

Group accounting policies under IFRS

Nature of the Financial Statements

The Group Financial Statements, which are presented in US dollars, include the accounts of companies in which Royal Dutch and Shell Transport together, either directly or indirectly, have control either through a majority of the voting rights (including potential voting rights) or the right to exercise a controlling influence or to obtain the majority of the benefits and be exposed to the majority of the risks.

Revenue recognition

Sales of oil, natural gas, chemicals and all other products are recorded when title passes to the customer. Revenue from the production of oil and natural gas properties in which the Group has an interest with other producers are recognised on the basis of the Group's working interest (entitlement method). Gains and losses on derivatives contracts and contracts involved in energy trading and risk management are shown net in the Statement of Income if these contracts are held for trading purposes. Purchase and sale of hydrocarbons under exchange contracts that are necessary to obtain or reposition feedstock utilised in the Group's refinery operations are shown net in the Statement of Income. Sales between Group companies, as disclosed in the segment information, are based on prices generally equivalent to commercially available prices.

In Exploration & Production and Gas & Power title typically passes (and revenues are recognised) when product is physically transferred into a vessel, pipe or other delivery mechanism. For sales by refining companies, title typically passes (and revenues are recognised) either when product is placed onboard a vessel or offloaded from the vessel, depending on the contractually agreed terms. Revenues on wholesale sales of oil products and chemicals are recognised when transfer of ownership occurs and title is passed, either at the point of delivery or the point of receipt, depending on contractual conditions.

Property, plant and equipment and intangible assets

(a) Recognition on the Balance Sheet

Property, plant and equipment, including expenditure on major inspections, and intangible assets are initially recorded on the Balance Sheet at cost where it is probable that they will generate future economic benefits. This includes capitalisation of decommissioning and restoration costs associated with provisions for asset retirement (see "Provisions") and certain development costs (see "Research and development"). Accounting for exploration costs is described separately below ("Exploration costs"). Intangible assets include goodwill. Interest is capitalised, as an increase in property, plant and equipment, on significant capital projects during construction.

Property, plant and equipment and intangible assets are subsequently recognised at cost less accumulated depreciation and impairment.

(b) Depreciation, depletion and amortisation

Property, plant and equipment related to oil and natural gas production activities are depreciated on a unit-of-production basis over the proved developed reserves of the field concerned, except in the case of assets whose useful life is shorter than the lifetime of the field, in which case the straight-line method is applied. Rights and concessions are depleted on the unit-of-production basis over the total proved reserves of the relevant area. Unproved properties are amortised as required by particular circumstances. Other property, plant and equipment are generally depreciated on a straight-line basis over their estimated useful lives which is generally 20 years for refineries and chemicals plants, 15 years for retail service station facilities, and until the next planned major inspection (generally 3 to 5 years) for inspection costs. Property, plant and equipment held under finance leases are depreciated over the shorter of the assets' estimated useful lives and the lease term.

Goodwill is not amortised but instead tested for impairment annually. Other intangible assets are amortised on a straight-line basis over their estimated useful lives (with a maximum of forty years).

(c) Recoverability of assets

Other than properties with no proved reserves (where the basis for carrying costs on the Balance Sheet is explained under "Exploration costs"), the carrying amounts of major Exploration & Production property, plant and equipment are reviewed for possible impairment annually, while all assets are reviewed whenever events or changes in circumstances indicate that the carrying amounts for those assets may not be recoverable. If assets are determined to be impaired, the carrying amounts of those assets are written down to recoverable amount which is the higher of fair value less costs to sell and value in use. For this purpose, assets are grouped based on separately identifiable and largely independent cash flows. Assets held for sale are recognised at the lower of carrying amount and fair value less costs to sell.

Estimates of future cash flows used in the evaluation for impairment of assets related to hydrocarbon production are made using risk assessments on field and reservoir performance and include outlooks on proved reserves and unproved volumes, which are then discounted or risk-weighted utilising the results from projections of geological, production, recovery and economic factors.

