Accounting Policies

for the year ended 31st March 2006

The group's and parent company's significant accounting policies are:

Basis of accounting and preparation

The accounts are prepared in accordance with International Financial Reporting Standards (IFRS) and interpretations issued by the International Financial Reporting Interpretations Committee (IFRIC) or the Standing Interpretations Committee (SIC) as adopted by the European Union. For Johnson Matthey, there are no differences between IFRS as adopted by the European Union and full IFRS as published by the International Accounting Standards Board and so the accounts comply with IFRS.

The accounts are prepared on the historical cost basis, except for certain assets and liabilities which are measured at fair value as explained below.

Previous accounts were prepared under UK Generally Accepted Accounting Principles (UK GAAP) and reconciliations converting the group's results and the parent company's balance sheet from UK GAAP to IFRS for the year ended 31st March 2005 and the group's and parent company's balance sheets at 1st April 2004 (the date of transition) are presented in note 44.

Johnson Matthey has taken advantage of the exemption allowed under IFRS 1 – 'First-time Adoption of International Financial Reporting Standards' not to restate comparative information to comply with International Accounting Standard (IAS) 32 – 'Financial Instruments: Disclosure and Presentation', IAS 39 – 'Financial Instruments: Recognition and Measurement' and IFRS 4 – 'Insurance Contracts'. Note 34 details the adjustment to the balance sheets at 1st April 2005 for the implementation of these standards. The group and parent company have also adopted the amendment to IAS 19 – 'Employee Benefits', which permits the full recognition of actuarial gains or losses that occur in the year in the statement of recognised income and expense, and the amendment to IAS 39 and IFRS 4, which ensures that financial guarantee contracts are included in the balance sheet where appropriate.

The parent company has not presented its own income statement and related notes as permitted by section 230 of the Companies Act 1985.

Basis of consolidation

The consolidated accounts comprise the accounts of the parent company and all its subsidiaries, including employee share ownership trusts, and include the group's interest in associates.

Entities over which the group has the ability to exercise control are accounted for as subsidiaries. Entities that are not subsidiaries or joint ventures but where the group has significant influence (i.e. the power to participate in the financial and operating policy decisions) are accounted for as associates.

The results and assets and liabilities of associates are included in the consolidated accounts using the equity method of accounting.

The results of businesses acquired or disposed of in the year are consolidated from or up to the effective date of acquisition or disposal respectively. The net assets of businesses acquired are incorporated in the consolidated accounts at their fair values at the date of acquisition.

Transactions and balances between subsidiaries are eliminated. No profit is taken on transactions between subsidiaries and the group's share of profits on transactions with associates is also eliminated.

In the parent company balance sheet, businesses acquired by the parent company from other group companies are incorporated at book value at the date of acquisition. Where the consideration given exceeds the book value of the assets acquired this difference is accounted for as goodwill.

Revenue

Revenue comprises all sales of goods and rendering of services at the fair value of consideration received or receivable after the deduction of any trade discounts and excluding sales taxes. Revenue is recognised when it can be measured reliably and the significant risks and rewards of ownership are transferred to the customer. With the sale of goods this generally occurs when the goods are despatched or made available to the customer, except for the sale of consignment products located at customers' premises where revenue is recognised on notification that the product has been used. With the rendering of services revenue is generally recognised by reference to the stage of completion as measured by the proportion that costs incurred to date bear to the estimated total costs. With royalties this generally occurs in accordance with the substance of the relevant agreement.

Construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion. This is normally measured by the proportion that contract costs incurred to date bear to the estimated total contract costs.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred.

When it is probable that the total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Accounting Policies

for the year ended 31st March 2006

Foreign currencies

Foreign currency transactions are recorded in local currency at the exchange rate at the date of transaction. Foreign currency monetary assets and liabilities are retranslated into local currency at the exchange rate at the balance sheet date.

Income statements and cash flows of overseas subsidiaries, associates and branches are translated into sterling at the average rates for the year. Balance sheets of overseas subsidiaries, associates and branches, including any fair value adjustments and including related goodwill, are translated into sterling at the exchange rates at the balance sheet date.

Exchange differences arising on the translation of the net investment in overseas subsidiaries, associates and branches, less exchange differences arising on related foreign currency financial instruments which hedge the group's net investment in these operations, are taken to a separate component of equity. The group has taken advantage of the exemption allowed in IFRS 1 to deem the cumulative translation difference for all overseas subsidiaries, associates and branches to be zero at 1st April 2004.

