Notes to the accounts

For the year ended 31 December 2001

The following accounting policies have been applied consistently, except as noted below, in dealing with items which are considered material in relation to the Group's financial statements.

ACCOUNTING POLICIES

i Basis of preparation of accounts

The financial statements of International Power plc and its subsidiary undertakings (the Group) are prepared under the historical cost convention and in accordance with applicable Accounting Standards. Minor adjustments have been made to comparative figures to make them consistent with the current year.

ii Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiary undertakings up to 31 December 2001. The results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

An associate is an undertaking in which the Group has a long-term participating interest, usually from 20% to 50% of the equity voting rights, and over which it exercises significant influence. A joint venture is an undertaking in which the Group has a long-term participating interest and over which it exercises joint control. The Group's share of the profits less losses of associates and of joint ventures is included in the consolidated profit and loss account and its interest in their net assets, is included in fixed asset investments in the consolidated balance sheet.

Purchased goodwill (both positive and negative) arising on consolidation in respect of acquisitions before 1 April 1998, when FRS 10 (Goodwill and Intangible Assets) was adopted, was set off to reserves in the year of acquisition. When a subsequent disposal occurs any related goodwill previously set off to reserves is taken back through the profit and loss account as part of the profit or loss on disposal.

Purchased goodwill (representing the excess of the fair value of the consideration given over the fair value of the separable net assets acquired) arising on consolidation in respect of acquisitions since 1 April 1998 is capitalised. Positive goodwill is fully amortised by equal annual instalments over its estimated useful life, currently not more than 20 years.

Negative goodwill arising on consolidation in respect of acquisitions since 1 April 1998 is included within fixed assets and released to the profit and loss account in the periods in which the fair values of the non-monetary assets purchased on the same acquisition are recovered, whether through amortisation or sale.

On the subsequent disposal or termination of a business acquired since 1 April 1998, the profit or loss on disposal or termination is calculated after charging/(crediting) the unamortised amount of any related goodwill/(negative goodwill).

In the Company's financial statements, investments in subsidiary undertakings, associates and joint ventures are stated at cost less amounts written off.

iii Income recognition

Turnover, from plants subject to power purchase agreements (PPAs), is recognised in accordance with the contract terms. Turnover from merchant plants is recognised as output delivered after taking account of related hedging contracts. Liquidated damages (LDs), principally in respect of late commissioning, are currently included in other operating income. Proprietary trading income is recognised on the basis of completed contracts and the mark-to-market value of outstanding contracts at the period end.

iv Pension costs

For defined benefit arrangements, pension contributions are charged to the profit and loss account so as to spread the cost of pensions over employees' working lives. The regular cost is attributed to individual years using the projected unit credit method. Variations in pension costs, which are identified as a result of actuarial valuations, are amortised over the average expected remaining working lives of employees. Differences between the amounts funded and the amounts charged to the profit and loss account are treated as either provisions or prepayments in the balance sheet.

For defined contribution arrangements, contributions are charged to the profit and loss account as they fall due.

v Project development costs

Project development costs (including appropriate direct internal costs) are capitalised from the point that the Board confirms that it is reasonably certain that the project will proceed to completion.

vi Foreign exchange

The profits or losses of overseas subsidiary undertakings, associates and joint ventures are translated into sterling at average rates of exchange. Balance sheets of subsidiary undertakings and net investments in associates and joint ventures are translated at closing rates.

Exchange differences arising on the retranslation at closing rates of overseas subsidiary undertakings' balance sheets and net investments in associates and joint ventures, together with the adjustment to convert the balance of retained profits to closing rates, are taken directly to reserves.

Transactions denominated in foreign currencies arising in the normal course of business are translated into sterling at the exchange rate ruling on the date payment takes place unless related or matching forward foreign exchange contracts have been entered into, when the rate specified in the contract is used. Monetary assets and liabilities expressed in foreign currencies that are not covered by hedging arrangements are translated into sterling at the rates of exchange ruling at the balance sheet date and any difference arising on the retranslation of those amounts is taken to the profit and loss account.

vii Interest

Interest on borrowings relating to major capital projects with long periods of development is capitalised during their construction and written-off as part of the total cost over the useful life of the asset. All other interest is charged to the profit and loss account as incurred. Included within the interest charge in the profit and loss account is the unwinding of discounts on long-term provisions.

viii Tangible fixed assets

Tangible fixed assets are stated at original cost less accumulated depreciation. In the case of assets constructed by the Group, related works, commissioning and borrowing costs as per FRS 15 are included in cost. Assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date.

