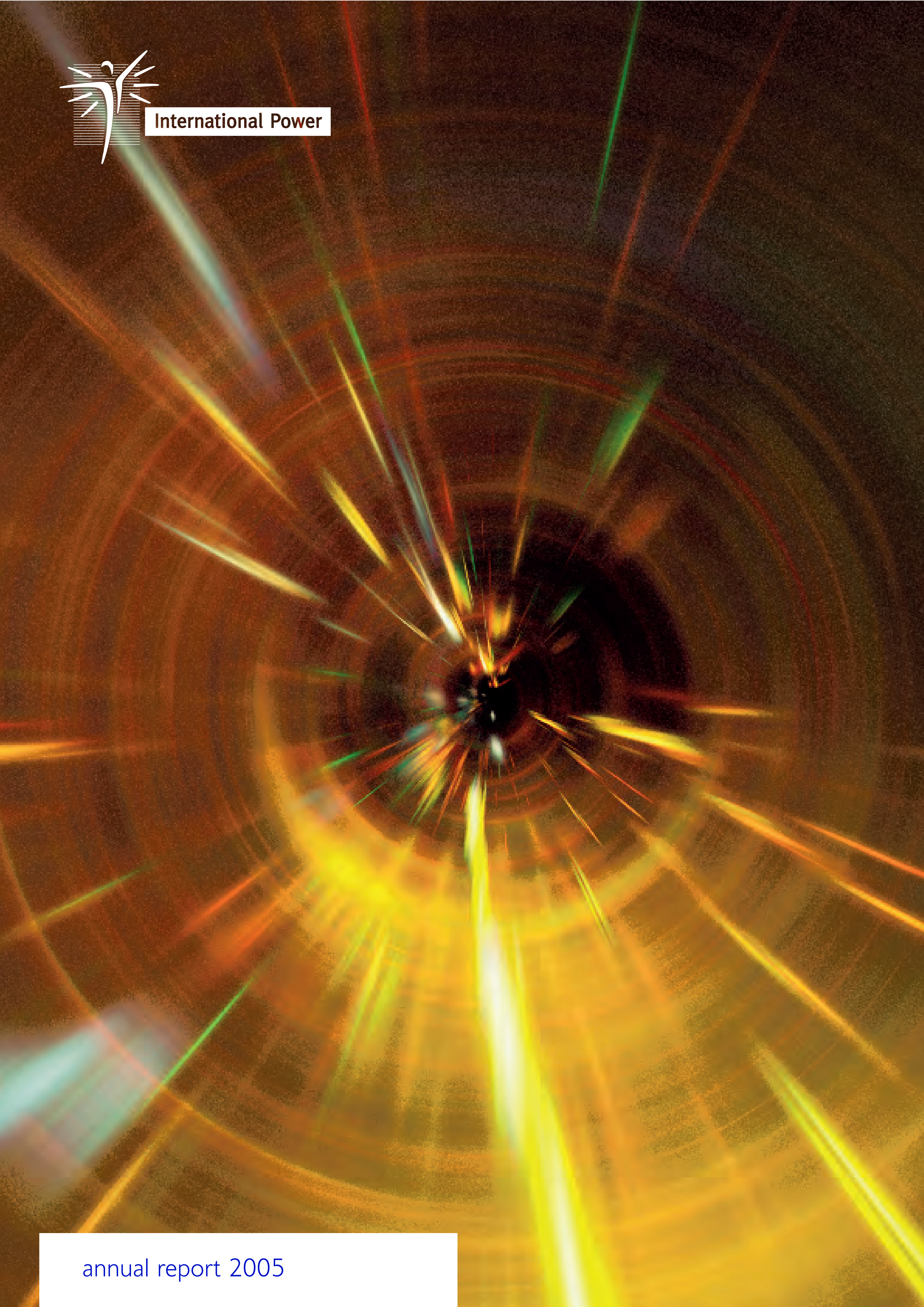


International Power

annual report 2005

Pego, Tejo Energia, Portugal

Contents

Our core business values

Financial discipline
Integrity of communication
Respect for the individual
Safe behaviour
Team first culture

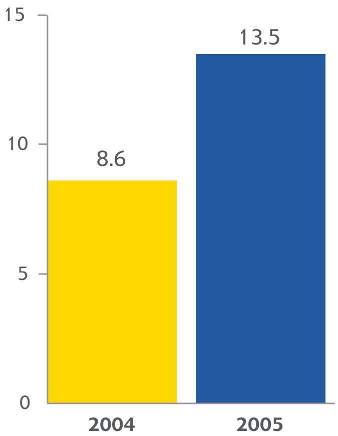
- Profit from operations (excluding exceptional items) of £501 million (2004: £222 million) – up 126%
- EPS (excluding exceptional items) of 13.5p (2004: 8.6p) – up 57%
- Free cash flow of £285 million (2004: £104 million) – up 174%
- 4.5p dividend per share – up 80%

2005 highlights

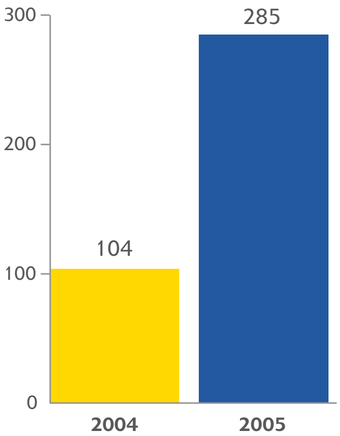
Increased earnings and free cash flow reflect improvements in the US and UK merchant markets as well as the successful integration of acquisitions.

Earnings per share (basic) (pre-exceptional)

pence per share



Free cash flow (£ million)



	Year ended 31 December 2005	Year ended 31 December 2004
	£m	£m
Revenue (including joint ventures and associates)	**2,936**	1,267
Profit from operations		
Excluding exceptional items	**501**	222
Including exceptional items	**611**	233
Profit before tax		
Excluding exceptional items	**299**	145
Including exceptional items	**419**	129
Earnings per share (EPS) in pence		
Basic excluding exceptional items	**13.5p**	8.6p
Basic including exceptional items	**19.4p**	7.5p
Dividend per share (DPS) in pence	**4.5p**	2.5p
Cash generated from operations	**512**	208
Free cash flow – see page 37	**285**	104
Capital expenditure		
Maintenance	**(72)**	(59)
Growth	**(188)**	(158)
Major acquisition expenditure		
Edison Mission Energy assets	**–**	1,073
Turbogás	**–**	135
Saltend	495	–

	As at 31 December 2005	As at 31 December 2004
	£m	£m
Net assets	**2,375**	2,058
Net debt	**2,979**	2,745
Gearing	**125%**	133%
Debt capitalisation	**56%**	57%

Chairman's statement

We have delivered strong growth in both earnings per share and dividend whilst continuing our commitment to pursue growth opportunities that will create additional shareholder value in the future.

In my last statement to you I set out the Company's objectives for 2005 – these were to focus on the integration and consolidation of our 2004 acquisitions, namely the Edison Mission Energy international asset portfolio and the Turbogás plant in Portugal, whilst ensuring that we delivered on our commitments to shareholders on earnings and dividends.

These objectives were set against the background of our original earnings per share guidance of 11.0p – 12.5p for 2005. In the event I am pleased to report that at the end of the year the Group reported an EPS (excluding exceptional items) of 13.5p. This is a 57% increase on the 2004 result and reflects improvements in the US and UK merchant markets as well as the successful integration of the assets we acquired. The growth in free cash flow from £104 million in 2004 to £285 million in 2005, a 174% increase, demonstrates that these earnings are backed by strong cash flow. The share price has consequently recovered well throughout the year.

In 2005 we made our first dividend payment and indicated that for the payment in 2006 we expected to maintain a dividend pay-out ratio at the 30% level. However, recognising the progress we made last year, both in terms of earnings and free cash flow, the Board has decided to recommend a final dividend of 4.5p per share in respect of the year ended 31 December 2005. This is an 80% increase on the payment in respect of 2004 and represents a pay-out ratio of 33%. It remains the Board's intention to move progressively towards a pay-out ratio of 40%. Payment of this dividend is due to be made towards the end of June following the 2006 Annual General Meeting (AGM), which will be held on 17 May 2006.

The growth in earnings and dividends is a testament to the quality of the contribution made by the Group's employees during the year – from the careful selection of acquisition opportunities and thorough due diligence programmes to the tightly run operating regimes that exist at all of our power plants. I would like to thank both the staff who were part of the Company before the recent important strategic moves as well as those who have now joined the Company and integrated well into the team.

During 2005 we continued to grow the business. Transactions included the acquisition of the 1,200 MW Saltend CCGT in the UK in partnership with Mitsui, the forming of a retail business in partnership with EnergyAustralia in Victoria and South Australia and, at the beginning of this year, we were part of a consortium which has agreed to acquire the Hidd CCGT/desalination plant in Bahrain. All of these acquisitions meet our strategic and financial criteria and will create additional shareholder value in the years ahead.

There have been changes to the Board of Directors. Jack Taylor will be retiring as a Non-Executive Director of the Company at the 2006 AGM and I would like to thank Jack for the six years of excellent service he has given to the Board and the Company.

On 1 June 2005, Bruce Levy joined the Board as an Executive Director with responsibility for the North America region. Bruce joined the Group in December 2004 having worked previously at the US power company, GPU. The Board is pleased with the progress being made in the North American business and held a Board meeting at ANP's headquarters in Boston in November 2005.

2005 is the first year we have produced our accounts in accordance with the newly adopted International Financial Reporting Standards (IFRS). The move from UK GAAP to IFRS has created an extra level of complexity in our reporting but, excluding the impact of IAS 39, has not made a material difference to the Group's reported performance when compared to the way it would have been presented under UK GAAP.

In relation to corporate governance issues, we continue the work to ensure the group is able to comply with s404 Sarbanes Oxley Act for 2006. We reviewed our US listing during 2005 and decided to maintain it although we will keep it under scrutiny to respond to market developments. With regard to the Combined Code we have taken steps to be more compliant, and have used an external facilitator for the first time to carry out our annual Board performance evaluation.

There is currently a significant amount of attention paid by boards, employees and shareholders to the state of UK corporate pension funds. Fortunately, this is not a major issue for International Power due to the relatively small pension deficit.

We expect 2006 to be a year of further growth. This is driven principally by continued recovery in two of our key merchant markets, namely the UK and the US, and our new-build programme in the Middle East progressively reaching commercial operation. We will continue with our disciplined approach to pursuing value enhancing growth opportunities in our core regions, alongside our commitment to increase our dividend pay-out over the medium-term.

Sir Neville Simms
Chairman

- Earnings per share (excluding exceptional items) up 57% to 13.5p
- Dividend payment of 4.5p per share, an 80% increase on 2004
- Strong performance from acquisitions
- 2006 expected to be a year of further growth

Chief Executive Officer's statement

Dear Shareholder

Our objectives going into 2005 were best summarised in one word – delivery. Namely, delivery of the successful integration of the acquisitions completed in 2004 – particularly the international portfolio of assets acquired from Edison Mission Energy (EME) – delivery of an immediate and significant increase in earnings and cash flow, and delivery of selected growth opportunities that would create both immediate and long-term value for our shareholders. I believe we have made very good progress on delivering these commitments, and I would like to explain some of the main achievements and challenges, and, most importantly, how we intend to build on this platform to create more value for you – our shareholders.

Performance

The integration of EME's international portfolio, comprising nine assets with a net generating capacity of some 3,200 MW, has proceeded very well, with the performance of the portfolio exceeding our acquisition plans. The assets are now fully integrated into our regional management structure, and are managed, operated, and traded alongside our existing portfolio. This has enabled us to eliminate duplicated regional costs, such as the EME London and Melbourne regional offices, and to extract maximum synergies. We did very extensive due diligence work on all the assets and this has been invaluable in setting key objectives and priorities, and allocating resources, both financial and personnel, to areas of highest return. We have made key appointments at some of the larger assets, such as First Hydro in the UK and Paiton in Indonesia, and have rotated the plant managers of Hazelwood and Loy Yang B, our two major assets in Victoria, Australia. These moves are designed to ensure the transfer of best practices between assets and regions, and recognise that we can also benefit and learn from a fresh perspective. The acquisition of Turbogás in Portugal, a 990 MW modern, efficient gas fired plant, was also an important step for us, significantly enhancing our position in this core European market. Again, this asset has performed very well in 2005.

Clearly, these acquisitions have been an important driver of our significant growth in earnings and cash flow, but not the only one, as our base portfolio has also performed well. Overall, our Group delivered an increase in earnings per share (excluding exceptional items) of 57% (up from 8.6p in 2004 to 13.5p in 2005), and an increase in free cash flow of over 174% (from £104 million in 2004 to £285 million in 2005). In light of this strong financial performance, the Board is proposing a dividend of 4.5p per share (2004: 2.5p), an increase of 80% year on year and representing a pay-out ratio of 33%. Let me now give you a brief review of our performance in our five core regions.

In the US, we saw the first signs of the anticipated market recovery in both Texas and New England. A combination of higher gas prices, retirement of older, inefficient plant (particularly in Texas), a warmer summer and steady increases in demand contributed to higher margins for our portfolio of modern efficient gas fired plant. Operational performance was good, with plant availability averaging over 95%. There is still some way to go before we get to full market recovery, which we continue to estimate in the 2007-2009 timeframe, but 2005 was a welcome improvement. Our long-term contracted plants continued to perform well and benefited from a significant contribution from EcoEléctrica in Puerto Rico. Our focus on operational excellence and high plant availability is a constant theme. We expect a further improvement in earnings in the US as our markets recover.

Europe is now the largest regional contributor to our Group's earnings, and benefited from an improvement in the UK wholesale generation market. Power prices were higher in the UK, again principally driven by high oil and gas prices, and this has particularly benefited our Rugeley coal fired plant. First Hydro, our pumped storage hydro unit in the UK, also had a very good year, with strong demand for its very fast response peaking services. 2005 also saw the introduction of carbon dioxide (CO_2) allocations and trading in the UK and Europe – this has worked well, but we are pressing the UK government to provide more clarity on the longer term allocations, as CO_2 is a key element in the cost base for a power plant, and therefore a very important consideration when evaluating further investments. We are strong advocates of a clear UK energy policy that provides a balanced fuel mix, and a level playing field for all participants. We were also delighted to add Saltend (1,200 MW CCGT) to our UK portfolio in 2005. Saltend was acquired with a gas supply contract and is already contributing to our earnings and cash flow. Our assets in continental Europe all performed well

We have delivered on our short-term commitments in 2005: the Group is well positioned in its core markets, and has a stronger base – both financially and commercially. But this is only the start: we are a long-term business and are committed to delivering long-term value.

– with major contributions from International Power Opatovice in the Czech Republic, Turbogás and Pego in Portugal, ISAB in Italy (acquired from EME) and Uni-Mar in Turkey.

Our Middle East portfolio continues to grow and we will see this more fully reflected in the financial results in 2006 onwards, when the current construction projects transition into commercial operation. Our plants in current operation had excellent availability and good financial results. Plants under construction, namely the four cogeneration plants for Saudi Aramco and the power and desalination plant in Qatar are all making good progress, and are scheduled to come into operation on a phased basis through 2006, and early 2007. We were also delighted to recently sign an agreement to acquire an existing power and desalination plant in Bahrain. We continue to review acquisition and new-build opportunities in the Middle East, building on our reputation in the region to win high quality projects – often combining power generation with desalination of water – complete with long-term offtake contracts.

Our earnings were up in Australia year-on-year and this was due to the EME acquisition, with 2005 benefiting particularly from the contribution from Loy Yang B, in Victoria. Underlying market prices for power in our markets of Victoria and South Australia were lower in 2005 and, although we do not expect a short-term correction, we remain confident of future market recovery. A lot has been achieved in Australia during 2005, including the commissioning of our first wind farm (46 MW in South Australia), the successful sale of Valley Power, a peaking plant in Victoria that the Australian competition authorities required us to divest as part of the EME acquisition, and the formation of a retail business in partnership with EnergyAustralia, which is a major established retailer in the region. The latter move gives us an additional route to market and we are actively pursuing initiatives to grow this business.

Our Asian portfolio operates under long-term offtake contracts, and all assets performed very well in 2005. The main reason for the improved profitability in 2005 was the acquisition of Paiton, where we have a 31% interest in this major, modern 1,230 MW coal fired plant in Indonesia, followed by Uch, where we acquired a 40% stake in this efficient gas fired plant in Pakistan.

Cash flow remains a top priority, as this both fuels our dividend policy and provides liquidity for our growth programmes. Our cash flow performance is significantly up in 2005, with free cash flow (namely after all pre-exceptional costs, including interest and tax) at £285 million compared to £104 million in 2004. We remain committed to maintaining good levels of liquidity and a prudent capital structure.

People

Over the last year I have visited every major acquired asset and indeed many of our existing portfolio, and I can confirm that we have not only very high quality assets, but also very experienced, professional, committed and enthusiastic teams in place. I would like to thank everyone for their terrific contribution.

Health, safety and the environment remain at the core of International Power – these initiatives are co-ordinated, monitored and reviewed from the corporate centre to ensure that best practices and experiences are not only shared across the Group, but are primarily implemented at asset and regional level. Every asset in our Group has a detailed programme of initiatives, including community action programmes, and you can read much more about these in our corporate social responsibility section. Health and safety, in particular, are personal responsibilities for everyone within the Group and we encourage and promote individual awareness and responsibility wherever possible.

Prospects

Overall, our Group is well positioned in its core markets, and has a stronger base – financially and commercially – from which to deliver both dividend and earnings growth. We have strong capabilities across the power generation value chain, and can deliver on both greenfield and acquisition opportunities. We have delivered on our short-term commitments in 2005, but this is only a start and we are in no way complacent – we are a long-term business and are committed to delivering long-term value.

Philip Cox
Chief Executive Officer

Asset portfolio

	Fuel/type	Gross capacity power MW	IPR ownership %	Net capacity power MW	Gross capacity heat (MWth) desal (MIGD) steam (million lbs/hr)	IPR net capacity heat (MWth) desal (MIGD) steam (million lbs/hr)
Assets in operation						
North America						
Hartwell, Georgia	Gas (OCGT)	310	50	155		
Hays, Texas[1]	Gas (CCGT)	1,100	100	1,100		
Midlothian, Texas[1]	Gas (CCGT)	1,650	100	1,650		
Oyster Creek, Texas	Gas (Cogen/CCGT)	425	50	213	100 MWth	50 MWth
Bellingham, Massachusetts[1]	Gas (CCGT)	570	100	570		
Blackstone, Massachusetts[1]	Gas (CCGT)	570	100	570		
Milford, Massachusetts	Gas (CCGT)	160	100	160		
EcoEléctrica, Puerto Rico	LNG (CCGT)	524	35	183		
North America total in operation		***5,309***		***4,601***	***100 MWth***	***50 MWth***
Europe						
International Power Opatovice, Czech Republic[2][3]	Coal/gas (Cogen)	585	99	580	1,945 MWth	1,925 MWth
ISAB, Italy	Gas (IGCC)	528	34	181		
Tejo Energia (Pego), Portugal	Coal	600	50	300		
Turbogás, Portugal	Gas (CCGT)	990	60	594		
Spanish Hydro, Spain	Hydro	84	67	57		
Uni-Mar (Marmara), Turkey	Gas (CCGT)	480	33	160		
Deeside, UK	Gas (CCGT)	500	100	500		
Derwent, UK	Gas (CCGT)	214	23	50		
First Hydro, UK	Pumped storage	2,088	70	1,462		
Rugeley, UK	Coal/50 MW of OCGT	1,050	100	1,050		
Saltend, UK	Gas (CCGT/Cogen)	1,200	70	840	0.30m lbs/hr	0.21m lbs/hr
Europe total in operation		***8,319***		***5,774***		
Middle East						
Hidd, Bahrain[4]	Gas (CCGT)/desalination	910	40	364	30 MIGD	12 MIGD
Al Kamil, Oman	Gas (OCGT)	285	65	185		
Shuweihat S1, UAE	Gas (CCGT)/desalination	1,500	20	300	100 MIGD	20 MIGD
Umm Al Nar, UAE	Gas (CCGT)/desalination	870	20	174	162 MIGD	32 MIGD
Middle East total in operation		***3,565***		***1,023***	***292 MIGD***	***64 MIGD***
Australia						
Canunda, South Australia	Wind/renewable	46	100	46		
Pelican Point, South Australia	Gas (CCGT)	485	100	485		
Synergen, South Australia	Gas/distillate	360	100	360		
Hazelwood, Victoria	Coal	1,635	92	1,500		
Loy Yang B, Victoria	Coal	1,000	70	700		
SEA Gas pipeline, Victoria[5]	n/a	n/a	33	n/a		
Kwinana, Western Australia	Gas (CCGT)	118	49	58		
EnergyAustralia[6]	n/a	n/a	50	n/a		
Australia total in operation		***3,644***		***3,149***		
Asia						
Paiton, Indonesia	Coal	1,230	31	385		
Malakoff, Malaysia[3]	Gas (OCGT/CCGT)	3,130	18	567		
HUBCO, Pakistan	Oil	1,290	17	214		
KAPCO, Pakistan	Gas/oil (CCGT)	1,600	36	575		
Uch, Pakistan	Gas/oil (CCGT)	586	40	234		
TNP (Pluak Daeng), Thailand	Gas (Cogen)	120	100	120	7.7 MWth[7]	7.7 MWth
Asia total in operation		***7,956***		***2,095***	***7.7 MWth***	***7.7 MWth***
TOTAL in operation around the world		**28,793**		**16,642**		

The tables below and opposite set out details in relation to our operating plants and assets under construction as at 6 March 2006.

Uthmaniyah, Tihama, Saudia Arabia

	Fuel/type	Gross capacity power MW	IPR ownership %	Net capacity power MW	Gross capacity heat (MWth) desal (MIGD) steam (million lbs/hr)	IPR net capacity heat (MWth) desal (MIGD) steam (million lbs/hr)
Assets under construction						
Hidd, Bahrain	Desalination	–	40	–	60 MIGD	24 MIGD
Malakoff, Malaysia(3)	Coal	1,890	18	342		
Ras Laffan B, Qatar	Gas (CCGT)/desalination	1,025	40	410	60 MIGD	24 MIGD
Tihama, Saudi Arabia	Gas (Cogen)	1,074	60	644	4.5m lbs/hr	2.7m lbs/hr
TNP (Pluak Daeng), Thailand	Gas (Cogen)	23	100	23		
Umm Al Nar Expansion, UAE	Gas (CCGT)/desalination	1,550	20	310	25 MIGD	5 MIGD
TOTAL under construction around the world		**5,562**		**1,729**		

(1) *Capacity shown for these assets is the nameplate capacity.*
(2) *In October 2005, Elektrárny Opatovice (EOP) changed its name to International Power Opatovice.*
(3) *Gross capacity amount shown for International Power Opatovice and Malakoff represents the actual net interest owned directly or indirectly by International Power Opatovice and Malakoff, respectively.*
(4) *Hidd acquisition is expected to complete in July 2006.*
(5) *687 km gas pipeline (33% owned by International Power) from Victoria to South Australia.*
(6) *EnergyAustralia (50% owned by International Power) services circa 275,000 electricity and gas retail accounts in Victoria and South Australia.*
(7) *District cooling system capacity.*

Control centre, Pelican Point, Australia

International Power – Group overview

- A portfolio approach: a balanced portfolio in terms of geographic spread, fuel diversity and contractual position
- Broad geographic spread through five core regions – North America, Europe, Middle East, Australia and Asia
- Our portfolio approach gives us access to multiple opportunities to create value whilst mitigating risks
- 28,800 MW (gross) power generating capacity in 18 countries
- Successful developments in linked businesses: desalination, steam and district heating, electricity retail, open-cast mining and gas transportation
- Comprehensive plant operation skills. Capabilities to produce electricity through thermal, hydro, pumped storage and wind technologies using different fuel types: gas, oil, coal and renewable resources

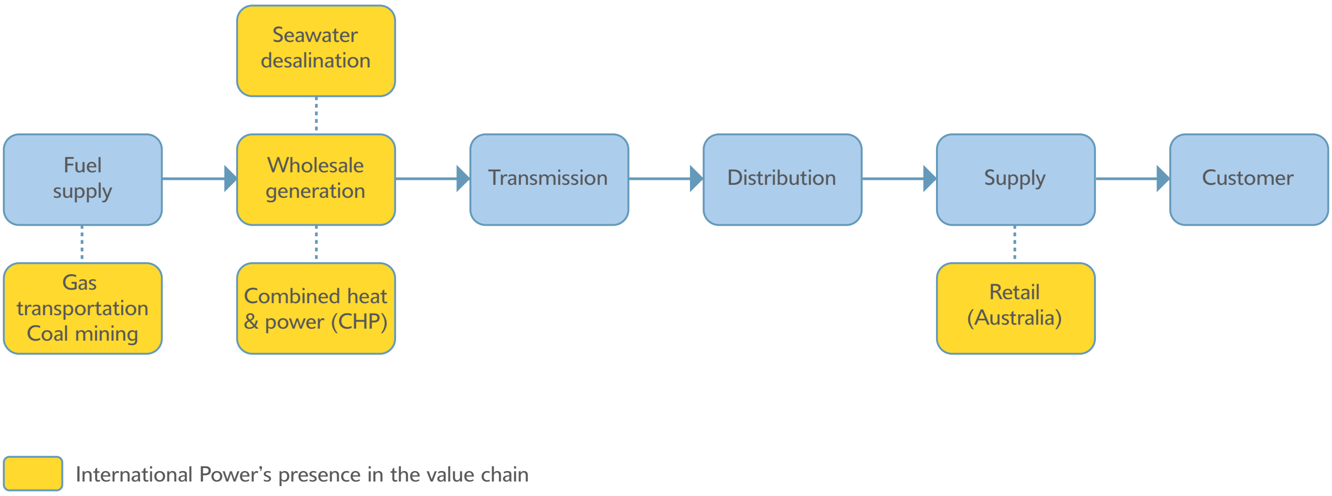
International Power's primary business is the generation of electricity. Overall, we have interests in 28,800 MW (gross) of power generating capacity in 18 countries.

Together with generating power, we use our capabilities to successfully and profitably develop closely linked businesses. These include wholesale production of fresh water through seawater desalination, production and distribution of steam, district heating via cogeneration, a small but growing electricity retail business, open-cast coal mining and gas transportation.

A portfolio approach

We add value and manage risk through a portfolio management approach, which involves maintaining a balance in the portfolio in terms of geographical spread, fuel diversity and contractual position. This portfolio approach gives us access to multiple opportunities to create value whilst mitigating the risks associated with over exposure to any particular market, fuel or contract type.

Geographically the business is focused in five core regions – North America, Europe, Middle East, Australia and Asia. Our balanced geographic presence gives us access to growth opportunities with attractive risk reward profiles whilst protecting the overall business from a downturn in any particular market.



The portfolio approach also extends through to our operational capabilities. We are able to operate a range of power plant technologies namely thermal, hydro, pumped storage and wind. These technologies produce electricity using different fuel types that include gas, oil, coal and renewable sources such as wind and water. This operational flexibility allows us to capture opportunities that are most economic and best suited to the market in question.

As electricity is a critical service for any economy, governments carefully decide whether or not they wish to liberalise this key sector. Several governments have retained full control of the sector and others have fully liberalised both the production and supply of electricity. The skills required for investing in liberalised (merchant) or non-liberalised markets are very different – and we have both.

The government-controlled markets offer opportunities to sell power to government bodies via long-term contracts that offer stable and regulated returns. Assets in the liberalised or merchant markets are subject to the forces of supply and demand and these markets are generally cyclical and more volatile. Hence these markets generally offer a higher risk/high reward environment for investments.

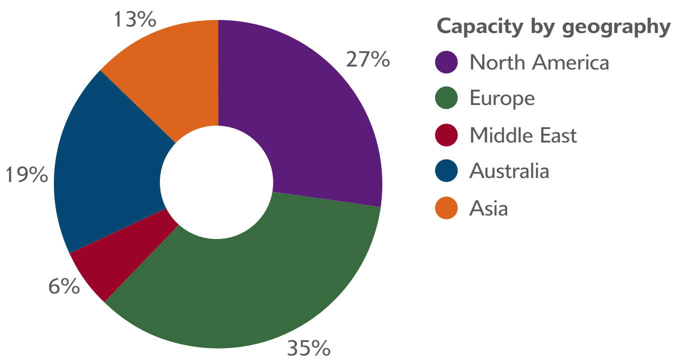
International Power maintains a balanced presence in both types of markets, providing the business with a stable platform of contracted earnings and cash flow overlaid by merchant generation which offers greater upside potential.

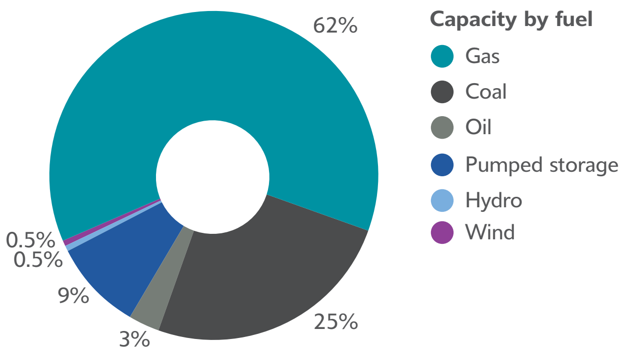
Capabilities

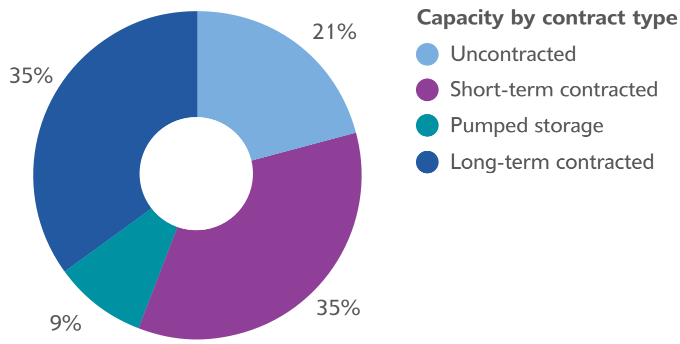
International Power's high quality asset portfolio, together with the capabilities of its teams around the world, form a strong combination for revenue optimisation, effective risk management and future growth in earnings and cash flow.

Through its heritage, International Power has in-depth experience in plant operations and engineering. This experience is invaluable not only for ensuring smooth plant operations, but also to ensure we understand all operational and technical issues relating to the potential acquisition or development of new power plants. Today, the Company has skills to execute power projects right from inception through to the delivery of power in the most advanced and complex traded markets of the world.

International Power portfolio
as at March 2006



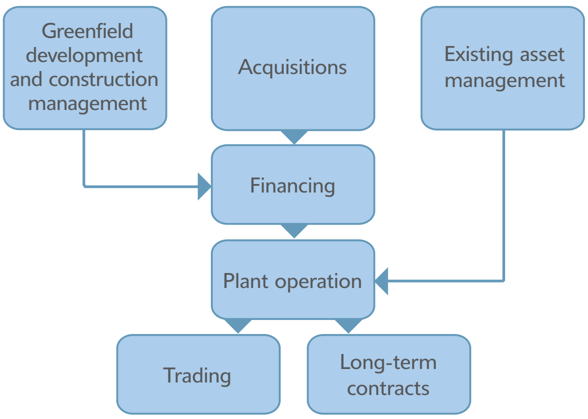




Notes:
Excludes assets under construction.
All numbers based on International Power's net share of MWs.

International Power has demonstrated the ability to execute acquisitions at the right time and at the right value, together with the capability to integrate newly acquired assets quickly and seamlessly.

The Company's core capabilities can be categorised into the following seven areas:



Greenfield development and construction management: We have excellent experience of developing large capital intensive infrastructure projects – from selecting the appropriate site to securing multiple government/stakeholder approvals and project managing the entire construction programme right through to successful commercial operation. International Power's successful growth in the Middle East is the most graphic example of our greenfield development expertise, where, in the last six years the Company has developed six major projects with a total value of approximately £3.8 billion.

Acquisitions: International Power has demonstrated the ability to execute acquisitions at the right time and at the right value, together with the capability to integrate quickly and seamlessly newly acquired assets into the portfolio. An excellent example of International Power's acquisition capabilities is the successful acquisition of the EME international asset portfolio which was completed in late 2004. All nine assets were smoothly integrated into the portfolio and have since met or exceeded financial and operational performance targets.

Financing: Given the very capital intensive nature of our business, the ability to fund projects is vital for success. International Power has consistently proven its financing capabilities through the execution of numerous greenfield and acquisition fundings, together with re-financings of existing assets. We have done this in different parts of the world, under different circumstances and through the combined use of local and international capital. As examples, Shuweihat S1 and Umm Al Nar in the Middle East were both financed in a challenging geopolitical environment, and Saltend was the first merchant plant in the UK to be financed in over five years. Non-recourse project finance is at the core of International Power's financing strategy and capital structure – this provides the most appropriate level of debt for each asset and also excellent risk mitigation for the Group.

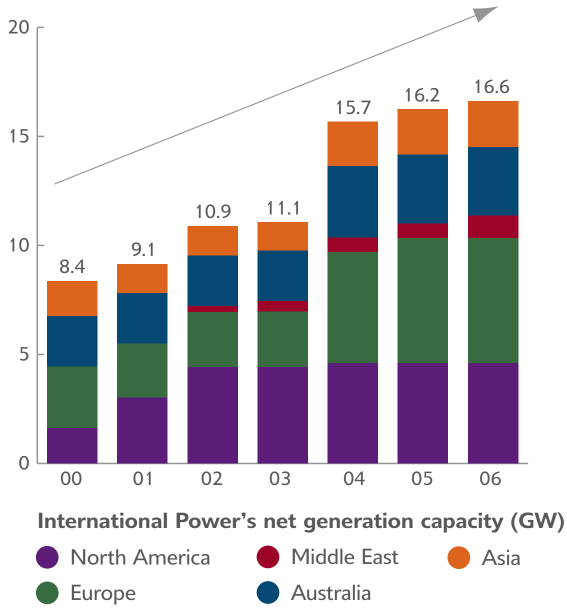
Plant operations: We have comprehensive power station operational experience and skills. Through-life engineering and maintenance plans, meticulously implemented, ensure maximum availability and are key for delivering value in both our merchant and long-term contracted markets. Effective plant operations are enhanced by ensuring information is shared around the portfolio and key operational staff are rotated to different assets on a regular basis.

Long-term contract expertise: We have strong commercial skills to structure and negotiate long-term power and water contracts in regulated markets such as Asia and the Middle East. Under these contracts, key cost risks such as fuel and turbine maintenance are mitigated through long-term hedging and supply arrangements. Overall, the contracts provide visibility and stability of earnings and cash generation over the long-term.

Trading: We operate in a number of merchant markets throughout the world. We have developed the skills necessary to maximise our returns in these markets, with a practical focus on co–ordinating trading and operations to ensure we optimise our returns by having our plant available whenever our trading teams see value. For us, trading means selling the physical output generated by our plant. Our traders operate within strict guidelines and risk policies to ensure our traded position is carefully monitored and managed. This includes matching fuel purchases with power sales and carrying out only a very limited amount of proprietary trading. Where possible we will forward sell output if we consider the return is favourable, which provides some certainty for near-term earnings and cash flow. We also ensure that lessons learnt in all our markets – for example the new environmental legislation in Europe relating to CO_2 allocations – can be shared with the rest of the business.

Asset management: All our investments have to deliver expected performance on a standalone basis first, and then as part of the regional and global portfolio. Through regular and robust technical, commercial and financial reviews, the corporate headquarters and regional offices together monitor the performance of each asset in the portfolio. We work to ensure that we maximise fleet efficiencies where we operate plants with similar technologies, for example through global spare parts supply agreements or by bringing certain engineering services in-house. In addition, we have a Health, Safety and Environment Committee which co-ordinates the Group's activities and enables best practices to be adopted at all plants. This co-ordinated approach helps us manage operational risk and extract the full portfolio benefits.

Opportunities to grow



International Power's net generation capacity (GW)

Since demerger in October 2000, the Group has grown significantly, nearly doubling our operational capacity through successful acquisitions and greenfield developments in our core markets.

Demand for electricity is growing in all of our markets, with growth rates ranging from 2% to 9%. This underlying growth in demand offers us two kinds of investment opportunities – investments to meet incremental demand and investments to replace existing older, less efficient capacity that is about to be retired. Our knowledge of market and commercial conditions in our five core regions means that we select only the best development or acquisition opportunities across our portfolio.

With non-recourse project debt as a fundamental building block, our capital structure is prudently balanced to provide us with the flexibility to carry out growth initiatives without overstretching our financial resources. We have access to multiple financial resources – including strong cash generation from our portfolio, our borrowing facilities and capacity, and our partnering capabilities – to execute selected opportunities which meet our stringent investment criteria.

EcoEléctrica, Puerto Rico

- Since 2000, the Group has nearly doubled its generating capacity through successful acquisitions and greenfield developments in our core markets
- The demand for electricity in our markets is growing at rates ranging from 2% to 9%
- Non-recourse project debt is a fundamental building block, and a prudently balanced capital structure provides flexibility to execute growth without overstretching the balance sheet
- We have strong commercial skills to structure and negotiate long-term power contracts in regulated markets such as Asia and the Middle East

Turbine hall, Deeside, UK

Business and financial review

Financial highlights

Financial highlights

- Profit from operations (excluding exceptional items) of £501 million (2004: £222 million) – up 126%
- EPS (excluding exceptional items) of 13.5p (2004: 8.6p) – up 57%
- EPS (including exceptional items) of 19.4p (2004: 7.5p) – up 159%
- Free cash flow of £285 million (2004: £104 million) – up 174%
- DPS of 4.5p – up 80%
- Dividend pay out ratio raised to 33% of EPS (subject to shareholder approval)

Operational highlights

- Strong performance from acquired assets
- US and UK continued market recovery
- Acquisition of 1,200 MW CCGT Saltend plant completed

Income statement

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Excluding exceptional items		
Revenue – (including joint ventures and associates)	**2,936**	1,267
Profit from operations		
– from subsidiaries	**303**	109
– from joint ventures and associates	**198**	113
Profit from operations	**501**	222
Interest	**(202)**	(77)
Profit before tax	**299**	145
Tax	**(55)**	(25)
Minority interests	**(45)**	(8)
Profit attributable to equity holders of the parent	**199**	112
Earnings per share (basic)	**13.5p**	8.6p
Including exceptional items		
Profit attributable to equity holders of the parent	**285**	98
Earnings per share (basic)	**19.4p**	7.5p

Balance sheet

	As at 31 December 2005 £m	As at 31 December 2004 £m
Net assets	**2,375**	2,058
Net debt	**2,979**	2,745
Gearing	**125%**	133%
Debt capitalisation	**56%**	57%

Strong financial performance with EPS (excluding exceptional items) at 13.5p – up 57%, profit from operations up in all regions with acquisitions performing well, UK and US merchant markets continuing recovery and 2006 expected to show further growth.

Segmental results – excluding exceptional items

	Subsidiaries		**Share of joint ventures and associates**		**Total**	
	Year ended 31 December 2005	Year ended 31 December 2004	**Year ended 31 December 2005**	Year ended 31 December 2004	**Year ended 31 December 2005**	Year ended 31 December 2004
	£m	£m	**£m**	£m	**£m**	£m
Revenue						
North America	**523**	188	**171**	72	**694**	260
Europe	**990**	308	**397**	212	**1,387**	520
Middle East	**24**	24	**43**	30	**67**	54
Australia	**369**	223	**51**	8	**420**	231
Asia	**27**	25	**341**	177	**368**	202
	1,933	768	**1,003**	499	**2,936**	1,267
Profit/(loss) from operations						
North America	**20**	(29)	**29**	8	**49**	(21)
Europe	**205**	52	**55**	45	**260**	97
Middle East	**12**	13	**12**	7	**24**	20
Australia	**119**	96	**6**	2	**125**	98
Asia	**6**	9	**96**	51	**102**	60
Segmental profit from operations	**362**	141	**198**	113	**560**	254
Corporate costs	**(59)**	(32)	**–**	–	**(59)**	(32)
Profit from operations (excluding exceptional items)	**303**	109	**198**	113	**501**	222
Exceptional items	**110**	11	**–**	–	**110**	11
Profit from operations	**413**	120	**198**	113	**611**	233

The regional performance is discussed in more detail on pages 14-33. Corporate costs and exceptional items are discussed on pages 34 and 35.

Dividend

The Board is proposing a dividend of 4.5p per share (2004: 2.5p), an increase of 80% year-on-year and representing a pay-out ratio of 33% of pre-exceptional EPS. We have increased our pay-out ratio earlier than planned (previously 30%), in light of our strong financial performance. Our intention to progressively move towards a dividend pay-out ratio of 40% in the medium-term remains unchanged.

Payment of this dividend, to shareholders registered on the Company share register on 26 May 2006, is due to be made on 23 June 2006 following approval at the 2006 AGM, which will be held on 17 May 2006.

Outlook

We expect 2006 to be a year of further growth. This is driven principally by continued recovery in two of our key merchant markets, namely the UK and the US, and our new build programme in the Middle East progressively reaching commercial operation. We will continue our disciplined approach to value enhancing growth opportunities in our core regions, alongside our commitment to increase our dividend pay-out over the medium-term.

Hays, North America

Regional review

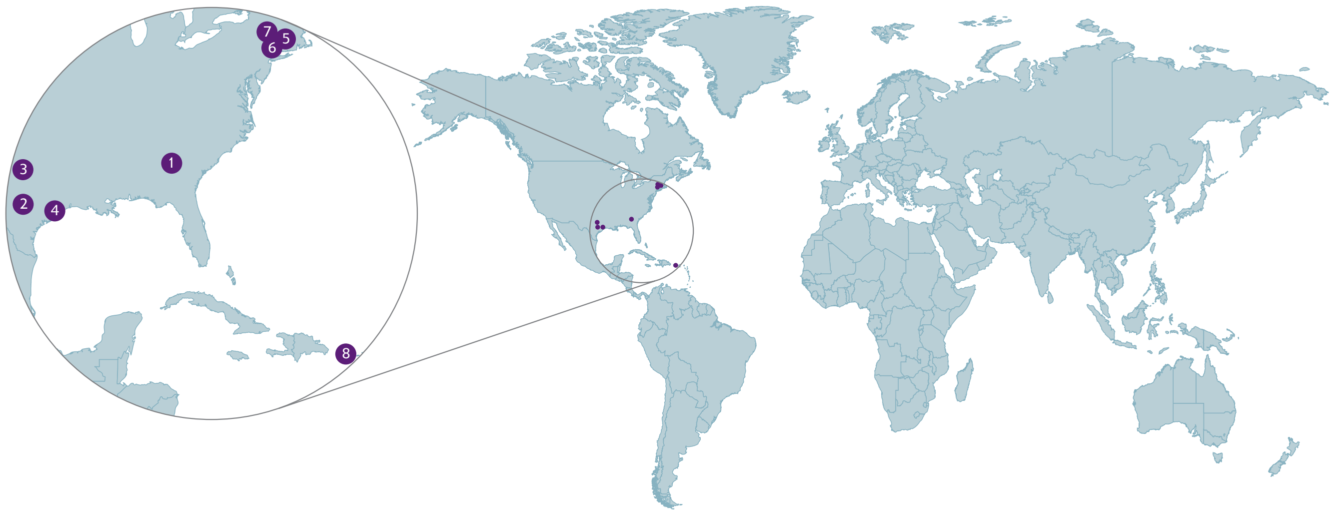
North America

- Profit from operations increased to £49 million compared to a loss of £21 million last year
- Strong operating and financial performance in Texas
- Significant contribution from EcoEléctrica in Puerto Rico
- Expectation for market recovery in both Texas and New England remains in the 2007-2009 timeframe

	Year ended 31 December 2005	Year ended 31 December 2004
	£m	£m
Revenue	**694**	260
Profit/(loss) from operations (before exceptional items)	**49**	(21)
Exceptional items	**–**	–
Profit/(loss) from operations (post exceptional items)	**49**	(21)

North America generated revenue of £694 million (2004: £260 million). Profit from operations amounted to £49 million compared to a loss from operations of £21 million last year. The region benefited from strong operating and financial performance in Texas at both Midlothian and Hays, with the latter returning to service in May 2005. The contracted assets once again performed well and benefited from a significant contribution from EcoEléctrica in Puerto Rico.

The Texas power market showed further signs of recovery during 2005 as pricing levels increased from the low levels in 2003 and 2004. Market prices improved driven by the demand for peak power (up 3% to 60,300 MW), a warm summer and a reduction in surplus generation following the retirements and mothballing of inefficient plant in 2004 and 2005. The current reserve margin in Texas is 24%, and we expect a further reduction this year. In Texas, gas fired generation typically sets the marginal price for power which means that the relatively high efficiency of our gas fired plants provides an economic advantage when gas prices are high.



	Fuel/type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth)	Net capacity heat (MWth)
Assets in operation					
1 Hartwell, Georgia	Gas (OCGT)	310	155	–	–
2 Hays, Texas[1]	Gas (CCGT)	1,100	1,100	–	–
3 Midlothian, Texas[1]	Gas (CCGT)	1,650	1,650	–	–
4 Oyster Creek, Texas	Gas (Cogen/CCGT)	425	213	100	50
5 Bellingham, Massachusetts[1]	Gas (CCGT)	570	570	–	–
6 Blackstone, Massachusetts[1]	Gas (CCGT)	570	570	–	–
7 Milford, Massachusetts	Gas (CCGT)	160	160	–	–
8 EcoEléctrica, Puerto Rico	LNG (CCGT)	524	183	–	–
North America total in operation		**5,309**	**4,601**	**100**	**50**

[1] Capacity shown for these assets is the nameplate capacity.

In New England, the underlying reserve margin is now estimated at 20%. In this market, oil fired generation has a greater role in determining the market price of power, therefore the relatively high efficiency of our gas fired plants does not enjoy the same benefits of a high gas price environment as in Texas. Overall, spark spreads showed a smaller recovery than we experienced in Texas. Q1 2004 benefited from some very high, short duration, price spikes which lifted the full year spreads that year. Excluding this, the underlying spreads for 2005 were ahead of 2004.

In January 2006 the New England system operator reported progress on the establishment of a capacity payment mechanism (a Forward Procurement Market instead of the previously proposed LICAP system). The details of the proposed capacity market are expected to be disclosed in Q4 2006. This is a positive development for the New England market and is designed to ensure improved security of supply and encourage the provision of reliable generation, particularly at times of peak demand.

For 2006, approximately 60% of our expected output in Texas and approximately 30% of our expected output in New England has been forward contracted. Both markets have shown signs of recovery and our expectation for market recovery in both Texas and New England remains in the 2007-2009 timeframe. Operationally, the plants have performed well. We have also introduced an in-house outage team which has delivered both improved maintenance and service levels, and cost savings.

Midlothian

North America

Midlothian, the 1,650 MW combined cycle gas turbine power station in Texas, is owned 100% by International Power and delivers its energy into the Texas ERCOT market (Electricity Reliability Council of Texas).

