are provided in notes 5, 29 and 30 of the Group Financial Statements.

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

	Treasury shares £m	Share-based payments reserve £m	Other £m	**Profit and loss reserve £m**
1 January 2008	(2)	51	2,392	**2,441**
Loss for the year (i)	–	–	(93)	**(93)**
Dividends	–	–	(500)	**(500)**
Employee share schemes:				
Increase in treasury shares	(9)	–	–	**(9)**
Value of services provided	–	40	–	**40**
Exercise of awards	1	(25)	–	**(24)**
Transfer	–	–	2,078	**2,078**
31 December 2008	(10)	66	3,877	**3,933**

(i) Includes a £1 million loss on re-measurement of interest rate derivatives and bonds designated as the hedged item (2007: £1 million gain) and a £138 million loss on re-measurement of foreign currency derivatives (2007: £2 million loss). 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

	2008 £m	2007 £m
1 January	**3,373**	3,731
(Loss)/profit attributable to the Company	**(93)**	5
Gains on revaluation of cash flow hedges	**17**	3
Deferred tax on revaluation gains	**(7)**	–
Dividends paid to shareholders	**(500)**	(417)
Employee share schemes:		
Increase in treasury shares	**(9)**	(2)
Value of services provided	**40**	31
Exercise of awards	**(24)**	(7)
Rights Issue	**2,164**	–
Share issue	**46**	29
Net movement in shareholders' funds for the financial year	**1,634**	(358)
31 December	**5,007**	3,373

The Directors propose a final dividend of 8.73 pence per share (totalling £446 million) for the year ended 31 December 2008. The dividend will be submitted for formal approval at the Annual General Meeting to be held on 11 May 2009. 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 2009.

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 2008, the Company had commitments of £169 million (2007: £138 million) relating to contracts with outsource service providers. Other commitments at 31 December amount to £nil (2007: £7 million).

(b) Lease commitments

At 31 December 2008, there were £1 million of land and buildings and £1 million of vehicle lease commitments in relation to the annual value of non-cancellable operating leases for the Company expiring in one to five years (2007: £1 million and £1 million respectively). The Company has guaranteed operating commitments of a subsidiary undertaking at 31 December 2008 of £7 million (2007: £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 2008, the credit risk exposure under financial guarantees issued by Centrica plc was £2,558 million (2007: £1,487 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 Europe and North America.

The principal fields in Europe are South Morecambe, North Morecambe, Statfjord, Grove, Seven Seas and the Rough field associated with Centrica Storage. The European reserves estimates are consistent with the guidelines and definitions of the Society of Petroleum Engineers, Society of Petroleum Evaluation Engineers and World Petroleum Congress Petroleum Resources Management System using accepted principles. 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.

Estimated net proven and probable reserves of gas (billion cubic feet)	Europe	North America	Total
1 January 2008	1,433	322	**1,755**
Revisions of previous estimates (i)	(5)	37	**32**
Purchases of reserves in place (ii)	62	53	**115**
Extensions, discoveries and other additions (iii)	100	–	**100**
Production	(238)	(37)	**(275)**
31 December 2008	**1,352**	**375**	**1,727**

Estimated net proven and probable reserves of liquids (million barrels)	Europe	North America	Total
1 January 2008	33	3	**36**
Revisions of previous estimates (i)	2	–	**2**
Purchases of reserves in place (ii)	4	1	**5**
Extensions, discoveries and other additions (iii)	(1)	–	**(1)**
Production	(6)	–	**(6)**
31 December 2008	**32**	**4**	**36**

(i) Includes minor reserves revisions to a number of fields in Europe and to the Medicine Hat, Bashaw and Entice fields in North America.
(ii) Reflects the equity acquisitions in the Grove field in the UK, the Heimdal, Skirne, Vale and Peik fields in Norway and the fields acquired with the Rockyview Energy and Transglobe Energy business combinations in North America.
(iii) Includes approval for the development of the Babbage and Seven Seas fields and development drilling in the Grove field.

Liquids reserves include oil, condensate and natural gas liquids.