Depreciation is calculated so as to write down the cost of tangible fixed assets to their residual value evenly over their estimated useful lives. Estimated useful lives are reviewed periodically, taking into account commercial and technological obsolescence as well as normal wear and tear, provision being made where the carrying value may not be recoverable.

The depreciation charge is based on the following estimates of useful lives:

	Years
Power stations	20-40
Fixtures, fittings, tools and equipment	4-5
Computer equipment and software	3-5
Hot gas path CCGT turbine blades	2-4

Freehold land is not depreciated.

ix Other fixed asset investments
Other fixed asset investments are stated at cost less provision for any impairment.

x Current asset investments
Current asset investments are stated at the lower of cost and market value.

xi Stocks
Operating stocks of fuel and stores are valued at the lower of cost and net realisable value. These are included as current assets.

xii Deferred taxation
Deferred taxation arises in respect of items where there is a timing difference between their treatment for accounting purposes and their treatment for taxation purposes. Provision for deferred taxation, using the liability method, is made to the extent that it is probable that the liability or asset will crystallise in the foreseeable future.

To the extent that dividends remitted from overseas subsidiary undertakings, associates and joint ventures are expected to result in additional tax liabilities, appropriate amounts are provided. No taxes are provided for unremitted earnings from overseas when such amounts are considered permanently reinvested.

xiii Financial instruments
The Group uses a range of derivative instruments, including interest rate swaps, options, energy-based futures contracts and foreign exchange contracts and swaps. Derivative instruments are used for hedging purposes, apart from energy-based futures contracts, which are used for trading purposes. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate. Accounting for foreign currency transactions is described in the foreign exchange policy in note vi. Changes in the market value of futures trading contracts are reflected in the profit and loss account in the period in which the change occurs.

xiv Debt instruments
New borrowings are stated at net proceeds received after deduction of issue costs. The issue costs of debt instruments are charged to the profit and loss account over the life of the instrument using an interest method.

New accounting standards
The financial statements comply, to the extent detailed below, with the following new Financial Reporting Standards issued by the UK Accounting Standards Board.

i *FRS 17 (Retirement benefits)* The Group has complied with the transitional disclosure requirements of this standard. The standard replaces the use of actuarial values for assets in a pension scheme in favour of a market-based approach. In order to cope with the volatility inherent in this measurement basis, the standard requires that the profit and loss account shows the relatively stable ongoing service cost, interest cost and expected return on assets. Fluctuations in market values are reflected in the statement of total recognised gains and losses.

ii *FRS 18 (Accounting policies)* The Group complies with this standard, which deals with the selection, application and disclosure of accounting policies in financial statements.

Compliance with the above new standards has not given rise to any restatement of figures reported for prior periods, though a restatement in respect of FRS 17 is expected when full compliance is required.

In addition, FRS 19 (Deferred tax) was issued by the UK Accounting Standards Board. The standard requires full provision of deferred tax. The Group will implement the standard in its 2002 *Annual Report*.

1 GROUP SEGMENTAL ANALYSIS

a) By class of business

		Continuing	Discontinued	Group
	Year ended 31 December 2001 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m
Group turnover				
Electricity generation	**1,103**	762	–	762
Discontinued	**–**	–	1,578	1,578
	1,103	762	1,578	2,340
Less: turnover of joint ventures	**(139)**	(96)	(5)	(101)
Less: turnover of associates	**(407)**	(382)	–	(382)
	557	284	1,573	1,857
Profit before interest and taxation (excluding all exceptional items)				
Electricity generation	**354**	201	–	201
Discontinued operations	**–**	–	166	166
Corporate costs	**(28)**	(34)	(46)	(80)
	326	167	120	287

b) By geographical area

Group turnover				
North America	**237**	115	–	115
Europe and Middle East	**521**	405	1,578	1,983
Australia	**194**	106	–	106
Rest of World	**151**	136	–	136
	1,103	762	1,578	2,340
Less: turnover of joint ventures	**(139)**	(96)	(5)	(101)
Less: turnover of associates	**(407)**	(382)	–	(382)
	557	284	1,573	1,857
Profit before interest and taxation (excluding all exceptional items)				
North America	**93**	34	–	34
Europe and Middle East	**141**	88	166	254
Australia	**72**	46	–	46
Rest of World	**48**	33	–	33
	354	201	166	367
Corporate costs	**(28)**	(34)	(46)	(80)
	326	167	120	287

An analysis of exceptional items is given in note 8.

