Notes to the accounts

FOR THE YEAR ENDED 31 DECEMBER 2003

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

ACCOUNTING POLICIES

i Basis of preparation of accounts

The financial statements of International Power plc and its subsidiary undertakings (the Group) are prepared under the historical cost convention and in accordance with applicable accounting standards, except for the departures noted below.

Certain energy-based futures contracts used for proprietary trading purposes are marked to market using externally derived market prices. This is a departure from the general provisions of Schedule 4 of the Companies Act 1985. An explanation of this departure is given in note xv.

ii Basis of consolidation

The consolidated financial statements include the financial statements of the Company and all of its subsidiary undertakings up to 31 December 2003. The results of subsidiary undertakings acquired or disposed of in the period are included in the consolidated profit and loss account from the date of acquisition or up to the date of disposal.

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

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

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

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

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

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

iii Income recognition

Turnover from plants subject to power purchase agreements (PPAs) is recognised in accordance with the contract terms in respect of owned assets or in accordance with note x for leased assets. Turnover from merchant plants is recognised as output is delivered after taking account of related hedging contracts. 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.

iv Pension costs

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

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

v 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 interest payable and similar charges.

vi Foreign exchange

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

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

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

vii Interest

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

viii Tangible fixed assets

Tangible fixed assets are stated at original cost less accumulated depreciation and any provisions for impairment in value. Liquidated damages, in respect of compensation for plants not achieving long-term performance levels specified in the original contracts, are recorded as a reduction in the cost of the assets. In the case of assets constructed by the Group, related works, commissioning and borrowing costs (as per FRS 15) are included in cost. Assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date.

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

Development expenditure is principally incurred in identifying and developing investment opportunities and typically includes feasibility studies, pre-bid costs, legal, professional and other related advisory costs.

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

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

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

Freehold land is not depreciated.

ix 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 on a discounted basis. Capitalised decommissioning costs are depreciated over the useful lives of the related assets. The unwinding of the discount is included in interest payable and similar charges.

x Leased assets
As lessee Assets leased under finance leases are capitalised and depreciated over the shorter of the lease periods and the estimated operational lives of the assets. The interest element of the finance lease repayments is charged to the profit and loss account in proportion to the balance of the capital repayments outstanding. Rentals payable under operating leases are charged to the profit and loss account on a straight line basis.

As lessor Rentals receivable under finance leases are allocated to accounting periods to give a constant periodic rate of return on the net cash investment in the lease in each period. The amounts due from lessees under finance leases are recorded in the balance sheet as a debtor at the amount of the net investment in the lease after making provision for bad and doubtful rentals receivable.

xi Fixed asset investments
Fixed asset investments (other than joint ventures and associates which are discussed in note ii) are stated at cost less provision for any impairment.

xii Current asset investments
Current asset investments are stated at the lower of cost and market value. These are included as liquid resources within the cash flow statement.

xiii Stocks
Plant spares, operating stocks of fuel and consumables are valued at the lower of cost and net realisable value. These are included as current assets.

xiv Deferred taxation
Deferred taxation is provided on timing differences, arising from the different treatment for accounts and taxation purposes of transactions and events recognised in the financial statements of the current year and previous years. Deferred taxation is calculated at the rates at which it is estimated that tax will arise. Deferred tax assets and liabilities are not discounted.

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

Energy-based futures contracts used for proprietary trading purposes are marked to market using externally derived market prices and subsequent movements in the fair value reflected through the profit and loss account. This is not in accordance with the general provisions of Schedule 4 of the Companies Act 1985, which requires that these contracts be stated at the lower of cost and net realisable value or that, if revalued, any revaluation difference be taken to a revaluation reserve. However, the Directors consider that these requirements would fail to provide a true and fair view of the results for the year since the marketability of energy trading contracts enables decisions to be taken continually on whether to hold or sell them. Accordingly the measurement of profit in any period is properly made by reference to market values. The effect of the departure on the financial statements is to reduce the loss for the year by £1 million (2002: increase the profit by £2 million) and decrease the net assets at 31 December 2003 by £4 million (2002: £nil).

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

1 GROUP SEGMENTAL ANALYSIS

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
a) By class of business		
Group turnover		
Electricity generation	**1,273**	1,129
Less: turnover of joint ventures	**(136)**	(122)
Less: turnover of associates	**(285)**	(290)
	852	717
Profit before interest and taxation (excluding all exceptional items)		
Electricity generation	**313**	417
Corporate costs	**(28)**	(29)
	285	388
b) By geographical area		
Group turnover		
North America	**414**	315
Europe	**474**	440
Middle East	**33**	–
Australia	**224**	226
Rest of the World	**128**	148
	1,273	1,129
Less: turnover of joint ventures	**(136)**	(122)
Less: turnover of associates	**(285)**	(290)
	852	717
Profit before interest and taxation (excluding all exceptional items)		
North America	**2**	99
Europe	**103**	100
Middle East	**23**	9
Australia	**101**	101
Rest of the World	**84**	108
	313	417
Corporate costs	**(28)**	(29)
	285	388

An analysis of exceptional items is given in note 8.