Midlothian is among the largest gas fired plants in the ERCOT market which has total capacity of 78,900 MW, including coal/lignite, nuclear, wind, hydro and gas fired plants. As older, less efficient plants in the ERCOT market have been retired or mothballed, the highly efficient and environmentally clean Midlothian plant has provided an increasing amount of power to the market. In 2005 the plant operated with a capacity factor of 55%.

Midlothian has received the Environmental Excellence award from the Texas Commission of Environmental Quality in recognition of its low emission combustion technology and its use of air cooling. This ensures efficient operation and minimises air emissions while using a fraction of the water normally used by similar sized generation units.

With its advanced, environmentally desirable design and operation, Midlothian will be a significant contributor to the ERCOT market for years to come.

First Hydro, UK

Regional review

Europe

- Profit from operations up 168% to £260 million from £97 million last year
- Growth in earnings mainly attributable to First Hydro, ISAB, Turbogás, Saltend and Rugeley
- Successfully completed acquisition and integration of 1,200 MW Saltend CCGT
- Receipt of £68 million compensation at Rugeley from TXU

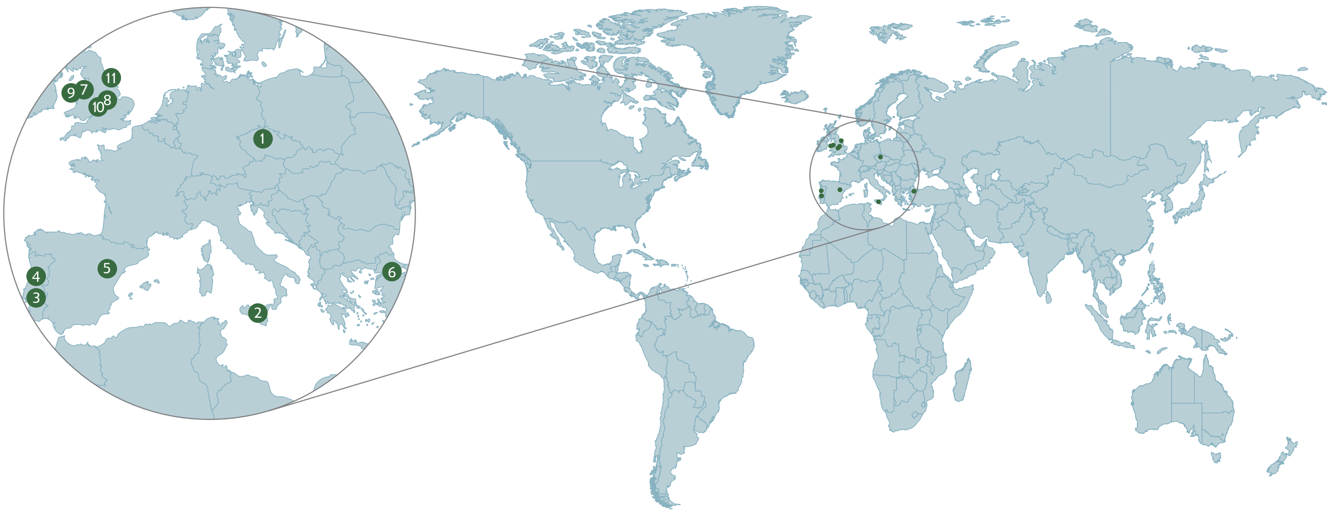
	Year ended 31 December 2005	Year ended 31 December 2004
	£m	£m
Revenue	**1,387**	520
Profit from operations (before exceptional items)	**260**	97
Exceptional items	**110**	11
Profit from operations (post exceptional items)	**370**	108

Europe generated revenue of £1,387 million (2004: £520 million) and profit from operations of £260 million, up from £97 million in 2004. Key contributors to this growth in earnings were First Hydro, ISAB, Turbogás and Saltend, together with a strong improvement in earnings at Rugeley. Spanish Hydro, International Power Opatovice (previously called EOP), Pego and Uni-Mar also performed well.

First Hydro delivered a strong contribution to profits with a robust performance in both the UK wholesale electricity and balancing services markets. High levels of availability and reliability in 2005 once again enabled First Hydro successfully to provide reserve capacity and rapid response services in the market.

In the UK, the rising oil price was a key factor in driving up the price of gas which, in turn, generally sets the price of power. Whilst this helped improve financial performance at Rugeley (which is coal fired with relatively stable fuel costs), underlying spreads for gas fired generation have not improved to the same extent. In 2006, forward markets indicate that both dark and spark spreads should be up on 2005. Approximately 65% of the expected output for 2006 from Rugeley, Deeside and Saltend is now forward contracted.

As a result of the improvement in outlook for dark spreads, we performed a review of the carrying value of Rugeley which was impaired in 2002. As a consequence of this review, we fully reversed the remaining impairment at Rugeley of £52 million.



	Fuel/type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth) steam (million lbs/hr)	Net capacity heat (MWth) steam (million lbs/hr)
Assets in operation					
1 International Power Opatovice, Czech Republic[(1)(2)]	Coal/gas (Cogen)	585	580	1,945 MWth	1,925 MWth
2 ISAB, Italy	Gas (IGCC)	528	181	–	–
3 Tejo Energia (Pego), Portugal	Coal	600	300	–	–
4 Turbogás, Portugal	Gas (CCGT)	990	594	–	–
5 Spanish Hydro, Spain	Hydro	84	57	–	–
6 Uni-Mar (Marmara), Turkey	Gas (CCGT)	480	160	–	–
7 Deeside, UK	Gas (CCGT)	500	500	–	–
8 Derwent, UK	Gas (CCGT)	214	50	–	–
9 First Hydro, UK	Pumped storage	2,088	1,462	–	–
10 Rugeley, UK	Coal/50 MW of OCGT	1,050	1,050	–	–
11 Saltend, UK	Gas (CCGT/Cogen)	1,200	840	0.30m lbs/hr	0.21m lbs/hr
Europe total in operation		**8,319**	**5,774**		

(1) In October 2005, Elektrarny Opatovice (EOP) changed its name to International Power Opatovice.
(2) Gross capacity amount shown for International Power Opatovice represents the actual net interest owned directly or indirectly by International Power Opatovice.

In February 2006, we confirmed our intention to install flue gas desulphurisation (FGD) equipment at Rugeley. FGD equipment will allow Rugeley to reduce sulphur emissions and operate at a higher load factor. This decision was primarily based on the anticipated longer-term CO_2 allocations for coal fired plant in the UK. We are currently negotiating an Engineering, Procurement and Construction (EPC) contract for this project.

During 2005 Rugeley received £68 million in partial settlement in respect of our claim for compensation for the termination of the TXU tolling agreement in November 2002. A further £15 million was received in January 2006, taking total receipts to £83 million.

The acquisition of Saltend was completed in July 2005 in a 70:30 partnership with Mitsui & Co., Ltd of Japan. Approximately 7% of the plant's generating capacity and all of the plant's steam output is contracted to BP Chemicals Limited until 2015 with the balance of the power output sold into the UK power market. As Saltend was acquired with a gas contract for its fuel supply, its fuel cost has been largely unaffected by the volatility of UK gas prices in the year. Saltend has delivered a strong financial performance.

In Portugal, Turbogás and Pego continue to perform well with high availability and a high utilisation by the offtaker, REN. In December 2005, we acquired an additional 5% shareholding in the 600 MW Pego power plant (and associated companies) from EdF for a consideration of £5 million, increasing our ownership to 50%, or 300 MW (net). International Power Opatovice delivered another good performance in 2005 due to a strong demand for power and district heating.

Saltend

Europe

In July 2005, Saltend power plant became the latest addition to International Power's UK portfolio when it was acquired in a 70:30 partnership with Mitsui & Co., Ltd of Japan. Saltend is a 1,200 MW combined cycle gas turbine (CCGT) cogeneration plant located near Hull, England. The plant primarily sells its output in the England and Wales power market, and supplies approximately 7% of its power and steam output to the adjacent BP Chemicals site.

Commissioned in 2000, Saltend is one of the latest gas fired plants to be built in the UK, and it is well placed to meet the economic and ecological demands of the UK power market. The plant is committed to continuous improvement and this is reflected in its management systems, which have been accredited with: ISO 9001-2000 Quality Management; ISO 14001-1996 Environment Management; and OHSAS 18001 Occupational Health and Safety Management. Saltend is a premier example of advanced and proven technology built around highly efficient equipment that forms the base of a lasting and successful future.

Umm Al Nar, UAE

Regional review

Middle East

- Profit from operations increased to £24 million from £20 million last year
- Portfolio growth – we now have six projects in five countries
- Shuweihat in first full year of operation
- Agreement to acquire 40% of 910 MW/30 MIGD Hidd power and water plant in Bahrain
- Financing completed and construction commenced at Ras Laffan B in Qatar
- Construction of the four Tihama sites in Saudi Arabia progressing on track

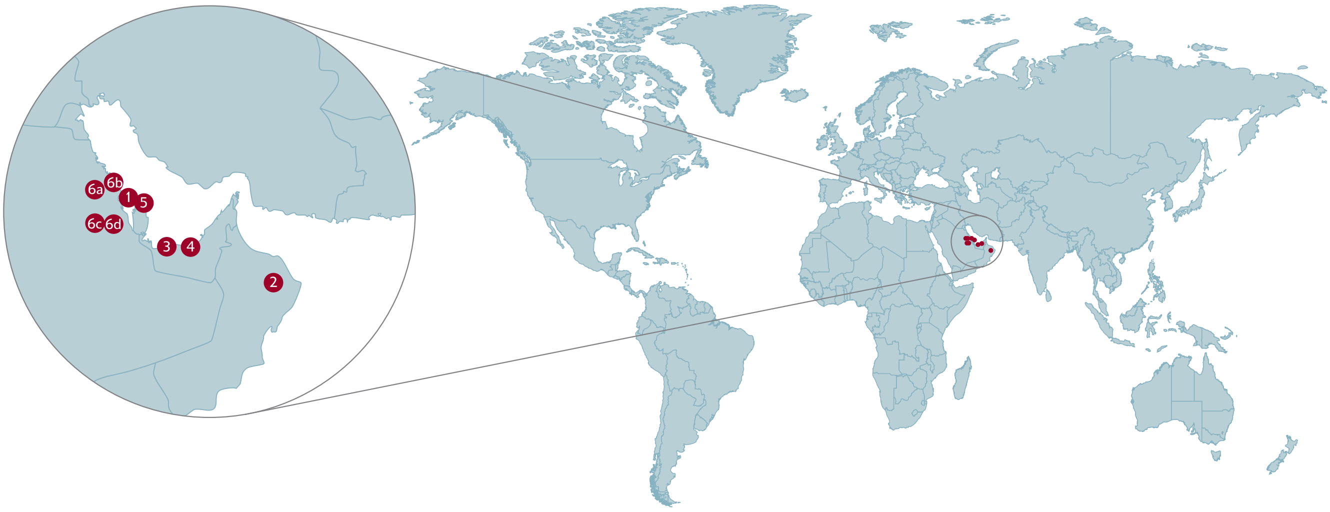
	Year ended 31 December 2005	Year ended 31 December 2004
	£m	£m
Revenue	**67**	54
Profit from operations (before exceptional items)	**24**	20
Exceptional items	**–**	–
Profit from operations (post exceptional items)	**24**	20

Revenue in the Middle East increased to £67 million (2004: £54 million) and profit from operations increased to £24 million from £20 million last year. The region benefited from a first full year of operation at Shuweihat in the UAE where the overall commercial availability for both power and water was at a very high (99%) level.

The existing plant at Umm Al Nar in the UAE also delivered high levels of availability for power and water, both in excess of 90% and well above its Power and Water Purchase Agreement (PWPA) requirements. In relation to plant expansion, all three new gas turbines have been fired and synchronised with the grid in open-cycle mode and full commercial operation is expected in the second half of 2006.

Construction at the four Tihama sites in Saudi Arabia, for Saudi Aramco – Ju'aymah, Ras Tanura, Shedgum and Uthmaniyah, together comprising 1,074 MW and 4.5m lbs/hr of steam – is progressing well. Uthmaniyah is at the most advanced stage of construction and is expected to commence operation in the first half of 2006. Overall, the Tihama construction programme is on track to conclude in the last quarter of 2006, with the four plants progressively reaching commercial operation throughout this year.

In Qatar, the financing for the Ras Laffan B (1,025 MW, 60 MIGD) power and water plant was completed in April 2005. The financing was strongly supported by a consortium of major local and international banks. International Power's equity contribution amounts to US$72 million (£42 million) for its 40% share in this project. Construction commenced in the first half of 2005 with final completion expected in 2008. The output from Ras Laffan B is contracted to Qatar General Electricity and Water Corporation (KAHRAMAA) under a 25-year PWPA.



		Fuel/type	Gross capacity power MW	Net capacity power MW	Gross capacity desal (MIGD) steam (million lbs/hr)	Net capacity desal (MIGD) steam (million lbs/hr)
	Assets in operation					
1	Hidd, Bahrain[1]	Gas (CCGT)/desalination	910	364	30	12
2	Al Kamil, Oman	Gas (OCGT)	285	185	–	–
3	Shuweihat S1, UAE	Gas (CCGT)/desalination	1,500	300	100	20
4	Umm Al Nar, UAE	Gas (CCGT)/desalination	870	174	162	32
	Middle East total in operation		**3,565**	**1,023**	**292**	**64**
	Assets under construction					
1	Hidd, Bahrain	Desalination	–	–	60	24
4	Umm Al Nar Expansion, UAE	Gas (CCGT)/desalination	1,550	310	25	5
5	Ras Laffan B, Qatar	Gas (CCGT)/desalination	1,025	410	60	24
6	Tihama, Saudi Arabia	Gas (Cogen)	1,074	644	4.5m lbs/hr	2.7m lbs/hr
	Middle East total under construction		**3,649**	**1,364**	–	–

Ju'aymah 6a
Ras Tanura 6b
Shedgum 6c
Uthmaniyah 6d

[1] Hidd acquisition is expected to complete in July 2006.

On 22 January 2006, along with our partners Suez Energy International of France and Sumitomo Corporation of Japan, we signed an agreement to acquire the Hidd independent power and water project in Bahrain: 40% owned by International Power, 30% by Suez Energy International and 30% by Sumitomo Corporation. The consortium also signed a 22-year PWPA with the Ministry of Electricity and Water for its output. The PWPA covers the output from the existing 910 MW combined cycle gas turbine (CCGT) and 30 MIGD water desalination facility, together with the output from a new-build 60 MIGD desalination expansion which is expected to be in operation by the end of 2007.

The total cost of the Hidd project is estimated to be US$1.25 billion (£728 million), which will be funded by a mix of debt and equity in an 85:15 ratio. The total project cost includes the purchase price for the existing plant and the cost of the 60 MIGD extension. International Power's 40% equity investment will be US$75 million (£44 million). Financial close is expected in April 2006, and completion of the acquisition is expected to take place in July 2006.

International Power now has six projects in five countries in the Middle East region with a project enterprise value of some US$6.5 billion (£3.8 billion) and an equity commitment of around US$400 million (£233 million). The growing economies of the Middle East, and the strong increase in demand for both power and water, make this region attractive for further investment by International Power.

Shuweihat S1

Middle East

Located in Abu Dhabi, Shuweihat S1 is one of the largest power and water plants in the United Arab Emirates (UAE). Shuweihat S1 commenced operation in 2004 and all of its output is contracted to the Abu Dhabi Water & Electricity Company (ADWEC) under a long-term agreement.

Fuelled by strong economic growth, the UAE is experiencing robust growth in demand for power and even greater growth in demand for water. The country relies on desalination (removal of salts from seawater) to produce fresh water for human consumption, agriculture and industrial use. At Shuweihat S1, which has the world's largest desalination units in commercial operation, waste heat from the power generation process is used to produce up to 100 million imperial gallons of fresh water every day.

Integrated power and water projects are standard in the Middle East, because the use of waste steam in the desalination process increases the overall efficiency of the plant. The excellent performance of Shuweihat's desalination units has encouraged the system operator to use these as preferred units for despatch.

Shuweihat's plant operation and maintenance is carried out jointly by International Power and CMS. In 2004 Shuweihat was awarded ISO 9001, ISO 14001 and OHSAS 18001 making it the first plant in the region to have achieved these environmental and operational certifications simultaneously.

Canunda, Australia

Regional review

Australia

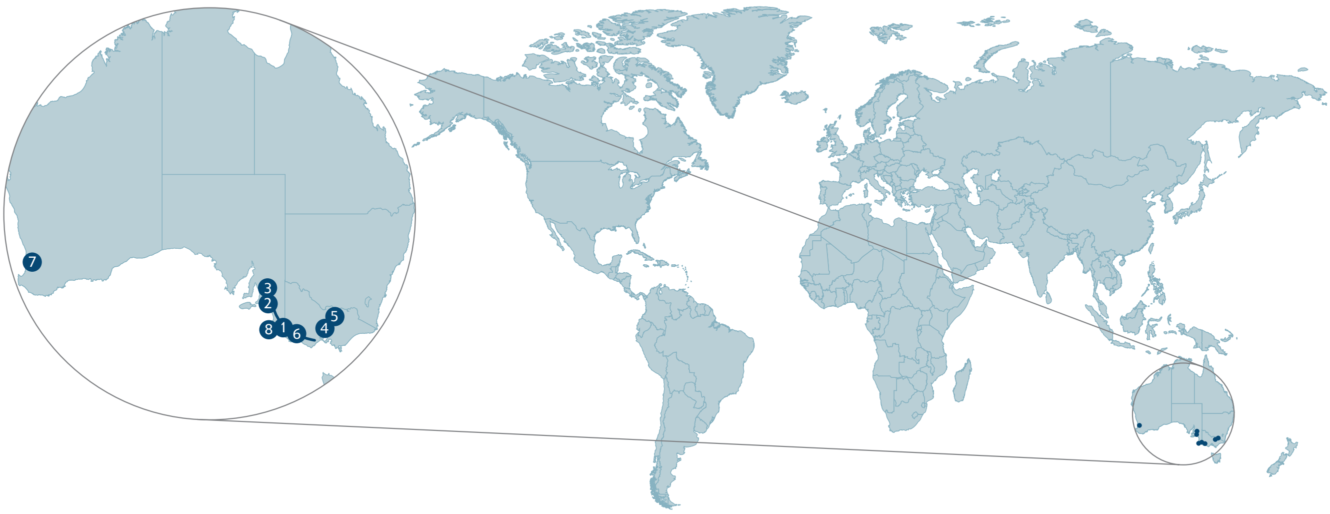
- Profit from operations increased to £125 million from £98 million last year
- First full year of earnings from 1,000 MW Loy Yang B
- 46 MW Canunda wind farm started commercial operation March 2005
- Established 50:50 retail joint venture with EnergyAustralia in Victoria and South Australia
- Valley Power peaking plant sold to Snowy Hydro

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Revenue	**420**	231
Profit from operations (before exceptional items)	**125**	98
Exceptional items	**–**	–
Profit from operations (post exceptional items)	**125**	98

Revenue in Australia rose to £420 million in 2005 (2004: £231 million). Profit from operations increased to £125 million (2004: £98 million) reflecting contributions from acquisitions and development projects, principally Loy Yang B, Kwinana, EnergyAustralia and Canunda. As expected, earnings from Hazelwood were down on 2004 due to the completion of contracts placed in prior years. Hazelwood's average achieved price in 2005 was once again ahead of the underlying market price for electricity.

In 2006, we expect to achieve prices at a slightly lower level than 2005. For 2006, some 70% of expected merchant output has been contracted.

Canunda, our new-build 46 MW wind farm in South Australia, successfully started commercial operation in March 2005 and is fully contracted under a long-term PPA. Canunda has 23 wind turbines of 2 MW each, currently the largest wind turbines in Australia, and can produce enough power to supply 30,000 homes.



		Fuel/type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth)	Net capacity heat (MWth)
	Assets in operation					
1	Canunda, South Australia	Wind/renewable	46	46	–	–
2	Pelican Point, South Australia	Gas (CCGT)	485	485	–	–
3	Synergen, South Australia	Gas/distillate	360	360	–	–
4	Hazelwood, Victoria	Coal	1,635	1,500	–	–
5	Loy Yang B, Victoria	Coal	1,000	700	–	–
6	SEA Gas pipeline, Victoria(1)	n/a	n/a	n/a	–	–
7	Kwinana, Western Australia	Gas (CCGT)	118	58	–	–
8	EnergyAustralia(2)	n/a	n/a	n/a	–	–
	Australia total in operation		**3,644**	**3,149**	–	–

(1) 687 km gas pipeline (33% owned by International Power) from Victoria to South Australia.
(2) EnergyAustralia (50% owned by International Power) services circa 275,000 electricity and gas retail accounts in Victoria and South Australia.

At Hazelwood, our largest brown coal fired generator in Victoria, the development of our existing open cast mine progressed on plan. Over the last three years, we have progressively been developing a large-scale infrastructure to mine a new area called the West Field, and in June 2005 a milestone was reached where 100% of the coal used by Hazelwood power station (namely 17 million tonnes per annum) was sourced from this new coal field. In September 2005, an agreement was reached with the Victorian government for a mining licence variation to the new West Field mine which allows access to additional coal and in return Hazelwood undertook to limit its life-time emission of CO_2 to 445 million tonnes. This is an important step to provide long-term security of supply of coal for Hazelwood.

International Power and EnergyAustralia, an experienced retailer in the Australian market, established a 50:50 partnership to provide electricity and gas to retail customers in Victoria and South Australia. Since formation in July 2005, this retail partnership has increased the number of power and gas accounts from 175,000 to 275,000. This additional route to customers provides a partial hedge for our generation assets in Australia, and is a further step to develop a stronger and more balanced portfolio.

In accordance with an agreement with the Australian Competition and Consumer Commission (ACCC), we sold the 300 MW Valley Power peaking plant in Victoria to Snowy Hydro in October 2005.

Loy Yang B

Australia

Loy Yang B power plant is located in Victoria's Latrobe Valley, 160 km south east of Melbourne. The plant is the state's most recently built base load power station producing 1,000 MW of electricity and supplying 17% of Victoria's power.

Loy Yang B was the first fossil fuelled power station in the world to gain quality accreditation to ISO 9001 and the first Australian power station to gain environmental accreditation to ISO 14001. Today Loy Yang B is accredited to: ISO 9001-2000; ISO 14001-2004; and has safety accreditation to AS/NZS 4801-2001.

As well as operating to stringent environmental standards, the plant administers a corporate Landcare programme on behalf of International Power. Since its commencement in 1997, Landcare has planted approximately 650,000 trees and shrubs together with native grasses. The programme was awarded the Judges Encouragement Award in the 2004 Prime Minister's Awards for Excellence in Community and Business Partnerships.

The integration of Loy Yang B into International Power's Australian portfolio was completed seamlessly. The plant is located just 10 km from our 1,635 MW Hazelwood power plant. With two coal fired plants located in such close proximity, International Power benefits from managerial and operational synergies in Victoria.

Paiton, Indonesia

Regional review

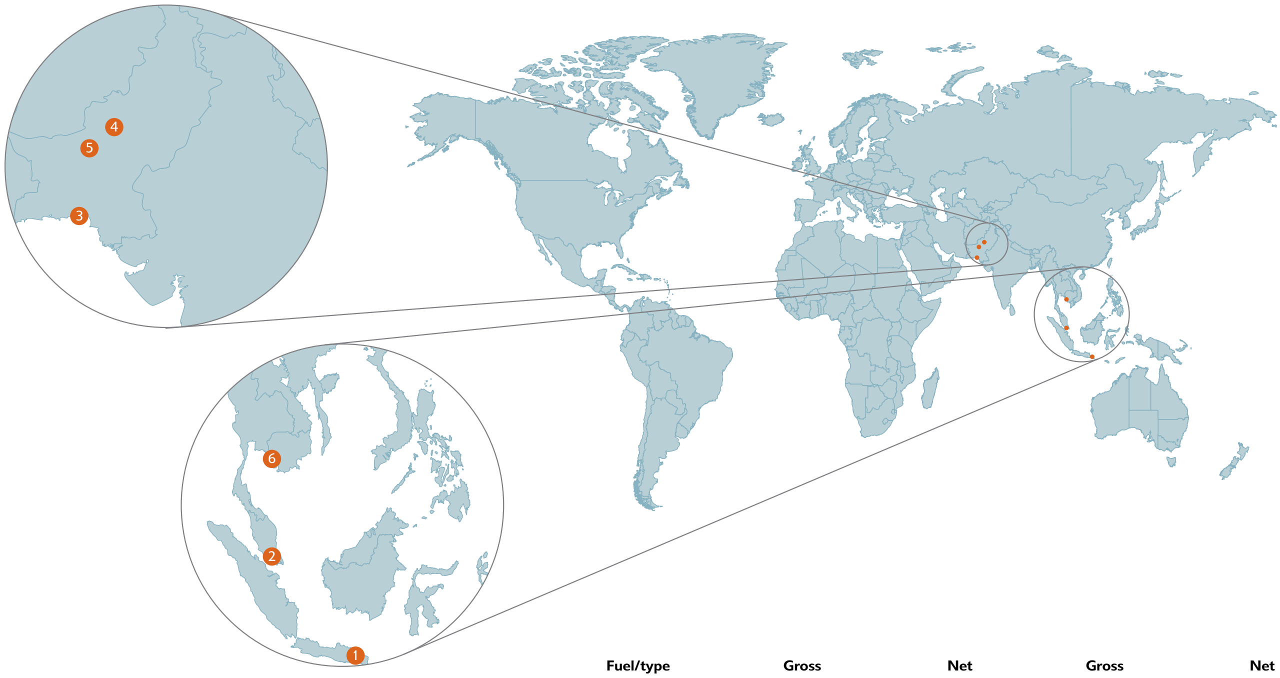
Asia

- Profit from operations increased to £102 million (2004: £60 million) – up 70%
- First full year of earnings from Paiton, Indonesia
- HUBCO and KAPCO both delivered a good performance

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Revenue	**368**	202
Profit from operations (before exceptional items)	**102**	60
Exceptional items	**–**	–
Profit from operations (post exceptional items)	**102**	60

Revenue in Asia increased to £368 million from £202 million in 2004, with a corresponding increase in profit from operations to £102 million from £60 million in 2004.

This growth in earnings is primarily attributable to earnings from Paiton, which contributed its first full year of profits since its acquisition in December 2004. In 2005, Paiton consistently generated high levels of output and achieved availability levels significantly in excess of its PPA requirements.



	Fuel/type	Gross capacity power MW	Net capacity power MW	Gross capacity heat (MWth)	Net capacity heat (MWth)
Assets in operation					
1 Paiton, Indonesia	Coal	1,230	385	–	–
2 Malakoff, Malaysia[1]	Gas (OCGT/CCGT)	3,130	567	–	–
3 HUBCO, Pakistan	Oil	1,290	214	–	–
4 KAPCO, Pakistan	Gas/oil (CCGT)	1,600	575	–	–
5 Uch, Pakistan	Gas/oil (CCGT)	586	234	–	–
6 TNP (Pluak Daeng), Thailand	Gas (Cogen)	120	120	7.7[2]	7.7
Asia total in operation		**7,956**	**2,095**	**7.7**	**7.7**
Assets under construction					
2 Malakoff, Malaysia[1]	Coal	1,890	342	–	–
6 TNP (Pluak Daeng), Thailand	Gas (Cogen)	23	23	–	–
Asia total under construction		**1,913**	**365**	–	–

[1] Gross capacity amount shown for Malakoff represents the actual net interest owned directly or indirectly by Malakoff.
[2] District cooling system capacity.

HUBCO and KAPCO in Pakistan continue to deliver a good performance. Both companies are listed on the Karachi Stock Exchange and as at 3 March 2006 the market value of International Power's shareholding in HUBCO and KAPCO totalled £186 million.

Uch, in Pakistan, delivered a solid contribution since acquisition in February 2005. Its fuel supplies were interrupted in early 2006 due to local civil unrest. However, the plant remained fully available on distillate fuel ensuring continuity of supply with no material financial impact. The pipeline was re-commissioned quickly and the plant continues to operate normally.

At Thai National Power (TNP), we are expanding our 120 MW plant by 23 MW to meet growing local demand for power. The construction of the expansion is expected to complete by the second half of 2006, and we have already refinanced the existing debt to provide the necessary funding.

At Malakoff in Malaysia the construction of the new-build coal fired 2,100 MW Tanjung Bin plant, in which Malakoff has a 90% interest, is on schedule to begin commercial operation in Q4 2006. In April 2005, Malakoff acquired a further 19% shareholding in the 1,303 MW CCGT Lumut power plant. This increased Malakoff's net installed capacity to 3,130 MW, which translates to net capacity of 567 MW for International Power. As at 3 March 2006 the value of International Power's shareholding in Malakoff was some £219 million.


FIN FAN COOLER
UNIT 5

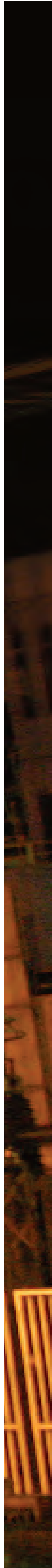
KAPCO

Asia

KAPCO sells its total output to Pakistan's state utility, Water and Power Development Authority (WAPDA) under a 25-year power purchase agreement (PPA). International Power owns a 36% stake in KAPCO, while the government owns 44%, having sold 20% via an Initial Public Offering (IPO) in February 2005. KAPCO is a multi fuel power station which produces 85% of its electricity using natural gas and 15% from low sulphur fuel oil.

KAPCO plays a pivotal role in Pakistan's energy sector, supplying nearly 10% of the country's total electricity requirements. The combined cycle technology of the power plant enables it to deliver electricity efficiently and flexibly as required by its customer.

KAPCO is the only major plant in Pakistan with the ability to self-start in case of a countrywide blackout, and is the first in Pakistan to be awarded three key accreditations simultaneously: ISO 9001 -2000 Quality Management; ISO 14001 -1996 Environment Management; and OHSAS 18001 Occupational Health and Safety Management.



Corporate

- Corporate costs increased in 2005 to support the expanded operational capacity
- Net interest for the year was £202 million
- The tax charge for the year (pre-exceptional items) was £55 million, compared to £25 million in 2004

Corporate costs

International Power's headquarters is in London, where corporate and business functions are based to support our worldwide operations. In addition, International Power operates regional business support offices in the UK, the US, Australia, the Czech Republic, Italy, Singapore and the UAE. These offices vary in size dependent on the scale of operations.

Corporate costs at £59 million are £27 million higher than 2004. This is due to the significant growth and complexity of the Group, together with some costs which may not necessarily recur such as higher employee share scheme costs and a provision for certain CEGB legacy pension liabilities.

Main image: Midlothian, North America

Marmara, Turkey

Interest

Net interest expense (excluding exceptional items) at £202 million is £125 million higher than 2004. This is mainly due to the impact of additional debt relating to the EME, Turbogás and Saltend acquisitions. 2004 also benefited from interest income earned on cash reserves held in contemplation of the EME and Turbogás acquisitions.

Tax

The tax charge (excluding the tax effect of exceptional items) at £55 million is £30 million up on the 2004 charge. This is mainly due to higher profitability and an increase in the effective tax rate from 25% to 31%. This higher tax rate reflects the tax profile of the EME portfolio and the reducing benefit of foreign tax holidays.

Exceptional items

Net exceptional gains of £120 million were booked in 2005, comprising:

- £58 million compensation in respect of the tolling agreement with TXU;
- £52 million on the impairment reversal of Rugeley plant;
- £4 million profit on disposal of Tri Energy;
- £3 million profit on sale of land in Thailand;
- £3 million profit on sale of shares in Interconnector UK.

The tax charge on exceptional items was £34 million relating to all of the above gains with the exception of the profit on disposal of Tri Energy.

International Power Opatovice, Czech Republic

Financial position and resources

- Free cash flow increased by 174% to £285 million
- Net assets increased by £317 million to £2,375 million
- Net debt has increased by £234 million to £2,979 million
- Debt capitalisation reduced to 56%
- Gearing now at 125% from 133%

Liquidity

Free cash flow for the year ended 31 December 2005 was £285 million, an increase of £181 million compared to 2004. This increase reflects the underlying profitability of the assets acquired in 2004 and 2005 together with improving margins in the UK and US merchant markets.

Dividends from joint ventures and associates of £92 million are up £23 million from 2004, reflecting the portfolio expansion.

Capital expenditure for growth projects at £188 million principally comprises of spend on the Tihama project in Saudi Arabia, together with the Hazelwood West Field mine extension and the completion of the Canunda wind farm project.

Acquisitions of £571 million in 2005 mainly relates to Saltend, together with the retail partnership with EnergyAustralia and some final spend relating to the IPM acquisition. Disposals of £211 million relate to the sale of Tri Energy, Italian Wind and Valley Power, together with the sale of 20% of Turbogás relating to EdP pre-emption rights. Foreign exchange and other includes an exchange charge of £160 million on retranslation of net debt balances held to finance our overseas investments, which have increased by a similar amount.

In June 2005 we took the opportunity to refinance our existing corporate revolving credit facility of US$450 million to increase the size to US$640 million, extend the tenure to June 2008 (with the option to extend for a further two years, subject to agreement by the bank syndicate) and improve the commercial terms.

Dividends from joint ventures and associates of £92 million are up £23 million from 2004, reflecting the portfolio expansion.

A summarised, reclassified presentation of the Group cash flow is set out below:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Profit for the year (post exceptionals)	**330**	104
Adjustment for non-cash items (see note below)*	**180**	91
Dividends received from joint ventures and associates	**92**	69
Movements in working capital	**(21)**	3
Capital expenditure – maintenance	**(72)**	(59)
Other cash movements	**3**	–
Tax and interest paid	**(227)**	(104)
Free cash flow	**285**	104
Finance costs – exceptional	**(5)**	(26)
Refinancing costs capitalised on acquisition debt	**(7)**	(22)
Capital expenditure for growth projects	**(188)**	(158)
Returns from investments/capital expenditure – other financial investments	**48**	(61)
Acquisitions	**(571)**	(1,195)
Disposals	**211**	17
Receipt from TXU administrators – exceptional	**58**	–
Dividends paid	**(37)**	–
Proceeds from share/rights issue	**2**	286
Funding from minorities	**80**	165
Foreign exchange and other	**(181)**	62
Increase in net debt	**(305)**	(828)
Opening net debt	**(2,745)**	(692)
Transitional adjustment on first-time adoption of IAS 39	**44**	–
Net cash/(debt) on acquisition of subsidiaries	**27**	(1,225)
Closing net debt	**(2,979)**	(2,745)

*Non-cash items include income statement charges for interest, tax, depreciation, the share of profit of joint ventures and associates, the exceptional profit on the TXU settlement and the reversal of Rugeley impairment.

Balance sheet

A summarised, reclassified presentation of the Group balance sheet is set out below:

	As at 31 December 2005 £m	As at 31 December 2004 £m
Non-current assets		
Intangibles and tangibles	**4,590**	3,748
Investments	**1,379**	1,255
Other long-term receivables	**623**	664
Total non-current assets	**6,592**	5,667
Net current liabilities (excluding net debt items)	**(327)**	(116)
Non-current liabilities (excluding net debt items)	**(911)**	(748)
Net debt	**(2,979)**	(2,745)
Net assets	**2,375**	2,058
Gearing	**125%**	133%
Debt capitalisation	**56%**	57%

The increase in intangibles and tangibles of £842 million principally reflects the acquisition of Saltend, capital expenditure on growth projects, such as Tihama, and retranslation gains of £179 million, principally on our Australian and US dollar assets.

The increase in net current liabilities relates to £228 million of derivatives recognised in the balance sheet following the adoption of IAS 39 and provisions for power contracts that were made on the acquisition of Saltend. Under IFRS, the derivative contracts are revalued at each period end but have no impact on future cash flow.

Non-current liabilities have increased by £163 million to £911 million principally due to derivatives recognised following the adoption of IFRS and deferred tax liabilities recognised on the acquisition of Saltend.

Net debt has increased in 2005 as a result of the acquisition of Saltend and further capital expenditure at Tihama, partially offset by strong cash flow generation and the disposals of Valley Power and Italian Wind.

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business while managing its currency, interest rate and counterparty credit risks.

Net debt and capital structure

Group net debt at 31 December comprised:

	2005 £m	2004 £m
Cash and cash equivalents	**620**	565
Assets held for trading	**52**	47
Convertible bonds	**(125)**	(158)
Other bonds	**(445)**	(449)
Secured bank loans and preferred equity	**(3,081)**	(2,750)
Net debt	**(2,979)**	(2,745)

The above net debt of £2,979 million excludes the Group's share of joint ventures' and associates' net debt of £1,625 million (2004: £1,285 million). These obligations are generally secured by the assets of the respective joint venture or associate borrower and are not guaranteed by International Power plc or any other Group company. In view of the significance of this amount, it has been disclosed separately.

The Group has sufficient credit facilities in place to fund and support adequately its existing operations and to finance the purchase of new assets. These facilities comprise a revolving credit facility and convertible bond. The revolving credit facility of US$640 million (£373 million) expires in June 2008 but can be extended by a further two years subject to bank approval. The convertible bond of US$252 million (£125 million) matures in August 2023 but with bond holders having the right to 'put' the bond back to the Group in August 2010, 2013, 2018 and 2023. In addition, the Group has uncommitted bilateral credit lines from various banks at its disposal at the corporate level.

The remaining portion of the 2% convertible bond of US$51 million (£29 million) matured in November 2005 and was fully repaid at a redemption price of 112.4% of its principal amount.

Secured non-recourse finance

The Group's financial strategy is to finance its assets by means of limited or non-recourse project financings at the asset or intermediate holding company level, wherever that is practical.

During 2005 an additional £275 million of non-recourse debt was secured in relation to the financing of Saltend. This was more than offset by a reduction in debt of £185 million relating to the disposal of assets, planned principal repayments of £56 million and TXU proceeds of £58 million which were used to repay non-recourse debt at Rugeley. Foreign exchange and other non-cash movements increased the sterling value of non-recourse debt by £160 million, principally due to the strengthening of the US dollar during 2005.

Corporate and Group debt

During 2005 both Standard & Poor's and Moody's reviewed the credit rating at corporate level. Standard & Poor's maintained the rating of BB-, but upgraded the outlook from negative to stable and Moody's maintained its rating of B2 with stable outlook. In January 2006 a rating from Fitch was issued of BB with stable outlook.

On 31 December 2005 we had aggregated debt financing of £3,651 million denominated principally in US dollars, Australian dollars, sterling, Euro, Czech koruna and Thai baht. Of this amount £187 million is due for repayment in 2006, with the majority of the remaining balance due after 2010.

Treasury and counterparty risk policy

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business whilst managing its currency, interest rate and counterparty credit risks. The Group's treasury policy is not to engage in speculative transactions. Group treasury acts within clearly defined guidelines that are approved by the Board. The major areas of treasury activity are set out opposite.

Further information on the Group's financial risk management objectives and policies are included on page 53 and in notes 32 and 33 to the consolidated financial statements.

Rugeley, UK

Currency translation exposure

Consistent with the majority of other international companies, the results of the Group's foreign operations are translated into sterling at the average exchange rates for the period concerned. The balance sheets of foreign operations are translated into sterling at the closing exchange rates. In order to hedge the net assets of foreign operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way.

It is our policy not to hedge currency translation through foreign exchange contracts or currency swaps. Average and year-end sterling rates for major currencies, which are significant to the Group, were:

	Average		At 31 December	
	2005	2004	**2005**	2004
US dollar	**1.82**	1.83	**1.72**	1.92
Australian dollar	**2.39**	2.48	**2.34**	2.45
Euro	**1.46**	1.46	**1.46**	1.41
Czech koruna	**43.56**	46.91	**42.27**	42.87

Currency transaction exposure

This arises where a business unit makes actual sales and purchases in a currency other than its functional currency. Transaction exposure also arises on the remittance from overseas of dividends or surplus funds. The Group's policy is to match transaction exposure where possible, and hedge remaining transactions as soon as they are committed, by using foreign currency contracts and similar instruments.

Short-term deposits

Surplus funds are placed for short periods in investments that carry low credit risk and are readily realisable in major currencies.

Interest rate risk

The Group's policy is to fix interest rates for a significant portion of the debt (61% as at 31 December 2005) using forward rate or interest rate swap agreements. Turbogás interest costs are a pass through in the PPA tariff and therefore not an exposure to the Group: adjusting for this item would increase fixed rate debt to 69%. The level of fixed interest rate debt has increased in 2005 as the hedging strategy for the EME international portfolio was implemented in January 2005. Significant interest rate management programmes and instruments require specific approval of the Board. The weighted average interest of the fixed rate debt was 7% in 2005. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement.

Counterparty credit risk

The Group's policy is to manage its credit exposure to trading and financial counterparties within clearly defined limits. Energy trading activities are strictly monitored and controlled through delegated authorities and procedures, which include specific criteria for the management of counterparty credit exposures in each of our key regions. Counterparty exposure via customer offtake agreements is monitored and managed by the local asset team with assistance from Group Treasury where appropriate. In addition, Group Treasury manages the Group-wide counterparty credit exposure on a consolidated basis, with the active and close involvement of the global risk manager. Financial counterparty credit exposure is limited to arrangements with relationship banks and commercial paper with companies which have strong investment grade credit ratings.

International Financial Reporting Standards

Under EU legislation, all listed companies are required to report their consolidated results under International Financial Reporting Standards (IFRS), as adopted by the EU, for accounting periods commencing on or after 1 January 2005. As a result of the need to present comparatives as well as current year numbers under IFRS, our date of transition to IFRS is 1 January 2004.

This is the Group's first annual report and accounts to be presented under IFRS. Comparative information, which was originally presented under UK GAAP in the 2004 *Annual Report*, has been restated on the same basis.

Bellingham, North America
Photography by Sky High Enterprises

Overview of impact

The financial information included in the financial statements has been prepared on the basis of all applicable IFRS issued by the International Accounting Standards Board and adopted by the EU. As required by IFRS 1 (First-time Adoption of International Financial Reporting Standards) the Group is required to explain how the transition from UK GAAP to IFRS has affected its reported financial position and financial performance. In accordance with these requirements we set out in note 42 to the accounts:

- a reconciliation of equity reported under UK GAAP to equity under IFRS as at 1 January 2004 and 31 December 2004;
- a reconciliation of the profit reported under UK GAAP for the year ended 31 December 2004 to profit reported under IFRS.

IFRS 1 states that an entity shall use the same accounting policies in its opening IFRS balance sheet, throughout all periods presented in its first IFRS financial statements and for all periods presented thereafter. In order to facilitate the transition to IFRS, it also allows adoption options and exemptions in the initial application of certain IFRSs. The Group has applied the following options (which are outlined in note 1 to the financial statements):

- Business combinations prior to 1 January 2004 have not been restated (in accordance with IFRS 3 Business Combinations).
- The deemed cost of the Group's US merchant fleet, owned by American National Power and which was impaired at 31 December 2003, has been measured at its fair value at 1 January 2004.
- Cumulative foreign exchange differences in reserves have been deemed to be zero on adoption of IFRS. Gains and losses on subsequent disposals of foreign operations will be measured by reference to their carrying values translated at 1 January 2004.
- The Group has recognised the pension schemes' surpluses and deficits in full as at 1 January 2004, with a corresponding adjustment to reserves. The Group has used the 'corridor' method to recognise actuarial gains and losses arising after the date of transition.

In accordance with the exemptions available under IFRS 1, the Group has decided not to restate the comparatives to take into account the requirements of the accounting standards applicable to financial instruments (IAS 32 and IAS 39). Hence for 2004 the information presented in the financial statements in respect of financial instruments is measured, recorded and presented in accordance with UK GAAP. Derivatives have been recognised at fair value at 1 January 2005, with a corresponding charge or credit to reserves. The adjustments made to the balance sheet at 1 January 2005, to reflect the adoption of IAS 32 and IAS 39, are also outlined in detail in note 42 to the financial statements.

Those areas which have the most significant impact on the Group's reported position and financial performance during 2004 and as at 1 January 2005 under IFRS compared with the previously reported results under UK GAAP are:

- the cessation of goodwill amortisation;
- differences in accounting for deferred tax, principally with respect to fair value adjustments on acquisition;
- dividends declared and not approved at the balance sheet date – these are not included as liabilities in the financial statements;
- the present value of net pension scheme obligations recognised on balance sheet (excluding actuarial gains and losses not recognised);
- the recognition of a charge to the income statement for share-based payments;
- split accounting of convertible debt in order to recognise both debt and equity components;
- recognition on the balance sheet at fair value of all qualifying derivatives;
- deferral of fair value mark to market gains and losses within hedging reserves for qualifing cash flow hedges.

A detailed description of the IFRS transition adjustments is included in note 42.

Accounting policy	Critical accounting judgements and key sources of uncertainty derive from the determination of the:
Income recognition	– correct revenue recognition policy based on the contractual arrangements in place and the allocation of the risks and rewards of ownership of the plant – appropriate accounting treatment of receipts from contractors
Recoverable amount of property, plant and equipment	– indications of impairment and the measurement of fair value using projected cash flows, together with risk adjusted discount rates, or other more appropriate methods of valuation
Fair values on acquisition	– useful economic life and residual value of certain assets – fair values of assets and liabilities acquired and hence how much of the purchase price is attributed to goodwill arising on acquisition of a business
Consolidation policy – amount of influence	– extent of influence the Group is in a position to exercise over the operations, strategic direction and financial policies of entities in which it holds an equity stake
Items of income and expense which require separate disclosure – 'exceptional items'	– items of income or expense which are material by virtue of their nature and amount which require separate disclosure. The Directors consider these items most appropriately disclosed as 'exceptional'
Taxation	– appropriate provisions for taxation taking into account anticipated decisions of the tax authorities – assessment of the ability to utilise tax benefits through future earnings

Accounting policies

A discussion follows on the policies we believe to be the most critical in considering the impact of estimates and judgements on the Group's financial position and results of operations.

Critical accounting policies and estimates

We prepare our consolidated financial statements in compliance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board as adopted by the European Union. As such, we are required to make certain estimates, judgements and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements, the reported amounts of revenue and expenses during the periods presented and the related disclosure of contingent assets and liabilities.

On an ongoing basis, we evaluate our estimates using historical experience, consultation with experts and other methods considered reasonable in the particular circumstances to ensure full compliance with IFRS and best practice. Actual results may differ significantly from our estimates, the effect of which is recognised in the period in which the facts that give rise to the revision become known.

Our Group accounting policies are detailed on pages 83 to 87. The table above identifies some of the areas where significant judgements are required, normally due to the uncertainties involved in the application of certain accounting policies.

Income recognition

The majority of our income is derived from owning and operating power plants worldwide. In merchant markets the Group enters into various types of hedging or forward contracts for the buying and selling of commodities related to this activity: principally sales of electricity and the purchase of fuel for its own power plants. These contracts typically fall within the definition of derivative financial instruments and where required have to be marked to market. Accounting for these contracts as cash flow hedges allows, to the extent the hedge is effective, the changes in value of the derivatives to be deferred in equity. In order to achieve cash flow hedge accounting it is necessary for the Group to determine, on an on-going basis, whether a forecast transaction is both highly probable and whether the hedge is effective. This requires both subjective and objective measures of determination.