The profit before interest and taxation after exceptional items of Europe and Middle East, and Rest of World is £161 million and £50 million, respectively. Corporate costs are £20 million after exceptional items.

North America profit before interest and taxation includes other income in respect of the late commissioning and performance recovery of new power plants amounting to £80 million (nine months ended 31 December 2000: £28 million). These amounts have previously been disclosed in turnover and have been restated.

Sales of electricity generated in each geographic region are made solely to customers in the same geographic area.

The comparative figures for turnover and operating costs have been restated to conform with the current basis of presentation. The segmental reporting has been changed in the current period to better represent the way in which the business is managed.

Acquisitions in the year ended 31 December 2001 contributed £22 million and £10 million respectively to turnover and operating profits of the continuing business.

c) Net assets employed by division

Geographical analysis by origin	Net operating assets 31 December 2001 £m	Net operating assets 31 December 2000 £m
North America	**1,287**	998
Europe and Middle East	**676**	630
Australia	**778**	851
Rest of World	**299**	331
Corporate and development	**(205)**	(59)
Net operating assets	**2,835**	2,751
Borrowings	**(1,540)**	(1,178)
Cash and short-term deposits	**643**	107
Deferred tax	**(27)**	(27)
Taxation	**(57)**	(28)
Goodwill – on acquisition of associated undertakings	**24**	136
Goodwill – on acquisition of subsidiary undertakings	**(26)**	(26)
Net assets per consolidated balance sheet	**1,852**	1,735

2 NET OPERATING COSTS BEFORE EXCEPTIONAL ITEMS

		Continuing	Discontinued	Group
	Year ended 31 December 2001 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m
Cost of sales	**383**	205	956	1,161
Other operating costs	**89**	48	499	547
Other operating income	**(80)**	(28)	–	(28)
	392	225	1,455	1,680

3 PROFIT ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit on ordinary activities before taxation is stated after charging/(crediting):	Year ended 31 December 2001 £m	Continuing Nine months ended 31 December 2000 £m	Discontinued Nine months ended 31 December 2000 £m	Group Nine months ended 31 December 2000 £m
Depreciation of tangible fixed assets	**95**	40	56	96
Amortisation of intangible fixed assets	**(1)**	–	14	14
Research and development costs	**–**	–	7	7
Development costs net of recoveries and amounts capitalised	**18**	7	–	7
Operating exceptional items (note 8)	**2**	–	227	227
Operating lease premium receivable	**–**	–	(68)	(68)
Property lease rentals payable (net of recoveries)	**3**	5	3	8
(Profit) on disposal of fixed assets (excluding exceptionals)	**(1)**	–	–	–
Foreign exchange (gains)/losses	**1**	(2)	–	(2)
Auditors' remuneration – audit (including audit of the Company of £0.3 million (31 December 2000: £0.4 million))	**0.7**	0.7	0.2	0.9
Auditors' remuneration – other fees paid to the auditors and their associates for services (including services for the Company of £0.8 million (31 December 2000: £6.6 million))	**1.0**	7.3	0.1	7.4

4 INTEREST RECEIVABLE AND SIMILAR INCOME

a) Group interest receivable and similar income	Year ended 31 December 2001 £m	Continuing Nine months ended 31 December 2000 £m	Discontinued Nine months ended 31 December 2000 £m	Group Nine months ended 31 December 2000 £m
Interest receivable and similar income	**24**	61	22	83

b) Interest receivable of associates				
Share of interest receivable of associates	**–**	3	–	3

