Corporate governance

WE ARE COMMITTED TO HIGH STANDARDS OF CORPORATE GOVERNANCE AND, ALONGSIDE REPORTING ON OUR GOVERNANCE PRACTICE IN TERMS OF THE REQUIREMENTS IN FORCE AT THE BEGINNING OF 2003, WE ALSO SET OUT HOW WE COMPLY WITH THE PRINCIPLES IN THE NEW CODE, AND HOW ANY SIGNIFICANT EXCEPTIONS WILL BE ADDRESSED.

In July 2003, the Financial Reporting Council issued the revised Combined Code on Corporate Governance, which applies to reporting years beginning on or after 1 November 2003. We are committed to high standards of corporate governance and, in addition to reporting on our governance practice in terms of the requirements for 2003, we also explain how we comply with the new code.

The Board

The full Board met nine times during 2003. Tony Isaac was unable to attend two of these meetings. All other Directors were in attendance on the relevant meeting dates. Meetings of the Chairman and the Non-Executive Directors are also held without the Executive Directors being present. During 2003, two such meetings took place. The Non-Executive Directors intend to meet once a year without the Chairman present. This meeting will be chaired by Tony Isaac, the Senior Independent Non-Executive Director, and will include a review of the Chairman's performance.

From January to 30 November 2003, the Board comprised the Chairman (Sir Neville Simms); a Non-Executive Deputy Chairman (Peter Giller); two Executive Directors (David Crane and Philip Cox) and three Non-Executive Directors (Tony Isaac, Jack Taylor and Adri Baan). Tony Isaac is the Senior Independent Non-Executive Director. The three Non-Executive Directors are considered to be independent. Peter Giller was not considered to be independent because of his former role as Chief Executive Officer of the Company.

On 30 November 2003, David Crane resigned as a Director. On 11 December 2003 Philip Cox succeeded him as Chief Executive Officer. Also on 11 December 2003 Mark Williamson was appointed as Chief Financial Officer and an Executive Director. Peter Giller resigned as Deputy Chairman and as a Director on 31 December 2003. On 1 January 2004, Steve Riley and Tony Concannon were appointed as Executive Directors. The Board believes that it now has the skills and experience necessary to provide effective leadership and control of the Company.

For the majority of 2003 the effectiveness of the Board was underpinned by a balance between Executive and Non-Executive Directors. Whilst there is at present one more Executive Director than independent Non-Executive Directors, the Chairman of the Company retains the casting vote. The Board is currently seeking to recruit a new Non-Executive Director. The Board has also indicated that it intends to appoint an additional Executive Director to head our US business in due course.

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election every three years and newly appointed Directors are subject to election by shareholders at the first Annual General Meeting (AGM) after their appointment. Arrangements are in place to ensure that newly appointed Directors receive a comprehensive briefing on the Company, and training is provided for Directors on their roles and their legal obligations to ensure that they are fully conversant with their responsibilities as Directors. In accordance with this policy Tony Concannon, Steve Riley and Mark Williamson have already attended a course arranged through the Institute of Directors.

A programme of continuous training is provided for the Directors. Directors are also kept informed of changes to the regulatory regime such as the revised Combined Code, new institutional investor guidelines and the US Sarbanes-Oxley Act. All of the Directors have access to the advice and services of the Company Secretary and also to external independent advice should they so wish. Periodically the Board meets at the site of one of the Group's assets and briefings are also given at Board meetings on particular parts of the business, including regional and functional reviews.

Below and left: EOP, Czech Republic

Operation of the Board

The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial policies of the Group. It maintains a schedule of all matters requiring specific Board approval. Throughout 2003, this included all strategy decisions and significant capital investment proposals. The Board receives information on capital expenditure projects and investment proposals in advance of Board meetings, as well as management reports on the operational and financial performance of the business. Financial performance is monitored on a monthly basis and the overall performance of the Group is reviewed against approved budgets. At least once a year, the CEO presents a corporate strategy plan to the Board for review and approval. Each investment decision is made in the context of this plan.

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

A questionnaire on Board performance is completed by each Director and discussed with the Chairman and the Company Secretary. The results of this questionnaire are discussed with the Board as a whole. Overall these evaluations confirmed that the Directors considered that the Board and its Committees worked effectively. The contribution by individual Directors to Board and Committee meetings was considered to be high. The review did highlight the imbalance of the Board and, following the departure of David Crane, it was decided to widen and strengthen the Executive Director team of the Company.

Chairman and Chief Executive Officer

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

In addition to his role as Chairman of the Company, Sir Neville Simms is also Chairman of Carillion plc. The Board believes this does not compromise his role as Chairman of the Company.

Philip Cox is also a Non-Executive Director of Wincanton plc. His remuneration from this role is retained by him. His remuneration for the year ended 31 March 2003 was £28,000.