When our power plants sell their output under long-term purchase agreements it is usual for the power plant owning company to receive payment (known as a 'capacity payment') for the provision of electrical capacity whether or not the offtaker requests electrical output. In these situations, where there is a long-term contract to purchase electricity output and electrical capacity, it is necessary for the Group to evaluate the contractual arrangements and determine whether they constitute a form of lease or a service contract. Where the arrangements are determined to be a form of lease an evaluation is then required of where the substantial risks and rewards of ownership reside in order to determine the form of lease it represents. For those arrangements determined to be finance leases, it is necessary to calculate the proportion of total capacity payments which should be treated as finance income, capital repayment and as a fee for service provision and for operating leases the split between rental payments and fees for service provision.

The Group receives amounts from contractors in respect of late commissioning and under performance of new power plants. Receipts which relate to compensation for lost revenue are treated as income when the compensation is due and payable by the contractor. Those receipts that relate to compensation for plants not achieving long-term performance levels specified in the original contracts are recorded as a reduction in the cost of the assets.

Recoverable amount of property, plant and equipment

The original cost of greenfield developed power plant and other assets includes relevant borrowings and development costs:

- Interest on borrowings relating to major capital projects with long periods of development is capitalised during construction and then amortised over the useful life of the asset.
- Project development costs (including appropriate direct internal costs) are capitalised when it is virtually certain that the project will proceed to completion and income will be realised.

Our key performance indicators address two key aspects of the business: its profitability and its cash generation.

Depreciation of plant is charged so as to write down the value of the asset to its residual value over its estimated useful life:

- Gas turbines and related equipment are depreciated over 30 years to a 10% residual value, unless the circumstances of the project or life of specific components indicate a shorter period or a lower residual value.
- Coal and hydro plant is considered on an individual basis.

Management regularly considers whether there are any indications of impairment to carrying values of property, plant and equipment and other assets (e.g. the impact of current adverse market conditions). Impairment reviews are generally based on risk adjusted discounted cash flow projections that require estimates of discount rates and future market prices over the remaining lives of the assets.

Fair values on acquisition

The Group is required to bring acquired assets and liabilities on to the Group balance sheet at their fair value. Power plant and equipment usually have long operating lives, and are often bought with associated long-term contracts such as PPAs. Hence determination of the fair values of these long-life assets and contracts can require a significant amount of judgement.

Consolidation policy – amount of influence

The determination of the level of influence the Group has over a business is often a mix of contractually defined and subjective factors that can be critical to the appropriate accounting treatment of entities in the consolidated accounts. We achieve influence through Board representation and by obtaining rights of veto over significant actions. We generally treat investments where the Group holds less than 20% of the equity as investments available for sale. These investments available for sale are carried at market value where market prices are available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

Where the Group owns between 20% and 50% of the equity of an entity and is in a position to exercise significant influence over the entity's operating and financial policies, we treat the entity as an associate or jointly controlled entity. Equally, where the Group holds a substantial interest (but less than 20%) in an entity and has the power to exert significant influence over its operations, we treat it as an associate or jointly controlled entity.

Exceptional items

The Directors consider that items of income or expense which are material by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the Group. The Directors label these items collectively as 'exceptional items'.

Determining which transactions are to be considered exceptional in nature is often a subjective matter. However, circumstances that the Directors believe would give rise to exceptional items for separate disclosure would include:

- disposals of investments;
- discontinued operations;
- impairments and impairment reversals.

All exceptional items are included under the appropriate income statement line item to which they relate. In addition, for clarity, separate disclosure is made of all such items in one column on the face of the income statement.

Taxation

The level of tax provisioning is dependent on subjective judgement as to the outcome of decisions to be made by the tax authorities in the various tax jurisdictions in which International Power operates.

It is necessary to consider the extent to which deferred tax assets should be recognised based on an assessment of the extent to which they are regarded as recoverable.

Al Kamil, Oman

Key performance indicators (KPIs)

Our financial KPIs address two key aspects of the business, its profitability and its cash generation.

Earnings per share (EPS)

EPS is a measure of the profitability of the Group and shareholder returns. Growth in profitability over time is indicative of the ability of the Group to add value. The Directors consider pre-exceptional EPS as the appropriate indicator of performance as it excludes significant items which, by virtue of their size or incidence, could potentially distort the year-on-year comparison.

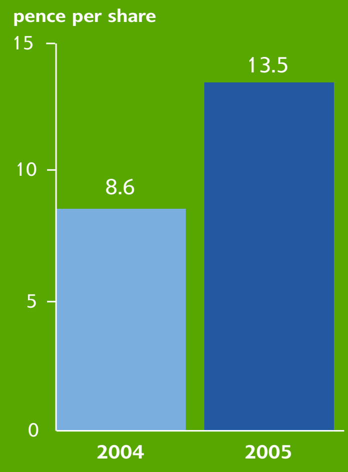
2005 EPS (excluding exceptional items) at 13.5p is 57% ahead of 2004. This increase results from the continued recovery in the UK and US merchant markets together with an excellent performance from the assets acquired in 2004 and 2005.

Free cash flow

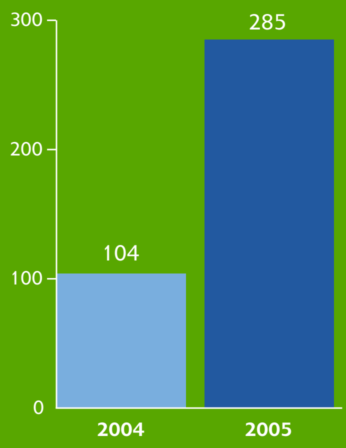
Power generation is a capital intensive business and hence it requires the assets within the Group to generate sufficient cash to repay the initial investment in the assets, to provide returns for shareholders and to provide funds for future investment opportunities. The Directors consider free cash flow to be the appropriate indicator of cash generating performance as it measures the cash generated from operating activities, excluding those cash flows relating to exceptional items.

Free cash flow in 2005 at £285 million is 174% ahead of 2004. This increase also reflects the underlying profitability of the acquired assets together with the improving margins in the UK and US merchant markets.

Earnings per share (basic) (pre-exceptional)



Free cash flow (£ million)



Board of Directors

Executive Directors

PHILIP COX (54)
Chief Executive Officer

Philip joined the Company on 1 May 2000 from Invensys plc as Chief Financial Officer. Philip was appointed Chief Executive Officer of International Power in December 2003. He has responsibility for the overall management of the business and the delivery of its strategy. He is a Non-Executive Director of Wincanton plc.

MARK WILLIAMSON (48)
Chief Financial Officer

Mark was appointed Chief Financial Officer of International Power in December 2003. His responsibilities include financial control and reporting, tax and risk management. Mark joined the Company in September 2000 from the Simon Group plc as the Group Financial Controller with responsibility for the Company's financial reporting.

BRUCE LEVY (50)
Executive Director, North America

Bruce runs American National Power (ANP). He joined the Company on 1 December 2004 having previously worked for US power company GPU, where he was senior Vice President and Chief Financial Officer. Bruce was appointed to the Board in June 2005.

STEVE RILEY (44)
Executive Director, Europe

Steve joined the business in 1985, holding senior positions in two UK power stations. He was appointed International Power's Managing Director, Australia in January 2000. In August 2003 he took up his current position as Executive Director, Europe. Steve was appointed to the Board in January 2004.

TONY CONCANNON (42)
Executive Director, Australia

Tony Concannon is a chartered engineer. He joined the industry in 1982 and has worked in a number of business areas including; power station operations, trading and international business development (based in Asia). He took on his role as International Power's Managing Director, Australia in August 2003. Tony was appointed to the Board in January 2004.

Chairman

SIR NEVILLE SIMMS (61)

Sir Neville became a Non-Executive Director of National Power in August 1998 and was appointed Chairman of International Power in October 2000. He is currently a member of the President's Committee of the CBI, a Governor of Ashridge Management College, Chairman of the BRE Trust and Chairman of the government's Sustainable Procurement Task Force. Sir Neville was a Non-Executive Director of the Bank of England from 1995 to 2002.

Non-Executive Directors

ADRI BAAN (63)
Non-Executive Director

Adri became a Non-Executive Director of the Company in June 2002. He is the Chairman of the Remuneration Committee. He was previously CEO of Philips Consumer Electronics, Member of the Board of Management of Royal Philips Electronics. He is currently on the Boards of KVWS, ICI PLC, OCÉ, Hagemeyer and Wolters Kluwer.

ANTHONY (TONY) ISAAC (64)
Non-Executive Director

Tony became a Non-Executive Director of the Company in October 2000. He is the Senior Independent Director and Chairman of the Audit Committee. He is the Chief Executive of The BOC Group plc and is a Non-Executive Director of Schlumberger Limited.

JOHN (JACK) TAYLOR (67)
Non-Executive Director

Jack became a Non-Executive Director of the Company in October 2000. He has 38 years' experience in project finance, private equity and international banking. Having served as the Asian Development Bank's Director-Infrastructure, Energy and Financial Sectors Department West and Private Sector Group, following a 30-year career as a senior executive with The Chase, Jack is today Executive Advisor to the Commonwealth Disaster Management Agency Ltd, and active in private equity in the UK, Europe and Asia, and Deputy Chairman of TRM International Ltd and the ITAP Alliance, international consultants.

STRUAN ROBERTSON (56)
Non-Executive Director

Struan became a Non-Executive Director of the Company on 1 October 2004. He was Group Chief Executive of Wates Group Ltd until January 2004. Before that he had a 25-year international career with BP plc, during which time he held a number of senior roles, including Chief Executive Officer of BP Oil Trading International and Executive Chairman of BP Asia Pacific. He is currently a Non-Executive Director at Forth Ports plc, Henderson TR Pacific Investment Trust plc and Tomkins plc. Previously he was the Senior Independent Director at WS Atkins plc.

FROM LEFT TO RIGHT STANDING: TONY CONCANNON, STRUAN ROBERTSON, MARK WILLIAMSON, STEVE RILEY, ADRI BAAN. SITTING: JACK TAYLOR, PHILIP COX, SIR NEVILLE SIMMS, TONY ISAAC, BRUCE LEVY.

Senior management team

FROM LEFT TO RIGHT STANDING: KEN OAKLEY, STEPHEN RAMSAY, KEN TEASDALE, GARETH GRIFFITHS. SITTING: PETER BARLOW, VINCE HARRIS, RANALD SPIERS, PENNY CHALMERS, SEAN NEELY.

PETER BARLOW

Peter is the head of corporate finance for International Power and is responsible for funding and bank relationships. He is also primarily responsible for the relationship with Mitsui. Peter joined us in 1998 and has been especially involved in corporate finance, project finance and treasury activities since that time.

PENNY CHALMERS

Penny heads up our corporate services. She is responsible for Group human resources, information technology and corporate communications. Penny has 18 years' experience in the energy sector and has been with us since 1997.

GARETH GRIFFITHS

Gareth manages global trading, with responsibility for our trading operations in the UK, US and Australia. He has 13 years' experience in the industry and was previously Vice President, Marketing and Trading for our US business.

VINCE HARRIS

Vince is the head of our Asia region and was previously head of one of the UK's first cogeneration businesses prior to becoming CEO of HUBCO in Pakistan. He is a chartered engineer and has 37 years' experience in the power generation industry.

SEAN NEELY

Sean heads up mergers and acquisitions at International Power. He is a chartered accountant with 14 years' experience in the power sector. He joined us in October 1998, and has a background in project finance and investment banking.

KEN OAKLEY

Ken joined the Group as head of tax in October 2000 and has responsibility for managing the Group's tax affairs. After qualifying as a chartered accountant and chartered taxation adviser, he now has 12 years' experience in the commercial tax sector.

STEPHEN RAMSAY

Stephen is our Company Secretary and General Counsel. He joined the Company in 1996, after 10 years as a solicitor in private practice, first working at National Wind Power and then in the international legal group before becoming Company Secretary in October 2000.

RANALD SPIERS

Ranald is head of our Middle East region. He has been with us for 13 years, having previously worked for the BP Group for 12 years across a wide spectrum of industries, including petrochemicals, detergents, oil refining, downstream gas, advanced materials and aerospace.

KEN TEASDALE

Ken heads up operations and engineering. He is a chartered electrical engineer and a chartered mechanical engineer. He has over 38 years' experience in the industry and was previously CEO of Hazelwood Power Company, our 1,635 MW coal fired power station in Victoria, Australia.

Hazelwood, Australia

- The Board has responsibility for defining the strategy of the business and reviewing the risk policies and profiles of the Group
- The Board has established business values and standards for the Company
- The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness
- The Board appointed an external facilitator to carry out the 2005 Board assessment
- The Company has an organisational structure with clear lines of accountability and authority across its worldwide operations

Corporate governance

We are committed to high standards of corporate governance and in this section set out how we comply with the principles in the Combined Code, and explain our reasons for any areas of non-compliance.

The Board

In 2005 the effectiveness of the Board was underpinned by a balance between Executive and Non-Executive Directors. The Board believes that it has the skills and experience necessary to provide effective leadership and control of the Company.

Bruce Levy joined the Board on 1 June 2005 as an Executive Director with responsibility for the North American business. There were no other changes during the year. At the end of the year the Board comprised of the Chairman (Sir Neville Simms), Executive Directors (Philip Cox, Mark Williamson, Tony Concannon, Steve Riley and Bruce Levy) and four Non-Executive Directors (Tony Isaac, Jack Taylor, Adri Baan and Struan Robertson). Sir Neville Simms was considered independent on his appointment as Chairman and the four Non-Executive Directors are considered to be independent. Tony Isaac is the Senior Independent Director.

The structure of the Board is not in strict compliance with the Combined Code in that the number of Non-Executive Directors is less than the number of Executive Directors. However, the Directors consider that the Board currently works effectively to carry out its duties and that the Non-Executive Directors have a strong independent presence at Board meetings to provide an effective counter balance to the Executive Directors. The size and structure of the Board is kept under review.

	Board (seven meetings)	Audit Committee (eight meetings[1])	Remuneration Committee (four meetings)	Appointments Committee (one meeting)
Sir Neville Simms	7	6	4	1
Philip Cox	7	n/a	n/a	n/a
Adri Baan	7	5	4	1
Tony Concannon	7	n/a	n/a	n/a
Tony Isaac	7	8	4	1
Bruce Levy[2]	4	n/a	n/a	n/a
Steve Riley	7	n/a	n/a	n/a
Struan Robertson	7	7	4	1
Jack Taylor	7	8	4	1
Mark Williamson	7	n/a	n/a	n/a

1. The Audit Committee held three main meetings relating to the preliminary statement, the interim statement and audit planning. All members of the Committee attended these meetings. The remainder of the meetings related to quarterly results and US reporting issues.

2. Bruce Levy joined the Board of Directors on 1 June 2005 and attended all Board meetings held since his appointment.

The full Board met seven times during 2005. Attendance by Directors at these and the Board committee meetings held during the year are detailed in the table above.

In addition to the above meetings, a meeting of the Chairman and the Non-Executive Directors was held without the Executive Directors being present. The Non-Executive Directors also met without the Chairman being present. This meeting was chaired by Tony Isaac, the Senior Independent Director, and included a review of the Chairman's performance.

Board membership

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election every three years and newly appointed Directors are subject to election by shareholders at the first AGM after their appointment. In addition, the Board seeks to maintain a balance between continuity and new blood amongst the Non-Executive Directors.

In accordance with this policy, Jack Taylor is due to step down as a Non-Executive Director at the 2006 AGM. The Board is currently seeking a replacement, using an external agency to find suitable candidates. Bruce Levy, who was appointed to the Board on 1 June 2005, will submit himself for re-election at this year's AGM. In addition, Tony Isaac will submit himself for re-election for a further term of up to three years. Tony Isaac has been a Non-Executive Director of the Company for nearly six years and the Board has therefore assessed whether it is appropriate for him to be re-elected as a Director. Following a review of his performance and contribution to the Board, the commitment to the role demonstrated by him, the need for Board continuity following the retirement of Jack Taylor at this year's AGM and his role as Chairman of the Audit Committee, the Board has decided that it is appropriate for Tony Isaac to seek re-election for a further term as a Director of the Company.

Board training

Arrangements are in place to ensure that newly appointed Directors receive a comprehensive briefing on the Company, and training is provided for Directors on their roles and their legal obligations to ensure that they are fully conversant with their responsibilities as Directors. In accordance with this policy, Bruce Levy received training on his role and responsibilities as a Director following his appointment to the Board. A programme of continuous training is also provided for the Directors. Periodically the Board meets at the site of one of the Group's assets and briefings are also given at Board meetings on particular parts of the business, including regional and functional reviews. During 2005 the Board visited the Group's business in North America where it met the regional management team and received a briefing about the local business operations. At other times the Board has also received a presentation on health, safety and environmental management from the head of operations, and a presentation on investor relations from the head of corporate communications. Directors are also kept informed of changes to the regulatory regime such as the revised UK Listing Rules, new institutional investor guidelines and the US Sarbanes-Oxley Act. All of the Directors have access to the advice and services of the Company Secretary and also to external independent advice should they so wish.

Insurance

The Company has in place appropriate insurance cover in respect of legal action against its Directors.

Operation of the Board

The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial policies of the Group. It also reviews the risk policies and profile of the Group. It maintains a schedule of all matters requiring specific Board approval. Throughout 2005 this included all strategy decisions and significant capital investment proposals and acquisitions. The Board receives information on capital expenditure projects and investment proposals in advance of Board meetings, as well as management reports on the operational and financial performance of the business. Financial performance is monitored on a monthly basis and the overall performance of the Group is reviewed against approved budgets. At least once a year, the Chief Executive Officer (CEO) presents a corporate strategy plan to the Board for review and approval. Each investment decision is made in the context of this plan.

The Board has established business values and standards for the Company, which provide a framework for the Company to balance the interests of all its stakeholders in the conduct of its business. The business values (FIRST) are set out in the CSR section of this *Annual Report*. The Company's Code of Business Conduct has been formally adopted by the Board and is set out on the Company's website. This code includes a whistle blowing procedure.

In respect of Board performance for 2005, the Board appointed an external facilitator to carry out the assessment. The assessment was in two parts. The first took the form of a questionnaire completed by each Director relating to the role and performance of the Board, including its committees, and Board priority tasks including strategy and safety. The results of this assessment were reviewed by the whole Board. The second part of the assessment took the form of a questionnaire completed by each Director relating to the effectiveness of individual Directors. The results of this part were reviewed by the Chairman in respect of the whole Board and by each Director for his own performance. The results of the review demonstrated that the Board members were extremely satisfied with the operation of the Board. The contribution by individual Directors to Board and Committee meetings was considered to be high.

Chairman and Chief Executive Officer

There is a clear division of responsibilities at the head of the Company between the roles of the Chairman and the CEO. The Chairman is responsible for the leadership and effective operation of the Board, in terms of its agenda, decision making and the utilisation of the skills and experience of the Directors. He monitors, with the assistance of the Company Secretary, the information provided to the Board to ensure that it is sufficient, pertinent, timely and clear. The Chairman is also responsible for ensuring that there is effective engagement and communication with shareholders. The CEO is responsible for the running of the Company, and leading the executive and operational teams in implementing the strategies approved by the Board.

Philip Cox is also a Non-Executive Director of Wincanton plc. His remuneration from this role is retained by him. His remuneration for the year ended 31 March 2005 was £28,000.

Non-Executive Directors and their function

Through membership of the Board committees, the Non-Executive Directors have responsibilities for: overseeing that systems of internal control and risk management are appropriate and effective; managing the relationship with the external auditors; evaluating the performance of management in meeting targets and objectives; setting the remuneration of Executive Directors; appointing Executive Directors; and planning senior management succession.

Board committees

The Company has established the following committees: the Audit Committee; the Remuneration Committee; and the Appointments Committee. No person other than a committee member is entitled to attend the meetings of these committees, except at the invitation of the Committee. The full terms of reference for each Committee are available on the Company's website: www.ipplc.com.

Audit Committee

The Committee selects and fixes the remuneration of the external auditors and reviews the effectiveness of the external audit process. The Committee also ensures policies and procedures are in place to ensure that the external auditors remain independent. In addition to reviewing the Group's accounts, results announcements, risk management and accounting policies, the Committee monitors the effectiveness of internal control systems for the Board. The Committee monitors the work of the internal audit function and its progress against the Group's annual internal audit plan, and also reviews reports from the external auditors.

During 2005 the Audit Committee was comprised of all the independent Non-Executive Directors of the Company and the Chairman. At the end of 2005 the Chairman, Sir Neville Simms, resigned from his membership of the Audit Committee. The Audit Committee Chairman is Tony Isaac, who is a Fellow of the Chartered Institute of Management Accountants and, before becoming Chief Executive of The BOC Group plc, was its Group Finance Director. The Company Secretary acts as secretary to the Committee.

Time was set aside for the Committee to meet each of the external auditors and the head of internal audit without executive management present. In addition to the members of the Committee, regular attendees at the Audit Committee meetings included representatives of the external auditors, the CEO, the Chief Financial Officer (CFO), other Executive Directors, the head of financial reporting and the head of internal audit.

Remuneration Committee

The Remuneration Committee is responsible for monitoring the performance of the Executive Directors of the Company against targets, and making recommendations to the Board on remuneration.

The Committee comprises all of the independent Non-Executive Directors of the Company and the Chairman. The Chairman of the Committee is Adri Baan. The Company Secretary acts as secretary to the Committee and the head of human resources at International Power acts as adviser to the Committee. Towers Perrin acts as external adviser to the Committee.

Appointments Committee

The Appointments Committee is responsible for matters of management succession and the identification and appointment of Directors. The Committee comprises of the Chairman and all of the independent Non-Executive Directors of the Company. The Chairman of the Committee is Sir Neville Simms. The head of human resources acts as secretary to the Committee.

Relations with shareholders

The Board is accountable to shareholders for the performance and activities of the Group. International Power ensures that its AGM provides shareholders with an opportunity to receive comprehensive information on all aspects of the Group's business activities and to question senior management about business issues and prospects.

All proxy votes are counted and the level of proxy votes lodged for each resolution is reported at the AGM and on the Company's website. In line with best practice, the Company aims to ensure that the notice of AGM and the *Annual Report* are sent to shareholders at least 20 working days before the AGM.

International Power also runs, within the terms of the regulatory framework, frequent contact programmes with industry analysts and institutional investors to discuss matters of strategy and financial performance. Contact is made principally by the CEO and the CFO. On issues of major importance the Chairman communicates with major shareholders. The Senior Independent Non-Executive Director (Tony Isaac) is also available as an alternative point of contact if shareholders have concerns over the Chairman's performance or where contact with the Chairman or other communication channels would be inappropriate. At each Board meeting an update is given on movements in major shareholdings and on contact programmes between the Executive Directors and institutional shareholders. Reports issued by financial analysts on the Company are circulated to Board members. These summaries and reports enable the Directors to gain an understanding of the views and opinions of those with an interest in the Company. All results presentations and stock exchange announcements are available to shareholders on the Company's website www.ipplc.com.

Accountability and audit

The Board is mindful of its responsibility to present a balanced and understandable assessment of International Power's financial position and prospects, both to investors and regulatory authorities. The *Annual Report*, preliminary, interim and quarterly results announcements are the principal means of achieving this objective.

An explanation of the respective responsibilities of the Directors and external auditors in connection with the financial statements is set out on pages 77 and 78. The Directors confirm on page 76 their view that the Group is a going concern.

The Audit Committee has a process in place to approve all non-audit services provided by the external auditor to ensure that the objectivity and independence of the external auditor is not compromised. In line with the requirements of the Sarbanes-Oxley Act, our procedures specify the services from which the external auditor is excluded and the approval process for all other services.

Malakoff, Malaysia

Audit Committee – terms of reference

- Relationship with external auditors – includes fixing the level of remuneration, the scope and adequacy of their audit, their performance and independence
- Financial reporting – reviews all financial reports including consideration of the Group's accounting policies, major judgemental areas and the effectiveness of internal control
- Internal audit – reviews the scope (including the annual plan) of the internal audit function and satisfies itself of its adequacy, particularly in terms of resource
- Risk management review – reviews reports prepared by the Risk Committee to ensure all relevant risks are addressed in the external and internal audit process
- Compliance – ensures there are proper procedures in place to review legislation and regulatory compliance activities

Synergen, Australia

Remuneration Committee – terms of reference

- Ensures that the remuneration package of Executive Directors is maintained on a sensible, comparative and defensible basis and enables the Company to compete effectively for good calibre executives
- Reviews the remuneration levels and other conditions of service of senior executives immediately below Board level

Appointments Committee – terms of reference

- Board structure and appointments – reviews the Board structure, size and composition and makes recommendations to the Board with regard to any changes that are deemed desirable
- Succession – responsible for putting in place plans for succession in relation to key posts immediately below Board level

Internal control

The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness.

Systems are in place to meet the requirements of the Combined Code and Turnbull Guidance and procedures and systems are being implemented to ensure compliance with the requirements of the Sarbanes-Oxley Act.

Any system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. The system can only provide reasonable, and not absolute, assurance against material financial misstatement or loss. The principal features of the Group's systems of internal control are:

Control environment

The Board encourages a culture of integrity and openness. The Company has an organisation structure with clear lines of accountability and authority across its worldwide operations, supported by appropriate reporting procedures. Each of the regional businesses is accountable to the CEO and is managed within the strategic guidelines and delegated authorities adopted by the Board. An executive management team, chaired by the CEO and comprising the Executive Directors, regional directors and functional heads, meets regularly to discuss issues facing the Group.

Control procedures

Control procedures have been established in each of the Company's operations to safeguard the Group's assets from loss or misuse and to ensure appropriate authorisation and recording of financial transactions. All acquisition and investment decisions are subject to disciplined investment appraisal processes. Risk management procedures are in place for the Company's operations, including its energy marketing and trading activities, which are overseen by the Global Commodities Risk Committee, which comprises executive and senior management, and is chaired by the global risk manager. The Group treasury function operates under defined policies and the oversight of the Treasury Committee, chaired by the CFO.

Performance reporting and information

Corporate plan: Executive management submits an annual corporate plan to the Board for approval. The plan for each business unit is the quantified assessment of its planned operating and financial performance for the next financial year, together with strategic reviews for the following four years. Group management reviews the plans with each operational team. The individual plans are based on key economic and financial assumptions and incorporate an assessment of the risk and sensitivities underlying the projections.

Performance monitoring: Monthly performance and financial reports are produced for each business unit, with comparisons to budget. Reports are consolidated for overall review by executive management, together with forecasts for the income statement and cash flow. Detailed reports are presented to the Board on a regular basis.

Performance review: Each business unit is subject to performance reviews with Group management regularly during the year. Actual results and forecasts for the year are compared to budget. Key operational and financial results are reviewed together with the risk profile and business environment of the reporting unit.

Investment projects: These are subject to formal review and authorisation procedures with designated levels of authority, including a review by an Investment Committee chaired by the CEO and comprising the Executive Directors and senior managers. Major projects are subject to Board review and approval.

Corporate reporting: The Company has a Disclosure Committee which is chaired by the Company Secretary and is comprised of members from the internal audit, corporate communications, human resources, operations and engineering, company secretariat and financial reporting departments. It reviews the *Annual Report*, the *Summary Annual Report* and 20F, and also monitors compliance with disclosures required under UK and US reporting regulations.

Risk identification and management

There is a continuous process for identifying, evaluating and managing the key risks faced by the Company. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Company's strategy and objectives. Assessments are conducted for all material entities.

As part of the annual business planning process, the key risks associated with achievement of the business' principal objectives are identified and their impact quantified. During the year, significant changes in the risk profile are highlighted through the business performance reports. The principal risks are reviewed by the Risk Committee, which provides reports to the Board and the Audit Committee.

Our risk identification processes enable us to identify risks which can be partly or entirely mitigated through use of insurance, or which we can self-insure. We negotiate best available premium rates with insurance providers on the basis of our extensive risk management procedures. Risks to which we pay particular attention include business interruption, Directors' and officers' liability and property damage.

Energy marketing and trading

The objective of the Group's energy marketing and trading operations is to maximise the return from the purchase of fuel and the sale of the associated output.

For each of the businesses that operate in merchant energy markets, local risk committees have been established to oversee the management of the market, operational and credit risks arising from the marketing and trading activities. The committees are made up of the trading manager, global and local risk managers, Directors and senior managers.

The Group hedges its physical generating capacity by selling forward its electrical output, and purchasing its fuel input, as and when commercially appropriate and within approved control limits. This is accomplished through a range of financial and physical products. Our limited proprietary trading operations use similar methods.

Energy market risk on our asset and proprietary portfolios is measured using various techniques including Value-at-Risk (VaR). VaR is used where appropriate and provides a fair estimate of the net losses or gains which could be recognised on our portfolios over a certain period and given a certain probability; it does not provide an indication of actual results. Scenario analyses are used to estimate the economic impact of sudden market movements on the value of our portfolios. This supplements the other techniques and methodologies and captures additional market risks.

Monitoring

The Board reviews the effectiveness of established internal controls through the Audit Committee which receives reports from management, the Risk Committee, the Group's internal audit function and the external auditors on the systems of internal control and risk management arrangements.

Internal audit reviews the effectiveness of internal controls and risk management through a work programme which is based on the Company's objectives and risk profile and is agreed with the Audit Committee. Findings are reported to operational and executive management, with periodic reporting to the Audit Committee.

Business unit managers provide annual self-certification statements of compliance with procedures. These statements give assurance that controls are in operation and confirm that programmes are in place to address any weaknesses in internal control. The certification process embraces all areas of material risk. Internal audit reviews the statements and reports any significant issues to the Audit Committee.

Compliance with the Combined Code

There were three areas where the Board was not fully compliant with the requirements of the revised Combined Code throughout 2005. After 1 June 2005, following the appointment of Bruce Levy as an Executive Director, there was a majority of Executive Directors over the Non-Executive Directors. The Board has reviewed the structure of the Board and has concluded there is no need at this time to appoint another Non-Executive Director, other than as a replacement for Jack Taylor.

Throughout 2005, the Chairman of the Board, Sir Neville Simms, was a member of both the Audit and Remuneration committees. The Code requires that the Chairman of the Company should not be a member of either of the Audit Committee or the Remuneration Committee. At the end of 2005 Sir Neville Simms' involvement in both the Audit and Remuneration committees was reviewed by the Board. Following the review, and taking into account the views of institutional investors, Sir Neville Simms agreed to resign from the Audit Committee, but retains his membership of the Remuneration Committee. The Chairman of the Remuneration Committee, Adri Baan, is an independent Non-Executive Director and there are three other independent Non-Executive Directors as members of the Committee. Therefore Sir Neville Simms was not in a position to exert any control over the affairs of the Remuneration Committee.

The Senior Independent Director does not have a contact programme to communicate with institutional investors, primarily to avoid potential confusion over channels of communication. During 2005 no institutional shareholder has requested such communication.

In all other respects, the Company has complied with the provisions of the Combined Code throughout the period of the review.

US corporate governance compliance

The Company has securities registered in the US and, as a result, it is required to comply with those provisions of the Sarbanes-Oxley Act 2002 (the Act) as it applies to foreign private issuers. The Board continues to monitor the new rules arising from the Act and arrangements are also being developed to ensure that the Company will be able to report on its systems of internal controls over financial reporting as required as at 31 December 2006.

Corporate social responsibility

Our aim is to ensure that International Power is known throughout the world as a responsible, efficient and successful company. Our stakeholders – our employees, shareholders, customers, suppliers, regulators and host communities – expect nothing less of us.

Corporate social responsibility considerations are integral elements of our decisions and they contribute to our global competitiveness and reputation in all areas of our business.

Today's fast-changing world relies increasingly upon electricity. It also demands responsibility from the industry that produces it. For a global wholesale generating company like International Power, this equates to following fair and ethical principles to govern the way we manage and conduct our business. It means working more smartly – by ensuring our key competencies, technical expertise and best practices are properly implemented over a widely dispersed and diverse range of assets to produce power, water and process heat more safely and cleanly.

At stake is our reputation, which is hard to earn and easy to lose. Our aim is to ensure that International Power continues to be known throughout the world as a responsible, efficient and successful company. Our stakeholders – our employees, shareholders, customers, suppliers, regulators and host communities – expect nothing less of us.

This strong commitment to corporate social responsibility (CSR) flows from the top. The Board is briefed regularly on our CSR performance and executive management is committed to delivering high standards of implementation. Consequently environmental and social considerations form part of our strategic decision-making process. This occurs at many levels, from environmental considerations incorporated into evaluations of asset acquisitions, expansions and developments, through to ensuring compliance with licensing and regulatory requirements as a minimum.

Establishing a sound reputation requires commitment at all levels of the Company. We work hard to build long-term sustainable partnerships in the communities in which we operate – particularly for our assets in developing countries. Our strategy is to provide local employment, support the local economy and act as a responsible neighbour and employer whilst contributing to the improvement of local health and education services.

CSR also covers the way we regard, develop and reward our employees. Details of this are contained in the Employees section on pages 60 and 61 of this report.

As with any large industrial process, the environmental impact arising from electricity generation is now subject to international – as well as national, regional and local – scrutiny and regulation. Our continuing obligation is to manage our growing portfolio of assets so as to reduce the environmental impact of our activities. As an example, our partnership with EnergyAustralia, is committed to purchasing 2.1% of its energy from green sources in 2006, an increase of 0.3% from 2005.

Our ability to deliver better performance is demonstrated by our track record in competitive energy markets which is based on our knowledge and experience in the power industry. By disseminating technical expertise widely throughout the Company, we strive to raise overall performance. This has commercial as well as environmental benefits. Effective management systems increase transparency and accountability. By publishing key performance data, we demonstrate publicly how we are putting our principles into practice.

In those instances where we share ownership of an asset, we encourage our partners to adopt our CSR standards and principles, typically through influence at business level board meetings. To date we have had good success with our partners.

In 2005 International Power was ranked 48 in the top 100 companies in the Business in the Community (BiTC) corporate responsibility and environment index which gave substantive peer group recognition of our commitment to continuously improving our CSR performance. This good BiTC ranking in 2005 followed our involvement in the FTSE4GOOD index in which we were included in 2004. The FTSE4GOOD index covers environment sustainability, stakeholder relationships and upholding and supporting universal human rights. We continue to be included within the FTSE4GOOD index, which identifies companies that meet globally-recognised corporate responsibility standards.

International Power's principal day-to-day focus is on achieving its financial objectives. That is the key measure of our success as measured by the financial community and is used internally in determining incentive compensation and for other purposes. Our financial success is critically important because it enables us to fulfil our responsibilities to all of our stakeholders, being: good return for shareholders; better pay and conditions for employees; recognition of successful delivery of products and services to customers; fulfilment of our obligations to our suppliers; and an ability to contribute positively to the needs of the communities in which we operate.

Policy

We believe integral to both achieving our financial objectives and to fulfilling our obligations to all of our stakeholders is careful adherence by all of our personnel to our core business values – FIRST.

Financial discipline

Our aim of long-term financial success depends upon financial discipline. While as a growth company we are entrepreneurial in our approach to investments, we are aware of our duty to protect shareholders' money.

Financial discipline means:

- making realistic risk assessments to value potential investments;
- not overpaying for assets we acquire or develop;
- ensuring that risk can be managed and properly priced;
- cutting out extravagance and waste in business-related expenditures, including administrative and overhead costs.

One of the International Power support vehicles at North Haven Club, Australia

Saving lives in Australia

In 2000 International Power Australia, through Pelican Point power station, funded the purchase of two vehicles for local surf life-saving clubs.

The North Haven and Semaphore Clubs say that the vehicles are the best support they could have received as they are used regularly to patrol local beaches and move life-saving equipment to and from the beach. On average these clubs save four lives each year – 20 since 2000.

Although keeping the beaches safe is their prime concern, the clubs also play an educational role in the community. North Haven primary school has a 'Dolphin Safe' programme where students assist with cleaning rocks in local waterways, making the area safer for the local dolphin population.

Our association with these clubs is ongoing, and further assistance will be considered in the future as part of the Australian business community relations programme.

Hub's mobile medical team at work, Pakistan

Community health project in Pakistan

During June 2005, the mobile medical team run by Hub power station, and staffed by a number of nurses and doctors, treated 31,899 people from 25 villages. In addition to this, 768 patients were treated in Hub's three community centres by lady health visitors.

The community centres have also hosted family planning clinics, mother and child vaccinations, well baby clinics, routine vaccinations, health education sessions and general medical clinics.

Integrity of communication

The Company is run on the basis of honesty, integrity, openness and fairness in business dealings, both internally and externally.

Good business decisions are based on full and good quality information presented clearly and concisely, in time, and with neither a positive nor negative bias. This applies equally to information flowing to and from management.

We seek to build sustainable business relationships based on honest communication. In dealing with our customers, suppliers, partners, investors, other external parties interested in our business (for example, the press or analysts) and our competitors, we operate on the "We say what we mean and we mean what we say" principle.

We will ensure that any corporate reports and any other external communications are complete, understandable and truthful and reflect the proper operations of the Company. At the same time, we will respect our confidentiality obligations.

Respect for the individual

International Power is a capital-intensive company staffed at all levels by highly skilled professionals with a range of expertise. Mutual respect is a key priority, demonstrated by:

- respecting the opinions of colleagues;
- zero tolerance for physical or verbal abuse;
- hiring new professionals with not only the right competencies, but also the proper attitude and work ethic to integrate within International Power;
- applying equal opportunities to all, regardless of their nationality, gender, ethnicity or religion;
- operating our business to the highest professional standards with zero tolerance for any person who compromises these standards.

While we do not guarantee lifetime employment, we do believe every International Power professional should have ample opportunity to use their existing skills and develop new ones to the full. If circumstances change, the Company and the individual will work together to find a fair and amicable separation arrangement.

Safe behaviour

It is relatively easy to introduce corporate policies and procedures which demand compliance, but in essence all unsafe acts or omissions can be avoided if the right attitude and a safe behaviour is automatically applied to everything we do.

This safe behaviour will deliver our Company goal of zero accidents and zero incidents whilst at work and would equally apply when not at work.

We therefore need to understand the right things to do and make sure that they are done properly, with no short cuts or excuses – in short, to behave safely all day, every day.

Team first culture

Our Company's business has evolved from a technology-driven industry into one in which technical skill, project development expertise, construction and procurement know-how, trading capability, financial, IT, legal, human resources, communications, accounting and tax acumen all play a substantial part. Such a complex business depends upon teamwork, with each employee bringing his or her individual skills and expertise to the fore.

Teamwork requires complete sharing of necessary information, inclusion rather than exclusion and a 'lend-a-hand' philosophy at all levels of the organisation.

Meeting our customers' needs calls for us to be customer-focused and responsive. We want our customers to know our team and respect its capabilities.

Keeping people informed

Effective dialogue with different groups of stakeholders is fundamental to successful CSR management. As well as the *Annual Report* to shareholders, we encourage communication through our on-line information service and welcome stakeholder monitoring and comment on our performance.

One initiative, designed to ensure effective communication with our employees, is the biennial International Power Global Forum. This incorporates employees from all areas and levels within the organisation and allows them to take part in discussions on Company-related issues. The Global Forum is a key mechanism to promote dialogue throughout our expanding organisation, ensuring discussion points are incorporated into our business in a meaningful way. The next Global Forum will take place in September 2007.

More informal communication with our employees on International Power's community-related activities is achieved via our internal extranet (ImPact) and *iprworld* (the global magazine). These provide a wealth of information including our performance, policies, latest news, awards, community projects and CSR case studies. Many of our regional businesses and individual power stations also provide information to employees and the local community on items of local interest.

Each asset at local level conducts direct contact with regulators. We continue to monitor and represent the Company's interests on current and future regional, national and international committees.

Any organisation or individual may visit our corporate website – www.ipplc.com – for up-to-date information about the Company and its activities. This information is supplemented by more detailed asset specific information on individual websites.

Health, safety and environment

During 2005, our Health, Safety and Environment Committee was active through inter-regional working groups to harmonise Group-wide policies and met formally four times to manage and communicate health, safety and environmental (HSE) issues. The formal Committee supports the more regular local HSE committee meetings. Continuous communication with individual assets is carried out on an 'as required' basis. HSE issues were reported, through the CEO, at main Board meetings throughout the year.

As well as monitoring performance, the Health, Safety and Environment Committee identifies and pools best practice, and encourages employees to learn from the experience of their colleagues around the world.

A continuing target for 2006, carried over from 2005, is to review the CSR credentials of our key EPC suppliers. At the same time we work with suppliers to ensure that they understand and can respond to our own CSR policies.

We recognise that regulatory requirements and local cultures differ widely but we are also keen to ensure that all employees are aware of the most appropriate health and safety principles in order to ensure their individual safe behaviour. In 2005 we achieved our target of progressively implementing behavioural safety training systems at a number of our locations. We are now confident that we will be able to build on this achievement and have set a 2006 target to implement behavioural safety initiatives across all of our assets, globally.

By evaluating initiatives and incidents from inside and outside the Company, we are able to refine our health and safety systems. Information is distributed Company-wide as Health and Safety Information Memoranda. Lessons learned are used to promote awareness and encourage best practice.

A key driver of Company policy in the last two years has been to establish a cohesive and consistent approach to HSE management. During 2005, the majority of our assets improved their environmental management systems by moving towards full ISO14001 certification, a programme that will continue to be promoted and encouraged in 2006. A new target for 2006 is to ensure that all International Power assets are certified or are at least working towards certification with the International Health and Safety standard OHSAS 18001 or directly equivalent country standard e.g. AS/NZS 4801 by the end of the year. Progress reports against both these targets will be monitored at the Company's quarterly HSE meetings.

Recognition and benchmarking

Power production is a complex process and our assets operate in competitive markets. Although our power stations throughout the world may use different fuels and different technologies to generate electricity, heat or steam, the way we record and report our CSR performance must be undertaken in a consistent and transparent way. By working to the Global Reporting Initiative and the Association of British Insurers' reporting guidelines we, and our stakeholders, can check and compare our performance with that of other power companies. International Power's annual web-based CSR report is now produced in line with these accepted guidelines.

Positive improvement

In terms of absolute figures our lost-time accidents (LTA) increased in 2005. However, relative to the growth of the Company's portfolio, 2005 proved to be another successful year in terms of LTA performance, improving on the figures for 2004. Examples of outstanding performance include our Milford plant in North America which has reached 3,336 days without an LTA, whilst Midlothian and Pego have all achieved over 1,500 days and Saltend has achieved 1,400 days without an LTA.

During 2005 we achieved improvements in our environmental performance by utilising the latest technology and optimising the way we operate our assets. As an energy company we provide

Tejo Energia, the owning company of the Pego project, has been awarded the Municipal Medal for Social and Economic Merit, recognising Pego's environmental achievements, safety practices and relations with the community.

electricity, heat, steam and water to our customers. Within our 2005 key performance indicators we have considered all of these process outputs in order to provide a more accurate representation of our total outputs, normalised by kWh equivalent. As a result, this method has allowed us to calculate our total output of SO_2, NO_x and CO_2 per kWh equivalent.

Demonstrating excellence

Tejo Energia, the owning company of the Pego project, has been awarded the Municipal Medal for Social and Economic Merit again in 2005. The medal is a prestigious award, subject to a high level of competition. The award recognises Pego's environmental achievements, environmental record, safety practices, relations with the community and partnerships in social projects on a local and regional level.

In Australia, the Hazelwood plant has received the Victorian government's approval for the continuation of its West Field mine development. In return Hazelwood undertook to limit its life-time emission of CO_2 to 445 million tonnes. This is the first time an Australian power generator has made such a commitment to the management of greenhouse emissions.

Targets

International Power has established a systematic dual approach to CSR target setting. Certain targets are set at an asset level (bottom up) via local business plans whilst other more generic targets are set at a corporate level (top down). This dual approach encourages consistency throughout the Company from a corporate level whilst allowing specific local targets to be set which may not be applicable to other sites or regions. In 2006 we will continue to ensure that we include both monitoring of achieved performance (reactive) and forward looking preventative (proactive) targets. A table of targets is available on our website: www.ipplc.com.

This approach allows us to develop and set an appropriate range of targets for our business. Some targets set in 2005 will continue and will be expanded year-on-year as part of an ongoing improvement programme. New performance targets are also added each year, as needed.

Future regulations

As always, one of our key objectives is to comply with all applicable legislation at local, regional, national and international level. We also keep abreast of all forthcoming legislation likely to affect our business. Assessing the likely ramifications for individual assets is the responsibility of the Company's Health, Safety and Environment Committee.

The revised Large Combustion Plant Directive and the EU Emissions Trading Directive are already having an impact at our European assets. We have continued to participate in industry-wide discussions to advise the UK Department of the Environment, Food and Rural Affairs and the Environment Agency for England and Wales on the implementation of both Directives. This is to ensure that the industry's view is voiced in terms of potential impact across the entire sector. International Power has strategies in place to enable our business to comply with the requirements of these key pieces of legislation.

Charitable giving

The Company's Charities and Donations Committee oversees the award of charitable and other donations. In addition to assessing requests and making awards in response to applications for assistance from a variety of charities and good causes, the Committee is also responsible for selecting the Company's community-based nominated charities and annual flagship projects. Donations are also made to alleviate hardship and to support relief efforts in response to natural disasters.

Within our regional businesses, each of our assets has an annual fund for charitable projects in the local area.

Nominated charities

International Power designates a number of organisations as nominated charities for periods of three years, providing a guaranteed level of annual funding over this time to support longer-term projects and planning. In 2005, the decision was made to continue with Sight Savers as one of our nominated charities for another three-year period. This three-year commitment allows us to build a strong relationship with our nominated charity. Sight Savers will be given an annual sum of £20,000 to fund cataract operations and train medical staff in Pakistan. In addition, we have decided to support the expansion of the Sight Savers eye hospital in Karachi, Pakistan, as a discrete project. We are donating the £50,000 required to fund equipment and instruments for the clinic, which deals specifically with child blindness. Our other nominated charity will continue to be Crisis, a London-based organisation which supports the homeless. Crisis also receives £20,000 per year for a three-year period.

During 2005 International Power and its subsidiaries contributed £1,173,707 to charitable causes and other community projects. Companies in which we have a minority shareholding (associates and joint ventures) contributed a further £662,132.

Flagship projects

Our flagship project programme – selected each year from nominations provided by our staff – has been running for four years. They are community projects funded annually by International Power. Flagship projects can range in size and scope, but they all have the same aim: improving quality of life in different corners of the world. The projects chosen for 2005 included a four-bed intensive care unit in Kot Addu, close to our KAPCO plant, and the refurbishing of a school in Thailand, near our Pluak Daeng plant. Both projects are now complete.

The status of our previous flagship projects can be found on our corporate website: www.ipplc.com.

Our responses to the Hurricane Katrina and Pakistani earthquake disasters

In response to the devastation along the US Gulf Coast caused by Hurricane Katrina, International Power plc's US subsidiary, American National Power, Inc., made a corporate donation to the American Red Cross of US$50,000 and matched employees' donations up to an additional US$50,000.

Following the devastating earthquake that hit Pakistan in October 2005, Kot Addu Power Company, Hub Power Company and Uch Power Company together donated over £1 million to President Musharraf's Relief Fund.