5 INTEREST PAYABLE AND SIMILAR CHARGES

a) Group interest payable and similar charges	Year ended 31 December 2001 £m	Continuing Nine months ended 31 December 2000 £m	Discontinued Nine months ended 31 December 2000 £m	Group Nine months ended 31 December 2000 £m
Interest on:				
Bank loans and overdrafts	**103**	79	13	92
Other borrowings	**16**	31	26	57
	119	110	39	149
Finance charges payable on finance leases	**–**	–	12	12
Finance charges on discounting of deferred consideration	**4**	–	–	–
Interest capitalised	**(23)**	(12)	–	(12)
Group interest payable and similar charges – ordinary	**100**	98	51	149
Exceptional interest (note 8)	**29**	–	–	–
Total Group interest payable and similar charges	**129**	98	51	149

b) Interest payable of joint ventures and associates				
Share of interest payable of joint ventures	**14**	10	1	11
Share of interest payable of associates	**33**	37	–	37
	47	47	1	48

6 DIRECTORS' AND EMPLOYEES' REMUNERATION

a) Directors' remuneration

Details of Directors' remuneration are set out on pages 35 to 38.

b) Employees' remuneration

Salaries and other staff costs, including Directors' remuneration were as follows:

	Year ended 31 December 2001 £m	Continuing Nine months ended 31 December 2000 £m	Discontinued Nine months ended 31 December 2000 £m	Group Nine months ended 31 December 2000 £m
Wages and salaries	**62**	39	48	87
Social security costs	**3**	2	4	6
Pension costs (note 7)	**4**	2	4	6
Total employees' remuneration	**69**	43	56	99
Less: amounts capitalised as part of assets in the course of construction	**(4)**	–	–	–
Total staff costs	**65**	43	56	99

Employee numbers

Average number of employees during the financial period, analysed by activity was:

	Year ended 31 December 2001	Nine months ended 31 December 2000
North America	**200**	142
Europe and Middle East	**660**	600
Australia	**586**	583
Rest of World	**752**	1,305
Corporate and development	**134**	199
Average number of employees – continuing business	**2,332**	2,829
Average number of employees – discontinued business	**–**	2,127
Total average number of employees	**2,332**	4,956

The total average number of employees for discontinued operations for the nine months ended 31 December 2000 is a pro-rata share of the nine month average.

7 PENSION SCHEME FUNDING

The majority of pensions for UK employees are funded through the industry-wide scheme, the Electricity Supply Pension Scheme (ESPS) which is a defined benefit scheme with assets invested in separate trustee administered funds. The ESPS is divided into sections, one of which was the National Power section. On demerger the Principal Employer became Innogy plc, with International Power plc staff participating temporarily in the Innogy section of the ESPS. As a result, Innogy is now responsible for the management of the scheme and its assets.

The majority of employees taken on in the Rugeley acquisition are members of another section of the ESPS, the Eastern Electricity section.

During the year, contributions have been paid to the Innogy Group based on the actuarial valuation of that Group. The principal assumptions used for that valuation are set out below, and the contributions paid during the year amounted to £1 million.

Valuation date	31 March 1998
Principal assumptions:	
Investment return	8.5%
Salary increases	6.0%
Pension increases	4.0%

The Innogy section of the ESPS will be split in early 2002 after International Power ceases participating in that section. The split will be on a share-of-fund basis as set out in the actuary's memorandum from the Demerger Agreement. The actuarial assumptions and methods used to determine the share of the fund will be those for the formal actuarial valuation of the Innogy section of the ESPS, as at 31 March 2001, to be set by the scheme actuary and agreed between Innogy Group Trustees and Innogy plc.

During the six months since the Rugeley acquisition, contributions have been paid to the Eastern Electricity section based on the terms agreed in that acquisition. Contributions paid during the six months ended 31 December 2001 were less than £1 million.

A transfer payment will be made from the Eastern Electricity section of the ESPS after International Power ceases participating in that section. The transfer payment will be based on assumptions agreed as part of the Rugeley acquisition.

Employees at Hazelwood participate in a standard Australian superannuation fund called Equisuper. This plan provides benefits primarily for employees in the electricity, gas and water industry, and was developed from the scheme sponsored by the State Electricity Commission of Victoria. At 30 June 2001, the market value of assets was 111% of accrued liabiities. The assets were £39 million (A$111 million) and liabilities were £35 million (A$99 million). The pension cost for 2001 was £1 million. The principal assumptions are set out below:

Valuation date	30 June 2001
Principal assumptions:	
Investment return	8.0%
Salary increases	6.0%
Pension increases	n/a

In other countries employees are members of local social security schemes and in some cases defined contribution plans.