Impairments, except those related to goodwill, are reversed as applicable to the extent that the events or circumstances that triggered the original impairment have changed.

Exploration costs

Group companies follow the successful efforts method of accounting for oil and natural gas exploration costs. Exploration costs are charged to income when incurred, except that exploratory drilling costs are included in property, plant and equipment, pending determination of proved reserves. Exploration wells that are more than 12 months old are expensed unless (a) (i) they are in an area requiring major capital expenditure before production can begin and (ii) they have found commercially producible quantities of reserves and (iii) they are subject to further exploration or appraisal activity in that either drilling of additional exploratory wells is under way or firmly planned for the near future, or (b) proved reserves are booked within 12 months following the completion of exploratory drilling.

Associated companies and joint ventures

Investments in companies over which Group companies have significant influence but not control are classified as associated companies and are accounted for on the equity basis. Interests in jointly controlled entities are also recognised on the equity basis. Interests in jointly controlled assets are recognised by including the Group share of assets, liabilities, income and expenses on a line-by-line basis.

Inventories

Inventories are stated at cost to the Group or net realisable value, whichever is lower. Such cost is determined by the first-in first-out (FIFO) method and comprises direct purchase costs, cost of production, transportation and manufacturing expenses and taxes.

Deferred taxation

Deferred taxation is provided using the liability method of accounting for income taxes based on provisions of enacted or substantively enacted laws. Recognition is given to deferred tax assets and liabilities for the expected future tax consequences of events that have been recognised in the Financial Statements or in the tax returns (temporary differences); deferred tax is not generally provided on initial recognition of an asset or liability in a transaction that, at the time of the transaction, affects neither accounting nor taxable profit. In estimating these tax consequences, consideration is given to expected future events.

Deferred tax assets are recognised where future recovery is probable. Deferred tax assets and liabilities are presented separately in the Balance Sheet except where there is a right of set-off within fiscal jurisdictions.

Deferred tax is not provided for taxes on possible future distributions of retained earnings of Group companies and equity accounted investments where the timing of the distribution can be controlled and it is probable that the retained earnings will be substantially reinvested by the companies concerned.

Employee benefits

(a) Employee retirement plans

Retirement plans to which employees contribute and many non-contributory plans are generally funded by payments to independent trusts. Where, due to local conditions, a plan is not funded, a provision is made. Valuations of both funded and unfunded plans are carried out by independent actuaries.

For plans which define the amount of pension benefit to be provided, pension cost primarily represents the increase in actuarial present value of the obligation for pension benefits based on employee service during the year and the interest on this obligation in respect of employee service in previous years, net of the expected return on plan assets.

Unrecognised gains and losses at the date of transition to IFRS have been recognised in the 2004 opening balance sheet. The Group recognises actuarial gains and losses that arise subsequent to January 1, 2004 using the corridor method. Under this method, to the extent that any cumulative unrecognised actuarial gain or loss exceeds 10% of the greater of the present value of the defined benefit obligation and the fair value of plan assets, that portion is recognised in income over the expected average remaining working lives of the employees participating in the plan. Otherwise, the actuarial gain or loss is not recognised.

For plans where benefits depend solely on the amount contributed to the employee's account and the returns earned on investments of these contributions, pension cost is the amount contributed by Group companies for the period.

(b) Postretirement benefits other than pensions

Some Group companies provide certain postretirement healthcare and life insurance benefits to retirees, the entitlement to which is usually based on the employee remaining in service up to retirement age and the completion of a minimum service period. These plans are not funded and a provision is made. Valuations of benefits are carried out by independent actuaries.

The expected costs of postretirement benefits other than pensions are accrued over the periods employees render service to the Group. Unrecognised gains and losses at the date of transition to IFRS have been recognised in the 2004 opening balance sheet.