Five Year Record

Results

Year ended 31 December	2004 (restated) (i),(ii) £m	2005 (restated) (ii) £m	2006 (restated) (ii) £m	2007 (restated) (ii) £m	2008 £m
Group revenue from continuing operations (ii)	11,316	13,394	16,359	16,272	**21,345**
Operating profit from continuing operations before exceptional items and certain re-measurements:					
British Gas Residential	242	90	95	571	**379**
British Gas Business	68	77	87	120	**143**
British Gas Services	72	111	102	151	**195**
Centrica Energy	773	903	686	663	**879**
Centrica Storage	69	154	228	240	**195**
Direct Energy	99	147	173	187	**215**
European Energy	5	(9)	7	17	**(56)**
Other operations	1	2	14	–	**(8)**
	1,329	1,475	1,392	1,949	**1,942**
Operating profit/(loss) from discontinued operations, net of tax:					
The Consumers' Waterheater Income Fund (iii)	33	38	50	39	**–**
OneTel (iv)	3	12	(11)	–	**–**
The AA (v)	80	–	–	–	**–**
Exceptional items and certain re-measurements after taxation	833	340	(862)	383	**(1,048)**
Profit/(loss) attributable to equity holders of the parent	1,591	1,012	(155)	1,505	**(145)**
	Pence	Pence	Pence	Pence	**Pence**
Earnings/(loss) per ordinary share (vii)	33.9	24.4	(3.8)	36.5	**(3.5)**
Adjusted earnings per ordinary share (vi),(vii)	16.1	16.2	17.3	27.2	**21.5**

Assets and liabilities

At 31 December	2004 (restated) (i) £m	2005 £m	2006 £m	2007 £m	2008 £m
Goodwill and other intangible assets	1,567	1,739	1,501	1,539	**2,181**
Other non-current assets	3,791	4,490	4,171	4,518	**5,658**
Net current assets/(liabilities)	155	666	(112)	381	**1,488**
Non-current liabilities	(3,205)	(4,453)	(3,918)	(3,056)	**(4,941)**
Net assets	2,308	2,442	1,642	3,382	**4,386**
Debt, net of cash, cash equivalents and available-for-sale financial assets:					
Net debt (excluding non-recourse debt)	(508)	(1,060)	(1,527)	(795)	**(511)**
The Consumers' Waterheater Income Fund (non-recourse) debt	(217)	(532)	(483)	–	**–**
	(725)	(1,592)	(2,010)	(795)	**(511)**

Cash flows

Year ended 31 December	2004 (restated) (i) £m	2005 £m	2006 £m	2007 £m	2008 £m
Cash flow from operating activities before exceptional payments	1,294	1,192	850	2,447	**371**
Payments relating to exceptional charges	(25)	(48)	(113)	(90)	**(74)**
Net cash flow from investing activities	497	(529)	(720)	(964)	**(1,122)**
Cash flow before cash flow from financing activities	1,766	615	17	1,393	**(825)**

(i) The 2004 comparatives have been restated on transition to IFRS.
(ii) Group revenue and cost of sales have been restated to report gas sales revenue of Centrica Storage net of cost of sales to better reflect the nature of the transactions as explained in note 2.
(iii) Discontinued in 2007.
(iv) Discontinued in 2005.
(v) Discontinued in 2004.
(vi) Adjusted earnings per ordinary share exclude certain re-measurements and exceptional items.
(vii) Figures for 2004 through to 2007 have been adjusted to reflect the bonus element of the Rights Issue. Details of the Rights Issue are provided in notes 5, 29 and 30.

Shareholder Information

Electronic communications and the Centrica website

At the 2007 Annual General Meeting the Company passed a resolution allowing the Centrica website to be used as the primary means of communication with its shareholders. Those shareholders who have positively elected for website communication (or who were deemed to have consented to electronic communication in accordance with the Companies Act 2006) will receive written notification whenever shareholder documents are available to view on the Centrica website.

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 2008 Annual Report, Annual Review and Notice of Meeting are available to view at **www.centrica.com/report2008**. 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 Annual Review.