FRS 17

In accordance with the requirements of FRS 17 (Retirement Benefits), this note discloses the main financial assumptions made in valuing the liabilities of the schemes and the fair value of assets held. However, as permitted by FRS 17, the costs, accruals and prepayments recorded in the financial statements continue to be reported under the requirements of SSAP 24 (Accounting for Pension Costs).

International Power operates defined benefit schemes in the UK and Australia. The most recent actuarial valuations have been updated by independent qualified actuaries to take account of FRS 17 reporting requirements for assessing the liabilities of the schemes at 31 December 2001. The market value of the scheme assets are at 31 December 2001.

Financial assumptions	UK %	Australia %
Discount rate	5.8	7.25
Rate of increase in salaries	4.0	4.0
Inflation rate	2.5	3.0
Increase to deferred benefits during deferment	2.6	n/a
Increases to pensions payments	2.6	n/a

The assets in the schemes and expected rates of return were:

Long-term rate of return expected at 31 December 2001	UK %	Australia %
Equities	7.4	7.5
Bonds	4.9	5.5
Other	–	5.5

Value at 31 December 2001	UK £m	Australia £m	Total £m
Equities	19	23	42
Bonds	16	12	28
Other	–	5	5
	35	40	75

The following amounts at 31 December 2001 were measured in accordance with the requirements of FRS 17:

	UK £m	Australia £m	Total £m
Total market value of assets	35	40	75
Present value of scheme liabilities	(39)	(25)	(64)
(Deficit)/surplus in the scheme	(4)	15	11
Related deferred tax liability	1	(5)	(4)
Net pension (liability)/asset	(3)	10	7

If the above amounts had been recognised in the financial statements, International Power's net assets at 31 December 2001 would be as follows:

	£m
Net assets per consolidated balance sheet	1,852
FRS 17 pension asset	7
Net assets including FRS 17 pension asset	1,859

8 EXCEPTIONAL ITEMS

		Continuing	Discontinued	Group
	Year ended 31 December 2001 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m	Nine months ended 31 December 2000 £m
Net operating exceptional items charged/(credited):				
Plant closure provision	**–**	–	21	21
Buy-out of PPA contract	**–**	–	206	206
Release of provision in respect of onerous property lease	**(8)**	–	–	–
Bank guarantee charge in respect of a trade investment (note 30)	**10**	–	–	–
Net operating exceptional items	**2**	–	227	227
Non operating exceptional items (credited)/charged:				
Profit on disposal of fixed asset investment (note 26)	**(30)**	–	–	–
Sale/termination of Chinese operations	**(2)**	25	–	25
Demerger costs	**–**	49	4	53
Restructuring costs	**–**	25	2	27
Non operating exceptional items	**(32)**	99	6	105
Exceptional interest charges:				
Australian refinancing charges	**29**	–	–	–
Exceptional interest payable and similar charges	**29**	–	–	–
Total exceptional items	**(1)**	99	233	332

The exceptional items had no material effect on the tax charge for either the year ended 31 December 2001 or the nine months ended 31 December 2000.

9 TAX ON PROFIT ON ORDINARY ACTIVITIES

	Year ended 31 December 2001 £m	Nine months ended 31 December 2000 £m
UK taxation		
Corporation taxation	**1**	(2)
Foreign taxation		
Overseas subsidiary taxation	**29**	9
Share of joint ventures' taxation	**2**	–
Share of associates' taxation	**26**	14
Total taxation on profit on ordinary activities	**58**	21

The tax charge has been reduced by utilisation of brought forward tax losses and the availability of certain overseas tax concessions.

10 PROFIT OF THE PARENT COMPANY

The profit of the parent company for the financial year amounted to £86 million (nine months ended 31 December 2000: loss of £116 million). By virtue of Section 230 of the Companies Act 1985, the Company is exempt from presenting a separate profit and loss account.

11 DIVIDENDS

	Year ended 31 December 2001 £m	Nine months ended 31 December 2000 £m
Demerger dividend	**–**	392

The Group demerger dividend represents the book value of the net assets of the UK energy business as at the date of demerger, which were distributed to shareholders in the form of Ordinary Shares in Innogy Holdings plc.