Above: Coal delivery facility, Pego, Portugal

Above: Marmara, Turkey

Non-Executive Directors and their function

Through membership of the Board Committees, the Non-Executive Directors have responsibilities for: ensuring that systems of internal control and risk management are appropriate and effective; evaluating the performance of management in meeting targets and objectives; setting the remuneration of Executive Directors; the appointment of Executive Directors; and senior management succession planning.

Board Committees

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

Audit Committee

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

The Audit Committee is comprised of all the independent Non-Executive Directors of the Company and the Chairman. Whilst the revised Combined Code states that the Audit Committee should be comprised of independent Non-Executive Directors only, the Board believes that due to the importance of the role of the Audit Committee, particularly in reviewing the role of the external auditors and internal control systems, it is appropriate for the Chairman to be a member of this Committee. The Audit Committee Chairman is Tony Isaac, who is a Fellow of the Chartered Institute of Management Accountants and, before becoming Chief Executive of The BOC Group plc, was its Group Finance Director. The Company Secretary acts as secretary to the Committee. During 2003 the Audit Committee met on four occasions. Tony Isaac and Jack Taylor attended each of these meetings, whilst Adri Baan and Sir Neville Simms attended three meetings each.

Time is set aside for the Committee to meet the external auditors without executive management present and these sessions have been extended to include the head of the Group's internal audit function. In addition to the members of the Committee, regular attendees at the Audit Committee meetings included representatives of the external auditors, the Chief Executive Officer, the Chief Financial Officer, the Group Financial Controller and the head of Internal Audit.

Remuneration Committee

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

The Committee is comprised of all of the independent Non-Executive Directors of the Company and the Chairman. The Chairman of the Committee is Adri Baan. The Human Resources Manager of International Power acts as secretary to the Committee. Whilst the revised Combined Code states that the Remuneration Committee should be comprised of independent non-executive directors only, the Board believes that given the importance of executive remuneration to the Company and the Chairman's role in maintaining contact with its principal shareholders on Directors' remuneration, it is appropriate that the Chairman of the Company be a

Our business values – FIRST – set out the ethical manner in which we operate throughout the world.

member of the Committee. During 2003 the Remuneration Committee met on four occasions. Sir Neville Simms, Adri Baan and Jack Taylor attended each of these meetings whilst Tony Isaac attended two meetings.

Appointments Committee

The Appointments Committee is responsible for matters of management succession and the identification and appointment of Directors. The Committee is comprised of the Chairman and all of the independent Non-Executive Directors of the Company. The Chairman of the Committee is Sir Neville Simms. The Human Resources Manager of International Power acts as secretary to the Committee. During 2003 the Committee met on three occasions. Sir Neville Simms was in attendance at all three meetings, whilst Adri Baan, Tony Isaac and Jack Taylor attended two meetings each.

When reviewing candidates for the appointment of Chief Executive Officer, the Appointments Committee instructed Spencer Stuart, external search consultants. The appointment of Philip Cox was made following full evaluation of internal and external candidates, after taking into account their past experience, their personal achievements and other factors such as their knowledge and experience of the global electricity industry and the business environment of International Power. For the other executive positions filled in December 2003 and in January 2004, the Appointments Committee evaluated the balance of skills, knowledge and experience required for the business. In appointing Mark Williamson, Steve Riley and Tony Concannon, the Committee was satisfied that the candidates' knowledge of the Group and the industry, and their past performance as senior managers, matched the skills and personal attributes necessary for the roles.

Relations with shareholders

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

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

International Power also runs, within the terms of the regulatory framework, frequent contact programmes with industry analysts and institutional investors to discuss matters of strategy and financial performance. Contact is made principally by the Chief Executive Officer and the Chief Financial Officer. On issues of major importance, the Chairman communicates with major shareholders. The Senior Independent Non-Executive Director (Tony Isaac) is also available as an alternative point of contact if shareholders have concerns over the Chairman's performance or where contact with the Chairman would be inappropriate. The Non-Executive Directors do not have any direct communications with institutional investors, primarily to avoid potential confusion over channels of communication. At each Board meeting an update is given on movements in major shareholdings and on contact programmes between the Executive Directors and institutional shareholders. Reports issued by financial analysts on the Company are circulated to Board members. These summaries and reports enable the Directors to gain an understanding of the views and opinions of those with an interest in the Company.

Above: SEA Gas pipeline, Australia

All results presentations and stock exchange announcements are available to shareholders on the Company's website, **www.ipplc.com**.

Accountability and audit

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

An explanation of the respective responsibilities of the Directors and external auditors in connection with the financial statements is set out on page 61. The Directors confirm on page 60 their view that the Group is a going concern.