Award winners Hassam Fateen and Taha Farooq pictured here with celebrities Patrick Stewart (left) and Danny John Jules (right), and Ken Teasdale of International Power (centre).

Young Environmentalist of the Year

The annual 'Young Environmentalist of the Year' awards took place at the Dorchester Hotel, London in November 2005. The awards, which International Power has co-sponsored since 2001, challenge children to prepare projects highlighting an area of environmental concern and to demonstrate an understanding and empathy with the issue.

This year's winners were Hussam Fateen from Pakistan (13-16 year-olds) with a project on threats to sea turtles in Pakistan and Taha Farooq also from Pakistan (8-12 year-olds) with a project on endangered species.

Hub, Pakistan

Employees

- We value our reputation as a caring employer and seek to attract and retain high calibre employees
- We endeavour to ensure that all of our staff conduct themselves, internally and externally, in a manner of the highest integrity
- We have a number of share-based plans that are an integral part of our strategy to reward and retain employees

We operate an incentive weighted compensation scheme which we believe rewards and develops staff on the following basis:

- **Achievement of tangible personal objectives**: annual targets are set for all personnel, calibrated at levels designed to ensure that individuals are able to contribute to the attainment of these objectives.
- **Professional and educational advancement:** we promote and facilitate mid-career training, internal and external seminars, personal development plans and other educational programmes. In addition, we encourage our employees to participate actively in their personal development and in relevant professional organisations.
- **Leadership:** we expect our employees to exercise leadership in their dealings with colleagues, partners, customers and suppliers.

This all relies on a foundation of personal integrity and respect. We endeavour to ensure that all of our staff conduct themselves, internally and externally, in a manner of the highest integrity.

Clear communication links are critical to enhance business and commercial awareness throughout our Company. Corporate publications, the International Power website and extranet, employee awareness briefings from executive management and team briefings are all used to promote communications and an understanding of the development and application of policies and strategy. We use the latest technology to aid rapid communication with all staff around the world, as well as holding the biennial International Power Global Forum.

Equal opportunities

The Group is committed to equal opportunities, both from a sense of social responsibility and also because it makes sound business sense to benefit from the wide ranging knowledge and experience of individuals in all sectors of society. This commitment to equal opportunities means that decisions to appoint, reward, train, develop and promote are taken purely on the basis of skills and abilities, as matched against the requirements of the job.

International Power operates in an increasingly complex business environment. We place a high priority on the recruitment, retention and training of staff at all levels, whether employed by us directly or by any of our subsidiaries, joint ventures or associates.

The Group values its reputation as a caring employer and seeks to attract and retain high calibre employees. Opportunities for training are given a high priority to ensure that all individuals can contribute to their own career development. This approach extends itself to the fair treatment of people with disabilities in relation to their recruitment, training and development.

Diversity in the workplace

Cultural awareness and diversity training is provided to all relevant managers within the business and specific cultural awareness training is provided to our employees prior to overseas assignments.

At a regional level a number of our assets are members of diversity organisations. Our UK assets are registered as 'Investors in People'. Rugeley is also accredited to the 'Positive about Disability' standard. Our UK assets also have established a set of policies and procedures to ensure diversity in the workplace. This ensures equal opportunities are integrated into their recruitment and selection processes and subsequent employment.

Since acquiring our Shuweihat and Umm Al Nar assets in the Middle East, we have increased our awareness of ethnicity and country of origin issues as these form part of the in-country work visa process. Our awareness continues to increase as our business expands throughout the world.

The Company uses a variety of techniques for assessing applications as part of its selection process. Where external selection techniques are implemented, the Company is at pains to ensure that the providers are able to demonstrate their methodologies are free of bias. Internal selection processes revolve around objective assessment of the candidates insofar as they are able to meet the specification of the job.

Employee share plans

International Power has in place a number of share-based plans under which employees of the Group and its subsidiary companies may acquire Ordinary Shares in International Power plc.

These plans form an integral part of the Group's strategy to provide appropriate reward and retention strategies for employees, to align employee and shareholder interests through incentive targets based on clear operational and financial criteria and to recruit, motivate and retain employees.

These employee share plans are:

- the 2002 Performance Share Plan (a discretionary plan open to Executive Directors and selected senior managers);
- the International Power Approved Executive Share Option Scheme (a discretionary plan open to selected UK-resident employees);
- the International Power Unapproved Executive Share Option Plan (a discretionary plan for selected UK-based employees);
- the Global Executive Share Option Plan (a discretionary plan for executives resident outside the UK);
- the International Power Sharesave Plan (open to all UK-resident employees);
- the International Power Global Sharesave Plan (open to employees in certain jurisdictions outside the UK).

All of the listed plans are currently in operation.

Executive Share Options have been granted to executives in seven countries outside the UK and the Global Sharesave Plan is now in operation in four countries outside the UK. As the Group continues to grow and employee numbers continue to increase, we anticipate that the extension of share plans to overseas jurisdictions will continue apace.

The vesting of any awards made under the 2002 Performance Share Plan, and the ability to exercise options granted under the Approved, Unapproved and Global Executive Share Option Plans, are all subject to the satisfaction of certain financial performance conditions. Information on the relevant performance conditions for each award or option grant under each plan is given in the Directors' remuneration report. The exercise of options under the Sharesave Plans are not subject to any performance condition.

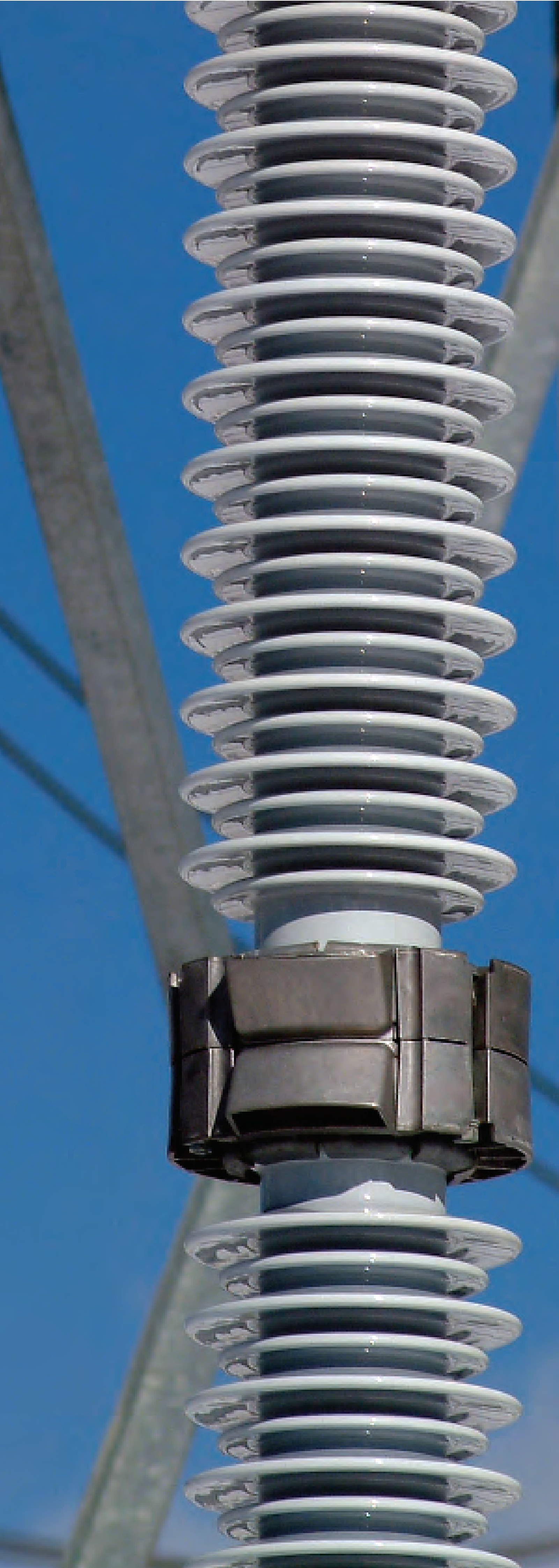
Bellingham, North America

Directors' remuneration

The Company's remuneration policy for each Executive Director takes account of the changing nature of the business in both the UK and overseas. Packages are designed to include:

- remuneration levels to retain and motivate top quality executives
- a significant performance-related element
- incentives to meet measurable performance criteria and align rewards with creating shareholder value
- opportunities to acquire International Power shares to build a strong share ownership culture

Main image: Blackstone, North America



Ju'aymah, Tihama, Saudi Arabia

Directors' remuneration

Executive Directors receive a remuneration package aligned with short and medium-term corporate and personal targets. The package comprises:

- a market competitive salary
- performance related annual bonus
- a long-term share-related incentive scheme
- pension benefits
- other benefits (healthcare, company car allowance)

Directors' remuneration report

The setting of remuneration policy and the determination of the compensation of Executive Directors is undertaken on behalf of the Board by the Remuneration Committee.

The Remuneration Committee has access to external independent advice in relation to remuneration. During the year the Committee appointed Towers Perrin to provide specialist advice on Director and senior management remuneration. Towers Perrin did not undertake any other services on behalf of the Company during the year ended 31 December 2005.

In addition, it received advice from James Richards, head of human resources, with regard to all aspects of remuneration. The CEO attended Committee meetings to report on Executive Directors' performance (other than his own).

This report to the shareholders by the Committee covers the following: remuneration policy (including information on share options, long-term incentive plans, Directors' service contracts and Directors' pension benefits); Directors' aggregate remuneration and compensation; and Directors' interests in the Company's shares.

Remuneration policy

The Company's remuneration policy for each Executive Director takes account of the changing nature of the business in both the UK and overseas. In order to compete with and meet these challenges, the Committee has designed executive remuneration along the following principles:

- Total remuneration levels that will retain and motivate top quality executives.
- All remuneration packages have a significant performance-related element.
- Incentives are based on meeting specific, measurable performance objectives, and align executives' rewards with creating value for our shareholders.
- Total remuneration packages that include significant opportunities to acquire International Power shares, consistent with our strategy of re-investment and building a strong share ownership culture.

This policy applies to the current year and the Committee intends to continue it for the foreseeable future, taking into account developing market practice. Since the beginning of 2006, the Company has consulted with major institutional shareholders, together with the ABI and RREV, regarding changes to the remuneration arrangements of our Executive Directors and a selection of key executives. International Power has undergone considerable transformation during the last two years, including the acquisitions of the international generation portfolio of Edison Mission Energy, Turbogás in Portugal and Saltend in the UK. As a consequence, the Company is now significantly larger, more geographically diverse and more complex to manage than before. Our market capitalisation has also increased significantly. These factors, together with a changing corporate governance and accounting environment, have led us to review our current remuneration arrangements to ensure they continue to be capable of providing a competitive package to attract and retain top quality executives and to drive performance.

Our pay policy is to be competitive around the median of the FTSE 51-100 group of companies. This reflects, and is in line with, the Company's market capitalisation in the FTSE 100. The Committee also has regard to the pay of staff and management generally within the Group, to ensure that an appropriate balance is maintained in remuneration levels.

In order to maintain market level remuneration packages for Executive Directors, from 1 January 2006, the Remuneration Committee increased:

- The maximum level of bonuses from 70% of base salary to 100%, for implementation in the 2006 financial year onwards. The target bonus for hitting budget is increased from 47% to 67%.
- The award level as part of the Performance Share Plan has been increased to 200% of base salary for the CEO, and increased to 150% of base salary for other Executive Directors.

Also, effective from 1 January 2006, the Remuneration Committee removed, for Executive Directors;

- the Bonus Share Retention Plan, which has achieved its objectives of providing a mechanism for Directors to increase substantially their shareholdings in the Company by foregoing a portion of their cash annual bonus. Therefore, no more awards will be made under this arrangement following the release of the 2005 bonus awards;
- participation in the annual grants of the Executive Share Option Schemes.

Elements of remuneration

Executive Directors receive a remuneration package aligned with short and medium-term corporate and personal targets. The package comprises a market competitive base salary; performance related annual bonus (for 2005 satisfied part in cash and part in shares); a long-term share-related incentive; pension benefits; and other benefits including a healthcare programme and a company car allowance.

With regard to the performance related elements of Executive Director remuneration packages, they are structured to provide significant awards for superior performance.

Main fixed and performance related elements of remuneration effective from 1 January 2006	
Fixed elements	**Performance elements**
Base salary	Annual bonus
Pension	Performance Share Plan
Benefits (e.g. car allowance, healthcare)	

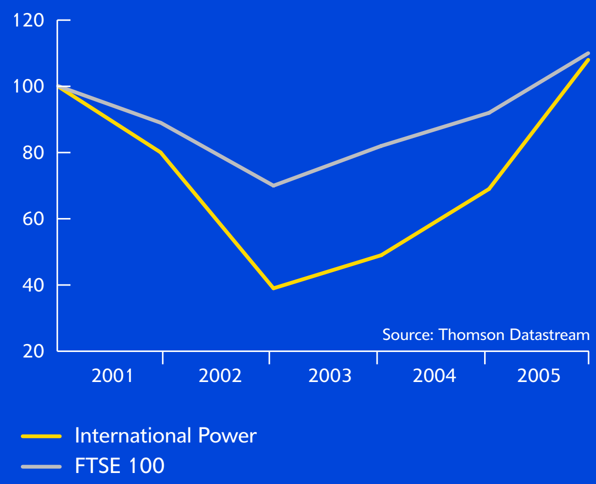
The total value of the fixed elements of remuneration referred to in the table above represents 133% of base salary. The face value of the performance related elements (annual bonus and long-term incentives) represents 300% of base salary for the CEO (270% for 2005), and 250% of base salary for other Executive Directors (270% for 2005). The level of remuneration actually receivable in respect of the performance related elements will be dependent upon the extent to which the performance conditions are achieved over the relevant performance period.

Base salary as at 1 January 2006

As part of our remuneration review, we have undertaken a market benchmarking exercise and it has become clear that our current base pay levels for the Executive Directors are significantly behind our policy position. This is partly because of our acquisitions and partly for historical reasons. We now have a team of experienced and high performing Directors and wish to ensure that their base pay is competitive. We therefore have increased the base pay of our Executive Directors by around 16% with effect from 1 January 2006 in order to bring them closer to the market median. However, we are mindful of shareholders' concerns about escalating base pay and, unless there are changes of role, our intention is that future increases are likely to be in line with inflation and market movements only. Salaries for Executive Directors, effective from 1 January 2006 are set out below:

Name	**Salary**
Philip Cox	£610,000
Mark Williamson	£360,000
Tony Concannon	£330,000
Steve Riley	£330,000
Bruce Levy	US$600,000

Pluak Daeng, Thailand



Total shareholder return (TSR)

The graph above shows the TSR performance of International Power's shares relative to the FTSE 100 index from the year 2001 to 2005.

Annual bonus

The International Power annual performance bonus is a non-pensionable payment for achieving targets set by the Remuneration Committee at the start of each financial year. The targets include EPS, cash flow, profit before interest and tax and personal targets. The maximum annual bonus opportunity for Executive Directors was set at 70% of base salary for the performance year 1 January to 31 December 2005. As set out in the last two annual reports, in order to increase the share ownership of Executive Directors and senior management, and to further increase the alignment of the remuneration package to shareholder return, the bonus award for 2005 will be made part in cash and part in shares. The bonus payable for the performance year 2006 will be paid fully in cash (i.e. no longer part in cash and part in shares).

For the 2005 performance period, the Committee reviewed the performance of each Executive Director against their qualitative and quantitative objectives. In addition they agreed that the executive team had worked well in this transformation year, in particular to deliver the benefits of integrating the assets purchased as part of the Edison Mission Energy, Turbogás and Saltend acquisitions whilst maintaining good operational results from the regions.

The Committee agreed that, taking into consideration the above, it would award the Executive Directors the following bonus for 2005.

Name	Bonus	Awarded as	
		Cash	No. of shares
Philip Cox	69%	£181,125	181,125
Mark Williamson	69%	£106,950	106,950
Tony Concannon	61%	£86,925	86,925
Steve Riley	69%	£98,325	98,325
Bruce Levy	69%	£56,869	56,869

The shares referred to above will be released to each Executive Director on 8 March 2006. The details of these payments are set out in the Directors' aggregate remuneration table on page 71.

As part of International Power's share retention arrangements, these shares (less a proportion of the shares sold to meet taxation liabilities) are required to be held until January 2007. An Executive Director may dispose of these shares prior to January 2007 if the value of his total beneficial interest in the shares of the Company is equal to or greater than 100% of his base salary.

For 2006 the maximum target bonus levels have been established on the following basis:

Maximum 2006 bonus achievable						
	Personal	EPS (Group)	Free cash flow (Group)	Profit from operations (Region)	Free cash flow (Region)	Return on equity (Region)
Philip Cox	10%	60%	30%	–	–	–
Mark Williamson	10%	60%	30%	–	–	–
Tony Concannon	10%	25%	10%	25%	15%	15%
Steve Riley	10%	25%	10%	25%	15%	15%
Bruce Levy	10%	25%	10%	25%	15%	15%

Selection of performance criteria

For awards previously made under the terms of the 2002 Performance Share Plan and the Approved, Unapproved and Global Executive Share Option Plans shown on the following pages, the performance conditions have been aligned with the key objective of growth in basic pre-exceptional EPS of the Company.

For future awards under the Performance Share Plan, commencing with the awards made in 2006, the Remuneration Committee has changed the performance measure from solely EPS growth to include an element of Total Shareholder Return (TSR). Therefore, half the award will be subject to a TSR performance condition measured against companies in the FTSE 51-100 grouping and the other half of the award will be subject to achieving specific EPS growth targets. By including a significant TSR element, this change in policy recognises shareholders' wishes to have a relative, market-based measure, such as TSR, when assessing performance.

For the TSR element of the performance measure, 25% of this element of the award will vest for median TSR performance and 100% will vest for upper quartile performance. In addition, before releasing any award in respect of the TSR element, the Remuneration Committee will satisfy itself that the Company's TSR performance is a genuine reflection of the underlying performance of the Company.

For the EPS element of the award, 25% of this element will vest for EPS growth of not normally less than 10% p.a. and 100% will vest for EPS growth of not normally less than 15% p.a. This performance range has been chosen taking into account financial analysts' current expectations but will be reviewed for each award in future years to ensure that it remains challenging. For the 2006 awards, the threshold and maximum performance conditions have been fixed at 21.0p (representing 16% compound growth on 2005 EPS performance) and 24.0p (representing 21% compound growth on 2005 EPS performance) respectively. Straight line pro-rating will apply for performance between the threshold and maximum data points for both the TSR and EPS growth elements.

If one of the above performance measures is not achieved, this will not prevent the vesting of the other half of the award if the relevant performance measure for that other half has been achieved (the level of vesting being subject to the level of performance actually achieved as outlined in the previous paragraph).

For future awards to staff who do not participate in the Performance Share Plan, but are eligible for a grant of Executive Share Option Plans, the performance measure will continue to be EPS growth.

This approach will continue for future awards under the 2002 Performance Share Plan and grants under the Approved, Unapproved and Global Executive Share Option Plans.

The Remuneration Committee will assess objectively the level of performance in respect of any performance condition.

Given that the principal performance measure for the Company's Share Plans is based on growth in EPS, the Committee will also take into account, and adjust appropriately for, the enhancement effects of any purchase and subsequent cancellation of shares, or placing of shares into treasury, by the Company.

Share Plans for Executive Directors: performance conditions

2002 Performance Share Plan

The annual awards made under this Plan will normally vest after the end of a three-year period. Each award attracts a performance condition that, historically, has reflected EPS. The performance conditions for awards made to date are as follows:

Date of award	Performance period	Threshold performance condition	Maximum performance condition	Vesting rate
24 May 2002	1 January 2002 to 31 December 2004	30% of the award will vest if average annual EPS growth over the Performance Period is not less than RPI+7%.	100% of the award will vest if average annual EPS growth over the Performance Period is equal to or greater than RPI+12%.	Vesting will be pro-rated for EPS growth between these two points.
		Performance condition not achieved		
10 March 2003 (Philip Cox only*)	1 January 2003 to 31 December 2005	30% of the award will vest if EPS performance for the year ended 31 December 2005 is not less than 9.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2005 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met. 100% of award vested 8 March 2006		
10 March 2003	1 January 2003 to 31 December 2005	30% of the award will vest if EPS performance for the year ended 31 December 2005 is not less than 9.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2005 is equal to or greater than 13.0p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met. 100% of award vested 8 March 2006		
2 March 2004	1 January 2004 to 31 December 2006	30% of the award will vest if EPS performance for the year ended 31 December 2006 is not less than 8.2p.	100% of the award will vest if EPS performance for the year ended 31 December 2006 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
11 March 2005	1 January 2005 to 31 December 2007	30% of the award will vest if EPS performance for the year ended 31 December 2007 is not less than 13.7p.	100% of the award will vest if EPS performance for the year ended 31 December 2007 is equal to or greater than 15.0p.	Vesting will be pro-rated for EPS performance between these two points.

* As part of the Company's 2003 succession management plan, a special conditional award was made in March 2003 to Philip Cox.

Philip Cox received an annual incentive conditional award of shares to the value of 100% of his base salary, subject to performance conditions, in 2002, 2003, 2004 and 2005. Mark Williamson, Tony Concannon and Steve Riley participated in the 2002 and 2003 awards up to 50% of their base salary and, following their appointment as Executive Directors, received a conditional award of 100% of their base salary in the 2004 and 2005 awards. Bruce Levy received a conditional award of 100% of his base salary in the 2005 award.

2006 awards

After the release of its preliminary results, and in accordance with the new policy, the Company will award Philip Cox 200% of his base salary in conditional shares under the 2002 Performance Share Plan. Mark Williamson, Tony Concannon, Steve Riley and Bruce Levy will be awarded 150% of their base salary in conditional shares under the 2002 Performance Share Plan. This award is subject to the performance conditions described on page 66. Shares will vest subject to the Remuneration Committee being satisfied with the level of achievement of the applicable performance condition.

Approved, Unapproved and Global Executive Share Option Plans

Pre-Demerger 'Legacy' Share Option Plans

In accordance with the rules at the time, there are no performance conditions attached to the National Power 'Legacy' Unapproved Options granted to Tony Concannon and Steve Riley prior to the demerger of National Power.

International Power Share Option Plans

The options granted under these Plans will normally become exercisable after the end of a three-year period. Each grant attracts a performance condition that reflects EPS. There is no retesting of performance conditions applicable to each option grant. The performance conditions for options granted to date are as follows:

Date of award	Performance period	Threshold performance condition	Maximum performance condition	Vesting rate
3 October 2000	1 January 2001 to 31 December 2003	Fully exercisable if average annual growth in normalised earnings per International Power share for the financial reporting period ending on 31 December 2000 to the reporting period ending on 31 December 2003 is equal to or exceeds 7%.		
24 March 2001	1 January 2001 to 31 December 2003	Performance condition achieved.		
24 May 2002	1 January 2002 to 31 December 2004	Fully exercisable if average annual EPS growth over the Performance Period (being 1 January 2002 to 31 December 2004) is not less than RPI+4%.		
		Performance condition not achieved.		
10 March 2003	1 January 2003 to 31 December 2005	30% of the award will be exercisable if EPS performance for the year ending 31 December 2005 is not less than 9.7p.	100% of the award will be exercisable if EPS performance for the year ending 31 December 2005 is equal to or greater than 11.5p.	Vesting will be pro-rated for EPS performance between these two points.
		2005 EPS 13.5p: Performance condition met, 100% of award exercisable from 10 March 2006.		
2 March 2004	1 January 2004 to 31 December 2006	Fully exercisable if EPS for the 2006 financial year is not less than 8.7p.		
11 March 2005	1 January 2005 to 31 December 2007	30% of the award will be exercisable if EPS performance for the year ending 31 December 2007 is not less than 13.7p.	100% of the award will be exercisable if EPS performance for the year ending 31 December 2007 is equal to or greater than 14.5p.	Vesting will be pro-rated for EPS performance between these two points.

Philip Cox participates in 2002, 2003, 2004 and 2005 share option grants to the value of 100% of his base salary. Mark Williamson, Tony Concannon and Steve Riley participate in the 2000, 2001, 2002 and 2003 share option grants to the value of 50% of their base salary and, following their appointment as Executive Directors, up to 100% of their base salary for 2004 and 2005. Bruce Levy participates in the 2005 option grant to the value of 100% of his base salary.

2006 Executive Share Options

Executive Directors will not be eligible to participate in this and future annual grants of Executive Share Options. However, after the release of its preliminary results, the Company will grant eligible other staff up to 50% of their base salary in Executive Share Options under the Approved, Unapproved, and Global Executive Share Option Plan. The exercise of these options will be subject to an EPS performance condition.

As a result of the 2005 performance conditions being met, the following shares under the Performance Share Plan will be released to the Executive Directors on 8 March 2006; also the following Executive Share Options become exercisable from 10 March 2006:

	Performance Share Plan	Executive Share Option Plan
Philip Cox	759,169	561,616
Mark Williamson	99,164	99,164
Tony Concannon	67,994	67,994
Steve Riley	88,505	88,505

Directors' service contracts

Service contract – Philip Cox

Philip Cox has a service contract subject to 12-months' notice by the Company. For termination other than for cause, he may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) to take account of the value of contractual benefits. The date upon which this contract was entered into was 25 February 2003.

Service contracts – Mark Williamson, Steve Riley and Tony Concannon

Mark Williamson, Steve Riley and Tony Concannon have service contracts which are subject to 12-months' notice by the Company. For termination by the Company, these Executive Directors may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) which will be paid on a monthly basis until the Executive Director secures alternative employment, up to a maximum of 12 monthly payments. The date upon which these contracts were entered into was 23 February 2004.

Appointment agreement – Bruce Levy

Bruce Levy has a US appointment agreement which is subject to 12-months' notice by the Company. For termination by the Company, he may receive a payment of 125% of annual basic salary (which includes the 12-months' notice) which will be paid on a monthly basis until he secures alternative employment, up to a maximum of 12 monthly payments. The date upon which his agreement was entered into was 21 December 2005.

Service contracts – Non-Executive Directors

The Chairman of International Power plc, Sir Neville Simms, has a letter of appointment with a 12-month notice period. The letter of appointment was signed on 22 February 2000. The other Non-Executive Directors are appointed on a three-year fixed-term, annual fixed-fee basis. Their appointment is reviewed at the end of each three-year period and extended for a period of one to three years if both parties agree.

The following table summarises the appointment and termination dates for Directors:

	Date contract entered into	Contract expiry
Non-Executive Directors		
Sir Neville Simms	22 February 2000	12-months' notice
Tony Isaac	2 October 2000	AGM May 2006
Adri Baan	30 May 2002	AGM May 2006
Jack Taylor	2 October 2000	AGM May 2006
Struan Robertson	27 September 2004	AGM May 2008

Sir Neville Simms' contract will expire at the 2010 AGM, following his 65th birthday, or earlier, subject to the above notice period.

Executive Directors		
Philip Cox	25 February 2003	12-months' notice
Mark Williamson	23 February 2004	12-months' notice
Tony Concannon	23 February 2004	12-months' notice
Steve Riley	23 February 2004	12-months' notice
Bruce Levy	21 December 2005	12-months' notice

Executive Director service contracts automatically terminate on the date they reach normal retirement age which is 22 September 2011 for Philip Cox, 16 December 2015 for Bruce Levy, 29 December 2017 for Mark Williamson, 16 August 2021 for Steve Riley and 17 December 2023 for Tony Concannon.

Non-Executive Directors' fees and shareholding requirements

In order to maintain our Non-Executive Director fee levels at a comparable scale to the market place, the Board have decided to increase Non-Executive Director annual fees with effect from 1 January 2006 (last increased in July 2003). It has also been agreed that Non-Executive Directors will no longer be required to use a proportion of their fee to purchase International Power shares. The fees for 2006 are set out below:

Sir Neville Simms	£250,000
Tony Isaac	£60,000
Adri Baan	£55,000
Jack Taylor	£45,000
Struan Robertson	£45,000

The above fees for the Non-Executive Directors comprise a basic fee, which covers Board membership (i.e. attendance at Board meetings, general duties as Directors, and their membership of Board Committees) of £45,000, a fee of £10,000 per annum for chairing each of the Audit and Remuneration Committees and a fee of £5,000 per annum for acting as Senior Independent Director.

The 2005 fees are set out in the Directors' aggregate remuneration table on page 71. The shares acquired by the Chairman and Non-Executive Directors under their former fee arrangement will, as part of their shareholding requirement, be required to be held until their appointment terminates. As part of this arrangement, the Chairman and Non-Executive Directors acquired the following shares in March 2005:

Sir Neville Simms	11,469
Tony Isaac	4,909
Adri Baan	4,909
Jack Taylor	3,269
Struan Robertson	3,214

Save as set out above, no remuneration or other benefits are provided as consideration for the performance of their duties.

Audit

The detail of the Directors' remuneration, pensions and interests in share options and long-term incentive plans as disclosed on pages 70 to 75 have been audited by the Company's external auditors.

Directors' pension benefits

The pension arrangements for Philip Cox and Mark Williamson are provided through the Senior Section of the International Power Group of the Electricity Supply Pension Scheme, which is a scheme approved by the Inland Revenue. The scheme provides for: a normal retirement age of 60; an accrual rate of one thirtieth of pensionable salary; four times salary death-in-service benefits; a widow's pension of two-thirds of executive's pension; and executive's contribution of 6% of salary up to 15% of Inland Revenue earnings limits.

The benefits provided through the scheme are restricted by Inland Revenue earnings limits. These arrangements are supplemented by the Company making contributions to life assurance cover and a Funded Unapproved Retirement Benefit Scheme, up to a cost to the Company of 30% of salary (which includes the cost of the benefit provided through the Senior Section of the International Power Group of the Electricity Supply Pension Scheme). With effect from 1 January 2006, this cost ceiling has been increased to 33%.

The pension arrangements for Tony Concannon and Steve Riley are also provided through the Senior Section of the International Power Group of the Electricity Supply Pension Scheme. As they are not restricted by the Inland Revenue earnings limit, the scheme provides for them: a normal retirement age of 60; an accrual rate of one forty-fifth of pensionable salary; four times salary death-in-service benefits; a widow's pension of two-thirds of executive's pension; and executive's contribution of 6% of salary. The Company does not supplement this arrangement.

	Accrued benefit			**Transfer value of accrued benefit**			**Transfer value of increase in accrued pension excluding inflation less Directors' contributions**
		Increase in year					
	At 31 December 2005	Including inflation	Excluding inflation	At 31 December 2005	At 31 December 2004	Increase less Directors' contributions	
	£	£	£	£	£	£	£
Philip Cox	11,200	4,000	3,800	194,000	106,400	71,900	49,600
Mark Williamson	18,700	4,000	3,600	257,000	164,100	77,200	33,400
Steve Riley	85,100	19,900	17,900	1,090,100	686,100	387,200	212,100
Tony Concannon	79,900	18,600	16,700	920,300	579,600	323,900	175,600

- The pension entitlement shown is that which would be paid annually on retirement based on service to the end of 2005. In addition to the pension shown above for service prior to 2 October 2000, Mark Williamson has an entitlement to an accrued lump sum of £336, Steve Riley has an entitlement to an accrued lump sum of £160,576, and Tony Concannon has an entitlement to an accrued lump sum of £152,407. The normal retirement age is 60.
- Dependants' pensions on death are 58% of members' pension in respect of service prior to 2 October 2000 and two-thirds of members' pension in respect of service thereafter. On death in service a lump sum of four times salary is payable. On death within the first five years of retirement, a lump sum is payable equal to the balance outstanding of the first five years' pension payments.
- Post-retirement increases are expected to be in line with inflation (guaranteed up to the level of 5% p.a. and discretionary above that level).
- The transfer value has been calculated on the basis of actuarial advice in accordance with Actuarial Guidance Note GN11.
- Members of the pension scheme have the option to pay Additional Voluntary Contributions; neither the contributions nor the resulting benefits are included in the above table.
- In addition to the above entitlements, during the year contributions to a funded unapproved retirement benefit scheme were £94,630 in respect of Philip Cox, and £62,725 in respect of Mark Williamson.

The Committee is considering the implications of the change in pensions legislation, which will be effective from 1 April 2006. However, no compensatory payments will be made to Directors to reflect these changes in legislation.

The pension arrangements for Bruce Levy are provided through a 401k Savings Plan, a Retirement Plan and a Supplemental Retirement Plan, which are money purchase schemes operated by American National Power, up to a cost to the Company of 30% of salary. With effect from 1 January 2006, this cost ceiling has been increased to 33%.

2005 Directors' remuneration and interests

Directors' aggregate remuneration

The table below shows the aggregate remuneration of the Directors of International Power plc for the year ended 31 December 2005.

	Salary	Fees	Performance related bonus – cash	Performance related bonus – shares	Payment in lieu of pension	Other benefits	Aggregate remuneration year to 31 December 2005	Aggregate remuneration year to 31 December 2004
	£	£	£	£	£	£	£	£
Sir Neville Simms	–	210,000	–	–	–	–	210,000	210,000
Philip Cox	525,000	–	181,125	518,923	101,325	16,024	1,342,397	979,401
Mark Williamson	310,000	–	106,950	306,412	64,480	13,331	801,173	526,859
Tony Concannon	285,000	–	86,925	249,040	–	107,183	728,148	520,586
Steve Riley	285,000	–	98,325	281,701	–	100,035	765,061	556,179
Bruce Levy	164,838	–	56,869	162,930	49,451	19,817	453,905	–
Tony Isaac	–	50,000	–	–	–	–	50,000	50,000
Adri Baan	–	45,000	–	–	–	–	45,000	45,000
Jack Taylor	–	40,000	–	–	–	–	40,000	40,000
Struan Robertson	–	40,000	–	–	–	–	40,000	10,000
Total	1,569,838	385,000	530,194	1,519,006	215,256	256,390	4,475,684	2,938,025

1. The International Power plc Non-Executive Directors' basic fee, which covers Board membership (i.e. attendance at Board meetings, general duties as Directors, and their membership of Board Committees) was £40,000. In addition, Tony Isaac received an additional fee of £5,000 per annum for his role as Senior Independent Director. Tony Isaac also received £5,000 per annum for his role as Chairman of the Audit Committee, and Adri Baan received an additional fee of £5,000 per annum for his role as Chairman of the Remuneration Committee. Struan Robertson joined the Company on 1 October 2004.
2. Sir Neville Simms' fee for 2005 was £210,000 per annum.
3. For Philip Cox, the payment in lieu of pension detailed in the above table sets out the contributions made to his death-in-service insurance premium and Funded Unapproved Retirement Benefits Scheme. He also received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. The value of the performance related bonus shares in the above table has been calculated using a share price of 286.50p (being the closing price on 3 March 2006).
4. For Mark Williamson, the payment in lieu of pension detailed in the above table sets out the contributions made to his death-in-service insurance premium and Funded Unapproved Retirement Benefits Scheme. He also received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. The value of the performance related bonus shares in the above table has been calculated using a share price of 286.50p (being the closing price on 3 March 2006).
5. Tony Concannon was appointed an Executive Director on 1 January 2004. He received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation and expatriate support. The value of the performance related bonus shares in the above table has been calculated using a share price of 286.50p (being the closing price on 3 March 2006). In addition, International Power Australia Pty Ltd incurs local charges regarding taxation of remuneration. For 2005, this cost is £318,028 (2004: £167,213). Tony Concannon funded 57.9% (2004: 64.9%) of these costs.
6. Steve Riley was appointed an Executive Director on 1 January 2004. He received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation and repatriation support. The value of the performance related bonus shares in the above table has been calculated using a share price of 286.50p (being the closing price on 3 March 2006).
7. Bruce Levy was appointed an Executive Director on 1 June 2005. His salary from that date is included in the above table. The payment in lieu of pension detailed in the above table sets out the contributions made to Bruce Levy's 401k Savings Plan, a Retirement Plan and a Supplemental Retirement Plan. He also received a company car allowance and private medical insurance, both of which are included in 'Other benefits'. Also included in 'Other benefits' is the value of his relocation support. The value of the performance related bonus shares in the above table has been calculated using a share price of 286.50p (being the closing price on 3 March 2006). The values shown in the above table have been converted from US dollar to sterling using the average annual exchange rate of 1.82 (see page 39).

The following information shows the interests of the Directors as at the end of the financial year in the Company's Long-Term Incentive Plans, Executive Share Option Plans and the Sharesave Plan. The table includes Bruce Levy who was appointed an Executive Director on 1 June 2005.

Long-term incentive plans

2002 Performance Share Plan

Directors who served during the year

	No. of shares under award as at 1 January 2005	Conditional awards made /(lapsed) during the year	Date of award	Market value of an Ordinary Share as at date of award (pence)	End of performance period	No. of shares under award as at 31 December 2005
Philip Cox	167,051	(167,051)	24 May 2002	174.50	31 December 2004	–
	759,169	–	10 March 2003	62.32	31 December 2005	759,169
	384,529	–	2 March 2004	123.53	31 December 2006	384,529
	–	292,887	11 March 2005	179.25	31 December 2007	292,887
Total awards	1,310,749	125,836				1,436,585
Mark Williamson	35,415	(35,415)	24 May 2002	174.50	31 December 2004	–
	99,164	–	10 March 2003	62.32	31 December 2005	99,164
	202,384	–	2 March 2004	123.53	31 December 2006	202,384
	–	172,942	11 March 2005	179.25	31 December 2007	172,942
Total awards	336,963	137,527				474,490
Tony Concannon	24,282	(24,282)	24 May 2002	174.50	31 December 2004	-
	67,994	–	10 March 2003	62.32	31 December 2005	67,994
	190,240	–	2 March 2004	123.53	31 December 2006	190,240
	–	158,995	11 March 2005	179.25	31 December 2007	158,995
Total awards	282,516	134,713				417,229
Bruce Levy[1]	–	158,995	11 March 2005	179.25	31 December 2007	158,995
Total awards	–	158,995				158,995
Steve Riley	31,608	(31,608)	24 May 2002	174.50	31 December 2004	-
	88,505	–	10 March 2003	62.32	31 December 2005	88,505
	190,240	–	2 March 2004	123.53	31 December 2006	190,240
	–	158,995	11 March 2005	179.25	31 December 2007	158,995
Total awards	310,353	127,387				437,740

(1) On appointment as a Director 1 June 2005

Executive share options

Directors who served during the year

	No. of shares under option as at 1 January 2005	Granted /(lapsed)	Exercise price per share (pence)	Exercise period from	Exercise period to	No. of shares under option as at 31 December 2005
Philip Cox	17,191[1]		174.50	24.05.2005	24.05.2012	17,191
	149,859[2]		174.50	24.05.2005	24.05.2012	149,859
	561,616[2]		62.32	10.03.2006	10.03.2013	561,616
	384,529[2]		123.53	02.03.2007	02.03.2014	384,529
		292,887[2]	179.25	11.03.2008	11.03.2015	292,887
Total options	1,113,195	292,887				1,406,082
Mark Williamson	5,403[1]		277.55	02.10.2003	02.10.2010	5,403
	30,624[2]		277.55	02.10.2003	02.10.2010	30,624
	7,168[1]		209.22	22.03.2004	22.03.2011	7,168
	16,728[2]		209.22	22.03.2004	22.03.2011	16,728
	35,415[2]		174.50	24.05.2005	24.05.2012	35,415
	99,164[2]		62.32	10.03.2006	10.03.2013	99,164
	202,384[2]		123.53	02.03.2007	02.03.2014	202,384
		172,942[2]	179.25	11.03.2008	11.03.2015	172,942
Total options	396,886	172,942				569,828
Tony Concannon	7,189[3]		287.76	23.12.1999	23.12.2006	7,189
	6,950[3]		343.73	02.12.2000	02.12.2007	6,950
	7,873[3]		313.92	01.12.2001	01.12.2008	7,873
	3,377[1]		277.55	02.10.2003	02.10.2010	3,377
	19,139[2]		277.55	02.10.2003	02.10.2010	19,139
	4,480[1]		209.22	22.03.2004	22.03.2011	4,480
	10,455[2]		209.22	22.03.2004	22.03.2011	10,455
	6,447[1]		174.50	24.05.2005	24.05.2012	6,447
	17,835[2]		174.50	24.05.2005	24.05.2012	17,835
	67,994[2]		62.32	10.03.2006	10.03.2013	67,994
	190,240[2]		123.53	02.03.2007	02.03.2014	190,240
		158,995[2]	179.25	11.03.2008	11.03.2015	158,995
Total options	341,979	158,995				500,974
Bruce Levy		158,995[4][5]	179.25	11.03.2008	11.03.2015	158,995
Total options		158,995				158,995
Steve Riley	12,722[3]	(12,722)	272.55	13.12.1998	13.12.2005	–
	12,302[3]		287.76	23.12.1999	23.12.2006	12,302
	12,001[3]		343.73	02.12.2000	02.12.2007	12,001
	13,904[3]		313.92	01.12.2001	01.12.2008	13,904
	5,674[1]		277.55	02.10.2003	02.10.2010	5,674
	32,155[2]		277.55	02.10.2003	02.10.2010	32,155
	6,810[1]		209.22	22.03.2004	22.03.2011	6,810
	18,282[2]		209.22	22.03.2004	22.03.2011	18,282
	31,608[2]		174.50	24.05.2005	24.05.2012	31,608
	88,505[2]		62.32	10.03.2006	10.03.2013	88,505
	190,240[2]		123.53	02.03.2007	02.03.2014	190,240
		158,995[2]	179.25	11.03.2008	11.03.2015	158,995
Total options	424,203	146,273				570,476

(1) International Power Approved Executive Share Options
(2) International Power Unapproved Executive Share Options
(3) National Power 'Legacy' Unapproved Executive Share Options
(4) International Power Global Executive Share Options
(5) On appointment as a Director 1 June 2005

Sharesave Options

Directors who served during the year

	No. of shares under option as at 1 January 2005	Granted during the year	Exercised during the year	Exercise price per share	Exercise period from	Exercise period to	No. of shares under option as at 31 Dec 2005
Philip Cox	20,499	–	–	80.12p	24 December 2007	24 June 2008	20,499
Mark Williamson	11,793	–	–	80.12p	24 December 2005	24 June 2006	11,793
Tony Concannon	9,435	–	9,435	80.12p	24 December 2005	24 June 2006	–
Steve Riley	11,793	–	11,793	80.12p	24 December 2005	24 June 2006	–

The middle market quotation for an Ordinary Share of the Company on 31 December 2005 was 239.50p and the daily quotations during the financial year ranged from 153.50p to 252.25p.

Shares held in trust

As at 31 December 2005, a total of 2,081,573 Ordinary Shares of the Company were held in two separate Employee Share Ownership Trusts (31 December 2004: 3,398,444). The Directors (together with all other employees of the Company and its subsidiaries) have an interest in all of these shares as they are potential beneficiaries. No shares have been purchased and placed into trust in the year ended 31 December 2005 (2004: 571,710 shares).

Summary of long-term incentive plans

Directors as at 31 December 2005

Award date	No. of shares under award	Market value at date of award	Prospective date of vesting
10 March 2003	1,014,832	62.32p	March 2006
2 March 2004	967,393	123.53p	March 2007
11 March 2005	942,814	179.25p	March 2008
Total	**2,925,039**		

Details of the performance conditions that apply with respect to the ability to exercise options under both the Approved and Unapproved Executive Share Option Plans, detailed below, are given on page 68.

Summary of Unexercised Executive Share Options

Grant date	No. of Options	Exercisable price	Date exercisable
23 December 1996(3)	19,491	287.76p	1999–2006
2 December 1997(3)	18,951	343.73p	2000–2007
1 December 1998(3)	21,777	313.92p	2001–2008
3 October 2000(1)	14,454	277.55p	2003–2010
3 October 2000(2)	81,918	277.55p	2003–2010
22 March 2001(1)	18,458	209.22p	2004–2011
22 March 2001(2)	45,465	209.22p	2004–2011
24 May 2002(1)	23,638	174.50p	2005–2012
24 May 2002(2)	234,717	174.50p	2005–2012
10 March 2003(2)	817,279	62.32p	2006–2013
2 March 2004(2)	967,393	123.53p	2007–2014
11 March 2005(2)	942,814	179.25p	2008–2015
Total	**3,206,355**		

(1) Approved Executive Share Options
(2) Unapproved Executive Share Options
(3) National Power 'Legacy' Unapproved Executive Share Options

Summary of Unexercised Sharesave Options

Directors as at 31 December 2005

Grant date	No. of Options	Exercisable price	Date exercisable
1 October 2002	11,793	80.12p	24 Dec 2005–24 June 2006
1 October 2002	20,499	80.12p	24 Dec 2007–24 June 2008
Total	32,292		

Directors' beneficial interests

Directors as at 31 December 2005

	As at 31 December 2005			As at 1 January 2005 (or date of appointment if later)		
Director	**Ordinary Shares**	**Executive Options**	**Sharesave Options**	Ordinary Shares	Executive Options	Sharesave Options
Sir Neville Simms	**178,220**	–	–	166,751	–	–
Philip Cox	**173,360**	**1,406,082**	**20,499**	89,285	1,113,195	20,499
Mark Williamson	**105,818**	**569,828**	**11,793**	61,568	396,886	11,793
Tony Concannon	**71,992**	**500,974**	**–**	20,962	341,979	9,435
Bruce Levy[(1)]	**30,000**	**158,995**	**–**	15,000	158,995	–
Steve Riley	**94,932**	**570,476**	**–**	41,522	424,203	11,793
Adri Baan	**38,801**	–	–	33,892	–	–
Tony Isaac	**25,501**	–	–	20,592	–	–
Jack Taylor	**16,549**	–	–	13,280	–	–
Struan Robertson	**3,163**	–	–	–	–	–

No Director had, at any time during the financial year, any beneficial interest in the shares of any subsidiaries.

The following changes have occurred to the Directors' share interests since the year end:
On 4 January 2006 the Company granted the following Sharesave Options to the following Directors of the Company: Tony Concannon 8,050 options[(2)]; Steve Riley 4,675 options[(2)]; Mark Williamson 8,050 options[(2)]; Bruce Levy 8,050 options[(3)]. The option exercise price is 200.00p per share.

[(1)] Date of appointment as Director 1 June 2005
[(2)] Sharesave Plan
[(3)] Global Sharesave Plan

No other changes to Directors' share interests have taken place between 31 December 2005 and 6 March 2006.

Adri Baan

Chairman of the Remuneration Committee
On behalf of the Board of Directors of International Power plc

6 March 2006

Directors' report

Introduction

The Directors submit their report and the audited financial statements of International Power plc (the Company) for the year ended 31 December 2005. The principal activity of the Company is to act as the holding company for a group of companies and a number of associated companies and joint ventures (the Group). The principal activities of the Group are the generation and sale of electricity.

Key information

The following sections form part of this Directors' report:

- Business and financial review (pages 12 to 43);
- Corporate governance (pages 48 to 53);
- Financial risk management objectives and policies (pages 38 and 53);
- Employees (pages 60 and 61);
- Directors' remuneration (pages 64 to 75);
- Current Directors' biographical details and Directors who served through the year (pages 44 and 45).