The loss before interest and taxation after exceptional items are for: North America loss of £402 million; Europe profit of £110 million and Rest of the World profit of £139 million (2002: Europe loss of £3 million, Rest of the World profit of £150 million).

North America loss before interest and taxation includes other income in respect of the late commissioning and performance recovery of new power plants amounting to £27 million (year ended 31 December 2002: £102 million).

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

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

Notes to the accounts continued

1 GROUP SEGMENTAL ANALYSIS continued

c) Net assets employed by geographical area	31 December 2003 £m	31 December 2002 £m
North America	**671**	1,197
Europe	**549**	536
Middle East	**72**	75
Australia	**976**	787
Rest of the World	**315**	303
Corporate and development	**(56)**	(66)
Net operating assets	**2,527**	2,832
Borrowings	**(1,435)**	(1,654)
Cash and short-term deposits	**743**	842
Deferred tax	**(205)**	(219)
Corporation tax	**(86)**	(53)
Goodwill – on acquisition of associated undertakings	**17**	20
Goodwill – on acquisition of subsidiary undertakings	**1**	1
Net assets per consolidated balance sheet	**1,562**	1,769

2 NET OPERATING COSTS

Excluding exceptional items:	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Cost of sales	**729**	558
Other operating costs	**64**	85
Other operating income	**(66)**	(134)
Net operating costs	**727**	509

Other operating income includes compensation for the late commissioning of plant, billings in respect of operations and maintenance services and profits on sale of development sites. Exceptional items would increase cost of sales by £404 million (2002: £103 million).

3 PROFIT/(LOSS) ON ORDINARY ACTIVITIES BEFORE TAXATION

Profit/(loss) on ordinary activities before taxation is stated after charging/(crediting):	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Depreciation of tangible fixed assets	**108**	111
Amortisation of intangible fixed assets	**–**	(1)
Other amortisation	**1**	2
Development costs net of recoveries and amounts capitalised	**14**	8
Operating exceptional items (note 8)	**369**	103
Property lease rentals payable (net of recoveries)	**3**	2
Foreign exchange (gains)/losses (net)	**(19)**	7
Auditors' remuneration – statutory audit:		
Fees due to the lead auditors, KPMG (including audit of the Company £0.5 m (2002: £0.4m))	**1.0**	0.7
Fees due to other auditors	**0.1**	0.1
	1.1	0.8
Auditors' remuneration – other fees paid to the lead auditors and their associates for services:		
Accounting consultations (including services to the Company £0.3m (2002: £0.3m))	**0.3**	0.4
Due diligence assistance (including services to the Company £0.1m (2002: £0.2m))	**0.1**	0.2

The Audit Committee and the firm of external auditors have safeguards 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 has been revised during the year to incorporate 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 pre-defined fee limit. Any work performed in excess of this limit must be approved by the Chief Financial Officer and the Audit Committee.

4 INTEREST RECEIVABLE AND SIMILAR INCOME

Group interest receivable and similar income	**Year ended 31 December 2003 £m**	Year ended 31 December 2002 £m
Interest receivable and similar income	**23**	24
Foreign exchange gains (net)	**19**	–
Total Group interest receivable and similar income	**42**	24

5 INTEREST PAYABLE AND SIMILAR CHARGES

a) Group interest payable and similar charges	**Year ended 31 December 2003 £m**	Year ended 31 December 2002 £m
Interest on:		
Bank loans and overdrafts	**101**	102
Other borrowings	**22**	17
	123	119
Foreign exchange losses (net)	**–**	7
Interest capitalised	**(2)**	(5)
Group interest payable and similar charges – ordinary	**121**	121
Exceptional interest (note 8)	**16**	–
Total Group interest payable and similar charges	**137**	121
b) Interest payable of joint ventures and associates		
Share of interest payable of joint ventures	**10**	12
Share of interest payable of associates	**22**	23
Total interest payable of joint ventures and associates	**32**	35

6 DIRECTORS' AND EMPLOYEES' REMUNERATION

a) Directors' remuneration

Details of Directors' remuneration are set out on pages 46 to 59.

b) Employees' remuneration

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Salaries and other staff costs, including Directors' remuneration were as follows:		
Wages and salaries	**68**	63
Social security costs	**4**	3
Pension costs (note 7)	**6**	5
Total employees' remuneration	**78**	71
Less: amounts capitalised as part of assets in the course of construction	**(1)**	(1)
Total staff costs	**77**	70

6 DIRECTORS' AND EMPLOYEES' REMUNERATION continued

Employee numbers

	Year ended 31 December 2003 No.	Year ended 31 December 2002 No.
Average number of employees during the financial year, analysed by geographic segment was:		
North America	**212**	207
Europe	**746**	769
Middle East	**342**	43
Australia	**591**	593
Rest of the World	**362**	367
Corporate and development	**163**	146
Total average number of employees	**2,416**	2,125

7 PENSION SCHEME FUNDING

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

For 2002 SSAP 24 disclosures, the pension expense was taken to be equal to the total contributions paid, as assets and liabilities in respect of members' pensionable service prior to 1 April 2002 were not transferred to the Group until late 2002.

Pension costs for 2003 have been calculated using assumptions consistent with those used to assess the initial rate of contributions paid by the Group, and based on market conditions at the start of the accounting period.

