

Accounting policies

British Sky Broadcasting Group plc (the “Company”) is a limited liability company incorporated in England and Wales, and domiciled in the United Kingdom.

a) Statement of compliance

The Company and its subsidiaries (together referred to as the “Group”) have a date of transition to International Financial Reporting Standards (“IFRS”) of 1 July 2004 (the “Transition Date”). The following IFRSs have been adopted from the Transition Date, which is earlier than required under the IFRS transitional provisions: IAS 32 “Financial Instruments: Disclosure and Presentation”, IAS 39 “Financial Instruments: Recognition and Measurement” and IFRS 5 “Non-current Assets Held for Sale and Discontinued Operations”.

b) Basis of preparation

The financial statements have been prepared on a historical cost basis, except for the remeasurement to fair value of financial instruments as described in the accounting policies below.

The accounts have been prepared on a going concern basis.

c) Basis of consolidation

The Group maintains a 52 or 53 week fiscal year ending on the Sunday nearest to 30 June in each year.

i. Subsidiaries

Subsidiaries are entities controlled by the Company. Control exists when the Company has the power, directly or indirectly, to govern the financial and operating policies of an entity so as to obtain benefits from its activities. Subsidiaries are included in the financial statements of the Company from the date control commences until the date that control ceases.

Intra-group balances, and any unrealised gains and losses or income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements.

ii. Associates and joint ventures

Associates are entities where the Group has significant influence, but not control or joint control, over the financial and operating policies of the entity. Joint ventures are those entities which are jointly controlled by the Group under a contractual agreement.

The consolidated financial statements include the Group’s share of the total recognised gains and losses of associates and joint ventures using the equity method, from the date that significant influence or joint control commences to the date that it ceases, based on the present ownership interests and excluding the possible exercise of potential voting rights, less any impairment losses (see note I). When the Group’s interest in an associate or joint venture has been reduced to nil because the Group’s share of losses exceeds its interest in the associate or joint venture, the Group only provides for additional losses to the extent that it has incurred legal or constructive obligations to fund such losses, or made payments on behalf of an associate or joint venture. Where the disposal of an investment in associates and joint ventures is considered highly probable, the investment ceases to be equity accounted and, instead, is classified as held for sale and stated at the lower of carrying amount and fair value less costs to sell.

d) Foreign currency translation

The Group’s presentational currency is Pounds Sterling. Trading activities denominated in foreign currencies are recorded in sterling at the actual exchange rates as of the date of the transaction. Monetary assets, liabilities and commitments denominated in foreign currencies at the year end are reported at the rates of exchange at the balance sheet date. Non-monetary assets and liabilities denominated in foreign currencies are translated at the exchange rate ruling at the date of the initial transaction. Gains and losses on retranslation of assets and liabilities are included net in the profit or loss for the period, except for exchange differences arising on non-monetary assets and liabilities where the changes in fair value are recognised directly in equity.

e) Derivative financial instruments and hedging activities

The Group uses a number of derivatives to hedge its exposures to fluctuations in interest and foreign exchange rates.

Derivatives are held at fair value from the date that a derivative contract is entered into. Certain derivatives held by the Group relating to highly probable forecast transactions (the "hedged items") that meet qualifying criteria under IAS 39 are designated as cash flow hedges, and are subject to hedge accounting. Other derivatives held by the Group do not meet the qualifying criteria for recognition as cash flow hedges, despite this being their economic purpose. Changes in the fair values of these derivatives are recognised immediately in the income statement. The Group does not hold or issue derivatives for speculative purposes.

Fair value is defined as the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. The fair value of derivative financial instruments is estimated with reference to the contracted value and the appropriate market value prevailing at each balance sheet date.

Derivatives that qualify for cash flow hedge accounting

Changes in the fair values of derivatives that are designated as cash flow hedges are initially recognised in the hedging reserve. In the circumstances where only the intrinsic value of a derivative is designated as a cash flow hedge, only the intrinsic value of the derivative is initially recognised in the hedging reserve, with all other movements being recognised in the income statement. Amounts accumulated in the hedging reserve are subsequently recognised in the income statement in the periods when the related hedged items are recognised in the income statement.

When a hedging instrument expires, is terminated or is exercised, or if a hedge no longer meets the qualifying criteria for hedge accounting, any cumulative gain or loss existing in the hedging reserve at that time remains in the hedging reserve and is recognised when the forecast transaction is ultimately recognised in the income statement, provided that the underlying transaction is still expected to occur. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in the hedging reserve is immediately recognised in the income statement and all future changes in the fair value of the hedging instruments are immediately recognised in the income statement.