(c) Share-based compensation plans

The fair value of share options granted to employees after November 7, 2002, and which had not vested by January 1, 2005, is recognised as an expense from the date of grant over the vesting period with a corresponding increase directly in equity. The fair value of the Group's share options was estimated using a Black-Scholes option pricing model.

Leases

Agreements under which Group companies make payments to owners in return for the right to use an asset for a period are accounted for as leases. Leases that transfer substantially all the risks and benefits of ownership are recorded at inception as finance leases within property, plant and equipment and debt. All other leases are recorded as operating leases and the costs are charged to income as incurred.

Financial instruments and other derivative contracts

The Group adopted IAS 32 and 39 with effect from January 1, 2005 and therefore accounted for financial instruments and other derivative contracts until the end of 2004 under US GAAP. Information for 2004 has not been restated and the impact on transition, which is restricted to certain commodity contracts and embedded derivatives and unquoted investments with estimable fair values, is described below.

(a) Financial assets

Investments: financial assets comprise debt and equity securities.

Securities of a trading nature

Securities of a trading nature are carried at fair value with unrealised holding gains and losses being included in income.

Securities held to maturity

Securities held to maturity are carried at amortised cost, unless impaired.

Available for sale securities

All other securities are classified as available for sale and are carried at fair value, other than unquoted equity securities with no estimable fair value which are reported at cost, less any impairment. Unrealised holding gains and losses other than impairments are taken directly to equity, except for translation differences arising on foreign currency debt securities which are taken to income. Upon sale or maturity, the net gains and losses are included in income.

Fair value is based on market prices where available, otherwise it is calculated as the net present value of expected future cash flows.

From January 1, 2005 this has resulted in certain unquoted equity securities being recognised at fair value compared with recognition at cost under US GAAP. This change in accounting has no impact on the timing of recognition of income arising from these investments.

Securities forming part of a portfolio which is required to be held long-term are classified under investments.

Interest on debt securities is accounted for in income by applying the effective interest method. Dividends on equity securities are accounted for in income when receivable.

Receivables are recognised initially at fair value based on amounts exchanged and subsequently at amortised cost less any impairment.

Cash and cash equivalents include cash in hand, short-term deposits and other investments which have a maturity from acquisition of three months or less and are readily convertible into known amounts of cash.

(b) Financial liabilities

Debt and accounts payable are recognised initially at fair value based on amounts exchanged and subsequently at amortised cost, except for fixed rate debt subject to fair value hedging.

Interest expense, other than interest capitalised, is accounted for in income using the effective interest method.

(c) Derivative contracts

Group companies use derivatives in the management of interest rate risk, foreign currency risk and commodity price risk. These derivative contracts are recognised at fair value, using market prices.

Those derivatives qualifying and designated as hedges are either: (1) a "fair value" hedge of the change in fair value of a recognised asset or liability or an unrecognised firm commitment, or (2) a "cash flow" hedge of the change in cash flows to be received or paid relating to a recognised asset or liability or a highly probable forecasted transaction.

A change in the fair value of a hedging instrument designated as a fair value hedge is taken to income, together with the consequential adjustment to the carrying amount of the hedged item. The effective portion of a fair value change of a derivative designated as a cash flow hedge is recognised directly in equity, until income reflects the variability of underlying cash flows; any ineffective portion is taken to income.

Group companies formally document all relationships between hedging instruments and hedged items, as well as risk management objectives and strategies for undertaking hedge transactions. The effectiveness of a hedge is also continually assessed and when it ceases, hedge accounting is discontinued.

Certain contracts to purchase and sell commodities are required to be recognised at fair value, generally based on market prices, (with gains and losses taken to income). These are contracts which can be net settled or sales contracts containing volume optionality.

Certain embedded derivatives within contracts are required to be separated from their host contract and recognised at fair value, generally based on market prices, (with gains and losses taken to income) if the economic characteristics and risks of the embedded derivative are not closely related to that of the host contract.

These policies are very similar to those applied until the end of 2004 under US GAAP.