Dividend

The Directors propose to pay a dividend of 4.5p per Ordinary Share in respect of the year ended 31 December 2005. This dividend has not been included within creditors as it was not approved before the year end. The dividend paid during the year of 2.5p per Ordinary Share represents the dividend in respect of the year ended 31 December 2004.

Charitable and political donations

The Group does not make political donations. Details of charitable donations are set out on pages 58 and 59.

Research and development

Pure research is not a core element of the business of the Company. For the period under review, the Company did not undertake any expenditure on research and development. The Company will look to take advantage of technical advances as they arise and will continue to seek to develop power stations in the regions in which the Group operates making effective use of current and new technology as it arises.

Share capital

During the period 1 January 2005 to 31 December 2005 the Company did not purchase any of its Ordinary Shares.

Resolutions will be proposed at the 2006 AGM to renew for a further year the Directors' general authority to allot shares; to renew for a year the partial disapplication of shareholders' statutory pre-emption rights over Ordinary Shares and, to renew the authority to purchase a proportion of the Company's shares.

An explanation of these and other resolutions being proposed at the 2006 AGM will be provided in the Notice of AGM, which will be sent to shareholders during April 2006.

Shares held in trust

As at 31 December 2005 2,081,573 Ordinary Shares of the Company were held in trust for the benefit of employees of the Company and its subsidiaries. These shares had a nominal value of £1,040,786 and a market value of £4,985,367. The employee share plans for which these shares may be utilised are the 2002 Performance Share Plan and the bonus and share retention plans.

Substantial shareholdings

As at the date of this report, the Company is aware of interests in 3% or more of the issued share capital of the Company on behalf of the organisations as shown in the table below.

Substantial shareholdings	**Number of shares**
AXA S.A.	74,899,385* 5.08%†
Legal and General Investment Management Limited	58,779,494 3.98%
Standard Life Investments Limited	58,397,077 3.96%

* Announced Pre Rights Issue
† Percentage figure relates to issued share capital Pre Rights Issue

Going concern

The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future. Accordingly, the Directors continue to adopt the 'going concern' basis for the preparation of the financial statements.

Auditors

A resolution to re-appoint KPMG Audit Plc as auditors of the Company and to authorise the Directors to agree their remuneration will be proposed at the forthcoming AGM.

Prompt payment policy

The Company aims to observe the highest standard of business practice as both a buyer and seller of products and services. The Company's average number of days outstanding in respect of trade creditors at 31 December 2005 was 36 days.

By order of the Board

Stephen Ramsay
Company Secretary
6 March 2006

Statement of Directors' responsibilities

IN RESPECT OF THE ANNUAL REPORT AND THE FINANCIAL STATEMENTS

The Directors are responsible for preparing the *Annual Report* and the Group and Company financial statements, in accordance with applicable law and regulations.

Company law requires the Directors to prepare Group and Company financial statements for each financial year. Under that law the Directors are required to prepare the Group financial statements in accordance with IFRSs as adopted by the EU and have elected to prepare the parent company financial statements in accordance with UK Accounting Standards.

The Group financial statements are required by law and IFRSs as adopted by the EU to present fairly the financial position and performance of the Group. The Companies Act 1985 provides, in relation to such financial statements, that references in the relevant part of that Act to financial statements giving a true and fair view are references to their achieving a fair presentation.

The Company financial statements are required by law to give a true and fair view of the state of affairs of the parent company.

In preparing each of the Group and Company financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- for the Group financial statements, state whether they have been prepared in accordance with IFRSs as adopted by the EU;
- for the parent company financial statements, state whether applicable UK Accounting Standards have been followed, subject to any material departures disclosed and explained in the parent company financial statements;
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the Group and the parent company will continue in business.

The Directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the parent company and enable them to ensure that its financial statements comply with the Companies Act 1985. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities.

Under applicable law and regulations, the Directors are also responsible for preparing a Directors' report, Directors' remuneration report and corporate governance statement that comply with that law and those regulations.

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the UK governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Independent auditor's report

TO THE MEMBERS OF INTERNATIONAL POWER plc

We have audited the Group and parent company financial statements (the financial statements) of International Power plc for the year ended 31 December 2005 which comprise the consolidated income statement, the consolidated and Company balance sheets, the consolidated cash flow statement, the consolidated statement of changes in equity and the related notes to the consolidated financial statements. These financial statements have been prepared under the accounting policies set out therein. We have also audited the information in the Directors' remuneration report that is described as having been audited.

This report is made solely to the Company's members, as a body, in accordance with section 235 of the Companies Act 1985. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of Directors and auditors

The Directors' responsibilities for preparing the *Annual Report* and the consolidated financial statements in accordance with applicable law and International Financial Reporting Standards (IFRSs) as adopted by the EU, and for preparing the parent company financial statements and the Directors' remuneration report in accordance with applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice) are set out in the statement of Directors' responsibilities on page 77.

Our responsibility is to audit the financial statements and the part of the Directors' remuneration report to be audited in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view and whether the financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985 and whether, in addition, the Group financial statements have been properly prepared in accordance with Article 4 of the IAS Regulation. We also report to you if, in our opinion, the Directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding Directors' remuneration and other transactions is not disclosed.

We review whether the corporate governance statement reflects the Company's compliance with the nine provisions of the 2003 FRC Combined Code specified for our review by the Listing Rules of the Financial Services Authority, and we report if it does not. We are not required to consider whether the Board's statements on internal control cover all risks and controls, or form an opinion on the effectiveness of the Group's corporate governance procedures or its risk and control procedures.

We read other information contained in the *Annual Report* and consider whether it is consistent with the audited financial statements. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements and the part of the Directors' remuneration report to be audited. It also includes an assessment of the significant estimates and judgements made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Group's and Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements and the part of the Directors' remuneration report to be audited are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements and the part of the Directors' remuneration report to be audited.

Opinion

In our opinion:

- the Group financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Group's affairs as at 31 December 2005 and of its profit for the year then ended;
- the Group financial statements have been properly prepared in accordance with the Companies Act 1985 and Article 4 of the IAS Regulation;
- the parent company financial statements give a true and fair view, in accordance with UK Generally Accepted Accounting Practice, of the state of the parent company's affairs as at 31 December 2005;
- the parent company financial statements and the part of the Directors' remuneration report to be audited have been properly prepared in accordance with the Companies Act 1985.

KPMG Audit Plc
Chartered accountants
Registered auditor
6 March 2006

KPMG Audit Plc

8 Salisbury Square
London
EC4Y 8BB

Consolidated income statement

FOR THE YEAR ENDED 31 DECEMBER 2005

Note		**Year ended 31 December 2005**			Year ended 31 December 2004		
		Excluding exceptional items £m	**Exceptional items £m**	**Including exceptional items £m**	Excluding exceptional items £m	Exceptional items £m	Including exceptional items £m
2	Revenue: Group and share of joint ventures and associates	**2,936**	**–**	**2,936**	1,267	–	1,267
15	Less: share of joint ventures' revenue	**(309)**	**–**	**(309)**	(144)	–	(144)
15	Less: share of associates' revenue	**(694)**	**–**	**(694)**	(355)	–	(355)
2	**Group revenue**	**1,933**	**–**	**1,933**	768	–	768
8	Cost of sales	**(1,565)**	**52**	**(1,513)**	(637)	–	(637)
	Gross profit	**368**	**52**	**420**	131	–	131
8	Other operating income	**64**	**58**	**122**	56	–	56
8	Other operating expenses	**(129)**	**–**	**(129)**	(78)	11	(67)
2/15	Share of results of joint ventures and associates	**198**	**–**	**198**	113	–	113
	Profit from operations	**501**	**110**	**611**	222	11	233
8	Disposal of investments	**–**	**10**	**10**	–	4	4
4	Finance income	**53**	**–**	**53**	30	–	30
5/8	Finance expenses	**(255)**	**–**	**(255)**	(107)	(31)	(138)
	Net financing costs	**(202)**	**–**	**(202)**	(77)	(31)	(108)
	Profit before tax	**299**	**120**	**419**	145	(16)	129
8/9	Income tax expense	**(55)**	**(34)**	**(89)**	(25)	–	(25)
3	**Profit for the year**	**244**	**86**	**330**	120	(16)	104
	Attributable to:						
	Minority interests	**45**	**–**	**45**	8	(2)	6
	Equity holders of the parent	**199**	**86**	**285**	112	(14)	98
11	**Earnings per share**:						
	Basic	**13.5p**		**19.4p**	8.6p		7.5p
	Diluted	**13.0p**		**18.5p**	8.5p		7.4p

Following the implementation of IFRS, the Group has decided to continue with its separate presentation of certain items as exceptional. These are items which, in the judgement of the Directors, need to be disclosed separately, by virtue of their size or incidence in order for the reader to obtain a proper understanding of the financial information (refer to note 8).

Consolidated balance sheet

AT 31 DECEMBER 2005

Note		31 December 2005 £m	31 December 2004 £m
	Non-current assets		
12	Goodwill	**189**	197
13	Other intangible assets	**194**	9
14	Property, plant and equipment	**4,207**	3,542
15	Investments in joint ventures and associates	**1,375**	1,169
16	Other investments	**4**	86
17	Finance lease receivables	**448**	484
18	Other long-term receivables	**97**	101
19	Deferred tax assets	**78**	79
	Total non-current assets	**6,592**	5,667
	Current assets		
20	Inventories	**110**	91
21	Trade and other receivables	**396**	227
17	Finance lease receivables	**12**	11
22	Derivative financial instruments	**268**	–
	Assets held for trading	**52**	47
23	Cash and cash equivalents	**620**	565
	Total current assets	**1,458**	941
	Total assets	**8,050**	6,608
	Current liabilities		
24	Loans and bonds	**187**	100
22	Derivative financial instruments	**496**	–
25	Trade and other payables	**511**	362
	Current tax liabilities	**106**	83
	Total current liabilities	**1,300**	545
	Non-current liabilities		
24	Loans and bonds	**3,464**	3,257
22	Derivative financial instruments	**191**	–
26	Trade and other payables	**95**	170
27	Retirement benefit obligations	**27**	29
27	Provisions	**41**	35
19	Deferred tax liabilities	**557**	514
	Total non-current liabilities	**4,375**	4,005
	Total liabilities	**5,675**	4,550
	Net assets	**2,375**	2,058
	Equity		
28/29	Share capital	**737**	737
29	Share premium reserve	**394**	392
29	Capital redemption reserve	**145**	145
29	Capital reserve	**422**	422
29	Hedging and translation reserves	**(69)**	(39)
29	Retained earnings	**463**	176
	Total equity attributable to equity holders of the parent	**2,092**	1,833
	Minority interests	**283**	225
	Total equity	**2,375**	2,058

The financial statements were approved by the Board of Directors on 6 March 2006 and signed on its behalf by

Philip Cox
Chief Executive Officer

Mark Williamson
Chief Financial Officer

Consolidated statement of changes in equity

FOR THE YEAR ENDED 31 DECEMBER 2005

	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	**Attributable to equity holders of the parent £m**	Minority interests £m	**Total £m**
At 1 January 2004	554	289	145	422	–	–	76	**1,486**	39	**1,525**
Exchange difference arising on translation of foreign operations	–	–	–	–	–	(39)	–	**(39)**	(1)	**(40)**
Net loss recognised directly in equity	–	–	–	–	–	(39)	–	**(39)**	(1)	**(40)**
Profit for the year	–	–	–	–	–	–	98	**98**	6	**104**
Total recognised income and expense for the year	–	–	–	–	–	(39)	98	**59**	5	**64**
Rights issue	183	103	–	–	–	–	–	**286**	–	**286**
Minority interests in acquisitions and disposals	–	–	–	–	–	–	–	**–**	30	**30**
Equity funding from minority interests	–	–	–	–	–	–	–	**–**	154	**154**
Dividends	–	–	–	–	–	–	–	**–**	(3)	**(3)**
Other movements	–	–	–	–	–	–	2	**2**	–	**2**
At 31 December 2004	737	392	145	422	–	(39)	176	**1,833**	225	**2,058**
Restatement on adoption of IAS 32 and IAS 39	–	–	–	–	(12)	–	(20)	**(32)**	(3)	**(35)**
As restated at 1 January 2005	737	392	145	422	(12)	(39)	156	**1,801**	222	**2,023**
Losses on cash flow hedges	–	–	–	–	(101)	–	–	**(101)**	3	**(98)**
Exchange difference arising on translation of foreign operations	–	–	–	–	(5)	88	–	**83**	5	**88**
Net (loss)/income recognised directly in equity	–	–	–	–	(106)	88	–	**(18)**	8	**(10)**
Profit for the year	–	–	–	–	–	–	285	**285**	45	**330**
Total recognised income and expense for the year	–	–	–	–	(106)	88	285	**267**	53	**320**
Recognition of equity component in 3.75% convertible US dollar bond	–	–	–	–	–	–	50	**50**	–	**50**
Issue of shares	–	2	–	–	–	–	–	**2**	–	**2**
Minority interests in acquisitions and disposals	–	–	–	–	–	–	–	**–**	16	**16**
Equity funding from minority interests	–	–	–	–	–	–	–	**–**	6	**6**
Dividends	–	–	–	–	–	–	(37)	**(37)**	(14)	**(51)**
Other movements	–	–	–	–	–	–	9	**9**	–	**9**
At 31 December 2005	**737**	**394**	**145**	**422**	**(118)**	**49**	**463**	**2,092**	**283**	**2,375**

As more fully explained in note 1(o), financial instrument accounting is determined on different bases in 2005 and 2004 due to the transitional provisions of IAS 32 and IAS 39.

Consolidated cash flow statement

FOR THE YEAR ENDED 31 DECEMBER 2005

Note		Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
	Cash flows from operating activities		
	Profit for the year	**330**	104
	Adjustments for:		
	Depreciation of property, plant and equipment and amortisation of intangibles	**188**	85
	Share of results of joint ventures and associates	**(198)**	(113)
	Net finance costs	**202**	108
	Income tax expense	**89**	25
	Decrease in finance lease receivables	**10**	2
	Profit on disposal of investments	**(10)**	(4)
	Exceptional impairment reversal	**(52)**	–
	Exceptional profit on receipt from TXU administrators	**(58)**	–
	Release of a guarantee on sale of Elcogas	**–**	(11)
	Other non-cash movements	**6**	–
	Increase/(decrease) in provisions	**3**	(1)
	Adjustment for non-cash items	**180**	91
	Dividends received from joint ventures and associates	**92**	69
	Purchase of property, plant and equipment – maintenance	**(72)**	(59)
	Proceeds from sale of property, plant and equipment	**3**	–
	Operating cash flows before movements in working capital	**533**	205
	Increase in inventories	**(13)**	(6)
	(Increase)/decrease in trade and other receivables	**(154)**	8
	Increase in trade and other payables	**146**	1
	Cash generated from operations	**512**	208
	Income taxes paid	**(31)**	(20)
	Interest paid	**(231)**	(113)
	Interest received	**35**	29
	Free cash flow	**285**	104
	Exceptional finance costs	**(5)**	(26)
	Refinancing costs capitalised on acquisition debt	**(7)**	(22)
	Exceptional receipt from TXU administrators	**58**	–
	Net cash inflow from operating activities	**331**	56
	Cash flows from investing activities		
	Purchase of property, plant and equipment – growth	**(188)**	(158)
	Compensation for long-term contractual performance shortfalls	**–**	5
30(g)	Proceeds from disposal of a subsidiary	**73**	–
30(i)	Acquisitions of subsidiaries net of cash and cash equivalents acquired	**(494)**	(1,045)
30(j)	Acquisitions of investments in joint ventures and associates	**(50)**	–
30(k)	Proceeds from disposal of investments	**138**	17
	Returns from/(investment in) joint ventures and associates	**48**	(60)
	Other financial investments	**–**	(1)
	Net cash used in investing activities	**(473)**	(1,242)
	Cash flows from financing activities		
	Dividends paid	**(37)**	–
	Proceeds from share issue	**2**	286
	Advances from banks	**563**	746
	Repayments to banks	**(415)**	(129)
	Funding from minority interests	**80**	165
	Dividends paid to minority interests	**(14)**	(3)
	Net cash from financing activities	**179**	1,065
	Net increase/(decrease) in cash and cash equivalents	**37**	(121)
	Cash and cash equivalents at beginning of the year	**565**	696
	Effect of foreign exchange rate changes thereon	**18**	(10)
23	**Cash and cash equivalents at end of the year**	**620**	565

Notes to the consolidated financial statements

FOR THE YEAR ENDED 31 DECEMBER 2005

1. ACCOUNTING POLICIES

a) General information

International Power plc (the Company) is a public limited company incorporated and domiciled in the United Kingdom. The address of its registered office is disclosed on the last page of this *Annual Report*. The consolidated financial statements of the Company for the year ended 31 December 2005 comprise the Company and its subsidiaries (together referred to as the Group) and the Group's interest in joint ventures and associates. The parent company financial statements present information about the Company as a separate entity and not about its Group. The principal activities of the Group are described in note 2.

b) Statement of compliance

European Union (EU) law (IAS Regulation EC 1606/2002) requires that the consolidated financial statements of the Group, for the year ended 31 December 2005, be prepared in accordance with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board as adopted by the EU (Adopted IFRSs). These annual financial statements of the Group have been prepared in accordance with Adopted IFRSs.

The Company has elected to prepare its parent company financial statements in accordance with UK GAAP. The parent company financial statements are presented on pages 132 to 138.

c) Transitional arrangements

On transition to IFRS, an entity is required to apply IFRS retrospectively, except where an exemption is available for adoption under IFRS 1 (First-time Adoption of International Financial Reporting Standards). The impact of the transition from UK GAAP to Adopted IFRSs is explained in note 42. The following is a summary of the key IFRS 1 elections made by the Group:

(i) The Group has elected to apply the IFRS 1 exemption, in relation to business combinations, to apply IFRS 3 (Business Combinations) prospectively from 1 January 2004. As a result, the carrying amount of goodwill under UK GAAP at 31 December 2003 is the deemed cost of goodwill at 1 January 2004 for Adopted IFRS purposes.

(ii) The Group has elected to adopt the IFRS 1 option which permits the cumulative foreign currency translation reserve to be deemed zero at 1 January 2004.

(iii) With respect to pension schemes the Group has elected to recognise the schemes' surpluses and deficits in full as at 1 January 2004, with a corresponding adjustment to reserves.

(iv) The Group has elected to apply IFRS 2 (Share-based Payments) to equity instruments that were granted on or after 7 November 2002.

(v) The Group has elected to measure the property, plant and equipment of its US operations at the date of transition to IFRSs at its fair value and use that fair value as its deemed cost at that date.

(vi) The Group has taken the exemption from the requirement to restate comparative information for IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) in accordance with IFRS 1 and has applied these standards prospectively from 1 January 2005 with no restatement of comparatives. As a consequence, the Group has continued to apply UK GAAP in respect of financial instruments for the comparative period presented. The impact of adopting IAS 32 and IAS 39 at 1 January 2005 is disclosed in note 42.

d) Adopted IFRS not yet applied

The following Adopted IFRSs were available for early application but have not been applied by the Group in these financial statements.

IFRS 7 (Financial Instruments: Disclosures) applicable for years commencing on or after 1 January 2007. The application of IFRS 7 in 2005 would not have affected the results or net assets as the standard is concerned only with disclosure. The Group plans to adopt it in 2007.

The Group has not adopted amendments to IAS 39 and IFRS 4 in relation to financial guarantee contracts which will apply for periods commencing on or after 1 January 2006.

Where the Group enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Group considers these to be insurance arrangements, and accounts for them as such. In this respect, the Group treats the guarantee contract as a contingent liability until such time as it becomes probable that the Group will be required to make a payment under the guarantee.

The Group does not expect the amendments to have any impact on the financial statements for the period commencing 1 January 2006.

e) Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis, except for certain derivative financial instruments, financial instruments held for trading, financial instruments classified as available for sale, which are carried at fair value, and the property, plant and equipment of the Group's US operations at 1 January 2004 which were held at deemed cost, being fair value on adoption of IFRS.

The principal accounting policies adopted are set out below. These have been applied consistently in dealing with items which are considered material in relation to the Group's financial statements, with the exception of those accounting policies relating to IAS 32 and IAS 39 on financial instruments. This is a result of the Group's decision to adopt the IFRS 1 exemption and not restate comparatives for IAS 32 and IAS 39. These accounting policies are denoted with an asterisk and have only been applied from 1 January 2005 and not to the 2004 comparatives. The accounting policies under UK GAAP applied to financial instruments in 2004 are also included in this note and denoted with double asterisks.

A full list of the UK GAAP accounting policies is provided in the Group's financial statements for the year ended 31 December 2004. Reconciliations of the income statement for the year ended 31 December 2004 and the balance sheet and total equity at 31 December 2004 from UK GAAP to IFRS are included in note 42, together with narrative describing the key GAAP differences applicable to the Group. A reconciliation of the balance sheet at 31 December 2004 to the balance sheet at 1 January 2005 to reflect the adoption of IAS 32 and IAS 39 is also included in this note, along with explanations of key differences.

The preparation of the consolidated financial statements in conformity with Adopted IFRSs requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of assets and liabilities, income and expenses. The estimates and associated assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about carrying amounts of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimates are revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods. Judgements and estimates made by management that have a significant effect on the consolidated financial statements are discussed in note 41.

f) Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company (its subsidiaries) up to 31 December each year. Control is achieved where the Company has the power to govern the financial and operating policies of an investee entity so as to obtain benefits from its activities. In assessing control, the potential voting rights that are currently exercisable or convertible are taken into account.

1. ACCOUNTING POLICIES continued

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition. The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets and liabilities recognised. Subsequently, any losses applicable to the minority interest in excess of the minority interest are allocated against the interests of the parent, except when there is a binding obligation to fund those losses and the minority is in a position to do so.

The results of subsidiaries acquired or disposed of during the year are included in the consolidated income statement from when control commences or up to when control ceases, as appropriate.

Where necessary, adjustments are made to the financial statements of subsidiaries to bring the accounting policies used into line with those used by the Group.

All intra-group transactions, balances, income and expenses are eliminated on consolidation.

g) Revenue recognition

Certain power plants sell their output in merchant markets, where electricity is sold through existing power exchanges, pool arrangements or through bilateral contracts with third parties. In these markets, revenue from energy sales is either recorded at the spot price obtained through pool or spot mechanisms when the electrical output is delivered or as set out below, when electricity is delivered in accordance with the terms of any related hedging or forward contracts.

(i) Because power is a non-financial item, forward contracts entered into and which continue to be held for the purpose of delivery (and sale) of power generated by our own power plants (known as 'own use' contracts) can be accounted for under accruals accounting, i.e. revenue for energy sales is recognised as output is delivered in accordance with the forward contract.

(ii) All other forward contracts, which are considered to be derivatives and do not qualify for 'own use', are recognised at fair value with changes in fair value recorded in the income statement. Where possible, the Group applies cash flow hedge accounting so that changes in fair values are deferred in a hedging reserve within equity and only reclassified to earnings when the hedged transaction affects earnings. In addition, to the extent that there is ineffectiveness in the cash flow hedge accounting of forward contracts, changes in fair values of the forward contracts are taken to the income statement in the period.

Other power plants sell their output under long-term power purchase agreements (PPAs). Under such arrangements it is usual for the Group to receive payment for the provision of electrical capacity whether or not the offtaker requests the electrical output (capacity payments) and for the variable costs of production (energy payments). In such situations, revenue is recognised in respect of capacity payments as:

(i) finance income (in accordance with note 1(p)) where the PPA is considered to be or to contain a finance lease;

(ii) as operating lease rentals, on a straight-line basis (in accordance with note 1(p)) where the PPA is considered to be or to contain an operating lease; or

(iii) as revenue in accordance with the contractual terms, to the extent that the capacity has been made available to the contracted offtaker during the period.

Under lease arrangements, those payments which are not included within minimum lease payments are accounted for as revenue (outlined in (iii) above).

Energy payments under PPAs are recognised in revenue as energy sales in all cases as the contracted power is delivered.

Where the PPAs extend over more than one accounting period, revenue for energy sales is recognised in each accounting period at the fair value of the Group's performance under the contract in each period.

Liquidated damages (LDs), in respect of late commissioning, are 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.

h) Foreign currencies

Foreign currency monetary assets and liabilities are translated at the rate of exchange at the balance sheet date. Foreign currency non-monetary items measured in terms of historical cost are translated at the rate of exchange at the date of the transaction. Exchange differences on monetary items are dealt with in the income statement. Exchange differences on non-monetary items are recognised in line with whether the gain or loss on the non-monetary item itself is recognised in the income statement or in equity.

In order to hedge its exposure to certain foreign exchange risks, the Group enters into forward contracts and options (refer to note 1(o), the accounting policy on derivative financial instruments for details of the Group's accounting policies in respect of such derivative financial instruments).

The net assets of the Group's overseas subsidiaries, joint ventures and associates are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period which approximates to actual rates. Exchange differences arising, if any, are classified as equity and transferred to the Group's translation reserve. Such translation differences are recognised as income or as expenses in the period in which the operation is disposed.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate. Exchange differences arising from the translation of the net investment in foreign operations and of related hedges are taken to the translation reserve. They are released to the income statement upon disposal. In respect of foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRS, are presented as part of retained earnings.

i) Goodwill

Goodwill arising on consolidation represents the excess of the cost of acquisition over the Group's interest in the fair value of the identifiable assets and liabilities and contingent liabilities of a subsidiary, joint venture or associate at the date of acquisition.

Goodwill is recognised as an asset and reviewed for impairment annually and when there are indications of impairment. Any impairment is recognised immediately in the income statement and is not subsequently reversed.

On disposal of a subsidiary, joint venture or associate, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Goodwill arising on acquisitions before the date of transition to IFRSs has been retained at the previous UK GAAP amounts subject to being tested for impairment at that date. Goodwill written off to reserves under UK GAAP prior to 1998 has not been reinstated and is not included in determining any subsequent profit or loss on disposal.

j) Other intangible assets

Emission allowances An intangible asset is recognised on receipt of allocated emission allowances and recorded at the fair value on allocation. The fair value of the grant is also recognised on receipt and deducted from the value of the intangible asset. As a result no net asset or liability is shown on the balance sheet at initial recognition. As emission allowances are utilised they are charged to the income statement within costs of sales. To the extent that these allowances were received by way of grant a corresponding credit is also booked to cost of sales.

Emission allowances are recognised at cost when purchased. Forward contracts for sales and purchases of emission allowances are measured at fair value. At the balance sheet date the net carrying amount of emission allowances held is compared with the fair value to assess for impairment.

A provision is made for the estimated shortfall between emission allowances held and the anticipated requirement and is charged to the income statement on a pro-rata basis according to current and expected future emissions throughout the accounting period based on the market value of those allowances.

Commodity contracts In the money commodity contracts, acquired in business combinations, which qualify as either 'own use' contracts or non derivatives in accordance with IAS 39 are classified as intangible assets and carried at cost less accumulated amortisation and impairment losses (refer to accounting policy note 1(n)) where cost represents fair value at the acquisition date. The intangible asset is then amortised on a systematic basis in accordance with the pattern in which the future economic benefits of the contract is expected to be consumed by the entity.

k) Property, plant and equipment

Property, plant and equipment are stated at original cost less accumulated depreciation and any provision for impairment in value. The property, plant and equipment of the Group's US operations which had been revalued to fair value on 1 January 2004, the date of transition to Adopted IFRSs, are measured on the basis of deemed cost, being the revalued amount at the date of that revaluation. In the case of assets constructed by the Group, related works, commissioning and borrowing costs as defined under IAS 23 (Borrowing costs) (refer to accounting policy note 1(u)) are included in cost. Assets in the course of construction are included in property, plant and equipment on the basis of expenditure incurred at the balance sheet date.

Depreciation is calculated so as to write-down the cost of property, plant and equipment to its residual value evenly over its estimated useful life. 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
Civil works	25-80
Power stations	20-60
Fixtures, fittings, tools and equipment	3-10
Computer equipment and software	3-5
Combined cycle gas turbine (CCGT) hot gas path parts, on average	2-4
Leasehold improvements	Life of lease

Freehold land is not depreciated.

Project development costs are principally incurred in identifying and developing investment opportunities and typically include feasibility studies, pre-bid costs, legal, professional and other related advisory costs. These costs (including appropriate direct internal costs) are recognised as expenses as incurred, except that directly attributable costs are capitalised when it is virtually certain that the project will proceed to completion and income will be realised. Such capitalised costs are amortised over the life of the related property or contract.

l) Investments in joint ventures and associates

A joint venture is an entity over whose activities the Group has joint control, established by contractual agreement.

An associate is an entity over which the Group is in a position to exercise significant influence, but not control or joint control, through participation in the financial and operating policy decisions of the investee.

The results, assets and liabilities of joint ventures and associates are incorporated in these financial statements using the equity method of accounting except when classified as held for sale. The results are presented after interest, tax and minority interests. Investments in joint ventures and associates are carried in the balance sheet at cost as adjusted by post-acquisition changes in the Group's share of the net assets of the joint venture or associate, less any impairment in the value of individual investments. Losses of the joint ventures and associates in excess of the Group's interest in those joint ventures and associates are not recognised unless the Group has a legal or constructive obligation to fund those losses.

Any excess of the cost of acquisition over the Group's share of the fair values of the identifiable net assets of the joint venture or associate at the date of acquisition is recognised as goodwill. Any deficiency of the cost of acquisition below the Group's share of the fair values of the identifiable net assets of the joint venture or associate at the date of acquisition (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

Where a Group company transacts with a joint venture or associate of the Group, profits and losses are eliminated to the extent of the Group's interest in the relevant joint venture or associate. Losses may provide evidence of an impairment of the asset transferred in which case appropriate provision is made for impairment.

m) Other investments

Other investments consist of available for sale investments in equity instruments which are measured at market prices where available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

n) Impairment of assets excluding goodwill

At each balance sheet date, the Group reviews the carrying amounts of its property, plant and equipment, other intangible assets and those other investments measured at cost, to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss, if any.

Recoverable amount is the higher of 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 the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. An impairment loss is recognised as an expense immediately.

At each balance sheet date, an assessment is made to determine whether there is any indication that an impairment loss recognised in prior periods may no longer exist or has decreased. Where such an indication exists, an impairment loss is reversed to the extent that the asset's carrying value does not exceed the carrying amount that would have been determined, net of depreciation or amortisation, if no impairment loss had been recognised.

o) Derivative financial instruments* (for year ended 31 December 2005)

As stated previously, in accordance with IFRS 1, the Group has applied the accounting requirements of IAS 32 and IAS 39 prospectively with effect from 1 January 2005, with no restatement of comparatives.

As explained in note 1(g), the Group's operating activities expose it to price risks associated with selling its generation output. The Group is also exposed to price risks associated with the purchase of its fuel requirements and to financial risks of changes in foreign currency exchange rates and interest rates. The Group uses a range of derivative instruments, including energy based futures and forward contracts, swaps and options to hedge its risk to changes in power prices, fuel costs, foreign exchange rates and interest rates. Derivative financial instruments are used for hedging purposes apart from energy based futures contracts, some of which are used for proprietary trading purposes.

The use of financial derivatives is governed by the Group's risk management policies approved by the Board of Directors, which provide written principles on the use of financial derivatives consistent with the Group's risk management strategy.

1. ACCOUNTING POLICIES continued

Derivative financial instruments are recognised initially, and subsequently, at fair value. The gain or loss on subsequent fair value measurement is normally recognised in the income statement unless the derivative qualifies for hedge accounting when recognition of any resultant gain or loss depends on the nature of the item being hedged (see below).

Cash flow hedges Changes in the fair value of derivative financial instruments that are designated and effective as hedges of future cash flows are recognised directly in equity and the ineffective portion which does not meet the hedge accounting requirements of IAS 39 is recognised immediately in the income statement.

Amounts accumulated in equity are recycled to the income statement in the period in which the hedged item also affects the income statement. However, if the hedged item results in the recognition of a non-financial asset or liability, the amounts accumulated in equity are transferred from equity and included in the initial measurement of the cost of the asset or liability.

Hedge accounting is discontinued when the hedging instrument expires or is sold, terminated, exercised, or no longer qualifies for hedge accounting. At that time, for forecast transactions, any cumulative gain or loss on the hedging instrument recognised in equity is retained in equity until the forecasted transaction occurs. If a hedged transaction is no longer expected to occur, the net cumulative gain or loss recognised in equity is transferred to the income statement.

Changes in the fair value of derivative financial instruments that do not qualify for hedge accounting are recognised in the income statement as they arise.

Fair value hedges For an effective hedge of an exposure to changes in the fair value, the hedged item is adjusted for changes in fair value attributable to the risk being hedged with the corresponding entry in net income. Gains or losses from remeasuring the derivative, or for non-derivatives, the foreign currency component of its carrying amount, are recognised in net income.

Hedge of a net investment in a foreign operation Hedges of net investments in foreign operations are accounted for on a similar basis to cash flow hedges. Effective gains or losses on the hedge are recognised in equity, with ineffective gains or losses recognised in the income statement. Cumulative gains or losses in equity are taken to the income statement on disposal of the foreign operation.

Embedded derivatives Derivatives embedded in other financial instruments or other non-financial host contracts are treated as separate derivatives when their risks and characteristics are not closely related to those of the host contract and the host contract is not carried at fair value.

Any unrealised gains or losses on such separated derivatives are reported in net income.

Derivative financial instruments (for year ended 31 December 2004)** The Group has taken advantage of the exemption within IFRS 1.36A which allows the Group not to comply with IAS 32 and IAS 39 in the presentation of comparative information within this first set of IFRS financial statements and to apply UK GAAP in the presentation of comparative information relating to financial instruments within the scope of FRS 4. In relation to the presentation and preparation of 2004 comparatives the Group's policy was as follows.

The Group uses a range of derivative instruments, including energy based futures and forward contracts, swaps and options to hedge its risk to changes in power prices, fuel costs, foreign exchange rates and interest rates. Derivative financial instruments are used for hedging purposes apart from energy based futures contracts, some of which are used for proprietary trading purposes. Interest differentials on derivative instruments are charged to the income statement as interest costs in the period to which they relate.

Only energy based futures contracts used for proprietary trading purposes are marked to market using externally derived market prices with subsequent movements in the fair value being reflected in the income statement.

p) Leasing

A lease is defined as an agreement whereby the lessor conveys to the lessee, in return for a payment or a series of payments, the right to use a specific asset for an agreed period of time. The definition can include arrangements such as long-term PPAs, where power plants are specifically designated to fulfill the requirements of an agreement.

Finance leases – Group as lessor

Where the Group determines a long-term PPA to be or to contain a lease, and where the offtaker has the principal risks and rewards of ownership of the power plant through its contractual arrangements with the Group, the arrangement is considered a finance lease. As discussed in note 1(g), capacity payments are apportioned between capital repayments relating to the provision of the plant, finance income and energy sales. The finance income element of the capacity payment is recognised as revenue, using a rate of return specific to the plant to give a constant periodic rate of return on the net investment in each period. The energy sales element of the capacity payment is recognised as revenue as it is earned.

Arrangements that do not convey the right to use a specific asset through the term of the agreement result in the continued recognition of property, plant and equipment, rather than a finance lease receivable, which is depreciated over its economic life.

The amounts due from lessees under finance leases are recorded in the balance sheet as financial assets, classified as finance lease receivables, at the amount of the net investment in the lease after making provision for bad and doubtful debts.

Operating leases – Group as lessor

An operating lease is any lease other than a finance lease. Thus where the Group determines a long-term PPA to be or to contain a lease, and where the Group retains the principal risks and rewards of ownership of the power plant, the arrangement is considered an operating lease.

For operating leases, the power plant is capitalised as property, plant and equipment and depreciated over its economic life.

Rental income from operating leases is recognised on a straight-line basis over the term of the arrangement.

Operating leases – Group as lessee

Rentals payable under operating leases are charged to income on a straight-line basis over the term of the relevant lease.

Benefits received and receivable as an incentive to enter into an operating lease are also spread on a straight-line basis over the lease term.

q) Inventories

Plant spares, operating stocks of fuel and consumables are valued at the lower of cost and net realisable value. Cost comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. Cost is calculated using the weighted average method.

r) Cash and cash equivalents

Cash and cash equivalents comprise bank balances and cash held by the Group and short-term deposits with an original maturity of three months or less. Bank overdrafts that are repayable on demand and form part of the Group's cash management are included as a component of cash and cash equivalents for the purpose of the cash flow statement.

s) Loans and bonds

New loans and bonds are stated at net proceeds received after deduction of issue costs. The issue costs of debt instruments are charged to the income statement over the life of the instrument at a constant rate of return on the carrying amount.

t) Convertible bonds

Convertible bonds are regarded as compound instruments, consisting of a liability component and an equity component. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component, representing the embedded option to convert the liability into equity of the Group, is included in equity.

Issue costs are apportioned between the liability and equity components of the convertible bonds based on their relative carrying amounts at the date of issue. The portion relating to the equity component is charged directly against equity.

The interest expense on the liability component is calculated by applying the prevailing market interest rate for similar non-convertible debt to the liability component of the instrument. The difference between this amount and the interest paid is added to the carrying amount of the convertible bond.

u) Borrowing costs
Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to be prepared for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognised in net income in the period in which they are incurred.

v) Provisions
Provisions are recognised when the Group has a present obligation as a result of a past event, and it is probable that the Group will be required to settle that obligation. Provisions are measured at the Directors' best estimate of the expenditure required to settle the obligation at the balance sheet date, and are discounted to present value where the effect is material.

w) Decommissioning costs
Provision is made for the estimated decommissioning costs at the end of the useful economic life of the Group's power stations and generating assets, if and when a legal or constructive obligation arises, on a discounted basis. The amount provided represents the present value of the expected costs. An amount equivalent to the initial provision is capitalised within property, plant and equipment and is depreciated over the useful lives of the related assets. The unwinding of the discount is included within finance costs. Where there is a subsequent change in estimates of decommissioning costs, the present value of the change is recognised in the income statement.

x) Environmental liabilities
Provision for environmental liabilities is made when expenditure on remedial work is probable and the Group is obliged, either legally or constructively through its environmental policies, to undertake such work. Where the amount is expected to be incurred over the long-term, the amount recognised is the present value of the estimated future expenditure and the unwinding of the discount is included within finance costs.

y) Tax
The tax expense represents the sum of the expected tax payable on taxable income for the year and deferred tax. Taxable profit differs from accounting profit, as reported in the income statement, because it excludes items of income or expense that are taxable or deductible in other years and it further excludes items that are never taxable or deductible. The Group's liability for current tax is calculated using tax rates that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is the tax expected to be payable or recoverable on differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit, and is accounted for using the balance sheet liability method. Deferred tax liabilities are generally recognised for all taxable temporary differences and deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised. Such assets and liabilities are not recognised if the temporary difference arises from goodwill, not deductible for tax purposes, or from the initial recognition (other than in a business combination) of other assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit.

Deferred tax liabilities are recognised for taxable temporary differences arising on investments in subsidiaries, joint ventures and associates. Where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future, no deferred tax liability is recognised.

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 calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised. Deferred tax is charged or credited in the income statement, except when it relates to items charged or credited directly to equity, in which case the deferred tax is also dealt with in equity.

Deferred tax assets and deferred tax liabilities are only offset to the extent that there is a legally enforceable right to offset current tax assets and current tax liabilities, they relate to taxes levied by the same taxation authority and the Group intends to settle its current tax assets and liabilities on a net basis.

z) Pension schemes
Payments to defined contribution pension plans are charged as an expense as they fall due. Payments made to state managed defined benefit pension plans are dealt with as payments to defined contribution plans where the Group's obligations under the plans are equivalent to those arising in a defined contribution pension plan.

For defined benefit pension plans, the cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at each balance sheet date.

The corridor method is applied in recognising actuarial gains and losses. Gains and losses in an individual scheme are recognised to the extent they exceed the greater of 10% of the gross assets or gross liabilities of the scheme. The amount recognised in the following year is the excess amortised over the remaining average service lives of the employees in the scheme and is recognised in the income statement.

The net defined benefit obligation recognised in the balance sheet represents the present value of the defined benefit obligations adjusted for unrecognised actuarial gains and losses and unrecognised service costs and as reduced by the fair value of the plan assets. Any asset resulting from this calculation is limited to unrecognised actuarial losses and past service cost plus the present value of available refunds and reductions in future contributions to the plan.

aa) Share-based payments
The Group issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the date of grant of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Group's estimate of the shares that will eventually vest and where applicable, adjusted for the effect of non market-based vesting conditions.

Fair value is measured using the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, any exercise restrictions and behavioural considerations.

2 SEGMENT REPORTING

The Group is a global energy business that operates solely in one business segment, that of electricity generation. The international operations are managed on a geographical basis, reflecting the different characteristics within each geographical market. These geographic segments are the basis on which the Group reports its primary segment information. In presenting information on the basis of geographical segments, segment revenues and segment assets are based in the geographical location of both customers and assets. There is no inter-segmental revenue.

	Year ended 31 December 2005			Year ended 31 December 2004		
	Subsidiaries £m	**Share of joint ventures and associates £m**	**Total £m**	Subsidiaries £m	Share of joint ventures and associates £m	Total £m
a) Revenue						
North America	**523**	**171**	**694**	188	72	260
Europe	**990**	**397**	**1,387**	308	212	520
Middle East	**24**	**43**	**67**	24	30	54
Australia	**369**	**51**	**420**	223	8	231
Asia	**27**	**341**	**368**	25	177	202
	1,933	**1,003**	**2,936**	768	499	1,267
b) Profit/(loss) from operations (excluding exceptional items)						
North America	**20**	**29**	**49**	(29)	8	(21)
Europe	**205**	**55**	**260**	52	45	97
Middle East	**12**	**12**	**24**	13	7	20
Australia	**119**	**6**	**125**	96	2	98
Asia	**6**	**96**	**102**	9	51	60
	362	**198**	**560**	141	113	254
Corporate costs	**(59)**	**–**	**(59)**	(32)	–	(32)
	303	**198**	**501**	109	113	222
Operating exceptional items			**110**			11
Profit from operations (including operating exceptional items)			**611**			233
Disposal of investments – exceptional			**10**			4
Financing costs – operating			**(202)**			(77)
Financing costs – exceptional			**–**			(31)
Profit before tax			**419**			129
Income tax expense – operating			**(55)**			(25)
Income tax expense – exceptional			**(34)**			–
Profit for the year			**330**			104

The segmental profit from operations after exceptional items for the year ended 31 December 2005 is £370 million for Europe (31 December 2004: Europe profit from operations of £108 million).

An impairment reversal of £52 million (2004: £nil) was recognised in Europe during the year. An analysis of exceptional items is given in note 8.

On 28 July 2005, International Power completed the acquisition of Saltend. During the year ended 31 December 2005 revenue of £187 million and profit from operations of £50 million are included within the consolidated income statement.

Further details of acquisitions are outlined in note 30.

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
c) Depreciation and amortisation expenses		
North America	**35**	21
Europe	**84**	22
Middle East	**3**	3
Australia	**62**	36
Asia	**2**	2
	186	84
Corporate costs	**2**	1
	188	85

Depreciation and amortisation expenses are included within profit from operations (excluding exceptional items).

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
d) Additions to property, plant and equipment		
North America	**26**	20
Europe	**24**	26
Middle East	**159**	108
Australia	**53**	81
Asia	**4**	2
	266	237
Corporate	**1**	2
	267	239

	Year ended 31 December 2005			Year ended 31 December 2004		
	Goodwill £m	Commodity contracts £m	Emission allowances £m	Goodwill £m	Commodity contracts £m	Emission allowances £m
e) Expenditure on goodwill and other intangible assets						
Europe	**2**	**234**	**25**	190	9	–

The table above includes both purchased goodwill and intangible assets recognised on the acquisition of subsidiaries during the year in addition to expenditure incurred on other intangible assets.

	Year ended 31 December 2005			Year ended 31 December 2004		
	Segment assets £m	Investments in joint ventures and associates £m	Total £m	Segment assets £m	Investments in joint ventures and associates £m	Total £m
f) Segment assets						
North America	**773**	**199**	**972**	632	182	814
Europe	**2,972**	**341**	**3,313**	2,118	325	2,443
Middle East	**383**	**71**	**454**	163	45	208
Australia	**2,196**	**39**	**2,235**	2,127	33	2,160
Asia	**93**	**725**	**818**	92	584	676
	6,417	**1,375**	**7,792**	5,132	1,169	6,301
Corporate	**258**	**–**	**258**	307	–	307
Total assets	**6,675**	**1,375**	**8,050**	5,439	1,169	6,608

	Segment liabilities £m	Investments in joint ventures and associates £m	Total £m	Segment liabilities £m	Investments in joint ventures and associates £m	Total £m
g) Segment liabilities						
North America	**588**	**–**	**588**	494	–	494
Europe	**2,102**	**–**	**2,102**	1,415	–	1,415
Middle East	**335**	**–**	**335**	153	–	153
Australia	**1,676**	**–**	**1,676**	1,557	–	1,557
Asia	**95**	**–**	**95**	78	–	78
	4,796	**–**	**4,796**	3,697	–	3,697
Corporate	**879**	**–**	**879**	853	–	853
Total liabilities	**5,675**	**–**	**5,675**	4,550	–	4,550

3 PROFIT FOR THE YEAR

Other operating income includes compensation for the late commissioning of plants, billings in respect of operations and maintenance services and profit on sale of development sites. Other operating expenses comprise corporate costs, Group-wide general administrative overheads and project development expenses.

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Profit for the year is stated after charging/(crediting):		
Amortisation of other intangible assets	**40**	–
Depreciation of property, plant and equipment	**148**	85
Development costs, net of recoveries and amounts capitalised	**3**	3
Operating exceptional items before tax (note 8)	**(110)**	(11)
Property lease rentals payable (net of recoveries)	**3**	2
Auditors' remuneration – statutory audit:		
Fees due to the lead auditor KPMG Audit Plc	**1.6**	1.2
Fees due to other auditors	**0.2**	0.6
	1.8	1.8

Auditors' remuneration – other fees paid to the lead auditors and their associates for services (Group and Company):

Audit related regulatory reporting services	**0.4**	0.4
Further assurance services	**0.5**	0.2

Fees paid to the lead auditor, KPMG Audit Plc, in respect of the statutory audit of the Company was £0.7 million (2004: £0.7 million).

Expenditure on audit related regulatory reporting services in 2005 and 2004 principally related to reviews of the interim financial statements, US regulatory reporting requirements and the transition to IFRS.

Further assurance services in 2005 and 2004 related principally to due diligence assistance. In 2005, fees of £0.1 million were paid to KPMG Audit Plc in respect of due diligence assistance and capitalised as part of acquisition costs relating to Saltend. During 2004, additional fees of £1.3 million were paid to KPMG Audit Plc for assurance services provided in connection with the Group's acquisitions of the international assets of Edison Mission Energy (EME). These fees were capitalised as part of the costs of acquisition.

The Audit Committee and the firm of external auditors have safeguards in place to avoid the possibility that the auditors' objectivity and independence could be compromised. These safeguards include the implementation of a policy on the use of the external auditor for non-audit related services. This policy incorporates the provisions of the Sarbanes-Oxley Act 2002 and subsequent Securities and Exchange Commission (SEC) rules.