The pension cost for 2003 is £3.1 million, comprising £2.6 million regular cost and £0.5 million variation cost.

The principal assumptions used to calculate these pension costs are set out below:

Pre-retirement investment return	6.5% pa
Post-retirement investment return	5.0% pa
Salary increases	3.8% pa
Pension increases in deferment	2.5% pa
Pension increases in payment	2.5% pa

The actuarial value of assets as at 31 March 2003, the date of the first formal actuarial valuation, was £33 million. The accrued liabilities valued on the projected unit method using assumptions set out below, were £43 million. The market value of assets was, therefore, 77% of accrued liabilities. Arrangements have been made to make good the past service deficit over the average future working lifetime of the membership (calculated to be approximately 12 years).

The principal assumptions used for the 31 March 2003 valuation are:

Pre-retirement investment return	6.6% pa
Post-retirement investment return	5.1% pa
Salary increases	4.1% pa
Pension increases in deferment	2.7% pa
Pension increases in payment	2.7% pa

AUSTRALIA: Employees at Hazelwood 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.

At 31 December 2003, the actuarial value of assets was 104% of accrued liabilities. The assets were £54 million and liabilities £52 million. The pension cost for 2003 was £2 million.

The principal assumptions are set out below:

Valuation date	**31 December 2003**
Principal assumptions:	
Investment return	7.5% pa
Salary increases	5.0% pa
Pensions increases	n/a

In other countries employees are members of local social security schemes and in some cases defined contribution plans. The charge for 2003 in respect of defined contribution plans was £1 million.

FRS 17

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

The valuation used for FRS 17 disclosures for the UK schemes has been based on the most recent actuarial valuations at 30 November 2001, 31 March 2002 and 31 March 2003, and updated by qualified independent actuaries to take account of the requirements of FRS 17 to assess the liabilities of the schemes at 31 December 2003.

The Group operates a number of defined benefit schemes for employees of its overseas businesses. Full actuarial valuations of these schemes have been carried out within the last three years and results have been updated to 31 December 2003 by qualified independent actuaries.

The assumptions used to calculate scheme liabilities under FRS 17 are:

	31 December 2003		31 December 2002		31 December 2001	
	UK %	**Australia %**	UK %	Australia %	UK %	Australia %
Financial assumptions						
Discount rate	**5.40**	**7.50**	5.50	7.00	5.80	7.25
Rate of increase in salaries	**4.30**	**4.00**	3.80	4.00	4.00	4.00
Inflation rate	**2.80**	**3.00**	2.30	3.50	2.50	3.00
Increase to deferred benefits during deferment	**2.90**	**n/a**	2.50	n/a	2.60	n/a
Increases to pensions payments	**2.90**	**n/a**	2.50	n/a	2.60	n/a

The amounts required to be disclosed by FRS 17 in respect of the performance statements were:

Analysis of amounts that would have been charged to operating profit in respect of defined benefit schemes	**Group 2003 £m**	Group 2002 £m
Current service	**(5)**	(3)
Past service cost	**–**	(1)
Total operating charge	**(5)**	(4)

Analysis of amounts that would have been credited to other finance income	**Group 2003 £m**	Group 2002 £m
Expected return on schemes' assets	**5**	5
Interest on schemes' liabilities	**(5)**	(4)
Net return	**–**	1

Analysis of amounts that would have been recognised in the consolidated statement of total recognised gains and losses	**Group 2003 £m**	Group 2002 £m
Actual return less expected return on schemes' assets	**5**	(11)
Experience gains/(losses) arising on schemes' liabilities	**(3)**	(1)
Changes in the assumptions underlying the present value of schemes' liabilities	**(7)**	(5)
Currency translation adjustment	**1**	–
Actuarial loss recognised in the consolidated statement of total recognised gains and losses	**(4)**	(17)

History of experience gains and losses	**Group 2003**	Group 2002
Difference between the actual and expected return on schemes' assets:		
Amount (£m)	**5**	(11)
Percentage of schemes' assets	**5%**	15%
Experience gains and losses on schemes' liabilities:		
Amount (£m)	**(3)**	(1)
Percentage of schemes' liabilities	**3%**	1%
Total amount recognised in the consolidated statement of total recognised gains and losses:		
Amount (£m)	**(4)**	(17)
Percentage of the present value of schemes' liabilities	**4%**	22%

7 PENSION SCHEME FUNDING continued

	31 December 2003 UK %	31 December 2003 Australia %	31 December 2002 UK %	31 December 2002 Australia %	31 December 2001 UK %	31 December 2001 Australia %
The assets in the schemes and expected rates of return (weighted averages) were:						
Long-term rate of return expected						
Equities	**7.8**	**7.6**	7.0	7.5	7.4	7.5
Bonds	**5.1**	**4.8**	4.5	5.5	4.9	5.5
Other	**6.6**	**6.1**	4.8	5.5	–	5.5