The ongoing effectiveness of the Group's cash flow hedges is assessed using the dollar-offset approach, with the expected cash flows for hedging instruments being compared to the expected cash flows of the hedged items. This assessment is used to demonstrate that each hedge relationship has been highly effective in the period and is expected to continue to be highly effective in future periods. The measurement of hedge ineffectiveness for the Group's cash flow hedges is calculated using the hypothetical derivative method, with the fair values of the hedging instruments being compared to those of the hypothetical derivative that would result in the designated item achieving perfect hedge effectiveness. The excess of the cumulative change in the fair value of the actual hedging instrument compared to that of the hypothetical derivative is deemed to be hedge ineffectiveness, which is recognised in the income statement.

Embedded derivatives

Derivatives embedded in other financial instruments or other host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contracts and the host contracts are not carried at fair value with unrealised gains or losses reported in the income statement. Embedded derivatives are carried on the balance sheet at fair value from the inception of the host contract. Changes in fair value are recognised within the income statement during the period in which they arise.

f) Goodwill and Intangible assets

i. Goodwill

Business combinations that have occurred since the Transition Date are accounted for by applying the purchase method of accounting. Following this method, goodwill is initially recognised on consolidation, representing the difference between the cost of the business combination and the fair value of the identifiable assets, liabilities and contingent liabilities assumed. Where a business combination occurs in several stages, as a result of successive share purchases, the goodwill associated with each stage is calculated using fair value information at the date of each additional share purchase. Any movement in the fair value of the Group's share of net assets held previously is recognised in a revaluation reserve.

In respect of business combinations that occurred prior to the Transition Date, goodwill has been included at its deemed cost, as permitted by IFRS 1 "First-time Adoption of International Financial Reporting Standards". Deemed cost represents the goodwill's carrying value under the Group's UK GAAP accounting policies on the Transition Date. On disposal of a subsidiary, associate or joint venture, the attributable amount of goodwill is included in the determination of profit or loss on disposal, except for goodwill written off to reserves under UK GAAP prior to the Transition Date, which is not reinstated and is not included in determining any subsequent gain or loss on disposal.

Goodwill is stated at cost less any impairment losses and is tested at least annually for impairment. Any impairment identified is recognised immediately in the income statement and is not subsequently reversed. The carrying amount of goodwill in respect of associates and joint ventures is included in the carrying amount of the investment in the associate or joint venture.

ii. Intangible assets

Research expenditure is recognised in the income statement as the expense is incurred. Costs incurred on development projects (relating to the application of research knowledge to plan or design new or substantially improved products for sale or use within the business) are recognised as intangible assets from the point at which it is probable that the Group has the intention and ability to generate future economic benefits for the Group from the development expenditure, that the development is technically feasible and that the subsequent expenditure can be measured reliably. Other development expenditure is recognised in the income statement as incurred.

Other intangibles, which are acquired by the Group separately or through business combinations, are stated at cost less accumulated amortisation and impairment losses, other than those that are classified as held for sale, which are stated at the lower of carrying amount and fair value less costs to sell.

Amortisation of an intangible asset begins when the asset is available for use, and is charged to the income statement through operating expenses on a straight-line basis over the estimated useful life of the intangible asset, being a period of no more than four years, unless the asset life is judged to be indefinite. If the useful life is indefinite or the asset is not yet available for use, no amortisation is charged and an impairment test is carried out at least annually. Other intangible assets are tested for impairment in line with accounting policy (l) below.

g) Property, plant and equipment

i. Owned assets

Property, plant and equipment are stated at cost net of accumulated depreciation and any impairment losses, (see accounting policy (l)), other than those that are classified as held for sale, which are stated at the lower of carrying amount and fair value less costs to sell.