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

Internal control

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

Systems are in place to meet the requirements of the Combined Code and the Turnbull Guidance.

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

Control environment

The Board encourages a culture of integrity and openness. The Company has an organisation structure with clear lines of accountability and authority across its worldwide operations, supported by appropriate reporting procedures. Each of the regional businesses is accountable to the Chief Executive and is managed within the strategic guidelines and delegated authorities adopted by the Board.

Control procedures

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

Above: Thai National Power (Pluak Daeng), Thailand

Performance reporting and information

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

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

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

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

Risk identification and management

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

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

Energy marketing and trading

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

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

Risk management is a key part of the annual planning process.

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

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

Monitoring

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

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

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

Compliance with the Combined Code

During the year the service agreements for both David Crane and Philip Cox contained a provision whereby if, before 31 December 2004, their service agreements were terminated by reason of a change of control of the Company, then their notice periods would be increased from 12 months to 24 months. This provision was agreed by the Remuneration and Appointments Committee upon the resignation of Peter Giller as CEO at the end of 2002 to provide security for the Executive Directors in the event of a change of control. David Crane's provision lapsed upon his resignation. Philip Cox's service agreement still has this provision in place. However, if no change of control takes place before 31 December 2004, then his notice period in the event of a change of control reverts to 12 months.

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

Above: Rugeley, UK
Left: KAPCO, Pakistan

Compliance with the revised Combined Code

The revised Combined Code applies to financial reporting years beginning on or after 1 November 2003; therefore the first reporting year to which the revised Combined Code applies for International Power is the year beginning 1 January 2004. The Board believes that it is broadly compliant with the requirements of the revised Combined Code. The Chairman, however, is a member of the Audit and Remuneration Committees. An explanation as to why the Company feels this is appropriate is provided in the narrative above. Other principal areas of variance with the revised Code requirements have already been outlined in the corporate governance report for 2003.

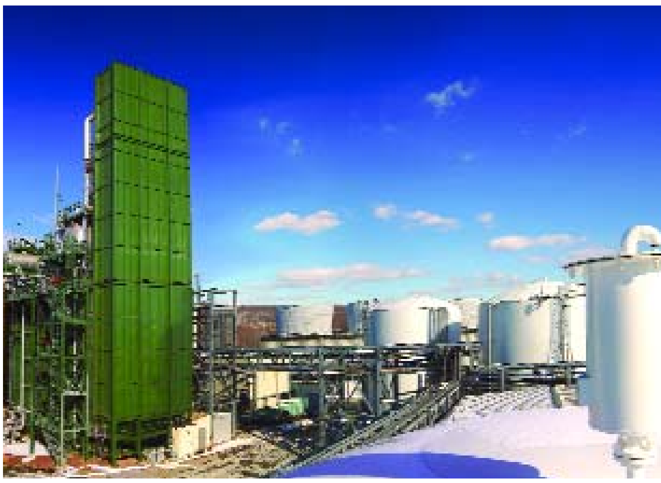
US corporate governance compliance

The Company has securities registered in the US and, as a result, it is required to comply with those provisions of the Sarbanes-Oxley Act 2002 (the Act) as it applies to foreign issuers. The Board continues to monitor the new rules arising from the Act and arrangements are also being developed to ensure that the Company will be able to report on its systems of internal controls over financial reporting as required for year ended 31 December 2005.

As recommended by the US Securities and Exchange Commission (SEC), the Company has established a Disclosure Committee comprising the Company Secretary, the head of Internal Audit and representatives of the investor relations, finance and company secretariat departments. The Committee meets regularly and is responsible for performing an oversight and advisory role in the disclosure process for the content and form of the annual report and Form 20-F. The Committee makes recommendations to the CEO, the CFO and the executive management on the adequacy of processes to permit the signing of certifications required by the Act.

In November 2003, the SEC approved changes to the listing standards of the New York Stock Exchange (NYSE) related to the corporate governance practices of listed companies. Under these rules, listed foreign private issuers, such as International Power, must disclose any significant ways in which their corporate governance practices differ from those followed by US domestic companies under the NYSE listing standards. There are no significant differences in the corporate governance practices undertaken by International Power as compared to those followed by US domestic companies under the NYSE standards. Under the terms of the NYSE rules, Sir Neville Simms is deemed to be an independent Director as all the payments he receives from the Company are in respect of Directors' fees and therefore his membership of the Audit Committee, Remuneration Committee and Appointments Committee is in accordance with the requirements of the NYSE corporate governance rules. The terms of reference of the Appointments Committee only relate to succession issues rather than corporate governance principles, which are currently reserved to the Board as a whole.

We strive to play a positive role in the communities in which we operate – they are one of our most important stakeholder groups.



Above and right: Milford, US