ACCOUNTING POLICIES

for the year ended 31st March 2008

The group's and parent company's significant accounting policies, together with the judgments made by management in applying those policies which have the most significant effect on the amounts recognised in the accounts, 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.

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 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 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 revenue is recognised 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 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.

Foreign currencies

Foreign currency transactions are recorded in the functional currency of the relevant subsidiary, associate or branch at the exchange rate at the date of transaction. Foreign currency monetary assets and liabilities are retranslated into the relevant functional 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 – 'First-time Adoption of International Reporting Standards' 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.

Finance costs and finance income

Finance costs and finance income are recognised in the income statement in the year incurred.

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.

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 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 (including contingent liabilities). 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 accumulated amortisation and any provisions 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 provisions 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 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 lease costs 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 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.

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.

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. Fair value hedge accounting is discontinued if the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the designation is revoked.

Changes in the fair value of derivative financial instruments designated as cash flow hedges are recognised in equity, to the extent that the hedges are effective. Ineffective portions are recognised in the income statement immediately. 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. If the hedging instrument expires or is sold, terminated or exercised, the hedge no longer meets the criteria for hedge accounting or the designation is revoked, amounts previously recognised in equity remain in equity until the forecast transaction occurs. If a forecast transaction is no longer expected to occur, the amounts previously recognised in equity are transferred to the income statement.

For hedges of net investments in foreign operations, the effective portion of the gain or loss on the hedging instrument is recognised in equity, while the ineffective portion is recognised in the income statement. Amounts taken to equity are transferred to the income statement when the foreign operations are sold.

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.

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 it 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 plans 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 and reimbursement rights, 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 adopted in the year

The standards and interpretations which were adopted during the year were IFRS 7 – 'Financial Instruments: Disclosures', Amendment to International Accounting Standard (IAS) 1 – 'Capital Disclosures' and IFRIC 10 – 'Interim Financial Reporting and Impairment'. There were no changes in accounting policy and no effect on current or prior year results or net assets of the group and parent company.

IFRIC 11 – 'IFRS 2 – Group and Treasury Share Transactions' was also adopted during the year. There were no changes in accounting policy and no effect on current or prior year results or net assets of the group. In the parent company the cost of share-based payments granted to its subsidiaries' employees (to the extent that it is not recharged) is accounted for as an additional investment in subsidiaries. The cost has been recharged to its subsidiaries this year and so this is the only change to the results for the year ended 31st March 2008. The parent company has restated its comparatives for the year ended 31st March 2007 and so investments in subsidiaries and equity at 31st March 2007 have been increased by £6.6 million.

Standards and interpretations issued but not yet applied

IFRS 8 – 'Operating Segments' was issued in November 2006 and is required to be applied for annual periods beginning on or after 1st January 2009. It replaces IAS 14 – 'Segment Reporting' and requires the identification of operating segments based on internal reporting to the chief operating decision maker and changes the disclosure requirements. Johnson Matthey has not yet completed its evaluation of the impact on its disclosures but adoption of the standard will not affect the reported results or net assets of the group and parent company.

IFRIC 12 – 'Service Concession Arrangements' was issued in November 2006 and is required to be applied for annual periods beginning on or after 1st January 2008. This will not affect the reported results or net assets of the group and parent company.

IAS 23 – 'Borrowing Costs' was revised in March 2007 and is required to be applied for annual periods beginning on or after 1st January 2009. It requires that borrowing costs that are directly attributable to the acquisition, construction or production of an asset which takes a substantial period of time to get ready for its intended use are capitalised as part of the cost of that asset. The effect on the group and parent company is still being evaluated.

IFRIC 13 – 'Customer Loyalty Programmes' was issued in June 2007 and is required to be applied for annual periods beginning on or after 1st July 2008. This will not affect the reported results or net assets of the group and parent company.

IFRIC 14 – 'The Limit on a Defined Benefit Asset, Minimum Funding Requirements and their Interaction' was issued in July 2007 and is required to be applied for annual periods beginning on or after 1st January 2008. The effect on the group and parent company is still being evaluated.

IAS 1 – 'Presentation of Financial Statements' was revised in September 2007 and is required to be applied for annual periods beginning on or after 1st January 2009. It requires a number of presentational changes but will not affect the reported results or net assets of the group and parent company.

IFRS 3 – 'Business Combinations' was revised and IAS 27 – 'Consolidated and Separate Financial Statements' was amended in January 2008 and are required to be applied for annual periods beginning on or after 1st July 2009. They require changes to the accounting for future business combinations and the accounting in the event of the loss of control over a subsidiary and so will not result in any restatement of reported results or net assets of the group and parent company.

Amendment to IFRS 2 – 'Vesting Conditions and Cancellations' was issued in January 2008 and is required to be applied for annual periods beginning on or after 1st January 2009. The effect on the group and parent company is still being evaluated.