When an item of property, plant and equipment is comprised of major components having different useful lives, the components are accounted for as separate items of property, plant and equipment.

ii. Leased assets

Assets held under finance leases, which confer rights and obligations similar to those attached to owned assets, are treated as property, plant and equipment (see accounting policy (q)).

iii. Depreciation

Depreciation is provided to write off the cost, less estimated residual value, of property, plant and equipment on a straight-line basis over its estimated useful life. Land, and assets that are not yet available for use, are not depreciated. Principal annual rates used for this purpose are:

| | |
|-----------------------------------|--|
| Freehold buildings | 4% |
| Leasehold improvements | Lower of lease period or life of the asset |
| Equipment, furniture and fixtures | 10% - 33 ¹ / ₃ % |
| Assets under finance leases | Lower of lease period or life of the asset |

iv. Borrowing costs

Borrowing costs are recognised in the income statement in the period in which they are incurred.

h) Inventories

i. Acquired and commissioned television programme rights

Programme rights are stated at the lower of cost and net realisable value ("NRV"), including, where applicable, estimated subscriber escalation payments, and net of the accumulated expense charged to the income statement to date.

Contractual obligations for programme rights not yet available for transmission are not included in the cost of programme rights, but are disclosed as contractual commitments. Payments made upon receipt of commissioned and acquired programming, but in advance of the legal right to broadcast the programmes, are treated as prepayments. Programme rights are recorded in inventory when the programmes are available for transmission.

The cost of programme rights is recognised in the operating expenses line of the income statement primarily as shown below:

Sports - 100% recognised on the first showing or, where contracts provide for sports rights for multiple seasons or competitions, such rights are principally recognised on a straight-line basis across the seasons or competitions.

Current affairs - 100% recognised in the income statement on first showing,

General entertainment - Recognised through the income statement based on the number of transmissions, as follows:

- One showing planned - 100%
- Two showings planned - 60%; 40%
- Three showings planned - 50%; 30%; 20%
- Four showings planned - 40%; 30%; 20%; 10%

Movies - Acquired movie rights are recognised in the income statement on a straight-line basis over the period of transmission rights. Where acquired movie rights provide for a second availability window, 10% of the cost is allocated to that window.

Where programme rights are surplus to Group requirements, and no gain is anticipated through a disposal of the rights, or where the programming will not be broadcast for any other reason, a write-down to the income statement is made. Reversals of inventory write-downs are recognised as reductions in operating expenses.

ii Digiboxes and related equipment

Digiboxes and related equipment includes digiboxes (including Sky+ boxes), Low Noise Blockers ("LNBS") and mini-dishes. These inventories are valued at the lower of cost and NRV, the latter of which reflects the value the business expects to realise from the digiboxes and the related equipment in the hands of the customer, and are recognised through the operating expenses line of the income statement. Any subsidy is expensed on enablement, which is the process of activating the viewing card once inserted in the digibox upon installation, so as to enable a viewer to view encrypted broadcast services, and effectively represents the completion of the installation process for new subscribers. The amount recognised in the income statement as the inventories are sold is recognised on a first-in first-out basis ("FIFO").

iii Raw materials, consumables and goods held for resale

Raw materials, consumables and goods held for resale are valued at the lower of cost and NRV. The cost of raw materials, consumables and goods held for resale is recognised through the operating expenses line of the income statement on a FIFO basis.

i) Financial assets and liabilities

Financial assets and liabilities are initially recognised at fair value plus any directly attributable transaction costs. At each balance sheet date, the Group assesses whether there is any objective evidence that any financial asset is impaired. Financial assets and liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the financial asset or liability.

a. Equity investments

Equity investments intended to be held for an indefinite period of time are classified as available for sale investments. They are carried at fair value, where this can be reliably measured, with movements in fair value recognised directly in reserves. Where the fair value cannot be reliably measured, the investment is carried at cost. Any impairment losses in equity investments are recognised in the income statement and are not reversible under any circumstances. Available for sale investments are included within non-current assets unless management have the intention of holding the investment for less than twelve months from the balance sheet date, in which case they are included in current assets. On disposal, the difference between the carrying amount and the sum of the consideration received and any cumulative gain or loss that had previously been recognised directly in reserves is recognised in the income statement.

b. Trade and other receivables

Trade and other receivables are non-derivative financial assets with fixed or determinable payments and are measured at amortised cost using the effective interest method. Trade and other receivables, with no stated interest rate, are measured at the original invoice amount if the effect of discounting is immaterial. An allowance account is maintained to reduce the carrying value of trade and other receivables for impairment losses identified from objective evidence, with movements in the allowance account, either from increased impairment losses or reversals of impairment losses, being recognised in the income statement.

c. Short-term deposits

This includes short-term deposits and commercial paper which have maturity dates of more than 3 months from inception. These deposits are held at amortised cost, less any allowance for impairment losses.