Where it is deemed that the work to be undertaken is of a nature that is generally considered reasonable to be completed by the auditor of the Group for sound commercial and practical reasons, the conduct of such work will be permissible provided that it has been pre-approved by the Audit Committee. Examples of pre-approved services include the completion of regulatory audits, provision of taxation and regulatory advice, reporting to the SEC and the completion of certain financial due diligence work. All these services are also subject to a predefined fee limit. Any work performed in excess of this limit must be approved by the Chief Financial Officer and the Audit Committee.

4 FINANCE INCOME

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Group finance income		
Interest income	**50**	30
Net gain on remeasurement of assets held for trading	**3**	–
Total Group finance income	**53**	30

5 FINANCE EXPENSES

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Group finance expenses		
Interest on:		
Bank loans and overdrafts	**212**	103
Other loans and bonds	**57**	12
	269	115
Less: amounts included in the cost of qualifying assets	**(14)**	(8)
Group finance costs – ordinary	**255**	107
Exceptional finance costs (note 8)	**–**	31
Total Group finance costs	**255**	138

6 EMPLOYEE BENEFIT COSTS AND EMPLOYEE NUMBERS

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Employee benefit costs, including Directors' remuneration, were as follows:		
Wages and salaries	**121**	83
Share-based payments	**6**	1
Social security costs	**10**	4
Contributions to defined contribution plans	**3**	1
Increase in liability for defined benefit plans (note 7)	**7**	5
Subtotal	**147**	94
Less: amount capitalised as part of property, plant and equipment	**(2)**	–
Total employee benefit costs	**145**	94

Details of Directors' remuneration are set out on pages 64 to 75. There are no personnel, other than the Directors, who as key management have authority and responsibility for planning, directing and controlling the activities, directly or indirectly, of International Power plc.

6 EMPLOYEE BENEFIT COSTS AND EMPLOYEE NUMBERS continued

Employee numbers

Average number of employees during the financial year, analysed by geographic segment was:	**Year ended 31 December 2005 Number**	Year ended 31 December 2004 Number
North America	**220**	201
Europe	**1,136**	804
Middle East	**615**	639
Australia	**742**	570
Asia	**633**	349
Corporate and development	**233**	187
Average number of employees	**3,579**	2,750

7 PENSION SCHEMES

Group entities operate pension arrangements in order to provide pension benefits to retired employees. Benefits granted have been developed to reflect local practice and may be provided through defined benefit or defined contribution schemes.

The main defined benefit plans are in the UK and Australia:

UK: 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, and the International Power Group of the ESPS was opened to members on 1 April 2002 and employees' past service rights were transferred into the Group later that year.

The majority of employees taken on in First Hydro, as part of the acquisition of the EME portfolio, are members of another section of the ESPS, the Edison Mission Energy Group.

The liabilities and costs shown in the disclosures for the UK schemes are based on the most recent actuarial valuations at 31 March 2004. The results of these valuations have been updated to 31 December 2005 by independent qualified actuaries to take account of the requirements of IAS 19.

AUSTRALIA: Employees at Hazelwood and Loy Yang B participate in a standard Australian superannuation fund called Equipsuper. 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. Employees at Synergen participate in the Electricity Industry Superannuation Scheme.

The liabilities and costs shown in the disclosures for the Australian schemes are based on the most recent actuarial valuations at 30 June 2005. The results of these valuations have been updated to 31 December 2005 by independent qualified actuaries to take account of the requirements of IAS 19.

The Group operates a number of other defined benefit schemes for employees of its businesses in other countries. Full actuarial valuations of these schemes have been carried out within the last three years and results have been updated to 31 December 2005 by independent qualified actuaries.

The liabilities and costs for IAS 19 were determined using the projected unit credit method. The Group has decided to recognise gains and losses through the income statement over the expected working lifetime of active employees to the extent that gains or losses are in excess of the 'corridor' (10% of the greater of the defined benefit obligation and the plan assets).

The charge for 2005 in respect of defined contribution plans was £3 million (2004: £1 million).

The Group used the following assumptions to calculate the scheme liabilities under IAS 19:

	31 December 2005		31 December 2004		31 December 2003	
Financial assumptions	**UK %**	**Australia %**	UK %	Australia %	UK %	Australia %
Discount rate	**4.7**	**4.6**	5.3	4.5	5.4	7.5
Rate of increase in salaries	**4.4**	**4.0**	4.4	4.0	4.3	4.0
Inflation rate	**2.9**	**3.0**	2.9	3.0	2.8	3.0
Increase to deferred benefits during deferment	**2.9**	**n/a**	3.0	n/a	2.9	n/a
Increases to pensions payments	**2.9**	**n/a**	2.9	n/a	2.9	n/a

The amount recorded in the income statement in relation to the defined benefit pension plans for the year ended 31 December 2005 was as follows:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Amounts charged to profit from operations		
Current service cost	**(9)**	(5)
Expected return on schemes' assets	**11**	7
Interest on schemes' liabilities	**(9)**	(6)
Curtailment cost	**–**	(1)
Total operating charge	**(7)**	(5)

The assets in the schemes and expected rates of return (weighted averages) were:

	31 December 2005		31 December 2004		31 December 2003	
Long-term rate of return expected:	**UK %**	**Australia %**	UK %	Australia %	UK %	Australia %
Equities	**7.1**	**7.5**	7.5	7.3	7.8	7.6
Bonds	**4.4**	**5.0**	4.9	4.8	5.1	4.8
Other	**6.0**	**5.9**	6.0	5.5	6.6	6.1
Total long-term rate of return expected	**6.6**	**6.7**	7.0	6.5	7.4	6.7

The expected rates of return reflect the Group's best estimate of the investment returns that will be earned on each asset class. These returns are based on advice provided by independent qualified actuaries.

	31 December 2005			31 December 2004			31 December 2003		
Assets in schemes:	**UK £m**	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Equities	**84**	**52**	**136**	66	44	110	36	35	71
Bonds	**14**	**17**	**31**	11	16	27	5	14	19
Other	**16**	**15**	**31**	12	10	22	4	5	9
Total market value of assets	**114**	**84**	**198**	89	70	159	45	54	99

Other assets principally comprise property and cash.

The reconciliation of the schemes' (deficits)/surpluses to the balance sheet amount is:

	31 December 2005			31 December 2004			31 December 2003		
	UK £m	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Total market value of assets	**114**	**84**	**198**	89	70	159	45	54	99
Present value of scheme liabilities	**(161)**	**(79)**	**(240)**	(114)	(70)	(184)	(58)	(58)	(116)
(Deficit)/surplus in the scheme	**(47)**	**5**	**(42)**	(25)	–	(25)	(13)	(4)	(17)
Unrecognised actuarial losses/(gains)	**22**	**(7)**	**15**	–	(4)	(4)	–	–	–
Unrecognised asset due to limit in IAS 19 para 58(b)	**–**	**–**	**–**	–	–	–	–	–	–
Pension liability before deferred tax	**(25)**	**(2)**	**(27)**	(25)	(4)	(29)	(13)	(4)	(17)

7 PENSION SCHEMES continued

Movements in fair value of assets:	**2005 £m**	2004 £m
At 1 January	**159**	99
Expected return on assets	**11**	7
Actuarial gains	**16**	9
Employer contributions	**9**	6
Scheme participants' contributions	**3**	2
Benefits paid	**(2)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Acquisitions, divestitures and combinations	**–**	41
Exchange differences	**3**	(2)
At 31 December	**198**	159

Movements in defined benefit obligations:	**2005 £m**	2004 £m
At 1 January	**184**	116
Service cost	**9**	5
Interest cost	**9**	6
Actuarial losses	**35**	4
Scheme participants' contributions	**3**	2
Benefits paid	**(2)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Acquisitions, divestitures and combinations	**–**	55
Settlements and curtailments	**–**	1
Exchange differences	**3**	(2)
At 31 December	**240**	184

As the Group's transition date to IFRS was 1 January 2004, the following historical data has been presented from that date. The historical data will be built up to a rolling five-year record over the next three years.

History of asset experience gains and losses	**Year ended 31 December 2005**	Year ended 31 December 2004
Difference between the actual and expected return on schemes' assets:		
Amount (£m)	**16**	9
Percentage of schemes' assets	**8%**	6%
Experience gains and losses on schemes' liabilities*:		
Amount (£m)	**11**	7
Percentage of the present value of schemes' liabilities	**5%**	4%

*Does not include the effect of changes in assumptions.

Contributions in 2006
The Group expects to make contributions of approximately £8 million to its main pension arrangements in 2006.

8 EXCEPTIONAL ITEMS

Following the implementation of IFRS, the Group has decided to continue with its separate presentation of certain items as exceptional. These are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order for the reader to obtain a proper understanding of the financial information.

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Cost of sales credited:		
Impairment reversal of Rugeley plant	**52**	–
Exceptional items recognised in cost of sales	**52**	–
Other operating income credited:		
Compensation in respect of the tolling agreement with TXU	**58**	–
Exceptional items recognised in other operating income	**58**	–
Other operating expense credited:		
Release of a guarantee on sale of Elcogas	**–**	11
Exceptional items recognised in other operating expenses	**–**	11
Disposal of investments:		
Profit on disposal of Tri Energy	**4**	–
Profit on disposal of shares in Interconnector UK	**3**	–
Profit on disposal of land in Thailand	**3**	–
Profit on partial disposal of a holding in HUBCO	**–**	4
Exceptional items recognised in disposal of investments	**10**	4
Finance costs:		
US swap termination costs	**–**	(15)
Other refinancing costs	**–**	(16)
Exceptional items recognised in finance costs	**–**	(31)
Attributable taxation:		
Taxation on Rugeley plant impairment reversal	**(16)**	–
Taxation on compensation in respect of the tolling agreement with TXU	**(17)**	–
Taxation on disposal of shares in Interconnector UK and on disposal of land in Thailand	**(1)**	–
Taxation on exceptional items	**(34)**	–
Total exceptional items after attributable taxation	**86**	(16)

During 2005 Rugeley received £68 million from the TXU administrators in relation to its contract termination claim. An exceptional item of £58 million has been recorded, with the remaining £10 million reflecting the recovery of debtor balances, costs associated with the claim that had previously been incurred and administrator fees. Further details regarding the impairment reversal of the Rugeley plant are provided in note 14.

9 TAX

a) Income tax expense for the year	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Current tax		
UK corporation tax charge	**25**	1
Foreign tax	**27**	18
Adjustments for prior years	**2**	(3)
Total current tax charge for the year	**54**	16
Deferred tax charge		
Origination and reversal of temporary differences	**43**	9
Benefits of tax losses recognised	**(8)**	–
Total deferred tax charge for the year	**35**	9
Total income tax expense for the year	**89**	25

9 TAX continued

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Income tax charged to:		
Income statement	**89**	25
Equity	**(46)**	(2)
	43	23

The deferred tax charge is derived as follows, £11 million from UK operations (2004: £nil) and £24 million from foreign operations (2004: £9 million).

Included in the income tax expense are the following amounts relating to exceptional items:		
Cost of sales exceptional items (deferred tax)	**16**	–
Operating income exceptional items (current tax)	**17**	–
Disposal of investments exceptional items (current tax)	**1**	–
Tax charge on exceptional items	**34**	–

Income tax expense for the year on ordinary activities varied from the standard rate of UK corporation tax as follows:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
b) Reconciliation of income tax expense to accounting profit		
Profit before tax (before exceptional items)	**299**	145
Tax at domestic income tax rate of 30% (2004: 30%)	**90**	44
Tax effect of:		
Different tax rates of subsidiaries operating in other jurisdictions	**23**	(7)
Share of results of joint ventures and associates	**(39)**	(12)
Tax holidays	**(12)**	(12)
Expenses that are not deductible in determining taxable profit	**15**	15
Utilisation of tax losses not previously recognised	**(24)**	–
Over/(under) provided in prior years	**2**	(3)
Income tax expense for the year before exceptional items	**55**	25
Income tax expense for the year on exceptional items	**34**	–
Income tax expense for the year	**89**	25

Included in profit before tax (before exceptional items) is a tax charge of £56 million relating to the Group's share of results of joint ventures and associates. The £39 million shown above represents 70% of this tax charge. The remaining 30% is already included within the tax charge calculated at the domestic income tax rate.

10 DIVIDENDS

At the Company's Annual General Meeting (AGM) held on 17 May 2005, shareholders approved the payment of a final dividend of 2.5p per Ordinary Share to members on the register as at 27 May 2005. This dividend amounted to £37 million and was previously reported in the Company's UK GAAP consolidated profit and loss account for the year ended 31 December 2004. Under IFRS, it is not treated as an appropriation of equity until shareholder approval has been received. Accordingly, the £37 million dividend paid in 2005 in respect of the 2004 year has been recorded as a distribution in 2005. The dividend was paid to shareholders on 8 July 2005.

In respect of the current year, the Directors propose a dividend of 4.5p per Ordinary Share, to be paid on 23 June 2006. The dividend is subject to approval by shareholders at the Group's next AGM and has not been included as a liability at 31 December 2005. There are no income tax consequences from the estimated total dividend to be paid of £66 million.

No dividend was paid in 2004 in respect of the year ended 31 December 2003.

11 EARNINGS PER SHARE (EPS)

	Year ended 31 December 2005 pence	Year ended 31 December 2004 pence
a) Earnings per share (basic)		
Before exceptional items	**13.5**	8.6
After exceptional items	**19.4**	7.5

b) Earnings per share (diluted)		
Before exceptional items	**13.0**	8.5
After exceptional items	**18.5**	7.4

c) Basis of calculation (basic) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items	**199**	112
Exceptional items	**86**	(14)
Profit attributable to equity holders of the parent after exceptional items	**285**	98

d) Basis of calculation (diluted) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items	**199**	112
After tax effect of interest on convertible bond	**7**	–
Profit attributable to equity holders of the parent before exceptional items	**206**	112
Exceptional items	**86**	(14)
Profit attributable to equity holders of the parent after exceptional items	**292**	98

e) Basis of calculation (basic) – number of Ordinary Shares	**Million**	Million
Weighted average number of issued Ordinary Shares for the purposes of basic EPS	**1,473.5**	1,308.3
Weighted average number of shares held by Employee Share Ownership Plans (ESOPs)	**(2.8)**	(2.8)
Weighted average number of shares	**1,470.7**	1,305.5

f) Basis of calculation (diluted) – number of Ordinary Shares	**Million**	Million
Weighted average number of shares – total	**1,470.7**	1,305.5
Dilutive potential Ordinary Shares:		
Employee share schemes	**19.8**	10.9
Convertible bond	**89.1**	3.0
Weighted average number of Ordinary Shares for the purposes of diluted EPS	**1,579.6**	1,319.4

12 GOODWILL

	31 December 2005 £m	31 December 2004 £m
Cost		
At 1 January	**197**	7
Acquired through business combinations	**2**	190
Eliminated on partial disposal of a subsidiary	**(9)**	–
Exchange differences	**(1)**	–
At 31 December	**189**	197

The addition of £2 million and the reduction of £9 million to goodwill during the year relates to the acquisition and disposal of 5% and 20% of Turbogás respectively (refer to note 30 (a)).

12 GOODWILL continued

Given the geographical diversity of the Group's power plants and the nature of their operations, the Directors consider that each power plant owning subsidiary is a separate cash generating unit. The following cash generating units have significant carrying amounts of goodwill:

	31 December 2005 £m	31 December 2004 £m
First Hydro (UK)	**153**	153
Turbogás (Portugal)	**27**	35
IPO (Czech Republic)	**7**	7
Others	**2**	2
At 31 December	**189**	197

The Group tests goodwill for impairment annually or when there is an indication that goodwill might be impaired. The cash generating units' recoverable amounts are determined from value in use calculations which have key assumptions relating to discount rates and market prices for electricity and fuel costs over the lives of the assets. These market prices are considered in the light of forecast demand and supply growth over the lives of the assets. Pre-tax risk adjusted discount rates take into account current market assessments of the time value of money and risks specific to the respective cash generating unit.

13 OTHER INTANGIBLE ASSETS

	31 December 2005 £m	31 December 2004 £m
Intangible assets		
Commodity contracts	**194**	9
Emission allowances	**–**	–
Carrying amount at 31 December	**194**	9

The above intangible assets balance can be analysed as follows:

Intangible assets – commodity contracts		
Cost		
At 1 January	**9**	–
On adoption of IAS 32 and IAS 39	**(9)**	–
At 1 January	**–**	–
On acquisition of subsidiaries	**234**	9
At 31 December	**234**	9
Accumulated amortisation		
At 1 January	**–**	–
Charge for the year	**40**	–
At 31 December	**40**	–
Carrying amount		
At 1 January (following adoption of IAS 32 and IAS 39)	**–**	–
At 31 December	**194**	9
Intangible assets – emission allowances		
Carrying amount		
At 1 January	**–**	–
Additions	**25**	–
Disposals	**(25)**	–
At 31 December	**–**	–

Commodity contracts are amortised over the period in which benefits are expected to arise. The addition in 2005 relates to commodity contracts acquired as part of the acquisition of Saltend Cogeneration Company Limited. The contracts were valued at £234 million on acquisition. The amortisation of these contracts is charged to cost of sales in the income statement.

The Group has recognised any allocated emission allowances net of the fair value of the grant. As a result, no net asset or liability is shown on the balance sheet at initial recognition. The amortisation of any emission allowances purchased to meet emission requirements generated in the current year are charged to cost of sales in the income statement.

As part of the European Union (EU) Emissions Trading Scheme (EUETS), designed to reduce greenhouse gas emissions in the EU over the medium term, the Group was granted emission allowances amounting to £55 million in respect of the year ended 31 December 2005. The EUETS commenced in 2005 and accordingly no allowances were received in 2004.

14 PROPERTY, PLANT AND EQUIPMENT

	Freehold land and buildings £m	Plant, machinery and equipment £m	Assets in course of construction £m	Total £m
Cost				
At 1 January 2004	89	2,547	23	2,659
Additions	7	44	188	239
On acquisition of subsidiaries	80	1,304	–	1,384
Reclassifications and transfers	–	43	(46)	(3)
Disposals	–	(2)	–	(2)
Exchange differences	(2)	(71)	(4)	(77)
At 31 December 2004	174	3,865	161	4,200
Additions	5	78	184	267
On acquisition of subsidiaries	–	365	–	365
Reclassifications and transfers	–	54	(54)	–
Disposals	(2)	(9)	–	(11)
Disposal of a subsidiary	–	(54)	–	(54)
Exchange differences	3	241	25	269
At 31 December 2005	**180**	**4,540**	**316**	**5,036**
Accumulated depreciation and impairment loss				
At 1 January 2004	22	589	–	611
Depreciation charge for the year	3	82	–	85
Eliminated on disposals	–	(2)	–	(2)
Exchange differences	–	(36)	–	(36)
At 31 December 2004	25	633	–	658
Depreciation charge for the year	11	137	–	148
Disposals	(2)	(9)	–	(11)
Disposal of subsidiaries	–	(3)	–	(3)
Impairment reversal	–	(52)	–	(52)
Exchange differences	–	89	–	89
At 31 December 2005	**34**	**795**	**–**	**829**
Carrying amount				
At 31 December 2005	**146**	**3,745**	**316**	**4,207**
At 31 December 2004	149	3,232	161	3,542

At the end of the year the Group carried out a review of the recoverable amount of its UK power plants following a period of sustained increase in UK dark spreads. This led to the recognition of an impairment reversal of £52 million for Rugeley, based on the estimated value in use of this asset. The post-tax risk adjusted discount rate used in measuring value in use was 8%. The post-tax risk adjusted discount rate which was used at the time of the initial impairment in 2002 was 8%. The impairment reversal has been included in cost of sales.

Interest capitalised in the year was £14 million (2004: £8 million). On a cumulative basis, after taking into account exchange differences and depreciation, the carrying amount of interest capitalised is £69 million (2004: £64 million).

The property, plant and equipment of the Group's US operations has been revalued to fair value as at 1 January 2004, the date of transition to Adopted IFRSs in accordance with the choice available under IFRS 1 (First-time Adoption of International Financial Reporting Standards), by applying a risk-adjusted discount rate of 9.7% to the post-tax cash flows expected from the plant over their remaining useful lives. The impact of this election is to reduce at 1 January 2004 the cost of property, plant and equipment by £466 million to £2,547 million and accumulated depreciation by the same amount to £589 million.

The total value of land that is not depreciated included within land and buildings is £49 million (2004: £47 million).

Property, plant and equipment at subsidiaries at carrying amounts of approximately £3,924 million (2004: £3,607 million) is the subject of fixed and floating charges from banks providing facilities which are non-recourse to the Company.

15 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

Summarised financial information in respect of the Group's joint ventures and associates is set out below:

	31 December 2005 £m	31 December 2004 £m
a) Joint ventures' net assets (including goodwill)		
Non-current assets	**1,362**	1,184
Current assets	**280**	179
Total assets	**1,642**	1,363
Current liabilities	**(188)**	(104)
Non-current liabilities	**(743)**	(594)
Total liabilities	**(931)**	(698)
Net assets	**711**	665
Group's share of joint ventures' net assets	**349**	312

	31 December 2005 £m	31 December 2004 £m
b) Associates' net assets (including goodwill)		
Non-current assets	**7,690**	6,167
Current assets	**1,755**	1,522
Total assets	**9,445**	7,689
Current liabilities	**(840)**	(799)
Non-current liabilities	**(5,468)**	(4,254)
Total liabilities	**(6,308)**	(5,053)
Net assets	**3,137**	2,636
Group's share of associates' net assets	**1,026**	857

	31 December 2005 £m	31 December 2004 £m
c) Results of joint ventures		
Revenue	**631**	299
Profit for the year	**104**	47
Group's share of results of joint ventures		
Share of revenue	**309**	144
Share of profit for the year	**50**	24

	31 December 2005 £m	31 December 2004 £m
d) Results of associates		
Revenue	**2,024**	1,266
Profit for the year	**449**	330
Group's share of results of associates		
Share of revenue	**694**	355
Share of profit for the year	**148**	89

At 31 December 2005 the Group's investments that are listed on a recognised stock market are those in The Hub Power Company Limited (HUBCO), Kot Addu Power Company Limited (KAPCO) and Malakoff Berhad. All are considered associates and International Power continues to equity account for Malakoff and HUBCO despite its shareholdings being less than 20% (see note 40). The Group's share of HUBCO and KAPCO was valued at £45 million (2004: £54 million) and £149 million (2004: unlisted) respectively, on the major Pakistan stock markets and the Group's share in Malakoff Berhad was valued at £203 million (2004: £159 million) on the Kuala Lumpur stock market. Market values for Group shareholdings in these investments were in excess of the respective book values at the year end.

A subsidiary, Al Kamil, is listed on the Muscat Securities Market and was valued at £15 million on 31 December 2005 (2004: £14 million).

The reporting period of Malakoff Berhad does not coincide with International Power's financial year. Consequently, the results of Malakoff Berhad for the period 1 December to 30 November are equity accounted by the Group each year. This treatment prevents Malakoff's results being made publicly available before its own shareholders have received the information through dissemination by Malakoff Berhad.

Included within the Group's share of net assets of joint ventures and associates is net debt of £1,625 million (2004: £1,285 million). These obligations are generally secured by the assets of the respective joint venture or associate borrower and are not guaranteed by International Power plc or any other Group company.

A full list of significant joint ventures and associates is included in note 40.

16 OTHER INVESTMENTS

	31 December 2005 £m	31 December 2004 £m
Non-current		
Investments available for sale carried at fair value	**–**	79
Other investments	**4**	7
	4	86

The Group owns minority shareholdings in a number of small businesses related to power generation and fuel supply activities in Europe and Asia. These equity instruments are not quoted but are shares in privately owned companies and therefore the fair value cannot be measured reliably. The carrying amount has thus been based on the cost of acquiring the shares in these companies.

17 FINANCE LEASE RECEIVABLES

	Minimum lease payments		Present value of minimum lease payments	
	31 December 2005 £m	31 December 2004 £m	31 December 2005 £m	31 December 2004 £m
Amounts receivable under finance leases:				
Within one year	**48**	50	**12**	11
Later than one year and not later than five years	**192**	211	**57**	65
After five years	**649**	717	**391**	419
	889	978	**460**	495
Less: unearned finance income	**(429)**	(483)		
Present value of minimum lease payments receivable	**460**	495		
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)			**448**	484
Current finance lease receivables (recoverable within 12 months)			**12**	11
			460	495

Rentals receivable under finance leases by the Group during the year amounted to £48 million (2004: £6 million). The cost of assets acquired by the Group during the year for onward finance leasing was £nil (2004: £487 million).

International Power's business is the generation of electricity. Sometimes the Group enters into arrangements such as long-term PPAs to secure contracted revenues for a long period of time. Some of these arrangements are determined to be or to contain finance leases. The average term of the finance leases entered into is usually a substantial portion of the asset's useful economic life.

Unguaranteed residual values of assets leased under finance leases at the balance sheet date are estimated at £nil (2004: £nil).

The interest rate inherent in the lease is fixed at the contract date for all of the lease term. The average effective interest rate contracted is approximately 8% per annum.

The fair value of the Group's finance lease receivables as at 31 December 2005 is estimated at £460 million (2004: £495 million) based on discounting estimated cash flows at the market rate.

18 OTHER LONG-TERM RECEIVABLES

	31 December 2005 £m	31 December 2004 £m
Other receivables	**67**	74
Other receivables from joint ventures and associates	**30**	27
Total other long-term receivables	**97**	101

19 DEFERRED TAX

Deferred tax accounted for in the consolidated balance sheet and the potential amounts of deferred tax are:

	31 December 2005 £m	31 December 2004 £m
Deferred tax liabilities:		
Property, plant and equipment accelerated capital allowances	**(552)**	(439)
Other temporary differences	**(238)**	(104)
Dividends of overseas subsidiaries	**(40)**	(16)
Total deferred tax liabilities	**(830)**	(559)

	31 December 2005 £m	31 December 2004 £m
Deferred tax assets:		
Provisions	**42**	8
Tax losses	**161**	166
Other temporary differences	**299**	77
Total gross deferred tax assets	**502**	251
Less: deferred tax assets not recognised	**(151)**	(127)
Total deferred tax assets	**351**	124
Net deferred tax liabilities	**(479)**	(435)

Deferred tax assets will be offset against suitable taxable profits when they arise.

Of the £161 million (2004: £166 million) deferred tax asset in respect of tax losses, £102 million (2004: £109 million) can be carried forward for a period of between 11 and 19 years. The balance can be carried forward indefinitely. No deferred tax asset in relation to these losses has been recognised.

No additional valuation allowance (2004: £10 million) has been made in the year.

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries, associates and joint ventures was £634 million (2004: £713 million). Calculation of the potential deferred tax liability has not been undertaken as the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future. If the temporary differences were to reverse in the future, it is probable that the majority of the potential tax liability would be covered by tax credits in respect of tax paid locally.

Certain deferred tax assets and liabilities have been offset in accordance with the Group's accounting policy. The following is the analysis of the deferred tax balances (after offset) for balance sheet purposes.

	31 December 2005 £m	31 December 2004 £m
Deferred tax liabilities	**(557)**	(514)
Deferred tax assets	**78**	79
	(479)	(435)

	31 December 2004 £m	**On adoption of IAS 32 and IAS 39 £m**	**1 January 2005 £m**	**Recognised in income £m**	**Other balance sheet movements £m**	**Recognised in equity £m**	**Acquisition/ disposal of subsidiaries £m**	**31 December 2005 £m**
Movement in temporary differences during the year								
Property, plant and equipment	316	–	316	(10)	–	–	–	**306**
Dividends of overseas subsidiaries, associates and joint ventures	16	–	16	24	–	–	–	**40**
Other temporary differences	103	(3)	100	21	7	(46)	51	**133**
	435	(3)	432	35	7	(46)	51	**479**

	1 January 2004 £m	Recognised in income £m	Other balance sheet movements £m	Recognised in equity £m	Acquisition of subsidiaries £m	31 December 2004 £m
Movement in temporary differences during the year						
Property, plant and equipment	194	9	8	–	105	316
Dividends of overseas subsidiaries, associates and joint ventures	16	–	–	–	–	16
Other temporary differences	21	–	(1)	(1)	84	103
	231	9	7	(1)	189	435

20 INVENTORIES

	31 December 2005 £m	31 December 2004 £m
Plant spares	**22**	17
Fuel inventories	**37**	40
Consumables	**51**	34
Total inventories	**110**	91

Inventories with a carrying amount of £50 million (2004: £40 million) are subject to fixed and floating charges of project finance facilities at various power plant subsidiaries. These project finance facilities are non-recourse to International Power plc.

21 TRADE AND OTHER RECEIVABLES

	31 December 2005 £m	31 December 2004 £m
Trade and other receivables net of allowance for irrecoverable amounts		
Trade receivables	**163**	106
Other receivables	**108**	69
Prepayments and accrued income	**125**	52
Total amounts falling due within one year	**396**	227

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value.

22 DERIVATIVE FINANCIAL INSTRUMENTS

	31 December 2005	
	Assets £m	**Liabilities £m**
Interest rate swaps	1	26
Energy derivatives	267	661
	268	**687**
Current	268	496
Non-current	–	191
	268	**687**

The Group utilises foreign currency exchange contracts to manage its foreign exchange rate exposures. As at 31 December 2005, the total notional value of these contracts was £6 million and the mark to market was £nil.

The Group utilises interest rate swaps to manage its interest rate exposures by swapping an element of its borrowings from floating rates to fixed rates. As at 31 December 2005, the total notional value of interest rate swaps was £1,416 million.

23 CASH AND CASH EQUIVALENTS

Cash and cash equivalents comprise bank balances and cash held by the Group and short-term bank deposits with an original maturity of three months or less. The carrying amount of these assets approximates to their fair value.

	31 December 2005 £m	31 December 2004 £m
Bank balances	**245**	154
Call deposits	**375**	411
Cash and cash equivalents in the cash flow statement	**620**	565

The total cash and cash equivalents balance includes £71 million (2004: £102 million) of cash which is considered to be 'restricted' as it is primarily to secure amounts required for debt payments and letter of credit expenses.

24 LOANS AND BONDS

	31 December 2005 £m	31 December 2004 £m
a) Interest-bearing loans and bonds (current)		
Current portion of secured bank loans	**187**	71
2% Convertible US dollar bonds 2005	**–**	29
Total interest-bearing loans and bonds	**187**	100
b) Interest-bearing loans and bonds (non-current)		
Secured bank loans	**2,721**	2,525
Secured bonds	**445**	449
Preferred equity facility	**173**	154
3.75% Convertible US dollar bonds 2023	**125**	129
Total interest-bearing loans and bonds	**3,464**	3,257

Secured bank loans and secured bonds
The bank loans and bonds are secured by fixed and floating charges over the assets of certain subsidiaries with a carrying amount of £2,842 million. Substantially all of the Group's power stations, generating assets and other operating assets are financed under facilities which are non-recourse to International Power plc and secured solely on the assets of the subsidiary concerned.

Preferred equity facility
The preferred equity facility comprises US$300 million in preference shares issued by Impala Magpie Limited to Mitsui Power Ventures Limited for the purposes of financing the acquisition of the EME portfolio.

Impala Magpie Limited is a 70% owned subsidiary of International Power plc and Mitsui Power Ventures Limited is a wholly-owned subsidiary of Mitsui & Co of Japan. Mitsui Power Ventures Limited is International Power's partner in IPM Eagle LLP, which is the owner of the assets formerly owned by Edison Mission Energy, and Saltend, which was acquired in July 2005.

The preference shares entitle the holder to a preferred dividend coupon of US dollar LIBOR plus 2%. The preference shares are redeemable from 16 December 2008 and may also be redeemed if funds become available following the sale of certain assets.

International Power (Impala) Limited, a wholly-owned subsidiary of International Power plc, has granted Mitsui Power Ventures Limited a put option to sell 70% of the Preference Shares it holds on the date of exercise. The put option is exercisable in certain circumstances, including where Impala Magpie Limited fails to redeem the Preference Shares on maturity.

International Power plc has agreed to guarantee International Power (Impala) Limited's obligations to Mitsui & Co of Japan and Mitsui Power Ventures Limited.

3.75% Convertible US dollar bonds 2023
On 22 August 2003, International Power (Jersey) Limited, a wholly-owned subsidiary company incorporated in Jersey, issued US$252.5 million 3.75% convertible notes due 2023, convertible into preference shares of International Power (Jersey) Limited at the holder's option, immediately exchangeable for Ordinary Shares of, and unconditionally guaranteed by, International Power plc.

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 176p at any time up to 12 August 2023. Each US$1,000 principal amount of notes will entitle the holder to convert into a US$1,000 paid-up value of preference shares of International Power (Jersey) Limited. The notes may be redeemed at the holder's option at their principal amount, together with accrued interest, to the date fixed for redemption.

If the conversion option is not exercised, the convertible unsecured notes will be redeemed on 22 August 2023 at a redemption price equivalent to their principal amount.

	31 December 2005 £m	31 December 2004 £m
Nominal value of convertible US dollar bonds issued	**144**	129
Embedded derivative component	**(30)**	–
Liability component at date of issue	**114**	129
Interest charged	**11**	–
Liability component at 31 December	**125**	129

The net proceeds received from the issue of the convertible bond have been split between the debt element and an embedded derivative component. This embedded derivative component represents the fair value of the option the Group had to cash settle any conversion option exercised by the bond holders. The embedded derivative is only recognised upon adoption of IAS 32 and IAS 39 as at 1 January 2005. The Group waived this cash settlement option on 17 January 2005, at which date the embedded derivative was transferred to reserves.

The interest charged for the year is calculated by applying an effective interest rate of 3.62% to the liability component for the period since the convertible US dollar bond was issued. This is in addition to the coupon interest rate of 3.75% per annum.

The Directors estimate the fair value of the liability component of the convertible US dollar bonds at 31 December 2005 to be approximately £125 million (31 December 2004: £115 million). This fair value has been determined by reference to the market price at 31 December 2005.

25 TRADE AND OTHER PAYABLES (CURRENT)

	31 December 2005 £m	31 December 2004 £m
Trade payables	**118**	114
Other payables	**153**	105
Accruals and deferred income	**240**	143
Total trade and other payables	**511**	362

The Directors consider the carrying amount of trade and other payables approximates to their fair value.

26 TRADE AND OTHER PAYABLES (NON-CURRENT)

	31 December 2005 £m	31 December 2004 £m
Other payables	**14**	163
Loans from minority interests	**81**	7
Total trade and other payables	**95**	170

27 PROVISIONS

	Retirement benefit obligations £m	Rationalisation and restructuring £m	Other £m	Total £m
At 1 January 2005	29	8	27	64
Provisions made during the year	–	–	11	11
Provisions used during the year	(2)	(3)	(3)	(8)
Exchange differences	–	–	1	1
At 31 December 2005	**27**	**5**	**36**	**68**

The majority of the rationalisation and restructuring provision relates to liabilities in respect of onerous property leases and employee-related compensation. Other provisions primarily comprise amounts provided for long service and annual leave liabilities and for mine site restoration. These liabilities are not expected to arise in the short-term. The Directors are uncertain as to the timing of when these provisions will be utilised.

28 SHARE CAPITAL

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	**£m**	**Number**	**£m**
At 1 January 2005	2,266,000,000	1,133	1,473,269,066	737
Issue of shares under the Sharesave Plan	–	–	858,892	–
Issue of shares under Executive Share Option Plan	–	–	608,679	–
At 31 December 2005	**2,266,000,000**	**1,133**	**1,474,736,637**	**737**

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2004	1,700,000,000	850	1,107,091,994	554
Increase in authorised share capital	566,000,000	283	–	–
Issue of shares	–	–	365,540,834	183
Issue of shares under the Sharesave Plan	–	–	33,077	–
Issue of shares under Executive Share Option Plan	–	–	603,161	–
At 31 December 2004	2,266,000,000	1,133	1,473,269,066	737

Rights Issue

The Group's Rights Issue closed on 14 September 2004. A total of 366 million Ordinary Shares were issued at 82 pence per share in a 33 for 100 Rights Issue. Of the total £286 million raised (net of £14 million expenses), £183 million was credited to share capital and £103 million to the share premium account.

Ordinary Shares

Ordinary Shares rank equally between each other with regard to the right to receive dividends and also in a distribution of assets on the winding up of the Group.

Deferred shares

The Group has 21 Deferred Shares of 1 pence each in issue. These shares were issued to ensure the demerger was effected as efficiently as possible. The holders of Deferred Shares have no rights to receive dividends or to attend or vote at any general meeting.

Unclassified share

Further to the redemption of the Special Share in August 2000, the Group's authorised share capital includes one unclassified share of £1.

Employee share schemes

a) Number of shares and exercise prices under Share Option Plans

The Group operates the following employee share plans for which shares may be issued by the Group out of authorised but unissued share capital upon exercise of options: the UK Approved Sharesave Plans and the Global Sharesave Plans; the UK Approved and Unapproved Executive Share Option Plans; the Global Executive Share Option Plans; and the 2002 Performance Share Plan. The total number of options outstanding at the end of the year was as follows:

			Number of Ordinary Shares	
	Option price range	**Date exercisable**	**Year ended 31 December 2005**	Year ended 31 December 2004
Sharesave Plans	70.33p-178.06p	2004-2009	**4,783,486**	5,963,482
Executive Share Option Plans	62.32p-343.73p	1998-2015	**32,687,124**	29,770,835
2002 Performance Share Plan	74.79p	2006 onwards	**4,276,215**	4,276,215
Total options outstanding			**41,746,825**	40,010,532

Details of each Plan are set out on the following pages:

i) Sharesave Plans

The UK Approved Sharesave Plan and the Global Sharesave Plan are savings related and enable employees in the UK and a number of other jurisdictions to invest up to a maximum of £250 (or foreign currency equivalent) per month for the purpose of acquiring shares in the Group. The option prices are fixed at a discount of 20% to the market value of the Group's Ordinary Shares as at the date of grant of the option. Options are exercisable at the prices set out below. The option exercise period commences either three or five years after the option has been granted (determined at the time that the employee enters into the savings agreement) and if the options remain unexercised after a period of six months following the beginning of the option exercise period, the options expire. Except for certain specific circumstances (e.g. redundancy) options lapse if the employee leaves the Group before the option exercise period commences. Details of the share options outstanding at the end of the year are as follows:

		Number of Ordinary Shares	
Option price	**Date exercisable**	**Year ended 31 December 2005**	Year ended 31 December 2004
167.37p	2006	**10,082**	10,082
178.06p	2004	**–**	7,496
178.06p	2006	**6,631**	6,631
80.12p	2005	**253,314**	1,100,049
80.12p	2007	**2,673,050**	2,693,549
97.93p	2006	**104,158**	119,227
97.93p	2008	**69,582**	72,817
70.33p	2006	**800,205**	888,915
70.33p	2008	**654,658**	780,259
97.93p	2007	**107,329**	128,354
97.93p	2009	**104,477**	156,103
		4,783,486	5,963,482

The number and weighted average exercise prices of Sharesave options are as follows:

	Year ended 31 December 2005		Year ended 31 December 2004 (restated for Rights Issue)	
	Number of Ordinary Shares	**Weighted average exercise price pence**	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**5,963,482**	**79.18**	6,742,186	80.34
Exercised during the year	**(858,892)**	**80.67**	(33,077)	79.04
Expired during the year	**(321,104)**	**79.45**	(745,627)	89.67
Options outstanding at end of the year	**4,783,486**	**78.90**	5,963,482	79.18
Options exercisable at end of the year	**253,314**		7,496	

The weighted average share price at the date of exercise for Sharesave Plan share options exercised during the year was 240.43 pence (2004: 141.66 pence). The share options outstanding at the end of the year have exercise prices in a range from 70.33 pence to 178.06 pence as outlined in the table above.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 2.12 years (2004: 2.89 years).

28 SHARE CAPITAL continued

ii) Executive Share Option Plans

The UK Approved and Unapproved Executive Share Option Plans and the Global Executive Share Option Plans are discretionary employee share option plans. Options are granted to those employees selected to participate in the Plan at the discretion of the Directors of the Company. The exercise price of the options is fixed at the market value of the Company's Ordinary Shares as at the date that the options are granted. The option exercise period is between the third and tenth anniversaries of the date of grant of the options and if the options are not exercised before the expiry of the tenth anniversary of the date of grant then the options lapse. Except for certain specific circumstances (e.g. redundancy) options lapse if the employee leaves the Group before the option exercise period commences or if the employee resigns from the Company. Details of the share options outstanding at the end of the year are as follows:

		Number of Ordinary Shares	
Option price	Date exercisable	Year ended 31 December 2005	Year ended 31 December 2004
272.55p	1998-2005	–	294,581
287.76p	1999-2006	**416,298**	489,158
343.73p	2000-2007	**499,572**	574,892
313.92p	2001-2008	**712,903**	776,425
277.55p	2003-2010	**2,574,081**	2,864,320
209.22p	2004-2011	**1,612,812**	2,044,424
193.19p	2004-2011	**136,076**	186,197
174.50p	2005-2012	**3,673,817**	4,050,234
62.32p	2006-2013	**10,626,586**	11,354,245
123.53p	2007-2014	**6,845,144**	7,136,359
179.25p	2008-2015	**5,589,835**	–
		32,687,124	29,770,835

The number and weighted average exercise prices of share options are as follows:

	Year ended 31 December 2005		Year ended 31 December 2004 (restated for Rights Issue)	
	Number of Ordinary Shares	Weighted average exercise price pence	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**29,770,835**	**141.65**	26,261,100	145.88
Granted during the year	**5,589,835**	**179.25**	6,393,750	123.53
Exercised during the year	**(608,679)**	**142.02**	(603,161)	62.32
Expired during the year	**(2,064,867)**	**187.83**	(2,280,854)	160.54
Options outstanding at end of the year	**32,687,124**	**145.14**	29,770,835	141.65
Options exercisable at end of the year	**9,625,559**		7,229,997	

The weighted average share price at the date of exercise for Executive Share Options exercised during the year was 232.62 pence (2004: 136.01 pence). The share options outstanding at the end of the year have exercise prices in a range from 62.32 pence to 343.73 pence as outlined in the table above.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 7.1 years (2004: 7.6 years).

iii) 2002 Performance Share Plan
Under this Plan, Directors and certain senior managers of the Group are awarded conditional awards over Ordinary Shares in the Group. These conditional awards may vest three years after the awards have been made subject to the satisfactory performance of a performance condition (determined at the time that the conditional awards are made). In 2003 the Group granted to the Trustee of the International Power Employee Share Ownership Trust an option to acquire 3,807,057 Ordinary Shares in the Group at an option price of 84 pence per share. Following the Rights Issue in 2004, the number of shares under option was increased to 4,276,215 and the option exercise price was adjusted to 74.79 pence per share. This option can only be exercised to the extent required to satisfy conditional awards made under the Performance Share Plan. These conditional awards can only vest after the end of the relevant performance period and only to the extent to which the performance conditions have been satisfied.

The above option of 4,276,215 on the Ordinary Shares remained outstanding and unexercised at 31 December 2003, 2004 and 2005 at an exercise price of 74.79 pence per share.

The life of this option is open-ended. It is anticipated that this share option will be utilised to satisfy the release of awards made under the 2002 Performance Share Plan from 2006 onwards. Assuming full vesting of the awards made as at 31 December 2005, it is estimated that this option will have been fully exercised by the end of 2008.

b) Fair value of options under Share Option Plans

i) Sharesave plans
No savings related options were awarded during the current or prior year.

ii) Executive Share Options Plans
The estimated fair value of the options granted during the year was 47 pence (2004: 32 pence).

These fair values were calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

	2005	2004
Weighted average share price	**179p**	124p
Weighted average exercise price	**179p**	124p
Expected volatility	**30%**	30%
Expected life	**4 years**	4 years
Risk free rate	**4.84%**	4.55%
Expected dividend yield	**1.94%**	1.94%

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous six years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

iii) 2002 Performance Share Plan
No performance share plan options were granted during the current or prior year.

c) Managers' share bonus arrangements
During 2004, 571,710 shares in International Power were acquired in respect of a project incentive arrangement for staff (excluding Executive Directors) for a consideration of £887,497. These shares have been placed in an Employee Share Ownership Trust. No additional purchases were made during 2005 in respect of this plan.

d) Employee Share Ownership Trust
A number of International Power plc Ordinary Shares are held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under the Group's 2002 Performance Share Plan and the Bonus Share Retention Plan. At 31 December 2005, the ESOTs held a total of 2,081,573 International Power plc Ordinary Shares (2004: 3,398,444). At 31 December 2005 the market value of these shares was £4,985,367 (2004: £5,191,123). The maximum number of shares required to meet all outstanding awards (assuming full vesting of those awards) as at 31 December 2005 was 7,522,005 (2004: 7,772,077).

29 SHARE CAPITAL AND RESERVES

	Attributable to equity holders of the parent							
	Share capital £m	Share premium reserve £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
At 1 January 2005 (as previously stated)	737	392	145	422	–	(39)	176	**1,833**
Effect of adoption of IAS 32 and IAS 39	–	–	–	–	(12)	–	(20)	**(32)**
At 1 January 2005 (restated)	737	392	145	422	(12)	(39)	156	**1,801**
Profit for the year	–	–	–	–	–	–	285	**285**
Other recognised income and expenses relating to the year (net)	–	–	–	–	(106)	88	–	**(18)**
Recognition of equity component in 3.75% convertible US dollar bond	–	–	–	–	–	–	50	**50**
Issue of shares	–	2	–	–	–	–	–	**2**
Dividends	–	–	–	–	–	–	(37)	**(37)**
Other movements	–	–	–	–	–	–	9	**9**
At 31 December 2005	**737**	**394**	**145**	**422**	**(118)**	**49**	**463**	**2,092**

	Attributable to equity holders of the parent							
	Share capital £m	Share premium £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
At 1 January 2004	554	289	145	422	–	–	76	1,486
Profit for the year	–	–	–	–	–	–	98	98
Other recognised income and expenses relating to the year (net)	–	–	–	–	–	(39)	–	(39)
Rights Issue	183	103	–	–	–	–	–	286
Other movements	–	–	–	–	–	–	2	2
At 31 December 2004	737	392	145	422	–	(39)	176	1,833

The share capital represents the authorised Ordinary Shares in the Company issued at par which carry a right to participate in the distribution of dividends or capital of the Company.

The share premium account represents the difference between the issue price and the nominal value of shares issued.

The capital redemption reserve was created in March 1995 when the Company purchased and then cancelled approximately 98 million of its Ordinary Shares in conjunction with HM Treasury's sale of its remaining 40% shareholding in the Company. The reserve was subsequently increased in the years ended 31 March 1996, 31 March 2000 and 31 December 2003 when further share purchases were made and these shares were cancelled. The capital redemption reserve is not distributable.

The capital reserve was vested in the Company at 31 March 1990 under the Transfer Scheme whereby the net assets of the Central Electricity Generating Board (CEGB) were divided among the CEGB successor companies. It is not distributable.

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Company, as well as from the translation of liabilities that hedge the Company's net investment in foreign subsidiaries.

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

On 17 January 2005, the Group waived its option to cash settle the conversion option of the US dollar bond. This election transferred the embedded derivative to reserves recognising the mark to market balance as an equity component of the bond.

