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.