d. Cash and cash equivalents

Cash and cash equivalents include cash in hand, bank accounts, deposits receivable on demand and deposits with maturity dates of 3 months or less from the date of inception. Bank overdrafts that are repayable on demand and which form an integral part of the Group's cash management are included as a component of cash and cash equivalents where offset conditions are met.

e. Trade and other payables

Trade and other payables are non-derivative financial liabilities and are measured at amortised cost using the effective interest method. Trade and other payables, with no stated interest rate, are measured at the original invoice amount if the effect of discounting is immaterial.

f. Borrowings

Borrowings are recorded at the proceeds received, net of direct issue costs. Finance charges, including any premium payable on settlement or redemption and direct issue costs, are accounted for on an accruals basis in the income statement using the effective interest method and are added to the carrying amount of the underlying instrument to which they relate, to the extent that they are not settled in the period in which they arise.

j) Net debt

Net debt comprises the borrowings of the Group (including Guaranteed Notes, the revolving credit facility ("RCF") and obligations under finance leases), together with the fair value of derivative assets or liabilities held to manage the interest rate and currency profile of long-term borrowings, net of cash, cash equivalents and short-term deposits.

k) Transponder rental prepayments

Payments made in respect of future satellite capacity have been recorded as prepaid transponder lease costs. These payments are recognised in the income statement on a straight-line basis over the term of the lease.

l) Impairment

At each balance sheet date, and in accordance with IAS 36 "Impairment of Assets", the Group reviews the carrying amounts of all its assets excluding inventories (see accounting policy (h)), non-current assets classified as held for sale, financial assets (see accounting policy (i)) and deferred taxation (see accounting policy (r)) to determine whether there is any indication that any of those assets have suffered an impairment loss.

An impairment, other than an impairment of an investment in a joint venture or associate, is recognised in the income statement whenever the carrying amount of an asset or its cash generating unit exceeds its recoverable amount. An impairment of an investment in a joint venture or associate is recognised within the share of profit from joint ventures and associates. The recoverable amount is the greater of net selling price, defined as the 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 risks specific to the asset. Where it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. Impairment losses recognised in respect of cash-generating units are allocated first to reduce the carrying amount of any goodwill allocated to those units, and then to reduce the carrying amount of other assets in the unit on a pro-rata basis.

An impairment loss for an individual asset or cash generating unit shall be reversed if there has been a change in estimates used to determine the recoverable amount since the last impairment loss was recognised and is only reversed to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised. Any impairment loss in respect of goodwill is irreversible.

m) Provisions

Provisions are recognised when the Group has a present legal or constructive obligation to make a probable transfer of economic benefits as a result of past events. The amounts recognised represent the Group's best estimate of the transfer of benefits that will be required to settle the obligation as of the balance sheet date. Provisions are discounted if the effect of the time value of money is material.

n) ESOP reserve

Where the Company or its subsidiaries purchase the Company's own equity shares, the cost of those shares, including any attributable transaction costs, is presented within the ESOP reserve as a deduction in shareholders' equity in the consolidated financial statements.

o) Revenue recognition

Revenue, which excludes value added tax and sales between Group companies, represents the gross inflow of economic benefit from Sky's operating activities. Revenue is measured at the fair value of the consideration received or receivable. The Group's main sources of revenue are recognised as follows:

- Revenue from the provision of direct-to-home ("DTH") subscription services is recognised as the services are provided, net of any discount given. Pay-per-view revenue is recognised when the event, movie or football match is viewed.
- Cable revenue is recognised as the services are provided to the cable wholesalers and is based on the number of subscribers taking the Sky channels, as reported to the Group by the cable wholesalers, and the applicable rate card.
- Advertising sales revenue is recognised when the advertising is broadcast. Revenue generated from airtime sales where Sky acts as an agent on behalf of third parties is recognised on a net commission basis.
- Sky Bet revenues include income from betting and gaming, which represents: a) amounts receivable in respect of bets placed on events which occur in the year; and b) net customer losses in the year in respect of the on-line casino operations and casino-style interactive roulette games.
- Sky Active revenues include income from on-line advertising, e-mail, telephony income from the use of interactive services (e.g. voting), interconnect, text services and digibox subsidy recovery revenues earned through conditional access and access control charges made to customers on the Sky digital platform. All Sky Active revenues are recognised in the income statement when the goods or services are delivered.
- Other revenue principally includes income from installations, digibox sales revenues (including the sales of Sky+ and Multiroom digiboxes), Sky Talk revenues, service call revenue, warranty revenue, customer management service fees, conditional access fees and access control fees. Other revenues are recognised, net of any discount given, when the relevant goods or service are provided.

p) Employee benefits

Wages, salaries and social security contributions

Wages, salaries, social security contributions, bonuses payable and non-monetary benefits for current employees, are recognised in the income statement as the employees' services are rendered.