£124 million (2004: £124 million) of the Group's retained earnings is not distributable as it arose from unrealised gains on intra-group transfers.

Set off against retained earnings at 31 December 2005 are treasury shares of £1 million (2004: £3 million).

30 ACQUISITIONS AND DISPOSALS

Year ended 31 December 2005

a) Turbogás

On 26 January 2005 the Company completed the purchase of an additional 5% in Turbogás, a 990 MW CCGT power station in Portugal, from Koch Transporttechnik. Following the acquisition of a 75% stake on 4 November 2004, the date from which the results of Turbogás have been consolidated using the acquisition method.

On 16 March 2005 the Company sold a 20% stake in Turbogás to EdP pursuant to an option agreement. This transaction leaves the Company with a 60% interest in Turbogás.

The investment has been accounted for as a subsidiary throughout 2005.

b) Tri Energy Company Limited

On 3 February 2005 IPM Eagle LLP, a 70% subsidiary of International Power plc, acquired a temporary 25% interest in Tri Energy Company Limited from Edison Mission Energy. Tri Energy is a 700 MW gas powered plant in Thailand. Pursuant to a call option agreement of the same date, on 9 March 2005 this stake was sold, 50% each, to Ratchaburi Gas Company Limited and Texaco Thailand Energy Company I. The investment was accounted for as an asset available for sale.

c) Uch Power Limited

On 9 February 2005 the Company completed the purchase from E.ON UK plc of a 40% stake in Uch Power Limited, the owner of a 586 MW gas fired plant in Pakistan. The investment has been accounted for as an associate since its acquisition.

d) Italian Wind

A 50% interest in Italian Wind was acquired by IPM Eagle LLP as part of the Edison Mission Energy portfolio on 17 December 2004. The owner of the other 50% of the project exercised its contractual right of first refusal to acquire the stake and a sale was completed on 31 March 2005. The investment was accounted for as an asset available for sale.

e) EnergyAustralia

On 7 July 2005 International Power Australia, a wholly owned subsidiary of International Power plc, completed the retail partnership agreement with EnergyAustralia. The consideration was A$60 million (£25 million) for a 50% share of the partnership, which is accounted for as a joint venture.

f) Saltend

On 28 July 2005 IPM Eagle LLP completed the purchase of 100% of the issued share capital of Saltend Cogeneration Company Limited and Saltend Operations Company Limited, the owner and operator respectively of a 1,200 MW CCGT power plant in Hull, from Calpine Corporation, for a total consideration of £495 million. The results of the two companies have been consolidated as subsidiaries from this date using the acquisition method.

30 ACQUISITIONS AND DISPOSALS continued

The details of the transaction, results and provisional fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Intangible assets	–	234	234
Property, plant and equipment	342	23	365
Inventories	3	–	3
Trade and other receivables (current)	29	–	29
Cash and cash equivalents	27	–	27
Trade and other payables (current)	(27)	(82)	(109)
Other payables (non-current)	(1)	–	(1)
Deferred tax liabilities	–	(53)	(53)
Total assets acquired	**373**	**122**	**495**

Consideration (including acquisition costs)	495
Amount owed by Calpine	5
	500

Satisfied by:	
Cash consideration paid	500
Cash and cash equivalents acquired	(27)
Net cash outflow to the Group	**473**

In the period from 28 July 2005 to 31 December 2005, Saltend contributed £187 million to revenue and £50 million to the Group's profit from operations. It also contributed £75 million to the Group's net operating cash flows and paid £7 million in respect of net finance costs.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of various contracts (included as intangible assets), the recognition of the plant at fair value and the recognition of out of the money power contracts. No goodwill arises on the acquisition. The fair values are considered provisional due to uncertainties arising from the vendor's Chapter 11 filing under the US Bankruptcy Code.

It is not possible to state what the impact on Group revenues and profit for the year would have been had the acquisition been completed on 1 January 2005 due to the difficulty in ascertaining what the valuation of the intangible assets and derivative liabilities and their corresponding amortisation profiles would have been at that time.

g) Valley Power

On 17 October 2005 IPM Eagle LLP completed the disposal of Valley Power Pty Ltd, the owner of a 300 MW peaking plant in Victoria, Australia, to Snowy Hydro Ltd. IPM acquired its interest in Valley Power as part of the acquisition of the international generation portfolio of Edison Mission Energy in December 2004. The divestment has been carried out as per an agreement with the Australian Competition and Consumer Commission (ACCC) reached at the time of the Edison Mission Energy acquisition. Valley Power was consolidated as a subsidiary in 2004 and 2005.

The details of the transaction and carrying amount of net assets are shown below:

	£m
Total assets	88
Total liabilities	(15)
Net assets disposed	**73**

Satisfied by:	
Cash consideration	**73**

h) Pego

On 13 December 2005 the Company acquired an additional 5% shareholding in the 600 MW Pego power plant and associated companies from EdF, increasing the Company's ownership to 50%.

i) Acquisition of subsidiaries net of cash and cash equivalents acquired

In addition to the net cash outflow to the Group of £473 million on the acquisition of Saltend, the £13 million cash consideration for the EME acquisition, not paid at 31 December 2004, was paid during 2005. Another £8 million was also spent on acquiring a further 5% of Turbogás. These combined purchases brought the total net cash and cash equivalents spent on the acquisition of subsidiaries to £494 million for the year.

j) Acquisition of investments in joint ventures and associates

The following net assets in joint ventures and associates were acquired during the year.

	Year ended 31 December 2005 £m
Net assets acquired	58
Satisfied by:	
Consideration	58
Cash consideration not yet paid at the balance sheet date	(8)
Net cash outflow to the Group	**50**

k) Proceeds from disposal of investments

The following investments were disposed of during the year.

	Year ended 31 December 2005 £m
Net assets disposed	(131)
Profit on disposal	(7)
	(138)
Satisfied by:	
Net cash inflow to the Group – cash consideration received at the balance sheet date	**(138)**

l) Fair value hindsight adjustments – acquisitions during 2004

The fair value of certain assets and liabilities associated with the purchase of Loy Yang B in Australia have been revised. This is due to the finalisation of the valuation of the long-term hedge agreement between Loy Yang B and the Victorian Government. The provision associated with this 'out of the money' contract has been increased by A$94 million (£38 million) from A$273 million (£111 million) to A$367 million (£149 million). An equal offsetting adjustment of A$94 million (£38 million) has been made to increase the fair value of the plant on acquisition. Corresponding deferred tax adjustments also net off such that there is no impact on goodwill or the fair value of total net assets acquired at Loy Yang B.

In addition, the fair value of certain acquired cap contracts, in relation to Valley Power and Loy Yang B, has been revised which has increased liabilities with a corresponding increase to the fair value of the plants on acquisition. The corresponding deferred tax adjustments also net off such that there is no impact on goodwill or the fair value of total net assets acquired at Loy Yang B and Valley Power.

Deferred tax adjustments have also been made to reflect the rebasing of the Loy Yang B assets for tax purposes with effect from 1 January 2004 as a consequence of entering into the new tax consolidation regime in Australia.

31 NET DEBT

Analysis of net debt

	31 December 2004 £m	On adoption of IAS 32 and IAS 39 £m	1 January 2005 £m	Exchange differences £m	Other non-cash movements £m	Cash flow £m	31 December 2005 £m
Cash and cash equivalents	565	–	565	18	–	37	**620**
Assets held for trading	47	–	47	2	3	–	**52**
	612	–	612	20	3	37	**672**
Debt financing							
Loans due within one year	(71)	–	(71)	–	(73)	(43)	**(187)**
Loans due after more than one year	(2,525)	22	(2,503)	(145)	63	(136)	**(2,721)**
Preferred equity facility	(154)	–	(154)	(18)	(1)	–	**(173)**
Convertible bonds	(158)	22	(136)	(17)	(3)	31	**(125)**
Secured bonds	(449)	–	(449)	–	4	–	**(445)**
Total debt financing	(3,357)	44	(3,313)	(180)	(10)	(148)	**(3,651)**
Net debt	(2,745)	44	(2,701)	(160)	(7)	(111)	**(2,979)**

	1 January 2004 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2004 £m
Cash and cash equivalents	696	(10)	–	–	(121)	565
Assets held for trading	47	–	–	–	–	47
	743	(10)	–	–	(121)	612
Debt financing						
Loans due within one year	(531)	34	(39)	466	(1)	(71)
Loans due after more than one year	(704)	(5)	(887)	(437)	(492)	(2,525)
Preferred equity facility	–	–	–	–	(154)	(154)
Convertible bonds	(200)	13	–	(1)	30	(158)
Secured bonds	–	–	(449)	–	–	(449)
Total debt financing	(1,435)	42	(1,375)	28	(617)	(3,357)
Net debt	(692)	32	(1,375)	28	(738)	(2,745)

32 FINANCIAL INSTRUMENTS – 2005

In accordance with IFRS 1, the Group has taken the exemption from the requirement to restate comparative information for IAS 32 and IAS 39. Accordingly the financial instruments disclosure presented in this note on the basis of IAS 32 and IAS 39 is only for 2005. The UK GAAP FRS 13 disclosures for 2004 are shown in note 33.

a) Treasury policy

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business whilst managing its currency, interest rate and counterparty credit risks. The Group's treasury policy is not to engage in speculative transactions. Group treasury acts within clearly defined guidelines that are approved by the Board.

b) Risk identification and management

There is a continuous process for identifying, evaluating and managing the key risks faced by the Group. Activities are co-ordinated by the Risk Committee, which is chaired by the CFO, and has responsibility, on behalf of the Board, for ensuring the adequacy of systems for identifying and assessing significant risks, that appropriate control systems and other mitigating actions are in place, and that residual exposures are consistent with the Group's strategy and objectives. Assessments are conducted for all material entities.

c) Interest rate risk and hedge accounting

The Group's policy is to fix interest rates for a significant portion of the debt, 61% as at 31 December 2005 using forward rate or interest rate swap agreements. Significant interest rate management programmes and instruments require the specific approval of the Board. The weighted average interest rate of fixed rate debt was 7%. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement. The Group accounts for interest rate swaps as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

Effective interest rates and repricing analysis

The following is a table illustrating the effective interest rates of interest earning financial assets and interest bearing financial liabilities at 31 December 2005 and the period in which they reprice:

								31 December 2005
	Effective interest rate	Total £m	Less than 12 months £m	1-2 years £m	2-3 years £m	3-4 years £m	4-5 years £m	More than 5 years £m
Financial assets								
Finance lease receivable:								
Euro	7.9%	460	12	12	14	15	16	391
Assets held for trading:								
Australian dollars	5.5%	52	52	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	5.4%	109	109	–	–	–	–	–
Czech koruna	1.9%	4	4	–	–	–	–	–
Euro	2.4%	55	55	–	–	–	–	–
Sterling	4.5%	331	331	–	–	–	–	–
US dollars	4.3%	109	109	–	–	–	–	–
Other currencies	3.2%	12	12	–	–	–	–	–
Total financial assets		**1,132**	**684**	**12**	**14**	**15**	**16**	**391**
Financial liabilities								
Secured bank loans:								
Australian dollars	6.7%	1,108	40	41	80	71	46	830
Effect of interest rate swap	*0.7%*	*(701)*	*(17)*	*(160)*	*(169)*	*(71)*	*(266)*	*(18)*
Czech koruna	2.8%	55	8	47	–	–	–	–
Effect of interest rate swap	*0.8%*	*(40)*	*–*	*(40)*	*–*	*–*	*–*	*–*
Euro	4.8%	371	21	22	24	23	27	254
Effect of interest rate swap	*0.4%*	*(43)*	*(5)*	*(5)*	*(8)*	*(21)*	*(4)*	*–*
Sterling	6.8%	335	85	17	15	22	17	179
Effect of interest rate swap	*(0.3)%*	*(192)*	*(19)*	*(12)*	*(10)*	*(15)*	*(136)*	*–*
US dollars	7.2%	1,013	31	33	37	31	540	341
Effect of interest rate swap	*0.2%*	*(440)*	*56*	*(23)*	*(24)*	*(200)*	*(17)*	*(232)*
Other currencies	7.7%	26	2	2	2	3	3	14
Sub total secured bank loans	6.6%	2,908	187	162	158	150	633	1,618
Sub total of effect of interest rate swaps	*0.4%*	*(1,416)*	*15*	*(240)*	*(211)*	*(307)*	*(423)*	*(250)*
Preferred equity:								
US dollars	7.2%	173	–	–	173	–	–	–
Convertible bond[1]:								
US dollars	7.4%	125	–	–	–	–	–	125
Secured bonds:								
Sterling	8.3%	445	–	–	–	–	–	445
Loans from minority interests:								
US dollars	8.0%	81	–	21	–	–	60	–
Total financial liabilities		**3,732**	**187**	**183**	**331**	**150**	**693**	**2,188**

(1) The effective interest rate for the convertible bond represents the liability element and the equity component (refer to note 24 for further details).

The effect of interest rate swaps refers to the annual movements in the principal amount of the interest rate swap, and are included in the above table to identify to which financial liability they relate. They are not included within total financial liabilities shown above as they are recognised as derivative financial instruments in the balance sheet.

The effect of the Group interest rate swaps effectively replaced £701 million of floating rate Australian dollar borrowings, £440 million of floating rate US dollar borrowings, £192 million of floating rate sterling borrowings, £40 million of floating rate Czech koruna borrowings and £43 million of floating rate euro borrowings with fixed rate borrowings.

Management estimates that a one percentage point increase in interest rates would have the effect of decreasing the Group's profit before tax by approximately £8 million.

32 FINANCIAL INSTRUMENTS – 2005 continued

The floating rate financial liabilities comprise bank borrowings bearing interest rates fixed in advance for various time periods up to 12 months by reference to LIBOR for that time period.

d) Energy trading risk, energy market risk and hedge accounting

The Group hedges exposures that arise from the ownership and operation of power plants and related sales of electricity and purchases of natural gas, and utilises derivatives to optimise the return achieved from these assets. The Group enters into derivative commodity financial instruments to convert floating or indexed electricity and gas prices to fixed prices in order to lessen its vulnerability to reductions in electricity prices for the electricity it generates and to increases in gas prices for the fuel it consumes in its power plants. Commodity derivative financial instruments also provide a way to meet customers' pricing requirements while achieving a price structure consistent with the Group's overall pricing strategy.

Energy market risk on our asset and proprietary portfolios is measured using various techniques including Value-at-Risk (VaR). VaR is used where appropriate and provides a fair estimate of the net losses or gains which could be recognised on our portfolios over a certain period and given a certain probability; it does not provide an indication of actual results. Scenario analyses are used to estimate the economic impact of sudden market movements on the value of our portfolios. This supplements the other techniques and methodologies and captures additional market risks.

The Group accounts for certain energy sales and fuel purchases as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

e) Currency exposures

Currency translation exposure

The results of the Group's foreign operations are translated into sterling at the average exchange rates for the period concerned. The balance sheets of foreign operations are translated into sterling at the closing exchange rates. In order to hedge the net assets of foreign operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way. It is our policy not to hedge currency translation through foreign exchange contracts or currency swaps.

Currency transaction exposure

This arises where a business unit makes sales and purchases in a currency other than its functional currency. Transaction exposure also arises on the remittance from overseas of dividends or surplus funds. The Group's policy is to match transaction exposure where possible, and hedge remaining transactions as soon as they are committed, by using foreign currency contracts and similar instruments.

Currency exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

Management estimates that a one percentage point weakening of sterling against all currencies would reduce the Group's profit before tax by approximately £3 million.

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The undrawn committed facilities available at 31 December 2005 in respect of which all conditions precedent have been met at that date amount to £441 million.

	31 December 2005		
	Facility £m	Undrawn £m	Available £m
US$640 million Corporate revolving credit facility (June 2008)[1]	373	142	142
US$110 million ANP Funding 1 revolving credit facility (May 2010)[2]	64	34	34
US$488 million Tihama term facility (December 2021)	284	72	72
A$92 million Canunda facility (December 2014)	39	12	12
CZK1,000 million IPO revolving credit facility (May 2007)	24	20	20
£60 million Corporate working capital facility (January 2006)[3]	60	60	60
£94 million Corporate letter of credit facilities[4]	94	1	1
£153 million Subsidiary facilities in various currencies	153	100	100
Total	**1,091**	**441**	**441**

(1) The drawn element of the US$640 million Corporate revolving credit facility relates to letters of credit issued of £181 million and £50 million of cash drawings.

(2) This facility includes a US$50 million supported and US$60 million unsupported working capital credit facility with capacity to issue letters of credit. At 31 December 2005, £8 million and £22 million of letters of credit had been drawn from each of these facilities respectively.

(3) This facility could have been utilised to draw cash and issue letters of credit in relation to merchant trading support. It was not renewed when it expired in January 2006.

(4) These facilities can be utilised to issue letters of credit. At 31 December 2005, £93 million of letters of credit had been drawn from these facilities and £28 million of cash and cash equivalents was used as collateral in relation to these facilities.

Uncommitted facilities available at 31 December 2005 were:

	31 December 2005		
	Total £m	Drawn £m	Undrawn £m
Facility			
Bank borrowing and overdraft facilities	36	18	18
£11 million Subsidiary facilities in various currencies	11	2	9
	47	**20**	**27**

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

g) Fair values of financial assets and liabilities

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial assets and liabilities as at 31 December 2005:

	31 December 2005	
	Carrying amount £m	Fair value £m
Financial assets		
Other investments	4	4
Finance lease receivables	460	460
Other long-term receivables from joint ventures and associates	30	30
Trade receivables (current)	163	163
Other receivables (current)	108	108
Derivative financial instruments	268	268
Assets held for trading	52	52
Cash and cash equivalents	620	620
Total financial assets	**1,705**	**1,705**
Financial liabilities		
Trade payables (current)	118	118
Other payables (current)	153	153
Derivative financial instruments	687	687
Secured bank loans	2,908	2,928
Preferred equity facility	173	173
Convertible bonds	125	125
Secured bonds	445	480
Loans from minority interests	81	81
Total financial liabilities	**4,690**	**4,745**

The methods and assumptions used to estimate fair values of financial assets and liabilities are as follows:

(i) Other investments comprise equity held in privately owned, unquoted companies and therefore fair value cannot be reliably measured. The fair value has thus been based on the cost amount.

(ii) The fair value of finance lease receivables and other long-term receivables have been estimated by discounting estimated cash flows.

(iii) Trade and other receivables (current) and trade and other payables (current) are stated at fair value, set equal to book value, because of their short maturity.

(iv) Assets held for trading have been estimated using quoted market prices and discounted cash flows.

(v) The fair value of the Group's forward exchange contracts, foreign currency swaps and foreign currency options have been calculated using market rates in effect at the balance sheet dates.

(vi) The fair value of energy derivatives is measured using discounted cash flows and other similar quantification techniques. Where there is no active market, fair value is determined using valuation techniques. These include using recent arm's length market transactions, reference to the current market value of another instrument which is substantially the same, discounted cash flow analysis and pricing models.

(vii) All loans and bonds have been calculated using market prices where available or the net present value of future cash flows arising.

h) Hedges

As explained on pages 38 and 39 of the business and financial review, the Group's policy is to hedge the following exposures:

(i) Interest rate risk – using interest rate swaps, options and forward rate agreements.

(ii) Structural and transactional currency exposures – using currency borrowings, forward foreign currency contracts, currency options and swaps.

32 FINANCIAL INSTRUMENTS – 2005 continued

(iii) Currency exposures on future expected sales – using currency swaps, forward foreign currency contracts, currency options and swaps.

(iv) Energy price fluctuations – using physical hedges through the operation of energy supply and trading activities together with financial products.

The hedging of structural currency exposures associated with foreign currency net investments is recognised in the consolidated balance sheet.

i) Cash flow hedging reserve movements

The following shows the cash flow hedging reserve balance at 31 December 2005 and the periods in which the cash flows are expected to occur:

	Interest rate swaps £m	Energy derivatives £m	Total £m
Unrecognised losses at 31 December 2005	(15)	(103)	**(118)**
Cash flows expected during			
2006	(2)	(67)	**(69)**
2007	(1)	(27)	**(28)**
2008	(1)	(10)	**(11)**
2009	(1)	1	**–**
2010 onwards	(10)	–	**(10)**
	(15)	(103)	**(118)**

Gains and losses recognised in the hedging reserves during the year were as follows:

	Interest rate swaps £m	Energy derivatives £m	Total £m
Gains and (losses) recognised in the hedging reserve on adoption of IAS 32 and IAS 39 at 1 January 2005	(20)	8	**(12)**
Gains and (losses) arising in previous years that were recognised during the year	(2)	(7)	**(9)**
Amount removed from equity and included with a non-financial item	5	–	**5**
Amount recognised in equity	2	(104)	**(102)**
	(15)	(103)	**(118)**

j) Hedge of a net investment

A foreign currency exposure arises from net investments in Group entities whose functional currency differs from the Group's presentation currency. The risk is defined as the risk of fluctuation in spot rates between the functional currency of the net investments and the Group's presentation currency. This will cause the amount of the net investment to vary.

In the absence of hedge accounting the foreign exchange gains and losses on retranslating the net assets of the foreign operation would be taken to reserves, whilst those on the loan would be recognised in the income statement. This creates a mismatch in foreign currency translation. When net investment hedging is applied, this mismatch is eliminated.

The Group, as part of its hedging strategy, has therefore chosen to borrow some debt denominated in foreign currencies in order to hedge the net investments in certain assets within its portfolio. As the hedging instrument is foreign currency borrowings rather than a derivative, no fair value for this instrument is included within the fair value of derivatives disclosed on the balance sheet.

k) Counterparty credit risk

The Group's policy is to manage its credit exposure to trading and financial counterparties within clearly defined limits. Energy trading activities are strictly monitored and controlled through delegated authorities and procedures, which include specific criteria for the management of counterparty credit exposures in each of our key regions. Counterparty exposure via customer offtake agreements is monitored and managed by the local asset team with assistance from Group treasury where appropriate. In addition, Group treasury manages the Group-wide counterparty credit exposure on a consolidated basis for financial counterparties, with the active and close involvement of the global risk manager. Financial counterparty credit exposure is limited to relationship banks and commercial paper with strong investment grade credit ratings.

We are exposed to credit-related losses in the event that counterparties to traded contracts and financial instruments do not perform according to the terms of the contract or instrument. This is mitigated by the fact that for the majority of the Group's commodity trading arrangements there is a legally enforceable right of set-off that reduces the credit exposure of the Group in the event of counterparty default.

Where possible the Group will also enter into master netting agreements that further serve to mitigate its credit exposure.

With regard to financial instruments subject to credit risk, we select counterparties with appropriate ratings for the size, type and duration of the instrument involved. A small proportion of counterparties trading energy are below investment grade. For those energy market transactions with counterparties below investment grade, and which are not supported by appropriate collateral, reserves are carried against the trading risk. Exposures within this band are restricted and closely monitored within narrow limits. We do not expect any significant credit loss to result from non-performance of instruments or traded contracts.

The immediate credit exposure of financial instruments is represented by those financial instruments that have a net positive fair value by counterparty at 31 December 2005. At 31 December 2005, the exposures for interest rate swaps, currency swaps and forward exchange contracts were not considered to be material. Contracts for differences also involve a degree of credit risk. This risk is controlled by appropriate authorisation and monitoring procedures.

33 FINANCIAL INSTRUMENTS – 2004

As stated in note 32, the Group has taken the exemption from the requirement to restate comparative information for IAS 32 and IAS 39. Accordingly the financial instruments disclosure presented in note 32 on the basis of IAS 32 and IAS 39 is only for 2005.

The following 2004 disclosures are provided in accordance with FRS 13 (Derivatives and Other Financial Instruments). Financial instruments comprise net debt (refer to note 31) together with other instruments deemed to be financial instruments including non-current receivables, payables and provisions. For consistency of presentation with the consolidated balance sheet presented under IFRS the description of items included within this note mirrors the headings used under IFRS rather than UK GAAP.

Policies

Treasury policy seeks to ensure that adequate financial resources are available for the development of the Group's business whilst managing its currency, interest rate and counterparty credit risks. The Group's treasury policy is not to engage in speculative transactions. Group treasury acts within clearly defined guidelines that are approved by the Board.

a) Short-term receivables and payables

Current asset receivables and payables have been excluded from all the following disclosures other than the currency risk disclosures as relevant. The fair value of current asset receivables and payables approximates to the carrying amount because of their short maturity. In accordance with FRS 13, deferred tax has been excluded from the following disclosures.

b) Interest rate risk

The Group's policy in 2004 was the same as outlined for 2005 in note 32.

Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the Group at 31 December 2004 was:

	31 December 2004		
	Total financial liabilities £m	Floating rate financial liabilities £m	Fixed rate financial liabilities £m
Currency			
Sterling	545	25	520
US dollar	1,171	706	465
Australian dollar	1,370	678	692
Euro	424	388	36
Czech koruna	52	12	40
Others	15	1	14
Total	3,577	1,810	1,767

All the Group's current liabilities (other than loans and bonds) are excluded from the above table either due to the exclusion of short-term items or because they do not meet the definition of financial liabilities. There are no material financial liabilities on which interest is not paid.

The effect of the Group interest rate swaps was to classify £692 million of floating rate Australian dollar borrowings, £103 million of floating rate US dollar borrowings, £71 million of floating rate sterling borrowings, £40 million of floating rate Czech koruna borrowings and £36 million of floating rate euro borrowings all at fixed rate in the above table.

In addition to the above, the Group's provisions are considered to be floating rate financial liabilities as, in establishing the provisions, the cash flows have been discounted.

The floating rate financial liabilities comprise bank loans bearing interest rates fixed in advance for various time periods up to 12 months by reference to LIBOR for that time period. The figures in the following tables take into account interest rate and currency swaps used to manage the interest rate and currency profile of financial liabilities and financial assets.

	31 December 2004 Fixed rate financial liabilities	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Currency		
Sterling	8.74	15
US dollar	5.82	11
Australian dollar	7.92	4
Euro	6.82	3
Czech koruna	3.98	2
Others	7.25	2
Weighted average	7.49	9

33 FINANCIAL INSTRUMENTS – 2004 continued

c) Interest rate risk profile of financial assets

The Group had the following financial assets at 31 December 2004:

	31 December 2004		
	Total £m	Floating rate financial assets £m	Fixed rate financial assets £m
Currency			
Sterling	246	246	–
US dollar	139	139	–
Australian dollar	212	202	10
Euro	578	104	474
Czech koruna	4	4	–
Others	18	18	–
Total	1,197	713	484

Cash deposits comprise deposits placed in money market funds, and a variety of investments with maturities up to three months. All investments are in publicly quoted shares or treasury instruments. Letters of credit totalling £97 million were supported on a cash collateral basis at 31 December 2004.

The previous table includes finance lease receivables which are analysed as follows:

	31 December 2004 Fixed rate financial assets	
	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Currency		
Australian dollar	7.15	3
Euro	7.89	14
Weighted average	7.87	14

d) Currency exposures

These policies in 2004 were the same as outlined for 2005 in note 32. The currency exposures in 2004 were not considered to be material.

e) Maturity of financial liabilities

The maturity profile of our financial liabilities, other than current trade and other payables, was as follows:

	31 December 2004 £m
In one year or less, or on demand	100
In more than one year but not more than two years	113
In more than two years but not more than five years	622
In more than five years	2,742
Total	3,577

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The committed facilities available at 31 December 2004 in respect of which all conditions precedent have been met at that date amounted to £700 million.

	31 December 2004		
	Facility £m	Undrawn £m	Available £m
US$450 million Corporate revolving credit facility (October 2006)[1]	234	78	78
US$50 million ANP Funding 1 revolving credit facility (May 2010)	26	18	18
CZK1,000 million IPO revolving credit facility (May 2007)	23	20	20
US$488 million Tihama term facility (December 2021)	254	181	181
A$92 million Canunda facility (December 2014)	38	12	12
£30 million Corporate letter of credit facility[2]	30	11	11
£95 million Subsidiary facilities in various currencies	95	66	66
Total	700	386	386

(1) The drawn element of the US$450 million Corporate revolving credit facility relates to letters of credit issued.

(2) These facilities include a £30 million letter of credit facility which becomes committed for any letters of credit that have been drawn. At 31 December 2004 £19 million of letters of credit had been drawn from this facility.

Uncommitted facilities available at 31 December 2004 were:

	31 December 2004		
	Total £m	Drawn £m	Undrawn £m
Facility			
Bank borrowing and overdraft facilities	22	–	22
ANP Funding 1 working capital facility	31	–	31
£13 million Subsidiary facilities in various currencies	13	3	10
	66	3	63

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

g) Fair values of financial assets and liabilities

Set out below is a comparison by category of carrying amounts and fair values of all the Group's financial assets and liabilities as at 31 December 2004:

	31 December 2004	
	Carrying amount £m	Fair value £m
Primary financial instruments held or issued to finance the Group's operations		
Financial assets	1,197	1,197
Current liability loans and bonds	(100)	(100)
Non-current liabilities excluding deferred tax	(3,477)	(3,508)

In addition to the above, the Group holds energy derivatives for trading purposes with a carrying amount and fair value of £3 million (gross gain of £37 million, gross loss of £34 million).

Financial assets in the above table comprise finance lease receivables, other long-term receivables, assets held for trading and cash and cash equivalents. Finance lease receivables and other long-term receivables have been estimated by discounting estimated cash flows. The carrying amount of assets held for trading and cash and cash equivalents approximates to fair value because of their short maturity.

The methods and assumptions used to estimate fair values of financial instruments are as follows:

(i) Current asset trade and other receivables and current liability trade and other payables are excluded from the above table. Their carrying amounts approximate to fair value because of their short maturity.

(ii) The fair value of assets held for trading maturing after three months has been estimated using discounted cash flows and quoted market prices.

(iii) The fair value of current liability loans and bonds approximates to carrying amount because of their short maturity.

(iv) The fair value of non-current liability loans and bonds and interest rate swaps has been calculated using market prices when available or the net present value of future cash flows arising.

(v) The fair value of the Group's forward exchange contracts, foreign currency swaps and foreign currency options has been calculated using the market rates in effect at the balance sheet dates.

(vi) The fair value of energy derivatives is measured using value at risk and other methodologies that provide a consistent measure of risk across diverse energy products. Within the above fair values, only the financial assets and liabilities have been marked to market.

33 FINANCIAL INSTRUMENTS – 2004 continued

Derivative financial instruments held to manage the interest rate, currency profile and exposure to energy prices

	Year ended 31 December 2004				
	Carrying amount £m	Fair value £m	Gain/ (loss) £m	Gross gain £m	Gross (loss) £m
Interest rate swaps and similar instruments	–	(38)	(38)	–	(38)
Energy derivatives	–	16	16	90	(74)

h) Hedges

These policies in 2004 were the same as outlined in note 32.

Gains and losses on instruments used for hedging were not recognised until the exposure that is being hedged is itself recognised or expires. Unrecognised gains and losses on instruments used for hedging, and the movements therein, are as follows:

	Debt £m	Foreign exchange £m	Energy derivatives £m	Total net gain/(loss) £m
Unrecognised gains and (losses) on hedges at 1 January 2004	(38)	–	37	(1)
Gains and (losses) arising in previous years that were recognised in the year ended 31 December 2004	(15)	–	33	18
Gains and (losses) arising in previous years that were not recognised in the year	(23)	–	4	(19)
Gains and (losses) arising in the year ended 31 December 2004 that were not recognised in the year	(15)	–	12	(3)
Unrecognised gains and (losses) on hedges at 31 December 2004	(38)	–	16	(22)
Of which:				
Gains and (losses) expected to be recognised in the year ended 31 December 2005	(2)	–	16	14
Losses expected to be recognised in the year ended 31 December 2006 or later	(36)	–	–	(36)

The hedging of structural currency exposures associated with foreign currency net investments is recognised in the consolidated balance sheet.

i) Counterparty credit risk

These policies in 2004 were the same as outlined for 2005 in note 32.

34 COMMITMENTS

Lease and capital commitments

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Capital commitments: contracted but not provided	**82**	182
Future minimum lease payments under non-cancellable operating leases:		
Within one year	**6**	6
Between one and five years	**21**	20
After five years	**27**	35
Offset by future minimum receipts under non-cancellable operating subleases	**(8)**	(12)

Operating lease payments substantially represent rentals payable by the Group for office properties and wind turbine equipment.

Fuel purchase and transportation commitments

At 31 December 2005, the Group's subsidiaries had contractual commitments to purchase and/or transport coal and fuel oil. Based on contract provisions, which consist of fixed prices, subject to adjustment clauses in some cases, these minimum commitments are currently estimated to aggregate £96 million (2004: £107 million) expiring within one year, £182 million (2004: £195 million) expiring between one and five years and £326 million (2004: £98 million) expiring after more than five years.

35 CONTINGENT LIABILITIES

a) Legal proceedings against the Company

The Company is aware of the following matters, which involve or may involve legal proceedings against the Group:

(i) Claims and potential claims by or on behalf of current and former employees, including former employees of the Central Electricity Generating Board (CEGB), and contractors in respect of industrial illness and injury.

RWE npower has agreed to indemnify International Power plc on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings to the extent such liability is not insured by Electra Insurance Limited.

(ii) In 1994 separate complaints were made by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Miners Association (SWSMA) to the European Commission against the Company, PowerGen plc, British Coal Corporation and HM Government. The complaint alleges violations of EU competition law arising out of the coal purchasing arrangements entered into by the CEGB prior to 1 April 1990 and requests the Commission to find that the CEGB's practices violated EU law. NALOO and SWSMA allege that such a finding would be grounds for a claim for damages in the English courts by their respective members. The Commission ruled on the complaint in 1998 and did not make any findings against the Group. Appeals against the Commission's findings were brought by NALOO and SWSMA. The SWSMA appeal was initially ruled out of time, but on appeal a faction was allowed to proceed. Progress with this claim will be influenced by the outcome of the NALOO appeal. At first instance, the European Court ruled that the Commission is under an obligation to investigate the complaint by NALOO. The Company, PowerGen plc, British Coal Corporation and the Commission appealed against the ruling to the European Court of Justice which delivered a judgment on 2 October 2003 for the main part dismissing the appeal. In its judgment, the court decided that the Commission has the power to investigate and the matter is now with the Commission for consideration. It is not practicable to estimate legal costs or possible damages, at this stage. RWE npower has agreed to indemnify International Power on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings.

The Directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions carried in the balance sheet, that it is remote that the matters referred to above will, in aggregate, have a material effect on the Group's financial position, results of operations or liquidity.

b) Taxation

The Company is aware of a number of issues which are, or may be, the subject of disputes with the tax authorities in the territories where the Group has operations, including its joint ventures and associates. The Directors are of the opinion, having regard to the professional advice received, that adequate provision has been made for the settlement of any tax liabilities that might arise.

c) Bonds and guarantees

Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Group totalling £609 million.

Energy trading activities relating to merchant plant are supported by letters of credit and guarantees issued by the Group totalling £193 million.

d) Joint ventures and associates

(i) Legal proceedings

Uch Power Limited (UPL), located in Pakistan, in which International Power has a 40% share, is party to a gas supply agreement (GSA) with the Oil & Gas Development Authority (OGDCL). At 31 December 2005 there were unresolved disputes between UPL and OGDCL in regards to amounts owed to UPL by OGDCL and amounts owed to OGDCL by UPL. These disputes relate to issues in 2002 and 2003 around events of force majeure claimed by OGDCL and other issues around OGDCL's failure to deliver gas in accordance with the terms and conditions of the GSA. The Group's share of the amounts subject to dispute at 31 December 2005 are amounts receivable of £14 million and amounts payable of £16 million. There is no recourse to International Power plc, under this claim.

(ii) Bonds and guarantees

The Group's joint ventures and associates also have various growth and expansion projects that are supported by bonds, letters of credit and guarantees. The Group's share of these bonds, letters of credit and guarantees amount to £53 million. These obligations are normally secured by the assets of the respective joint venture or associate. Any amounts guaranteed by International Power plc or any other Group subsidiary are included within bonds and guarantees disclosed in note 35(c).

36 RELATED PARTY TRANSACTIONS

The key management personnel of International Power plc comprises the Chairman, Executive Directors and Non-Executive Directors. The compensation of key management personnel can be found in the Directors' remuneration report set out on pages 64 to 75 of the *Annual Report*.

(i) Operations and maintenance contracts

In the course of normal operations, the Group has contracted on an arm's length basis to provide power station operation and maintenance services to joint ventures and associates. During the year the Group derived income of £69 million (2004: £37 million) from these arrangements. Included in trade receivables is £6 million (2004: £7 million) in relation to these contracts.

(ii) Retail supply contracts

In the course of normal operations, the Group has contracted on an arm's length basis to provide power and gas to its retail joint ventures. During the year the Group derived income of £8 million (2004: £nil) from these arrangements. Included in trade receivables is £1 million (2004: £nil) in relation to these contracts.

(iii) Transportation contracts

In the course of normal operations, the Group has contracts in place, in relation to fuel transportation, with one of its joint ventures. During the year, the Group incurred costs of £8 million (2004: £8 million) in relation to these contracts. There was no trade payable or receivable in relation to these contracts at 31 December 2005.

(iv) Other contracts
Mitsui & Co. of Japan (Mitsui) is, pursuant to the terms of the UK Listing Rules, a related party of the Company due to its interest in Saltend and the assets acquired from EME. In 2005, TNP, a wholly owned subsidiary of the Company, entered into a contract with a company in the same group as Mitsui, relating to the supply of material for the 23 MW extension of its 120 MW plant. The capital cost of this contract is JPY1,039 million (£5.1million). This contract was entered into after a competitive tendering process.

37 EVENTS AFTER THE BALANCE SHEET DATE

In January 2006 International Power signed an agreement to acquire 40% of the Hidd independent power and water project in Bahrain. Completion is expected to take place in July 2006.

Also in January 2006 Rugeley Power Limited received a further £15 million in respect of our claim for compensation for the termination of the TXU tolling agreement in November 2002.

38 EVENTS SUBSEQUENT TO THE DATE OF THE AUDITOR'S REPORT

There are no events to report subsequent to the date of the auditor's report.

39 SUBSIDIARIES

The Group has the following significant investments in subsidiaries.

Name and nature of business	Country of incorporation and registration	Type of share	Group effective shareholding
Canunda Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
Gippsland Power Pty Limited* (power generation)	Australia	Ordinary Shares	70%
Hazelwood Power Partnership* (power generation)	Australia	Partners' Capital	92%
Latrobe Power Partnership* (power generation)	Australia	Partners' Capital	70%
Perth Power Partnership* (power generation)	Australia	Partners' Capital	49%
Synergen Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
International Power Opatovice A.S.* (power generation)	Czech Republic	Ordinary Shares	99%
Deeside Power Development Company Limited (power generation)	England and Wales	Ordinary Shares	100%
First Hydro Company* (power generation)	England and Wales	Ordinary Shares	70%
First Hydro Finance plc* (financing company)	England and Wales	Ordinary Shares	70%
IPM Eagle LLP* (investment holding company)	England and Wales	Partners' Capital	70%
Normanglade 4 LLP* (financing company)	England and Wales	Partners' Capital	70%
Pelican Point Power Limited* (power generation)	England and Wales†	Ordinary Shares	100%
Rugeley Power Limited (power generation)	England and Wales	Ordinary Shares	100%
Saltend Cogeneration Company Limited* (power generation)	England and Wales	Ordinary Shares	70%
IPR Insurance Company Limited* (insurance captive)	Guernsey	Ordinary Shares	100%
International Power (Jersey) Limited (financing company)	Jersey**	Ordinary Shares	100%
Al Kamil Power Company SAOG* (power generation)	Oman	Ordinary Shares	65%
Turbogás – Produtora Enérgetica S.A* (power generation)	Portugal	Ordinary Shares	60%
Tihama Power Generation Company Limited* (power generation)	Saudi Arabia	Ordinary Shares	60%
Electro Metalurgica del Ebro SL* (power generation)	Spain	Ordinary Shares	64%
Ibérica de Enérgías SL* (power generation)	Spain	Ordinary Shares	70%
Thai National Power Company Limited* (power generation)	Thailand	Ordinary Shares	100%
ANP Bellingham Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Blackstone Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Funding I, LLC* (financing company)	US	Ordinary Shares	100%
Hays Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Midlothian Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Milford Power Limited Partnership* (power generation)	US	Partners' Capital	100%

All subsidiaries operate in their country of incorporation, except as indicated below. All subsidiaries have a 31 December year end. The Group also has a number of overseas branch offices.

* Held by an intermediate subsidiary

** Operates in the UK

† Operates in Australia

40 JOINT VENTURES AND ASSOCIATES

The Group has the following significant investments in joint ventures and associates.

Name and nature of business	Country of incorporation, registration and operation	Accounting period end	Type of share	Group effective shareholding
Joint ventures				
EA – IPR Retail Partnership*	Australia	31 December	Partners' Capital	50%
South East Australia Gas Pty Limited* (gas pipeline)	Australia	30 June	Ordinary Shares	33%
EcoEléctrica LP* (power generation)	Bermuda**	31 December	Partners' Capital	35%
Pražská Teplárenská A.S.* (power generation)	Czech Republic	31 December	Ordinary Shares	49%
Hartwell Energy Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Oyster Creek Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Associates				
Derwent Cogeneration Limited* (power generation)	England and Wales	31 March	Ordinary Shares	23%
PT Paiton Energy* (power generation)	Indonesia	31 December	Ordinary Shares	31%
ISAB Energy Srl* (power generation)	Italy	31 December	Ordinary Shares	34%
Malakoff Berhad* (power generation)	Malaysia	31 August	Ordinary Shares	18%
Kot Addu Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	36%
Uch Power Limited* (power generation)	Pakistan	31 December	Ordinary Shares	40%
The Hub Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	17%
Carbopego – Abastecimento de Combustiveis, S.A.* (fuel supplies)	Portugal	31 December	Ordinary Shares	50%
Pegop – Energia Electrica, S.A.* (power station operations)	Portugal	31 December	Ordinary Shares	50%
Tejo Energia - Producao e Distribuicao de Energia Electrica, S.A.* (power generation)	Portugal	31 December	Ordinary Shares	50%
Q Power QSC*	Qatar	31 December	Ordinary Shares	40%
Uni-Mar Enerji Yatırımlari A.S.* (power generation)	Turkey	31 December	Ordinary Shares	33%
Arabian Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%
Shuweihat CMS International Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%

International Power continues to equity account for Malakoff and HUBCO, despite its shareholdings being less than 20%, as it continues to exert and has the power to exert significant influence over both assets. At both HUBCO and Malakoff, International Power continues to have significant board representation.

* Held by an intermediate subsidiary

** Operates in Puerto Rico

41 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Group's accounting policies are set out in note 1 to these financial statements. Management is required to exercise significant judgement in the application of these policies. Areas which Management believes require the most critical accounting judgements are as follows (apart from those policies involving estimation which are outlined in (b) below).

a) Critical accounting judgements in applying the Group's accounting policies

Cash flow hedge accounting

The Group enters into various types of hedging or forward contracts for the buying and selling of commodities: principally sales of electricity and the purchase of fuel for its own power plants. In merchant markets these contracts typically fall within the definition of derivative financial instruments and accordingly have to be marked to market. Accounting for these contracts as cash flow hedges allows, to the extent the hedge is effective, the changes in value of the derivatives to be deferred in equity. In order to achieve cash flow hedge accounting it is necessary for the Group to determine, on an on-going basis, whether a forecast transaction is both highly probable and whether the hedge is effective. This requires both subjective and objective measures of determination.

Income recognition from long-term PPAs

When power plants sell their output under long-term PPAs it is usual for the power plant owning company to receive payment (known as a 'capacity payment') for the provision of electrical capacity whether or not the off-taker requests electrical output. In these situations, where there is a long-term contract to purchase electricity output and electrical capacity, it is necessary for the Group to evaluate the contractual arrangements and determine whether they constitute a form of lease or a service contract.

41 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY continued

For those arrangements determined to be leases, further judgements are required to determine whether the arrangement is a finance or operating lease. This assessment requires an evaluation of where the substantial risks and rewards of ownership reside. For finance leases it is necessary to calculate the proportion of total capacity payments which should be treated as finance income, capital repayment and as a fee for service provision. For operating leases it is necessary to determine the allocation of total capacity payments between rental payments and fees for service provision.

Evaluation of levels of control and influence
The determination of the level of influence the Group has over a business is often a mix of contractually defined and subjective factors that can be critical to the appropriate accounting treatment of entities in the consolidated accounts. We achieve influence through Board representation and by obtaining rights of veto over significant actions. We generally treat investments where the Group holds less than 20% of the equity as investments available for sale. These investments available for sale are carried at market value where market prices are available. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost.

Where the Group owns between 20% and 50% of the equity of an entity and is in a position to exercise significant influence over the entity's operating and financial policies, we treat the entity as a joint venture or an associate. Equally, where the Group holds a substantial interest (but less than 20%) in an entity and has the power to exert significant influence over its operations, we treat it as a joint venture or an associate. This treatment is applied to our interests in Malakoff Berhad in Malaysia of which we own 18% and The Hub Power Company in Pakistan of which we own 17% (refer to note 40).

Exceptional items
The Directors consider that items of income or expense which are material by virtue of their nature and amount should be disclosed separately if the financial statements are to fairly present the financial position and financial performance of the entity. The Directors label these items collectively as 'exceptional items'.

Determining which transactions are to be considered exceptional in nature is often a subjective matter. However, circumstances that the Directors believe would give rise to exceptional items for separate disclosure would include:

(i) disposals of investments;

(ii) discontinued operations;

(iii) impairments and impairment reversals.

All exceptional items are included under the appropriate income statement line item to which they relate. In addition, for clarity, separate disclosure is made of all items in one column on the face of the income statement.

Taxation
The level of tax provisioning is dependent on subjective judgement as to the outcome of decisions to be made by the tax authorities in the various tax jurisdictions around the world in which International Power operates. It is necessary to consider the extent to which deferred tax assets should be recognised based on an assessment of the extent to which they are regarded as recoverable.

b) Key sources of estimation uncertainty

Useful economic lives of property, plant and equipment
The original cost of greenfield developed power plant and other assets includes relevant borrowings and development costs:

(i) Interest on borrowings relating to major capital projects with long periods of development is capitalised during construction and then amortised over the useful life of the asset.

(ii) Project development costs (including appropriate direct internal costs) are capitalised when it is virtually certain that the contract will proceed to completion and income will be realised.

Depreciation of plant and other assets is charged so as to write down the value of those assets to their residual value over their respective estimated useful lives. The Directors are required to assess the useful economic lives of the assets so that depreciation is charged on a systematic and proportionate basis to the current carrying amount. It is Group policy to depreciate gas turbines and related equipment over 30 years to a 10% residual value, unless the circumstances of the project or life of specific components indicate a shorter period or a lower residual value. Coal and hydro plants are considered on an individual basis.

Fair values on acquisition
The Group is required to bring acquired assets and liabilities on to the Group balance sheet at their fair value. Power plant and equipment usually have long operating lives, and are often bought with associated long-term contracts such as PPAs. Hence determination of the fair values of these long-life assets and contracts can require a significant amount of judgement.