	2003 UK £m	2003 Australia £m	2003 Total £m	2002 UK £m	2002 Australia £m	2002 Total £m	2001 UK £m	2001 Australia £m	2001 Total £m
Assets in schemes									
Equities	**36**	**35**	**71**	27	24	51	19	23	42
Bonds	**5**	**14**	**19**	4	12	16	16	12	28
Other	**4**	**5**	**9**	3	4	7	–	5	5
Total market value of assets	**45**	**54**	**99**	34	40	74	35	40	75
Present value of scheme liabilities	**(58)**	**(50)**	**(108)**	(43)	(36)	(79)	(39)	(25)	(64)
(Deficit)/surplus in the scheme	**(13)**	**4**	**(9)**	(9)	4	(5)	(4)	15	11
Related deferred tax asset/(liability)	**4**	**(1)**	**3**	3	(1)	2	1	(5)	(4)
Net pension (liability)/asset	**(9)**	**3**	**(6)**	(6)	3	(3)	(3)	10	7

Other assets principally comprise property and cash.

If the above amounts had been recognised in the financial statements, the Group's net assets and profit and loss reserve at 31 December would be as follows:

	Group 2003 £m	Group 2002 £m	Group 2001 £m
Net assets			
Net assets excluding pension asset/(liability)	**1,562**	1,769	1,697
FRS 17 pension (liability)/asset	**(6)**	(3)	7
Net assets including FRS 17 pension (liability)/asset	**1,556**	1,766	1,704
Reserves			
Profit and loss reserve excluding net pension (liability)/asset	**113**	330	260
Net pension (liability)/asset	**(6)**	(3)	7
Profit and loss reserve including FRS 17 pension (liability)/asset	**107**	327	267

	Group 2003 £m	Group 2002 £m
Movement in (deficit)/surplus during the year:		
(Deficit)/surplus in the schemes at the beginning of the year	**(5)**	11
Current service cost	**(5)**	(3)
Contributions	**5**	4
Past service cost	**–**	(1)
Other finance income	**–**	1
Actuarial loss	**(4)**	(17)
Deficit in the schemes at the end of the year	**(9)**	(5)

8 EXCEPTIONAL ITEMS

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
Net operating exceptional items charged/(credited):		
Deeside impairment	–	45
Rugeley impairment	–	58
Impairment of US plant	404	–
Reversal of HUBCO impairment	(35)	–
Net operating exceptional items	**369**	103
Exceptional income from investments:		
Backlog dividend received from KAPCO	–	(42)
Exceptional income from investments	**–**	(42)
Total operating exceptional items and investment income	**369**	61
Non-operating exceptional items credited:		
Profit on disposal of a 5% holding in HUBCO	(17)	–
Profit on disposal of a Czech fixed asset investment	(7)	–
Release of provision in respect of sale of Chinese operations	(3)	–
Non-operating exceptional items	**(27)**	–
Exceptional interest charges:		
Write off of unamortised finance charges	16	–
Exceptional interest payable and similar charges	**16**	–
Total exceptional items before attributable taxation	**358**	61
Taxation on exceptional items	(26)	(1)
Total exceptional items after attributable taxation	**332**	60

The revised carrying values of the plants were determined 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.

9 TAX ON PROFIT ON ORDINARY ACTIVITIES

	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
a) Analysis of charge in year		
Current taxation		
UK corporation tax at 30% (year ended 31 December 2002: 30%)	26	25
Foreign taxation	13	21
Share of joint ventures' taxation	2	2
Share of associates' taxation	16	17
Total current taxation charge for year	**57**	65
Deferred taxation		
Origination and reversal of timing differences	(30)	11
Share of joint ventures' deferred taxation	1	–
Total deferred taxation charge for year	**(29)**	11
Total taxation charge for the year	**28**	76
Included in the tax on profit are the following amounts relating to exceptional items:		
Operating exceptional items (deferred tax)	(27)	(14)
Exceptional income from investments (current tax)	–	13
Non-operating exceptional items (current tax)	2	–
Exceptional interest charges (current tax)	(1)	–
Taxation credit on exceptional items	**(26)**	(1)

9 TAX ON PROFIT ON ORDINARY ACTIVITIES continued

b) Reconciliation of current tax charge

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

	2003			2002		
	Current tax £m	**Deferred tax £m**	**Total £m**	Current tax £m	Deferred tax £m	Total £m
Corporation tax at 30%	**52**	**–**	**52**	77	–	77
Permanent differences	**6**	**–**	**6**	5	–	5
Origination or reversal of timing differences	**2**	**(2)**	**–**	(25)	25	–
Tax holidays	**(10)**	**–**	**(10)**	(9)	–	(9)
Effect of tax rate applied to overseas earnings	**6**	**–**	**6**	4	–	4
Tax charge for the year before exceptional items	**56**	**(2)**	**54**	52	25	77
Exceptional items	**1**	**(27)**	**(26)**	13	(14)	(1)
Tax charge for the year	**57**	**(29)**	**28**	65	11	76

10 PROFIT OF THE PARENT COMPANY

The profit of the parent company for the financial year amounted to £121 million (year ended 31 December 2002: loss of £176 million). By virtue of Section 230 of the Companies Act 1985, the Company is exempt from presenting a separate profit and loss account.