Other exchange differences are taken to operating profit.

Research and development

Research expenditure is charged to the income statement in the year incurred.

Development expenditure is charged to the income statement in the year incurred unless it meets the IFRS recognition criteria for capitalisation. When the recognition criteria have been met any further development expenditure is capitalised as an intangible asset.

Interest

Interest is recognised in the income statement in the year incurred.

Property, plant and equipment

Property, plant and equipment are stated at cost less accumulated depreciation and any provisions for impairment. Finance costs are not capitalised.

Depreciation is generally provided using the straight line method to write off the cost less estimated residual value over the useful life of the asset. The estimated useful lives vary according to the class of the asset, but are typically: leasehold property 30 years (or the life of the lease if shorter); freehold buildings 30 years; and plant and equipment 4 to 10 years. Freehold land is not depreciated.

Goodwill

Goodwill arises on the acquisition of a business when the fair value of the consideration given exceeds the fair value attributed to the net assets acquired. It is subject to annual impairment reviews.

The group and parent company have taken advantage of the exemption allowed under IFRS 1 and so goodwill arising on acquisitions made before 1st April 2004 is included at the carrying amount at that date less any subsequent impairments. Up to 31st March 1998 goodwill was eliminated against reserves.

Intangible assets

Intangible assets are stated at cost less any accumulated amortisation and any provision for impairment. They are amortised in accordance with the relevant income stream or by using the straight line method over their useful lives from the time they are first available for use. The estimated useful lives vary according to the specific asset but are typically: 1 to 8 years for customer contracts and relationships; 3 to 8 years for capitalised software; 3 to 10 years for patents, trademarks and licences; and 3 to 8 years for capitalised development currently being amortised.

Intangible assets which are not yet being amortised are subject to annual impairment reviews.

Investments in subsidiaries

Investments in subsidiaries are stated in the parent company's balance sheet at cost less any provision for impairment. Any distributions from pre-acquisition profits are recognised as a reduction to the cost of the investment.

Leases

Leases are classified as finance leases whenever they transfer substantially all the risks and rewards of ownership to the group. The assets are included in property, plant and equipment or capitalised software and the capital elements of the leasing commitments are shown as obligations under finance leases. The assets are depreciated on a basis consistent with similar owned assets or the lease term if shorter. The interest element of the lease rental is included in the income statement.

All other leases are classified as operating leases and the rentals payable are expensed on a straight line basis over the lease term.

Grants

Grants related to assets are included in deferred income and released to the income statement in equal instalments over the expected useful lives of the related assets.

Grants related to income are generally deducted in reporting the related expense.

Precious metal inventories

Inventories of gold, silver and platinum group metals are valued according to the source from which the metal is obtained. Metal which has been purchased and committed to future sales to customers or hedged in metal markets is valued at the price at which it is contractually committed or hedged, adjusted for unexpired contango and backwardation. Other precious metal inventories owned by the group, which are unhedged, are valued at the lower of cost and net realisable value using the weighted average cost formula.

Other inventories

Non precious metal inventories are valued at the lower of cost, including attributable overheads, and net realisable value. Except where costs are specifically identified, the first-in, first-out or weighted average cost formulae are used to value inventories.

Derivative financial instruments

The group and parent company use derivative financial instruments, in particular forward currency contracts and currency swaps, to manage the financial risks associated with their underlying business activities and the financing of those activities. The group and parent company do not undertake any trading activity in derivative financial instruments.

Derivative financial instruments are measured at their fair value. Derivative financial instruments may be designated at inception as fair value hedges, cash flow hedges or net investment hedges if appropriate.

Changes in the fair value of any derivative financial instruments that are not designated as or are not determined to be effective hedges are recognised immediately in the income statement.

Changes in the fair value of derivative financial instruments designated as fair value hedges are recognised in the income statement, together with the related changes in the fair value of the hedged asset or liability.

Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in equity. If the hedged item results in the recognition of a non-financial asset or liability, the amount recognised in equity is transferred out of equity and included in the initial carrying amount of the asset or liability. Otherwise, the amount recognised in equity is transferred to the income statement in the same period that the hedged item is recognised in the income statement.

Hedges of net investments in foreign operations are accounted for in a similar way to cash flow hedges.