Provisions

Provisions are liabilities where the timing or amount of future expenditure is uncertain. Provisions are recorded at the best estimate of the present value of the expenditure required to settle the present obligation at the balance sheet date. Non-current amounts are discounted using the credit-adjusted risk-free rate for the Group. Specific details for decommissioning and restoration costs and environmental remediation are described below.

Estimated decommissioning and restoration costs are based on current requirements, technology and price levels and are stated at fair value, and the associated asset retirement costs are capitalised as part of the carrying amount of the related property, plant and equipment. The liability, once an obligation, whether legal or constructive, crystallises, is recognised with a corresponding amount of property, plant and equipment in the period when a reasonable estimate of the fair value can be made. The fair value is calculated using amounts discounted over the useful economic life of the assets. The effects of changes resulting from revisions to the timing or the amount of the original estimate of the provision are incorporated on a prospective basis.

Provisions for environmental remediation resulting from ongoing or past operations or events are recognised in the period in which an obligation, legal or constructive, to a third party arises and the amount can be reasonably estimated. Measurement of liabilities is based on current legal requirements and existing technology. Recognition of any joint and several liability is based upon Group companies' best estimate of their final pro rata share of the liability. Liabilities are determined independently of expected insurance recoveries. Recoveries are recognised and reported as separate events and brought into account when reasonably certain of realisation. The carrying amount of provisions is regularly reviewed and adjusted for new facts or changes in law or technology.

Parent Companies' shares held by Group companies

Parent Companies' shares held by Group companies are not included in the Group's net assets but, after deducting dividends received, are reflected at cost as a deduction from equity.

Administrative expenses

Administrative expenses are those which do not relate directly to the activities of a single business segment and include expenses incurred in the management and co-ordination of multi-segment enterprises.

Research and development

Development costs which are expected to generate probable future economic benefits are capitalised. All other research and development expenditure is charged to income as incurred, with the exception of that on buildings and major items of equipment which have alternative use.

Discontinued operations

Discontinued operations comprise those activities which have been disposed of during the period, or remain held for sale at period end, and represent a separate major line of business or geographical area of operation which can be clearly distinguished, operationally and for financial reporting purposes, from other activities of the Group.

Business combinations

Assets acquired and liabilities assumed on a business combination are recognised at their fair value at the date of the acquisition; the amount of the purchase consideration above this value is reflected as goodwill.

Currency translation

Assets and liabilities of non-US dollar Group companies are translated to US dollars at year-end rates of exchange, whilst their statements of income and cash flows are translated at quarterly average rates. Translation differences arising on aggregation are taken directly to a currency translation differences account within equity. As part of the transition to IFRS, the balance of this account was eliminated at January 1, 2004 and transferred to retained earnings with no impact on total equity. Upon divestment or liquidation of an entity, cumulative currency translation differences related to that entity are taken to income.

The US dollar equivalents of exchange gains and losses arising as a result of foreign currency transactions (including those in respect of inter-company balances unless related to transactions of a long-term investment nature) are included in income.

New accounting standards and interpretations

Certain new IFRS and IFRIC interpretations have been published which are not mandatory for 2005. The Group has elected to early adopt in 2005 IFRS 6 Exploration for and Evaluation of Mineral Resources and IFRIC 4 Determining whether an Arrangement Contains a Lease, and these are reflected in the accounting policies described above. The Group is assessing the impact of IFRIC 3 Emission Rights which also remains subject to potential change prior to its mandatory use in 2006. All other published pronouncements, which are not mandatory in 2005, are not expected to have an impact on the Group.

IFRS is currently being applied in Europe and in other parts of the world simultaneously for the first time. Furthermore, due to a number of new and revised standards included within the body of standards that comprise IFRS, there is not yet a significant body of established practice on which to draw in forming judgements regarding interpretation and application. Accordingly, practice is continuing to evolve and the full financial effect of reporting under IFRS as it will be applied and reported on in the Group's first IFRS Financial Statements cannot be determined with certainty at this stage.