11 EARNINGS PER SHARE

a) Earnings per share – basic	**Year ended 31 December 2003 pence**	Year ended 31 December 2002 pence
Before exceptional items	**10.2**	15.5
Exceptional items	**(29.9)**	(5.4)
After exceptional items	**(19.7)**	10.1

b) Earnings per share – diluted		
Before exceptional items	**10.1**	15.5
Exceptional items	**(29.9)**	(5.4)
After exceptional items	**(19.7)**	10.1

c) Basis of calculation – earnings	**£m**	£m
Profit attributable to shareholders before exceptional items	**113**	173
Exceptional items	**(332)**	(60)
Loss/profit attributable to shareholders after exceptional items	**(219)**	113

d) Basis of calculation – number of Ordinary Shares	**Million**	Million
Weighted average number of issued Ordinary Shares	**1,114.1**	1,117.6
Weighted average number of shares held by Employee Share Ownership Plans (ESOPs)	**(3.2)**	(2.2)
	1,110.9	1,115.4
Dilutive potential Ordinary Shares:		
Employee share schemes	**9.2**	2.6
Weighted average number of Ordinary Shares taking account of applicable dilutive instruments	**1,120.1**	1,118.0

FRS 14 requires presentation of diluted earnings per share when a company could be called upon to issue shares that would decrease net profit or increase net loss per share. A net loss per share would only be increased by the exercise of out-of-the money share options. Since it seems inappropriate to assume that option holders would act irrationally, no adjustment has been made for out-of-the-money options and hence diluted EPS (after exceptional items) equals basic EPS (after exceptional items).

12 INTANGIBLE FIXED ASSETS

The Group	Goodwill £m	Negative goodwill £m	Total £m
Cost			
At 1 January 2003	10	(10)	–
Exchange rate differences	1	(1)	–
At 31 December 2003	**11**	**(11)**	**–**
Amortisation			
At 1 January 2003	(2)	3	1
(Charged)/credited in the year	(2)	2	–
At 31 December 2003	**(4)**	**5**	**1**
Net book value at 31 December 2003	**7**	**(6)**	**1**
Net book value at 31 December 2002	8	(7)	1

Goodwill arising on the acquisition of joint ventures and associated undertakings is set out in note 14 – fixed asset investments.

13 TANGIBLE FIXED ASSETS

a) The Group	Freehold land and buildings £m	Plant, machinery and equipment £m	Assets in course of construction £m	Total £m
Cost				
At 1 January 2003	82	2,903	88	3,073
Additions	4	68	48	120
Compensation for long-term performance shortfalls	–	(127)	–	(127)
Reclassifications and transfers	2	98	(111)	(11)
Disposals	(1)	(5)	–	(6)
Exchange rate differences	2	76	(2)	76
At 31 December 2003	**89**	**3,013**	**23**	**3,125**
Depreciation and diminution in value				
At 1 January 2003	18	582	–	600
Provided during the year	3	105	–	108
Impairment	–	404	–	404
Compensation for long-term performance shortfalls	–	(33)	–	(33)
Reclassifications and transfers	–	(5)	–	(5)
Disposals	–	(3)	–	(3)
Exchange rate differences	1	5	–	6
At 31 December 2003	**22**	**1,055**	**–**	**1,077**
Net book value at 31 December 2003	**67**	**1,958**	**23**	**2,048**
Net book value at 31 December 2002	64	2,321	88	2,473

Interest capitalised in the year was £2 million. On a cumulative basis, the net book value of interest capitalised is £85 million.

The total value of land that is not depreciated included within freehold land and buildings is £27 million (31 December 2002: £28 million).

13 TANGIBLE FIXED ASSETS continued

b) The Company	Freehold land and buildings £m	Plant, machinery and equipment £m	Total £m
Cost			
At 1 January 2003	1	5	6
Additions	–	–	–
At 31 December 2003	**1**	**5**	**6**
Depreciation and diminution in value			
At 1 January 2003	1	3	4
Provided during the year	–	1	1
At 31 December 2003	**1**	**4**	**5**
Net book value at 31 December 2003	**–**	**1**	**1**
Net book value at 31 December 2002	–	2	2

14 FIXED ASSET INVESTMENTS

	Joint ventures	Associated undertakings			
a) The Group	Share of net assets £m	Share of net assets £m	Goodwill £m	Other investments £m	Total £m
At 1 January 2003	102	283	20	102	507
Share of post-tax profit	19	94	(2)	–	111
Additions	8	–	–	2	10
Distribution and loan repayments	(10)	(58)	–	(1)	(69)
Disposals	–	(4)	–	(4)	(8)
Reclassifications and transfers	7	–	–	–	7
Amortisation	–	–	–	(1)	(1)
Exchange rate differences	–	(17)	(1)	(1)	(19)
At 31 December 2003	**126**	**298**	**17**	**97**	**538**

Included within the Group's share of net assets of joint ventures and associated undertakings is net debt of £712 million (31 December 2002: £503 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.