Other financial instruments

All other financial instruments are initially recognised at fair value plus transaction costs. Subsequent measurement is as follows:

- Unhedged borrowings are measured at amortised cost.
- Available-for-sale investments are measured at fair value with changes in fair value recognised directly in equity. On disposal of the investment the amount recognised in equity will be transferred to the income statement at the trade date.
- All other financial assets and liabilities, including short term receivables and payables, are measured at amortised cost less any impairment provision.

Cash and cash equivalents

Cash and deposits comprise cash at bank and in hand, including short term deposits with a maturity date of three months or less from the date of acquisition. The group and parent company routinely use short term bank overdraft facilities, which are repayable on demand, as an integral part of their cash management policy. Therefore cash and cash equivalents in the cash flow statements are cash and deposits less bank overdrafts. Offset arrangements across group businesses have been applied to arrive at the net cash and overdraft figures.

Taxation

Current and deferred tax are recognised in the income statement, except when they relate to items recognised directly in equity when the related tax is also recognised in equity.

Current tax is the amount of income tax expected to be paid in respect of the taxable profits using the tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amount in the balance sheet. It is provided using the tax rates that are expected to apply in the period when the asset or liability is settled, based on tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets are recognised to the extent that it is probable that future taxable profits will be available against which the temporary differences can be utilised. No deferred tax asset or liability is recognised in respect of temporary differences associated with investments in subsidiaries, branches and associates where the group is able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future.

Provisions and contingencies

Provisions are recognised when the group has a present obligation as a result of a past event and a reliable estimate can be made of a probable adverse outcome, for example warranties, environmental claims and restructurings. Otherwise, material contingent liabilities are disclosed unless the transfer of economic benefits is remote. Contingent assets are only disclosed if an inflow of economic benefits is probable.

The group considers financial guarantees of its share of the borrowings and precious metal leases of its associates to be insurance contracts. The parent company considers financial guarantees of its subsidiaries' borrowings and precious metal leases to be insurance contracts. These are treated as contingent liabilities unless it becomes probable that they will be required to make a payment under the guarantee.

Share-based payments and employee share ownership trusts (ESOTs)

The fair value of outstanding share options granted to employees and shares allocated to employees under the long term incentive plan after 7th November 2002 is calculated using an adjusted Black-Scholes options valuation model and the resulting cost is charged to the income statement over the relevant vesting periods, adjusted to reflect actual and expected levels of vesting where appropriate.

The group and parent company provide finance to the ESOTs to purchase company shares in the open market. Costs of running the ESOTs are charged to the income statement. The cost of shares held by the ESOTs are deducted in arriving at equity until they vest unconditionally in employees.

Pensions and other post-employment benefits

The group operates a number of contributory and non-contributory plans, mainly of the defined benefit type, which require contributions to be made to separately administered funds.

The costs of the defined contribution plans are charged to the income statement as they fall due.

For defined benefit plans, the group and parent company recognise the net assets or liabilities of the schemes in their balance sheets. Obligations are measured at present value using the projected unit credit method and a discount rate reflecting yields on high quality corporate bonds. Assets are measured at their fair value at the balance sheet date. The changes in scheme assets and liabilities, based on actuarial advice, are recognised as follows:

- The current service cost is spread over the period during which benefit is expected to be derived from the employees' services based on the most recent actuarial valuation and is deducted in arriving at operating profit.
- The interest cost, based on the discount rate at the beginning of the year and the present value of the defined benefit obligation during the year, is included in operating profit.
- The expected return on plan assets, based on market expectations at the beginning of the year for returns over the entire life of the related obligation and amended for changes in the fair value of plan assets as a result of contributions paid in and benefits paid out, is included in operating profit.
- Actuarial gains and losses, representing differences between the expected return and actual return on plan assets, differences between actuarial assumptions underlying the plan liabilities and actual experience during the year, and changes in actuarial assumptions, are recognised in the statement of recognised income and expense in the year they occur.
- Past service costs are spread evenly over the period in which the increases in benefit vest and are deducted in arriving at operating profit. If an increase in benefits vests immediately, the cost is recognised immediately.
- Gains or losses arising from settlements or curtailments are included in operating profit.

Standards and interpretations issued but not yet applied

IFRS 7 – 'Financial Instruments: Disclosures' was issued in August 2005 and is required to be applied for annual periods beginning on or after 1st January 2007. It revises and enhances the disclosure required by IAS 30 – 'Disclosure in the Financial Statements of Banks and Similar Financial Institutions' and IAS 32 – 'Financial Instruments: Presentation'.