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.