Group share of associated undertakings' net assets	31 December 2003 £m	31 December 2002 £m
Share of fixed assets	**821**	602
Share of current assets	**226**	221
	1,047	823
Share of liabilities due within one year	**(79)**	(157)
Share of liabilities due after more than one year	**(670)**	(383)
	(749)	(540)
Share of net assets	**298**	283

Group share of joint ventures' net assets	31 December 2003 £m	31 December 2002 £m
Share of fixed assets	**302**	260
Share of current assets	**35**	40
	337	300
Share of liabilities due within one year	**(37)**	(46)
Share of liabilities due after more than one year	**(174)**	(152)
	(211)	(198)
Share of net assets	**126**	102

The Group investments that are listed on a recognised stock market are those in The Hub Power Company Limited (HUBCO) and Malakoff Berhad. Both are associated undertakings.

At 31 December 2003, the Group's share of HUBCO was valued at £90 million (2002: £126 million) on the major Pakistan stock markets and the Group's share in Malakoff Berhad was valued at £128 million (2002: £108 million) on the Kuala Lumpur stock market. Market values for both Group shareholdings were in excess of the respective book values at the year end.

Kot Addu Power Company Limited (KAPCO), in which the Group holds 36% of the shares, is classified as a trade investment because International Power plc does not exercise significant influence over the company.

b) The Company	Subsidiary undertakings Investment £m	Subsidiary undertakings Loans £m	Other investments £m	Total £m
At 1 January 2003	1,015	862	1	1,878
Additions	1,172	362	2	1,536
Distribution and loan repayments	(438)	–	–	(438)
Disposals	(94)	(784)	–	(878)
Amortisation	–	–	–	–
Impairment	(227)	(15)	–	(242)
Exchange rate differences	–	(6)	–	(6)
At 31 December 2003	**1,428**	**419**	**3**	**1,850**

Details of the principal subsidiary undertakings, associates and joint ventures are provided in note 32.

Within other investments are a number of International Power plc Ordinary Shares held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under a number of employee share plans (see note 22). At 31 December 2003, the ESOTs held a total of 3,003,312 International Power plc Ordinary Shares (2002: 1,917,414). At 31 December 2003, the market value of these shares was £3,709,090. The maximum number of shares required to meet all outstanding awards (assuming full vesting of those awards) as at 31 December 2003 was 842,171 (2002: 1,730,255).

15 STOCKS

	Group 31 December 2003 £m	Group 31 December 2002 £m	Company 31 December 2003 £m	Company 31 December 2002 £m
Plant spares	**18**	14	**–**	–
Fuel stocks	**18**	15	**–**	–
Consumables	**29**	26	**–**	–
Total stocks	**65**	55	**–**	–

16 DEBTORS

	Group 31 December 2003 £m	Group 31 December 2002 £m	Company 31 December 2003 £m	Company 31 December 2002 £m
Amounts recoverable within one year:				
Trade debtors	**50**	48	**–**	–
Due from subsidiary undertakings	**–**	–	**217**	55
Other debtors	**54**	23	**27**	14
Prepayments and accrued income	**53**	59	**3**	3
Total amounts recoverable within one year	**157**	130	**247**	72
Amounts recoverable after more than one year:				
Other debtors	**3**	4	**–**	–
Total amounts recoverable after more than one year	**3**	4	**–**	–
Total debtors	**160**	134	**247**	72

17 CURRENT ASSET INVESTMENTS

	Group 31 December 2003 £m	Group 31 December 2002 £m	Company 31 December 2003 £m	Company 31 December 2002 £m
Current asset investments	**70**	43	**–**	–

Current asset investments are primarily short-term money market deposits used for fund management and treasury purposes.

18 CREDITORS: AMOUNTS FALLING DUE WITHIN ONE YEAR

	Group		Company	
	31 December 2003 £m	31 December 2002 £m	**31 December 2003 £m**	31 December 2002 £m
Trade creditors	**71**	106	**1**	1
Amounts due to subsidiary undertakings	**–**	–	**814**	562
Other creditors	**58**	34	**14**	11
Other taxation and social security	**–**	–	**1**	1
Corporation tax	**86**	53	**19**	12
Accruals and deferred income	**100**	134	**41**	52
Bank loans (secured)	**531**	810	**–**	–
6.25% Euro Dollar Bonds 2003	**–**	37	**–**	37
2% Convertible US Dollar Bonds 2005	**–**	231	**–**	–
Total bonds	**–**	268	**–**	37
Total creditors: amounts falling due within one year	**846**	1,405	**890**	676

The bank loans are secured by fixed and floating charges over the assets of certain subsidiary undertakings.

Secured loans without recourse
Secured bank loans without recourse are those where the obligation to repay lies solely with the subsidiary undertaking and are secured solely on the assets of the subsidiary undertaking concerned.

At 31 December 2003, we were in discussions with bank groups in relation to claimed technical defaults on the non-recourse debt for the US merchant portfolio. As these issues were not formally resolved at 31 December 2003, the debt at ANP has been reported as current non-recourse debt in our accounts.

19 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR

	Group		Company	
	31 December 2003 £m	31 December 2002 £m	**31 December 2003 £m**	31 December 2002 £m
Other creditors	**5**	7	**–**	–
Bank loans (secured):				
between one and five years	**262**	138	**–**	–
over five years	**442**	438	**–**	–
Total bank loans	**704**	576	**–**	–
2% Convertible US Dollar Bonds 2005	**62**	–	**–**	–
6.25% Convertible US Dollar Bonds 2023	**138**	–	**–**	–
Total bonds	**200**	–	**–**	–
Total creditors: amounts falling due after more than one year	**909**	583	**–**	–

The bank loans are secured by fixed and floating charges over the assets of certain subsidiary undertakings.