Shareholders who have registered to receive shareholder documentation from Centrica electronically can:

- view the Annual Report and Annual Review on the day they are 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 certificates;
- lost or out-of-date dividend cheques and payment of dividends into a bank or building society account;
- death of the registered holder of shares; or

any other query relating to your Centrica shareholding, please contact Equiniti:

Telephone: 0871 384 2985*
Textphone: 0871 384 2255*

Write to: Equiniti, Aspect House, Spencer Road, Lancing, West Sussex BN99 6DA

Email: centrica@equiniti.com

A range of frequently asked questions is also available at **www.centrica.com/shareholders**.

FlexiShare

The Centrica FlexiShare service
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 share 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 designated 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 then 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 the preparation of 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 sharedealing services available. If you are selling, you will need to present your share certificate at the time of sale. FlexiShare (details above) offers a 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 which trades under the symbol CPYYY. During the year, Centrica's ADR ratio was changed from one ADR being equivalent to ten UK ordinary shares into one ADR being equivalent to four UK ordinary shares. The ratio change is intended to improve market liquidity in the US. The 150% ADR distribution (forward split) became effective from 6 October 2008.

For enquiries, please contact:
ADR Depositary
BNY Mellon Shareowner Services
PO Box 358516
Pittsburgh, PA 15252-8516
Email: shrrelations@bnymellon.com
or via **www.bnymellon.com/shareowner**

Telephone: 1 877 353 1154 toll-free in the US or 001 201 680 6825 from outside the US

Website address: **www.adrbnymellon.com**

ShareGift
ShareGift (registered charity No. 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 (ie 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*.

* Calls to these numbers are charged at 8 pence per minute from a BT landline. Other providers' telephony costs may vary.

Shareholder Information continued

Financial calendar

22 April 2009	Ex-dividend date for 2008 final dividend
24 April 2009	Record date for 2008 final dividend
11 May 2009	AGM, Queen Elizabeth II Conference Centre, London SW1
10 June 2009	Payment date for 2008 final dividend
30 July 2009	Announcement date for 2009 interim results
11 November 2009	Payment date for proposed 2009 interim dividend

Analysis of shareholders as at 31 December 2008

Distribution of shares by the type of shareholder	Holdings	Shares
Nominees and institutional investors	11,601	4,741,759,374
Individuals	761,553	365,899,195
Total	773,154	5,107, 658,569

Size of shareholding	Number of holdings	Shares
1–500	574,405	132,242,943
501–1,000	119,346	82,312,542
1,001–5,000	71,842	126,845,459
5,001–10,000	4,443	30,319,472
10,001– 50,000	1,802	32,112,596
50,001–100,000	225	16,378,546
100,001– 1,000,000	639	245,110,873
1,000,001 and above	452	4,442,336,138
Total	773,154	5,107,658,569

As at 31 December 2008 there were 78,825 participants in the Centrica FlexiShare service, with an aggregate shareholding of 129,276,869 shares, registered in the name of Equiniti Corporate Nominees 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 and the 2008 Rights Issue

The share capital of Centrica plc was consolidated on two occasions, in 1999 and 2004, and in 2008 the Company offered shareholders the right to subscribe for additional shares as set out below:

- 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;
- 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; and
- on 31 October 2008, a Rights Issue was announced on the basis of three new ordinary shares for every eight existing shares held on 14 November 2008, at a subscription price of 160 pence per share. Dealing in the new fully paid ordinary shares commenced on the London Stock Exchange on 15 December 2008. Shareholders who subscribed for their rights in full should, for UK tax on chargeable gains (CGT) purposes, treat the existing and new shares as the same asset acquired at the time of acquisition of their existing shares, and the subscription monies for the new shares should be added to the base cost of their existing shareholding. Further tax information can be found in the Rights Issue prospectus on the Centrica website.

ACCESSIBILITY

If you would like this Annual Report in an alternative format, such as large print, Braille or CD, you can request these in the following ways:

Telephone: 0800 111 4371 Textphone: 18001 0800 111 4371

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

Downstream:
- supplies energy to homes and to businesses
- provides home and energy services

Downstream businesses include:
- British Gas
- Direct Energy in North America
- retail operations in Europe

Upstream:
- generates electricity and produces gas
- 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
- assets and trading operations in Europe

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

www.centrica.com

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

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