Impairment analysis
Management regularly considers whether there are any indications of impairment to the carrying amounts of its power plants and other long life assets. This includes a review of market conditions in both the short-term and long-term. Impairment reviews are generally based on pre-tax risk adjusted discounted cash flow projections that require estimates of discount rates and future market prices over the remaining lives of the assets. We benchmark the results of this testing against post-tax risk adjusted cash flows, discounted on a post-tax basis. At each balance sheet date, consideration is also given as to whether there is any indication that an impairment loss recognised in prior periods has reversed. During the year the Group reversed the impairment of its Rugeley plant in the UK (refer to note 14).

Provisions
Within the Group there are a number of long-term provisions. The carrying amount of these provisions is estimated based on assumptions about such items as the risk adjustment to cash flows or discount rates used, future changes in prices and estimates of costs. For example, the pensions liability is based on assumptions relating to discount rates used, future changes in salaries and future changes in prices affecting other costs. A change in estimates could have a material impact on the carrying amount of these provisions.

42 EXPLANATION OF TRANSITION TO IFRSs

As stated in note 1, these are the Group's first consolidated financial statements prepared in accordance with Adopted IFRSs.

The accounting policies set out in note 1 have been applied in preparing the consolidated financial statements for the year ended 31 December 2005, the comparative information presented in these consolidated financial statements for the year ended 31 December 2004 and in preparation of an opening IFRS balance sheet at 1 January 2004 (the Group's date of transition).

In preparing its opening IFRS balance sheet, the Group has adjusted amounts reported previously in consolidated financial statements prepared in accordance with its old basis of accounting (UK GAAP). An explanation of how the transition from UK GAAP to IFRSs has affected the Group's financial position and financial performance is set out in the following tables and the notes that accompany the tables.

The transition to IFRS has no impact on the cash flows of the Group.

Implementation of IAS 32 and IAS 39

The Group has taken the exemption from the requirement to restate comparative information for IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) in accordance with IFRS 1 (First-time Adoption of International Financial Reporting Standards).

The Group has continued to apply UK GAAP in respect of financial instruments for the comparative period presented. If IAS 32 and IAS 39 had been adopted, the market value of derivative financial instruments would have been recognised on the face of the balance sheet with the movements accounted for through the income statement or hedging reserve as appropriate.

IAS 32 and IAS 39 have been implemented with effect from 1 January 2005.

	1 January 2004			31 December 2004		
	UK GAAP £m	Effect of transition to Adopted IFRSs £m	Adopted IFRSs excluding IAS 32 and IAS 39 £m	UK GAAP as restated £m	Effect of transition to Adopted IFRSs £m	Adopted IFRSs excluding IAS 32 and IAS 39 £m
Non-current assets						
Goodwill	1	6	7	2	195	197
Other intangible assets	–	–	–	9	–	9
Property, plant and equipment	2,048	–	2,048	3,545	(3)	3,542
Investments in joint ventures and associates	441	–	441	1,167	2	1,169
Other investments	95	–	95	86	–	86
Finance lease receivables	–	–	–	484	–	484
Other long-term receivables	3	–	3	101	–	101
Deferred tax assets	–	–	–	–	79	79
Total non-current assets	2,588	6	2,594	5,394	273	5,667
Current assets						
Inventories	65	–	65	91	–	91
Trade and other receivables	157	–	157	227	–	227
Finance lease receivables	–	–	–	11	–	11
Assets held for trading	47	–	47	47	–	47
Cash and cash equivalents	696	–	696	565	–	565
Total current assets	965	–	965	941	–	941
Total assets	3,553	6	3,559	6,335	273	6,608
Current liabilities						
Loans and bonds	531	–	531	100	–	100
Trade and other payables	229	–	229	398	(36)	362
Current tax liabilities	86	–	86	83	–	83
Total current liabilities	846	–	846	581	(36)	545
Non-current liabilities						
Loans and bonds	904	–	904	3,257	–	3,257
Trade and other payables	5	–	5	170	–	170
Retirement benefit obligations	–	15	15	15	14	29
Provisions	33	–	33	35	–	35
Deferred tax liabilities	205	26	231	215	299	514
Total non-current liabilities	1,147	41	1,188	3,692	313	4,005
Total liabilities	1,993	41	2,034	4,273	277	4,550
Net assets	1,560	(35)	1,525	2,062	(4)	2,058
Equity						
Share capital	554	–	554	737	–	737
Share premium reserve	289	–	289	392	–	392
Capital redemption reserve	145	–	145	145	–	145
Capital reserve	422	–	422	422	–	422
Hedging and translation reserves	–	–	–	–	(39)	(39)
Retained earnings	111	(35)	76	129	47	176
Total equity attributable to equity holders of the parent	1,521	(35)	1,486	1,825	8	1,833
Minority interests	39	–	39	237	(12)	225
Total equity	1,560	(35)	1,525	2,062	(4)	2,058

	31 December 2004		1 January 2005
	Adopted IFRSs excluding IAS 32 and IAS 39 £m	Effect of IAS 32 and IAS 39 adjustment £m	Adopted IFRSs including IAS 32 and IAS 39 £m
Non-current assets			
Goodwill	197	–	197
Other intangible assets	9	(9)	–
Property, plant and equipment	3,542	–	3,542
Investments in joint ventures and associates	1,169	(9)	1,160
Other investments	86	–	86
Finance lease receivables	484	–	484
Other long-term receivables	101	–	101
Deferred tax assets	79	2	81
Total non-current assets	5,667	(16)	5,651
Current assets			
Inventories	91	–	91
Trade and other receivables	227	(3)	224
Finance lease receivables	11	–	11
Derivative financial instruments	–	91	91
Assets held for trading	47	–	47
Cash and cash equivalents	565	–	565
Total current assets	941	88	1,029
Total assets	6,608	72	6,680
Current liabilities			
Loans and bonds	100	–	100
Derivative financial instruments	–	78	78
Trade and other payables	362	–	362
Current tax liabilities	83	–	83
Total current liabilities	545	78	623
Non-current liabilities			
Loans and bonds	3,257	(44)	3,213
Derivative financial instruments	–	221	221
Trade and other payables	170	(147)	23
Retirement benefit obligations	29	–	29
Provisions	35	–	35
Deferred tax liabilities	514	(1)	513
Total non-current liabilities	4,005	29	4,034
Total liabilities	4,550	107	4,657
Net assets	2,058	(35)	2,023
Equity			
Share capital	737	–	737
Share premium reserve	392	–	392
Capital redemption reserve	145	–	145
Capital reserve	422	–	422
Hedging and translation reserve	(39)	(12)	(51)
Retained earnings	176	(20)	156
Total equity attributable to equity holders of the parent	1,833	(32)	1,801
Minority interests	225	(3)	222
Total equity	2,058	(35)	2,023

The impact of deferred tax on the adjustments described above is set out in note 19.

42 EXPLANATION OF TRANSITION TO IFRSs continued

a) IAS 12 (Income Tax)

Deferred tax is recognised on the difference between the tax and book values of an asset or liability that existed at the date of acquisition in a business combination.

The tax charge in the income statement is affected by the inclusion of the share of joint ventures' and associates' tax charge in the Group's profit from operations.

b) IAS 19 (Employee Benefits)

The pension schemes' surpluses and deficits were recognised in full at 1 January 2004, with a corresponding adjustment to reserves. The corridor method is applied in recognising future actuarial gains and losses. These will be recognised in the income statement to the extent they exceed the greater of 10% of the gross assets or gross liabilities of the schemes. The amount recognised in the following year is the excess amortised over the remaining average service lives of the employees in the schemes.

c) IFRS 2 (Share-based Payments)

A charge is made for both employee share ownership plans (ESOPs) and other share-based schemes based on actuarial valuations of the fair value of the option or scheme at the time of grant or inception.

d) IAS 10 (Events after the Balance Sheet Date)

Dividends are not accrued until they are approved at the Annual General Meeting.

e) IAS 36 (Impairment of Assets)

Positive goodwill is not subject to amortisation but is evaluated annually for impairment or whenever changes in circumstances indicate that goodwill might be impaired. Negative goodwill arising on future acquisitions will be recognised directly in the income statement.

f) IAS 32 and IAS 39 (Financial Instruments)

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial liabilities and equity instruments
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements into which the Group has entered. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Other investments
Other investments are classified as either held for trading or available for sale, and are measured at subsequent reporting dates at fair value. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in net income for the year.

Available for sale investments are initially recorded at cost and then remeasured at subsequent reporting dates to fair value. Unrealised gains and losses on available for sale investments are recognised directly in equity. However, impairment losses, foreign exchange gains and losses and interest calculated using the effective interest method are recognised in the income statement. On disposal or impairment of the investments, the gains and losses in equity are recycled into the income statement.

Convertible bonds
Split accounting is applied to the convertible debt, whereby the debt component is separated from any equity component or embedded derivative. The resulting discounted value of debt is accreted to the redemption value at maturity, increasing the annual interest charge. An equity component of a convertible bond is held in equity and not revalued unless and until the bond is converted. Any embedded derivative would be marked to market through the income statement at reporting year ends.

There is no impact on the results for 2004 as IAS 32 and IAS 39 are implemented prospectively with no restatement to comparatives. The embedded derivative option was closed out in January 2005 and no future mark to market adjustment is required as the bond is now considered a debt instrument with an equity component only.

Derivative financial instruments and hedge accounting
All qualifying derivatives are recognised at fair value on the balance sheet. Gains and losses on derivatives that do not meet the hedge accounting criteria are recognised in the income statement. Gains and losses on derivatives that qualify for cash flow hedge accounting are initially recognised as a separate component of equity (to the extent that the hedge is effective) and subsequently recycled to the income statement as the hedged item impacts earnings. Any ineffective element of these hedges is immediately recognised in the income statement.

There is no impact on the results for 2004 as IAS 32 and IAS 39 are implemented prospectively with no restatement to comparatives.

i) The effect of the transition to IFRS on retained earnings

	1 January 2004 £m	31 December 2004 £m
Goodwill	6	8
Share-based payments	2	5
Employee benefits	(11)	(10)
Events after balance sheet date	–	37
Deferred tax	(31)	(42)
Other	(1)	(2)
Total adjustment to retained earnings	(35)	(4)
Attributable to:		
Minority interests	–	(12)
Equity holders of the parent	(35)	8

j) Reconciliation of the income statement for 2004

	UK GAAP £m	Effect of transition to IFRSs £m	IFRSs excluding IAS 32 and IAS 39 £m
Revenue: group and share of joint ventures and associates	1,267	–	1,267
Less: share of joint ventures' revenue	(144)	–	(144)
Less: share of associates' revenue	(355)	–	(355)
Group revenue	768	–	768
Cost of sales	(637)	–	(637)
Gross profit	131	–	131
Other operating income	56	–	56
Other operating expenses	(66)	(1)	(67)
Share of results of joint ventures and associates	111	2	113
Profit from operations	232	1	233
Disposal of investments	4	–	4
Finance income	30	–	30
Finance costs	(138)	–	(138)
Net financing costs	(108)	–	(108)
Profit before tax	128	1	129
Income tax expense	(28)	3	(25)
Profit for the year	100	4	104
Attributable to:			
Minority interests	6	–	6
Equity holders of the parent	94	4	98
Earnings per share:			
Basic	7.2p		7.5p
Diluted	7.1p		7.4p

The UK GAAP numbers have been re-presented using an IFRS format.

Company balance sheet

AS AT 31 DECEMBER 2005

Note		As at 31 December 2005 £m	As at 31 December 2004 (restated) £m
	Fixed assets		
5	Tangible assets	**2**	2
6	Investments:		
	Subsidiary undertakings	**3,065**	3,214
	Other investments	**1**	2
	Total fixed assets investments	**3,066**	3,216
	Total fixed assets	**3,068**	3,218
	Current assets		
7	Debtors	**343**	186
	Cash at bank and in hand	**53**	182
	Total current assets	**396**	368
8	Creditors: amounts falling due within one year	**(1,415)**	(1,533)
	Net current liabilities	**(1,019)**	(1,165)
	Total assets less current liabilities	**2,049**	2,053
9	Retirement benefit obligations	**(18)**	(12)
9	Provisions	**(33)**	(31)
	Net assets	**1,998**	2,010
	Capital and reserves		
10/11	Called up share capital	**737**	737
11	Share premium account	**394**	392
11	Capital redemption reserve	**145**	145
11	Capital reserve	**415**	415
11	Profit and loss account	**307**	321
	Shareholders' funds – equity	**1,998**	2,010

The financial statements were approved by the Board of Directors on 6 March 2006 and signed on its behalf by

Philip Cox
Chief Executive Officer

Mark Williamson
Chief Financial Officer

Notes to the Company financial statements
For the year ended 31 December 2005
1 ACCOUNTING POLICIES
a) Basis of preparation

The financial statements have been prepared in accordance with applicable accounting standards, and under the historical cost accounting rules.

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

In these financial statements the following new standards have been adopted for the first time:

(i) FRS 20 (Share-based Payments);

(ii) FRS 21 (Events after the Balance Sheet Date);

(iii) FRS 23 (The Effects of Changes in Foreign Exchange Rates);

(iv) the presentation requirements of FRS 25 (Financial Instruments: Disclosure and Presentation);

(v) FRS 26 (Financial Instruments: Measurement);

(vi) FRS 28 (Corresponding Amounts).

The adoption of these new standards had no impact on the Company's profit or net assets with the exception of FRS 20 and FRS 21:

(i) FRS 20 resulted in the recognition of a share-based payments charge to the profit and loss account of £6 million in 2005 (2004: £1 million).

(ii) Under FRS 21, dividends declared after the balance sheet date are not accrued until such time as they are approved at the AGM. As a result, the dividends previously accrued for at 31 December 2004 in the prior year Company accounts has been adjusted to increase the net assets of the Company by £37 million in the 31 December 2004 comparatives.

The recognition and measurement requirements of FRS 17 (Retirement Benefits) have also been adopted, previously the transitional disclosures of that standard had been followed.

The accounting policies under these new standards are set out below. FRS 28 (Corresponding Amounts) has had no material effect as it imposes the same requirements for comparatives as hitherto required by the Companies Act 1985.

The corresponding amounts in these financial statements are restated in accordance with the new policies, other than those covered by the exceptions permitted by FRS 25 and FRS 26. FRS 25 and FRS 26 permits the corresponding amounts not to be restated and the Company has adopted this approach.

Under section 230(4) of the Companies Act 1985 the Company is exempt from the requirement to present its own profit and loss account.

As the results of the Company are being presented together with its consolidated financial statements (refer to pages 79 to 131), the Company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the Group (or investees of the Group qualifying as related parties).

b) Income recognition

Dividend income from subsidiary undertakings is recognised in the profit and loss account on receipt of the cash.

c) Pension schemes

The Company operates a pension scheme (by participating in the International Power section of the Electricity Supply Pension Scheme) providing benefits based on final pensionable pay. The assets of the scheme are held separately from those of the Company.

Pension scheme assets are measured using market values. Pension scheme liabilities are measured using a projected unit credit method and discounted at the current rate of return on a high quality corporate bond of equivalent term and currency to the liability.

The pension scheme surplus (to the extent that it is recoverable) or deficit is recognised in full. The movement in the scheme surplus/deficit is split between operating charges, finance items and, in the statement of total recognised gains and losses, actuarial gains and losses.

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

d) Tangible fixed assets

Tangible fixed assets are stated at original cost less accumulated depreciation and any provision for impairment in value.

Depreciation is calculated so as to write-down the cost of tangible fixed assets to their residual value evenly over their estimated useful lives.

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

	Years
Fixtures, fittings, tools and equipment	3-10
Computer equipment and software	3-5
Leasehold improvements	Life of lease

e) Fixed asset investments

Investments in subsidiary undertakings are stated at cost less provision for impairment.

f) Deferred taxation

Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of transactions and events recognised in the financial statements of the current year and previous years. Deferred taxation is calculated at the rates at which it is estimated that tax will arise. Deferred tax assets and liabilities are not discounted.

g) Derivative financial instruments (for year ended 31 December 2005)

The Company has applied the accounting requirements of FRS 25 and FRS 26 prospectively with effect from 1 January 2005. Loans and receivables and long-term loans payable are held at amortised cost.

h) Financial guarantees

Where the Company enters into financial guarantee contracts to guarantee the indebtedness of other companies within its group, the Company considers these to be insurance arrangements, and accounts for them as such. In this respect, the Company treats the guarantee contract as a contingent liability until such time as it becomes probable that the Company will be required to make a payment under the guarantee.

i) Share-based payments

The Company issues equity-settled share-based payments to certain employees. Equity-settled share-based payments are measured at fair value (excluding the effect of non market-based vesting conditions) at the date of grant. The fair value determined at the date of grant of the equity-settled share-based payments is expensed on a straight-line basis over the vesting period, based on the Company's estimate of the shares that will eventually vest and where applicable, adjusted for the effect of non market-based vesting conditions.

Fair value is measured using the Black-Scholes pricing model. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, any exercise restrictions and behavioural considerations.

j) Foreign currencies

Foreign currency monetary assets and liabilities are translated at the rate of exchange at the balance sheet date. Foreign currency non-monetary items measured in terms of historical cost are translated at the rate of exchange at the date of the transaction. Exchange differences on monetary items are dealt with in the profit and loss account. Exchange differences on non-monetary items are recognised in line with whether the gain or loss on the non-monetary item itself is recognised in the profit and loss account or in equity.

2 PROFIT OF THE PARENT COMPANY

The profit of the parent company for the financial year amounted to £21 million (2004: £84 million). By virtue of Section 230(4) of the Companies Act 1985, the Company is exempt from presenting a separate profit and loss account.

3 EMPLOYEES

The average number of persons employed by the Company (including Directors) during the year, analysed by category, was as follows:

	Year ended 31 December 2005 Number	Year ended 31 December 2004 Number
UK business	**162**	148
International business	**34**	20
	196	168

The aggregate payroll costs of these persons were as follows:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Wages and salaries	**21**	14
Share-based payments	**6**	1
Social security costs	**6**	1
Other pension costs	**4**	4
	37	20

For details of the Company's share-based payments, refer to note 28 of the Group accounts.

4 PENSION ARRANGEMENTS

The valuation used for the FRS 17 disclosure at 31 December 2005 has been based on a full assessment of the liabilities of the International Power section of the Electricity Supply Pension Scheme at 31 March 2004.

The major assumptions used by the actuary were:

	Year ended 31 December 2005 %	Year ended 31 December 2004 %	Year ended 31 December 2003 %
Inflation assumption	**2.9**	2.9	2.8
Rate of increase in salaries	**4.4**	4.4	4.3
Rate of increase of pensions in payment	**2.9**	3.0	2.9
Rate of increase of deferred pensions	**2.9**	3.0	2.9
Rate used to discount plan liabilities	**4.7**	5.3	5.4

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

	31 December 2005		31 December 2004		31 December 2003	
	Long-term rate of return %	**Value £m**	Long-term rate of return %	Value £m	Long-term rate of return %	Value £m
Equities	**7.1**	**60**	7.5	44	7.8	36
Bonds	**4.6**	**7**	5.0	5	5.1	5
Other	**6.0**	**7**	6.2	6	6.6	4
Total market value of assets		**74**		55		45
Present value of scheme liabilities		**(92)**		(67)		(58)
Deficit in scheme		**(18)**		(12)		(13)
Related deferred tax asset		**5**		4		4
Net pension liability		**(13)**		(8)		(9)

Analysis of amounts charged to operating profit under FRS 17:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Current service cost	**4**	3
Settlement/curtailment cost	**–**	1
Total operating cost	**4**	4

Analysis of amounts credited to other finance income under FRS 17:

	Year ended 31 December 2005 £m	Year ended 31 December 2004 £m
Expected return on pension plan assets	**4**	3
Interest on pension plan liabilities	**(4)**	(3)
Net return	**–**	–

Analysis of amount recognised in statement of total recognised gains and losses under FRS 17:

	2005 £m	2004 £m
Actual return less expected return on pension scheme assets	**9**	3
Experience (losses)/gains arising on the scheme liabilities	**(6)**	4
Changes in assumptions underlying the present value of the scheme liabilities	**(9)**	(7)
Actuarial loss recognised in statement of total recognised gains and losses	**(6)**	–

Analysis of movement in deficit during the year

	2005 £m	2004 £m
Deficit in scheme at 1 January	**(12)**	(13)
Current service cost	**(4)**	(3)
Settlement/curtailment cost	**–**	(1)
Contributions	**4**	5
Actuarial loss	**(6)**	–
Deficit in scheme at 31 December	**(18)**	(12)

History of experience gains and losses

	2005	2004	2003
Difference between the actual and expected return on pension scheme assets:			
Amount (£m)	**9**	3	4
Percentage of scheme assets	**12%**	5%	9%
Experience (losses)/gains arising on the scheme liabilities:			
Amount (£m)	**(6)**	4	–
Percentage of the present value of scheme liabilities	**7%**	6%	–
Total amount recognised in statement of total recognised gains and losses:			
Amount (£m)	**(6)**	–	4
Percentage of the present value of scheme liabilities	**7%**	–	7%

Reconciliation to balance sheet under FRS 17:

	31 December 2005 £m	31 December 2004 £m
Total market value of assets	**74**	55
Scheme liabilities	**(92)**	(67)
Deficit in scheme	**(18)**	(12)

NOTES TO THE COMPANY BALANCE SHEET continued

5 TANGIBLE FIXED ASSETS

	Freehold land and buildings £m	Plant, machinery and equipment £m	Total £m
Cost			
At 1 January 2005	2	6	8
Additions	–	1	1
At 31 December 2005	**2**	**7**	**9**
Depreciation and diminution in value			
At 1 January 2005	1	5	6
Provided during the year	–	1	1
At 31 December 2005	**1**	**6**	**7**
Net book value			
At 31 December 2005	**1**	**1**	**2**
At 31 December 2004	1	1	2

6 FIXED ASSET INVESTMENTS

	Subsidiary undertakings			
	Investment £m	Loans investments £m	Other £m	Total £m
At 1 January 2005	2,637	577	2	3,216
Additions	173	175	–	348
Capitalisation of loan due from subsidiary undertakings	69	(69)	–	–
Distribution and loan repayments	(392)	(187)	–	(579)
Disposals	–	–	(1)	(1)
Impairment loss reversed	40	15	–	55
Exchange differences	42	(15)	–	27
At 31 December 2005	**2,569**	**496**	**1**	**3,066**

Details of the principal subsidiary undertakings, associates and joint ventures are provided in notes 39 and 40 of the Group accounts.

7 DEBTORS

	31 December 2005 £m	31 December 2004 £m
Amounts falling due within one year:		
Due from subsidiary undertakings	**275**	111
Other debtors	**25**	73
Corporation tax	**38**	–
Prepayments and accrued income	**5**	2
Total amounts falling due within one year	**343**	186

8 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	31 December 2005 £m	31 December 2004 (restated) £m
Trade creditors	**2**	5
Amounts due to subsidiary undertakings	**1,286**	1,448
Other creditors	**15**	14
Other taxation and social security	**1**	1
Bank loans	**64**	–
Corporation tax	**–**	15
Accruals and deferred income	**47**	50
Total creditors: amounts falling due within one year	**1,415**	1,533

9 PROVISIONS

	Retirement benefit obligations (restated) £m	**Deferred tax (restated) £m**	**Rationalisation and restructuring £m**	**Total (restated) £m**
At 1 January 2005	12	24	7	43
Charged to profit and loss	–	–	6	6
Credited to profit and loss	–	–	(2)	(2)
Charged/(credited) to reserves	6	(2)	–	4
At 31 December 2005	**18**	**22**	**11**	**51**

10 SHARE CAPITAL

	Authorised Ordinary Shares of 50p		**Issued and fully paid Ordinary Shares of 50p**	
	Number	**£m**	**Number**	**£m**
At 1 January 2005	2,266,000,000	1,133	1,473,269,066	737
Issue of shares under the Sharesave Scheme	–	–	858,892	–
Issue of shares under Executive Share Option Scheme	–	–	608,679	–
At 31 December 2005	**2,266,000,000**	**1,133**	**1,474,736,637**	**737**

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2004	1,700,000,000	850	1,107,091,994	554
Increase in authorised share capital	566,000,000	283	–	–
Issue of shares	–	–	365,540,834	183
Issue of shares under the Sharesave Scheme	–	–	33,077	–
Issue of shares under Executive Share Option Scheme	–	–	603,161	–
At 31 December 2004	2,266,000,000	1,133	1,473,269,066	737

Rights Issue
The Company's Rights Issue closed on 14 September 2004. A total of 366 million Ordinary Shares were issued at 82 pence per share in a 33 for 100 Rights Issue. Of the total £286 million raised (net of £14 million expenses), £183 million was credited to share capital and £103 million to the share premium account.

Ordinary Shares
Ordinary Shares rank equally between each other with regard to the right to receive dividends and also in a distribution of assets on the winding up of the Company.

Deferred shares
The Company has 21 Deferred Shares of 1 pence each in issue. These shares were issued to ensure the demerger was effected as efficiently as possible. The holders of Deferred Shares have no rights to receive dividends or to attend or vote at any general meeting.

Unclassified share
Further to the redemption of the Special Share in August 2000, the Company's authorised share capital includes one unclassified share of £1.

NOTES TO THE COMPANY BALANCE SHEET continued

11 SHARE CAPITAL AND RESERVES

	Attributable to equity holders of the parent					
	Called up share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Profit and loss account £m	Total shareholders' funds – equity £m
At 1 January 2005	737	392	145	415	289	**1,978**
Prior year adjustments	–	–	–	–	32	**32**
At 1 January 2005 (restated)	737	392	145	415	321	**2,010**
Profit for the year	–	–	–	–	21	**21**
Issue of shares	–	2	–	–	–	**2**
Dividends	–	–	–	–	(37)	**(37)**
Other movements	–	–	–	–	2	**2**
At 31 December 2005	**737**	**394**	**145**	**415**	**307**	**1,998**

As stated in note 1, changes in UK GAAP have occurred and these are reflected in the above table as prior year adjustments. The adoption of FRS 20 relating to share-based payments resulted in the recognition of £3 million as an addition to shareholders' funds. In addition, the application of FRS 21 resulted in the 2004 dividends declared not paid of £37 million being added to shareholders' funds. The remaining prior year adjustment of £8 million reflects the adoption of FRS 17 (Retirement Benefits) and is a reduction in shareholders' funds.

The share premium account, capital redemption reserve and capital reserve are not distributable.

The application of FRS 20 has required the investment in International Power's own shares to be reclassified in the balance sheet as a deduction from shareholders' funds.

A number of International Power plc Ordinary Shares are held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under the Company's 2002 Performance Share Plan and the Bonus Share Retention Plan. At 31 December 2005, the ESOTs held a total of 2,081,573 International Power plc Ordinary Shares (2004: 3,398,444). At 31 December 2005 the market value of these shares was £4,985,367 (2004: £5,191,123). The maximum number of shares required to meet all outstanding awards (assuming full vesting of those awards) at 31 December 2005 was 7,522,005 (2004: 7,772,077).

£124 million (2004: £124 million) of the Company's profit and loss reserve is not distributable as it arose from unrealised gains on intra-group transfers.

12 COMMITMENTS

Lease and capital commitments	**Year ended 31 December 2005 £m**	Year ended 31 December 2004 £m
Property leases (annual commitment):		
Expiring within one year	**–**	–
Expiring between one and five years	**–**	–
Expiring after five years	**5**	5

13 CONTINGENT LIABILITIES

a) Taxation

The Company is aware of a number of issues which are, or may be, the subject of disputes with the tax authorities. The Directors are of the opinion, having regard to the professional advice received, that adequate provision has been made for the settlement of any taxation liabilities that might arise.

b) Bonds and guarantees

Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Company totalling £448 million. Energy trading activities relating to merchant plant are supported by letters of credit and guarantees issued by the Company totalling £169 million.

14 RELATED PARTY DISCLOSURES

The Company has taken advantage of the exemption contained in FRS 8 and has therefore not disclosed transactions or balances with entities which form part of the Group.

Five-year financial summary

CONSOLIDATED INCOME STATEMENTS

The following tables of the consolidated income statements and the pre-exceptional items for the years ended 31 December 2003, 31 December 2002 and 31 December 2001, and the balance sheets at 31 December 2003, 31 December 2002, 31 December 2001 have been prepared under UK GAAP. They have been re-presented under an IFRS format, in the table below, to aid comparability.

	Year ended 31 December 2005 (IFRS) £m	Year ended 31 December 2004 (IFRS) £m	Year ended 31 December 2003 (UK GAAP) £m	Year ended 31 December 2002 (UK GAAP) £m	Year ended 31 December 2001 (UK GAAP) £m
Revenue: Group and share of joint ventures and associates	**2,936**	1,267	1,273	1,129	1,103
Less: share of joint ventures' and associates' revenue	**(1,003)**	(499)	(421)	(412)	(546)
Group revenue	**1,933**	768	852	717	557
Cost of sales – pre-exceptional	**(1,565)**	(637)	(729)	(558)	(383)
Cost of sales – exceptional	**52**	–	(404)	(103)	(2)
Gross profit/(loss)	**420**	131	(281)	56	172
Other operating income – pre-exceptional	**64**	56	66	134	80
Other operating income – exceptional	**58**	–	–	–	–
Other operating expenses – pre-exceptional	**(129)**	(78)	(64)	(85)	(89)
Other operating expenses – exceptional	**–**	11	–	–	–
Share of results of joint ventures and associates – pre-exceptional	**198**	113	160	180	161
Share of results of joint ventures and associates – exceptional	**–**	–	35	42	–
Profit from operations	**611**	233	(84)	327	324
Disposal of investments – exceptional	**10**	4	27	–	32
Finance income – pre-exceptional	**53**	30	42	24	24
Finance expenses – pre-exceptional	**(255)**	(107)	(153)	(156)	(147)
Finance expenses – exceptional	**–**	(31)	(16)	–	(29)
Profit before tax	**419**	129	(184)	195	204
Income tax expense – pre-exceptional	**(55)**	(25)	(54)	(77)	(64)
Income tax expense – exceptional	**(34)**	–	26	1	–
Profit for the year	**330**	104	(212)	119	140
Attributable to:					
Minority interests – pre-exceptional	**45**	8	7	6	2
Minority interests – exceptional	**–**	(2)	–	–	–
Equity holders of the parent – pre-exceptional	**199**	112	113	173	137
Equity holders of the parent – exceptional	**86**	(14)	(332)	(60)	1
Basic earnings/(loss) per share:					
Excluding exceptional items	**13.5p**	8.6p	9.1p	13.8p	11.0p
Including exceptional items	**19.4p**	7.5p	(17.6)p	9.0p	11.0p
Diluted earnings/(loss) per share including exceptional items	**18.5p**	7.4p	(17.6)p	9.0p	10.7p

The share of results from joint ventures and associates under UK GAAP, in the above table, is shown before interest, taxation and minority interests.

With effect from 1 January 2004, we reverted to equity accounting for our 36% stake in KAPCO and now account for it as an associate. KAPCO had previously been accounted for as a trade investment with dividend receipts recorded in income from investments. To aid comparability the dividends received in 2003 and 2002 have been included in the share of results of joint ventures and associates in the above table.

International Power

Pre-exceptional items	Year ended 31 December 2005 (IFRS) £m	Year ended 31 December 2004 (IFRS) £m	Year ended 31 December 2003 (UK GAAP) £m	Year ended 31 December 2002 (UK GAAP) £m	Year ended 31 December 2001 (UK GAAP) £m
Revenue: Group and share of joint ventures and associates	**2,936**	1,267	1,273	1,129	1,103
Less: share of joint ventures' and associates' revenue	**(1,003)**	(499)	(421)	(412)	(546)
Group revenue	**1,933**	768	852	717	557
Cost of sales	**(1,565)**	(637)	(729)	(558)	(383)
Gross profit	**368**	131	123	159	174
Other operating income	**64**	56	66	134	80
Other operating expenses	**(129)**	(78)	(64)	(85)	(89)
Share of results of joint ventures and associates	**198**	113	160	180	161
Profit from operations	**501**	222	285	388	326

The comments set out below the table on the preceding page also apply to the results presented above.

CONSOLIDATED BALANCE SHEETS

	As at 31 December 2005 (IFRS) £m	As at 31 December 2004 (IFRS) £m	As at 31 December 2003 (UK GAAP) (restated) £m	As at 31 December 2002 (UK GAAP) (restated) £m	As at 31 December 2001 (UK GAAP) £m
Non-current assets	**6,592**	5,667	2,585	2,981	3,152
Inventories	**110**	91	65	55	25
Other current asset receivables and derivatives	**676**	238	160	134	158
Cash and cash equivalents and assets held for trading	**672**	612	743	842	643
Current assets	**1,458**	941	968	1,031	826
Current liabilities	**(1,300)**	(545)	(846)	(1,405)	(615)
Non-current liabilities	**(4,375)**	(4,005)	(1,147)	(838)	(1,666)
Net assets	**2,375**	2,058	1,560	1,769	1,697
Net debt	**2,979**	2,745	692	812	897
Gearing	**125%**	133%	44%	46%	53%
Debt capitalisation	**56%**	57%	31%	31%	35%
Capital expenditure (including acquisitions)	**786**	1,469	130	319	467

Shareholder profile

AS AT 31 DECEMBER 2005

CATEGORY OF HOLDINGS

	Number of shareholders	Percentage of total shareholders	Ordinary Shares	Percentage of issued share capital
Private individuals	477,551	99.25	200,325,024	13.59
Nominee companies	3,264	0.68	1,231,895,070	83.53
Limited and public limited companies	242	0.05	11,292,443	0.77
Other corporate bodies	105	0.02	14,910,002	1.01
Pension funds, insurance companies and banks	19	0.00	16,314,098	1.10
Total	**481,181**	**100.00**	**1,474,736,637**	**100.00**

RANGE OF HOLDINGS

	Number of shareholders	Percentage of total shareholders	Ordinary Shares	Percentage of issued share capital
1 – 199	116,326	24.18	17,824,531	1.21
200 – 499	268,467	55.79	77,560,170	5.26
500 – 999	67,989	14.13	45,833,125	3.11
1,000 – 4,999	25,155	5.23	43,865,742	2.98
5,000 – 9,999	1,914	0.40	12,650,819	0.86
10,000 – 49,999	648	0.13	12,288,445	0.83
50,000 – 99,999	136	0.03	9,795,159	0.66
100,000 – 499,999	264	0.05	60,978,804	4.13
500,000 – 999,999	98	0.02	68,613,172	4.65
1,000,000 – highest	184	0.04	1,125,326,670	76.31
Total	**481,181**	**100.00**	**1,474,736,637**	**100.00**

Shareholder services and information

Annual General Meeting (AGM)
The 2006 Annual General Meeting (AGM) will be held on Wednesday 17 May 2006. Further details will be set out in the Notice of the AGM to be sent out in April 2006.

Electronic proxy voting
For the AGM you may, if you wish, register the appointment of a proxy electronically by logging on to the following website: **www.sharevote.co.uk**. You will need your voting reference numbers (the three 8-digit numbers shown on your Proxy Form). Alternatively, if you have already registered for a shareview portfolio with Lloyds TSB Registrars, then log on to your portfolio at **www.shareview.co.uk** and click on company meetings.

Shareview
www.shareview.co.uk is a service offered by Lloyds TSB Registrars that enables you to check your holdings in many UK companies and helps you to organise your investments electronically. If you have access to the internet you can register for this portfolio service which is easy to use, secure and free by logging on to **www.shareview.co.uk**. Once you have registered for a portfolio, you can also use this service to change your address details on line.

Individual Savings Accounts (ISAs)
Information on the International Power corporate ISA, which offers a tax-efficient way of holding shares, can be obtained from the ISA manager, The Share Centre on **01296 414144** or from International Power's website.

Shareholder enquiries
If you have any queries on the following:

- transfer of shares;
- change of name or address;
- lost share certificates;
- lost or out-of-date dividend cheques and payment of dividends directly into a bank or building society account;
- death of the registered holder of shares;
- receiving duplicate copies of this report;
- receiving the *Annual Report* in addition to the *Summary Annual Report*;

please contact Lloyds TSB Registrars on **0870 600 3978** or write to them at The Causeway, Worthing, West Sussex BN99 6DA.

Additional information can be found on the Lloyds TSB website at **www.lloydstsb-registrars.co.uk**.

Share dealing services
Lloyds TSB Registrars have in place a low-cost share dealing service for both the purchase and sale of shares. This is a postal service only. For information on the low-cost dealing service, or to obtain a dealing form, please contact Lloyds TSB Registrars on **0870 600 3978**.

Share price
Our latest share price information is available on **www.ipplc.com/ipplc/investors/shareinfo**. This link will provide you with International Power's latest share price, historical closing prices and volumes and an interactive share price graph.

In addition, you can now access the latest share price on your Blackberry, PDA or mobile phone at **http://mobile.ipplc.com**.

General enquiries
Please contact:
Stephen Ramsay
Company Secretary
International Power plc
Senator House
85 Queen Victoria Street
London EC4V 4DP.
Tel: 020 7320 8706

Corporate investor & media enquiries
Please contact:
Aarti Singhal
Head of Communications
International Power plc
Senator House
85 Queen Victoria Street
London EC4V 4DP.
Tel: 020 7320 8681

Website
The 2005 *Annual Report* and *Summary Annual Report* are available at **www.ipplc.com**, which also carries a wide range of other information on the Group.

Corporate social responsibility
Our annual corporate social responsibility report is available on our website.

SEC reporting
The 20-F will be available on our website prior to 30 April 2006.

Financial calendar

Announcement of Q1 results	11 May 2006
Annual General Meeting	17 May 2006
Announcement of interim results for the period ended 30 June 2006	10 August 2006
Announcement of Q3 results	9 November 2006

GLOSSARY

ABI	Association of British Insurers, a body which, inter alia, sets standards of corporate governance on behalf of Insurance companies.
ANP	American National Power.
Availability	A measure giving the proportion of electrical energy that was available during a period of time, after taking account of both planned and unplanned plant outages.
Bond	Security that obligates the issuer (International Power) to make specified payments to the bondholder (financial institutions).
Brownfield	Building a plant on a previously operational site.
CCGT	Combined cycle gas turbine – turbines, that are typically fuelled by natural gas, are used to drive generators and use exhaust gases to produce steam that in turn drives an additional turbine coupled to a generator.
CO	Carbon monoxide.
CO_2	Carbon dioxide.
Cogeneration	The simultaneous generation of heat and electricity, typically where the need for both arises for industrial or commercial purposes.
Corridor approach	Under this approach to pension plans, actuarial gains and losses are not recognised immediately. Only when the cumulative gains or losses fall outside the corridor is a specified portion recognised in the income statement from the following year onwards. The corridor is 10% of the present value of the pension rights accrued or of the fund assets at market value, whichever is greater.
CSR	Corporate social responsibility.
Dark spread	The difference between the cost of coal to generate electricity and the price at which that electricity is sold.
Debt capitalisation	Net debt divided by the sum of the net debt and total equity.
Emission allowances	Under the EU Emissions Trading Scheme allowances are granted to entities under a cap and trade emission scheme. Credits can also be purchased by entities to enable them to emit additional CO_2
EPS	Earnings per share, calculated by dividing the profit after interest, tax and minority interests by the weighted average number of shares in issue.
Gearing	Net debt divided by total equity.
Generator nameplate capacity (installed)	The maximum output of a generator, under specific conditions designated by the manufacturer. Installed generator capacity is commonly expressed in megawatts (MW) and is usually indicated on a nameplate physically attached to the generator.
Greenfield	Building a plant on a new site.
Hedge contracts	A contract that gives protection against risks of future commodity price movements.
HSE	Health, safety and environment.
HUBCO	The Hub Power Company.
IFRS	International Financial Reporting Standards.
ISO 14001	The international standard of environment management systems.
LNG	Liquefied natural gas.
Load factor	The proportion of electricity actually sold, compared with the maximum possible sales of electricity at maximum net capacity.
LTIP	Long-term incentive plan.
KAPCO	The Kot Addu Power Company.
Merchant market	A merchant market is a deregulated market in which the price of commodities, such as gas and electricity, can change due to market forces and power is sold into a traded market.
Merchant plant	Our merchant plants operate in merchant markets selling power without long-term power purchase agreements (PPAs).
MIGD	Millions of imperial gallons per day.
MW	Megawatt: one MW equals 1,000 kilowatts.
MWth	One megawatt of thermal power.
National Allocation Plan	The Plan issued under the EU Emissions Trading Scheme that sets out how greenhouse gas emission allowances will be allocated to affected industry sectors and the assets within the relevant sector.
NO_x	Oxides of nitrogen.

GLOSSARY continued

Non-recourse debt	Debt secured on an asset, and where the lender has no recourse to the shareholder.
O&M	Operations and maintenance, usually used in the context of operating and maintaining a power station.
OCGT	Open cycle gas turbine – turbines, typically fuelled by gas or diesel oil, are used to drive the generators to produce electricity.
Offtake agreement	Power purchase agreement between a company owning a power station and its customer (the offtaker) whereby the customer takes the electricity generated by a power station.
OHSAS 18001	Occupational Health and Safety Assessment Series 18001. A management system specification, developed by British Standards Institute, for health and safety which is compatible with ISO 9001:1994 (Quality) and ISO 14001:1996 (Environmental) management.
PBIT	Profit before interest and tax.
Peak load	The maximum demand for electricity during a specified high demand period. This may require use of plant (for example pumped storage) that is kept in reserve for peak periods.
PFO	Profit from operations, which includes profit after interest, tax and minority interests of joint ventures and associates.
PPA	Power Purchase Agreement (see also Offtake agreement).
Put	To sell a security back to the issuer at a pre-determined price.
Recourse debt	Debt where the lender has recourse to parties other than the borrower, usually a parent company or shareholder.
Reserve margin	The amount of plant reserve capacity above the system's peak electricity requirements.
Rights Issue	The offer of new shares to shareholders pro-rata to their current holding, usually at a discounted price.
RPI	Retail Price Index.
RREV	Research Recommendations Electronic Voting. A body which acts on behalf of institutional investors monitoring the corporate governance performance of quoted companies, and which issues recommendations for voting on resolutions at those companies' general meetings.
SO_2	Sulphur dioxide.
Spark spread	The difference between the fuel costs to generate electricity and the price at which electricity is sold.
UK GAAP	Generally Accepted Accounting Principles in the UK.
US Sarbanes-Oxley Act	The Sarbanes-Oxley Act of 2002 was enacted in reaction to the highly publicised bankruptcies of Enron and WorldCom and is concerned with strictly enforcing corporate governance and financial disclosure.

Designed and produced by Natural

www.naturalassociates.com

Board and senior management photography by Orla Deevy

Printed in the UK by Royle Corporate Print

This document is printed throughout using vegetable-based inks. The cover and pp1-76 are printed on Robert Horne Revive Special Silk which contains 60% fibre from sustainable sources, 30% de-inked post consumer waste and 10% mill waste; pp77-144 are printed on Robert Horne Revive Uncoated, a 100% recycled paper made from 80% de-inked post consumer waste and 20% mill waste. The papermill and the printer are both accredited to ISO 14001.

Our core business values

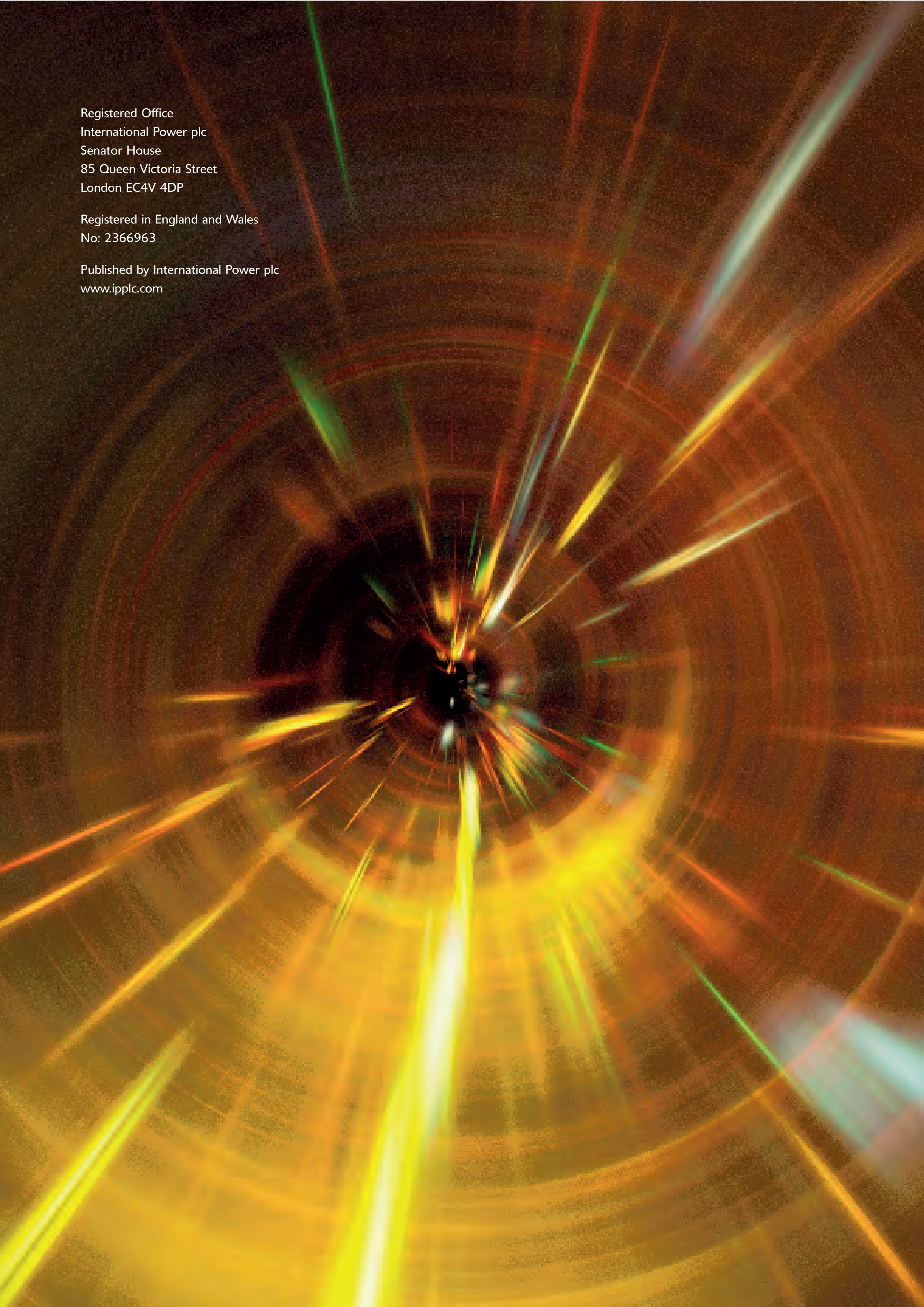
Financial discipline
Integrity of communication
Respect for the individual
Safe behaviour
Team first culture

Hidd, Bahrain

www.ipplc.com

Available on the website:

- investor presentations
- press releases
- share price information
- financial data and reports



Registered Office
International Power plc
Senator House
85 Queen Victoria Street
London EC4V 4DP

Registered in England and Wales
No: 2366963

Published by International Power plc
www.ipplc.com