Convertible bonds

2% Convertible US Dollar Bonds 2005
On 24 November 2000, International Power (Cayman) Limited, a wholly-owned subsidiary company incorporated in the Cayman Islands, issued US$357 million 2% convertible notes due 2005, convertible into Preference Shares of International Power (Cayman) Limited at the holder's option, exchangeable for Ordinary Shares of, and unconditionally guaranteed on a senior unsecured basis by, International Power plc.

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 300p at any time between 4 January 2001 and 23 November 2005. 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 (Cayman) Limited. Investors may elect to receive their Ordinary Shares in the form of American Depositary Receipts.

On 24 November 2003, US$254 million of the notes were redeemed at the holder's option at a redemption price of 107.1% of its principal amount, together with accrued and unpaid interest. The balance of US$103 million will remain for a further two-year period at an effective interest rate of 4.6%.

The 'unput' convertible unsecured notes will be redeemed on 24 November 2005 at a redemption price of 112.4% of its principal amount. Accordingly the convertible bond is now shown within long-term liabilities.

3.75% Convertible US Dollar Bonds
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.

19 CREDITORS: AMOUNTS FALLING DUE AFTER MORE THAN ONE YEAR (continued)

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 200p at any time between 2 October 2003 and 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.

Premium on redemption of convertible bonds

Provision is made for the possible premium on redemption of the 2005 and 2023 convertible bonds. This is included within the carrying amount of the bonds. At 31 December 2003, the amount accrued was £8 million (31 December 2002: £13 million). The finance cost charged in the profit and loss account comprises the aggregate of the coupon on the convertible unsecured notes and the proportion of the premium on redemption that relates to the financial year.

20 PROVISIONS FOR LIABILITIES AND CHARGES

a) The Group	Deferred tax £m	Rationalisation and restructuring £m	Other £m	Total £m
At 1 January 2003	219	11	25	255
Charged to profit and loss	28	1	1	30
Credited to profit and loss	(58)	–	(4)	(62)
Provisions utilised/released	–	(3)	(2)	(5)
Transfer to corporation tax	(4)	–	–	(4)
Foreign exchange	20	–	4	24
At 31 December 2003	**205**	**9**	**24**	**238**

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.

b) The Company	Deferred tax £m	Rationalisation and restructuring £m	Total £m
At 1 January 2003	36	11	47
Provisions utilised/released	–	(3)	(3)
Reclassifications and transfers	(6)	–	(6)
At 31 December 2003	**30**	**8**	**38**

21 DEFERRED TAXATION

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

	31 December 2003 £m	31 December 2002 £m
Full potential deferred tax liabilities		
Tangible fixed assets accelerated capital allowances	**(175)**	(237)
Other timing differences	**(21)**	(24)
Dividends of overseas subsidiary undertakings	**(16)**	(17)
Total gross deferred tax liabilities	**(212)**	(278)
Less: deferred tax liabilities not provided	**–**	–
Total deferred tax liabilities provided	**(212)**	(278)
Full potential deferred tax assets		
Provisions	**3**	2
Tax losses	**86**	45
Other timing differences	**35**	12
Total gross deferred tax assets	**124**	59
Less: deferred tax assets not recognised	**(117)**	–
Total deferred tax asset recognised	**7**	59
Net deferred tax liability recognised	**(205)**	(219)

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

22 SHARE CAPITAL

	Authorised Ordinary Shares of 50p	£m	Issued and fully paid Ordinary Shares of 50p	£m
At 1 January 2003	1,700,000,000	850	1,117,561,520	559
Issue of shares under the Sharesave Scheme	–	–	1,944	–
Issue of shares under Executive Share Option Scheme	–	–	180,853	–
Shares bought back and cancelled	–	–	(10,652,323)	(5)
At 31 December 2003	**1,700,000,000**	**850**	**1,107,091,994**	**554**

Deferred Shares

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

Unclassified Share

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

Employee Share Plans

a) Share Options Plans

The Company operates the following employee share plans for which shares may be issued by the Company out of authorised but unissued share capital upon exercise of options: the 2002 Performance Share Plan; the UK Approved and Unapproved Executive Share Option Plans; the Global Executive Share Option Plan; the UK Approved Sharesave Plan and the Global Sharesave Plan. The UK Approved Sharesave Plan and the Global Sharesave Plan are savings related and enable employees to invest up to a maximum of £250 per month.