Pension obligations

The Group provides pensions to eligible employees through the BSkyB Pension Plan which is a defined contribution scheme. The amount charged to the income statement in the year represents the cost of contributions payable by the Group to the scheme in exchange for employee services rendered in that year. The assets of the BSkyB Pension Plan are held independently of the Group.

Termination benefits

Termination benefits are recognised as a liability when, and only when, the Group has a demonstrable commitment to terminate the employment of an employee or group of employees before the normal retirement date or as the result of an offer to encourage voluntary redundancy.

Equity compensation benefits

The Group issues equity-settled share-based payments to certain employees which must be measured at fair value and recognised as an expense in the income statement with a corresponding increase in equity. The fair values of these payments are measured at the dates of grant using option-pricing models, taking into account the terms and conditions upon which the awards are granted. The fair value is recognised over the period during which employees become unconditionally entitled to the awards, subject to the Group's estimate of the number of awards which will lapse, either due to employees leaving the Group prior to vesting or due to non-market based performance conditions not being met. Where an award has market-based performance conditions, the fair value of the award is adjusted at the date of grant for the probability of achieving these via the option pricing model. The total amount recognised in the income statement as an expense is adjusted to reflect the actual number of awards that vest, except where forfeiture is due to the failure to meet market-based performance measures.

In accordance with the transitional provisions in IFRS 1, and IFRS 2 "Share-based payment", the recognition and measurement principles in IFRS 2 have only been applied to options and awards granted after 7 November 2002 that had not vested by 1 January 2005.

q) Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the asset to the lessee. All other leases are classified as operating leases.

The Group as lessor

Amounts due from lessees under finance leases are recorded as receivables at the amount of the Group's net investment in the leases. Finance lease income is allocated to reflect a constant periodic rate of return on the Group's net investment outstanding.

The lease income receivable from operating leases is recognised on a straight-line basis over the term of the lease.

The Group as lessee

Assets held under finance leases are recognised as assets of the Group at their fair value on the date of acquisition, or, if lower, at the present value of the minimum lease payments. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability.

The lease expense arising from operating leases is charged to the income statement on a straight line basis over the term of the lease, unless another systematic basis is more appropriate. Benefits received and receivable as incentives to enter into operating leases are recorded on a straight line basis over the lease term.

r) Taxes, including deferred taxes

The Group's liability for current tax is based on taxable profits for the year, and is calculated using tax rates that have been enacted or substantively enacted at the balance sheet date.

Deferred tax assets and liabilities are recognised using the balance sheet liability method, providing for temporary differences between the carrying amounts of assets and liabilities in the balance sheet and the corresponding tax bases used in the computation of taxable profit. The following temporary differences are not provided for: goodwill, the initial recognition of assets or liabilities that affect neither accounting profit nor taxable profit, and differences relating to investments in subsidiaries to the extent that it is not probable that they will reverse in the foreseeable future. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates that have been enacted or substantially enacted at the balance sheet date.

A deferred tax asset is only recognised to the extent that it is probable that future taxable profits will be available against which the asset can be utilised. The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is charged or credited in the income statement, except where it relates to items charged or credited directly to equity, in which case the deferred tax is also included within equity.

s) Dividends

Dividends are recognised in the profit and loss reserve in the period in which they are declared or paid.

t) Earnings per share

Basic earnings per share represents the profit attributable to the equity shareholders, divided by the weighted average number of Ordinary Shares in issue during the year, excluding the weighted average number of Ordinary Shares purchased by the Group and held in the Group's ESOP Trust during the year to satisfy employee share awards.

Diluted earnings per share represents the profit attributable to the equity shareholders, divided by the weighted average number of Ordinary Shares in issue during the year, excluding the weighted average number of Ordinary Shares purchased by the Group and held in the Group's ESOP Trust during the year to satisfy employee share awards, plus the weighted average number of dilutive shares resulting from share options and other potential Ordinary Shares outstanding during the year.

u) Reportable segments

A reportable segment, as defined by IAS 14 "Segmental Reporting", is a distinguishable business or geographical component of the Group, that provides products or services, that are subject to risks and rewards that are different from those of other segments. The Group has no reportable segments.