		Number of Ordinary Shares (millions)			
Note		Sharesave Schemes	Executive Share Option Schemes	Performance Share Plan	Total
i)	Outstanding at 1 January 2003	3.7	11.2	–	14.9
	Granted	2.2	11.8	3.8	17.8
ii)	Exercised/lapsed	(0.2)	(0.3)	–	(0.5)
	Total options outstanding at 31 December 2003	**5.7**	**22.7**	**3.8**	**32.2**

			Number of Ordinary Shares	
i) Options outstanding	Option price	Date exercisable	31 December 2003	31 December 2002
Sharesave Schemes	307.51p	2003	**–**	4,486
	250.00p	2003	**775**	775
	188.00p	2004	**12,159**	18,856
	188.00p	2006	**8,976**	17,952
	200.00p	2004	**6,780**	6,780
	200.00p	2006	**7,592**	16,029
	90.00p	2005	**1,076,670**	1,181,040
	90.00p	2007	**2,492,950**	2,492,950
	110.00p	2006	**291,557**	–
	110.00p	2008	**216,667**	–
	79.00p	2006	**875,724**	–
	79.00p	2008	**748,259**	–
Executive Share Option Schemes	297.94p	1996-2003	**52,935**	54,085
	336.21p	1997-2004	**101,858**	101,858
	306.14p	1998-2005	**290,736**	290,736
	323.23p	1999-2006	**472,639**	472,639
	386.09p	2000-2007	**555,541**	555,541
	352.61p	2001-2008	**761,052**	766,660
	331.42p	2002-2007	**33,206**	33,206
	311.75p	2003-2010	**2,689,810**	2,704,525
	235.00p	2004-2011	**1,935,593**	1,949,477
	217.00p	2004-2011	**165,778**	165,778
	196.00p	2005-2012	**4,038,393**	4,056,787
	70.00p	2006-2013	**11,609,290**	–
Performance Share Plan 2002	84.00p	2005-2006	**3,807,057**	–
Total options outstanding			**32,251,997**	**14,890,160**

ii) Options exercised	Option price	Number of options	Nominal value £	Consideration £
Executive Share Option Schemes	70.00p	180,853	90,426	126,597
Sharesave Schemes	90.00p	1,944	972	1,750
Total options exercised during the year		**182,797**	**91,398**	**128,347**

b) Profit Sharing Share Scheme

In addition to the above, the Company operates an Inland Revenue Approved Profit Sharing Share Scheme. No further appropriations have been made in respect of this scheme. On 26 May 2003, 454,285 shares in International Power plc, representing the balance of the shares held in trust were released to 1,885 present and former employees of the Group. No further appropriations were made in respect of this scheme during the year.

c) Demerger Share Plan

At demerger, the Board of the Company established the Demerger Share Plan to provide an incentive to those employees (other than Executive Directors) who were remaining in continuous full-time employment with the Company. On 3 October 2000, the Board made conditional awards of 288,359 shares to 181 employees of the Company. No specific purchases of shares were made in respect of this Plan as the Company utilised the balance of shares unallocated from two former employee share plans which ceased operation at demerger to meet the vesting of conditional awards under this plan. During the year, a total of 15,241 shares were released to individuals ceasing employment with the Company in accordance with their entitlement under the rules of the Demerger Share Plan. On 3 October 2003, the Demerger Share Plan vested and a total 244,094 shares were released to employees.

d) 2002 Performance Share Plan

At the AGM in May 2003, shareholders approved the establishment of the 2002 Performance Share Plan. The Company granted to the Trustee an option to acquire 3,807,057 Ordinary Shares in the Company at an option price of 84 pence per share. This option can only be exercised to the extent required to satisfy conditional awards made on 10 March 2003 under the 2002 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 achieved. The performance period ends on 31 December 2005. No shares were released in respect of this share plan during 2003.

e) Managers' share bonus arrangements

During 2003 a total of 1,800,000 shares in International Power were acquired in respect of the annual incentive arrangements for Executive Directors and senior managers for a consideration of £1.5 million. These shares have been placed in an Employee Share Ownership Trust.

f) Employee Share Schemes

The Group takes advantage of the exemption granted under UITF 17 (Employee Share Schemes) whereby no compensation expense need be recorded for SAYE employee schemes.

23 RESERVES

a) The Group	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Profit and loss account £m	Total shareholders' funds – equity £m
At 1 January 2003	559	289	140	422	330	1,740
Share buyback	(5)	–	5	–	(13)	(13)
Loss for the financial year	–	–	–	–	(219)	(219)
Other recognised gains and losses relating to the year (net)	–	–	–	–	15	15
At 31 December 2003	**554**	**289**	**145**	**422**	**113**	**1,523**

b) The Company	£m	£m	£m	£m	£m	£m
At 1 January 2003	559	289	140	415	137	1,540
Share buyback	(5)	–	5	–	(13)	(13)
Profit for the financial year	–	–	–	–	121	121
At 31 December 2003	**554**	**289**	**145**	**415**	**245**	**1,648**

The share premium account, capital redemption reserve and capital reserve are not distributable.

The cumulative amount of goodwill set off to reserves prior to the adoption of FRS 10 on acquisition of subsidiary undertakings is £95 million (31 December 2002: £95 million). £143 million of the Company's profit and loss reserve is not distributable as it arose from unrealised gains on intra-group transfers.

Notes to the accounts continued

24 NOTES TO THE CASH FLOW STATEMENT

Note	a) Reconciliation of operating profit to net cash inflow from operating activities	Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
	Operating (loss)/profit	**(279)**	105
13	Impairment	**404**	103
		125	208
13	Depreciation	**108**	111
12	Goodwill amortisation	**–**	(1)
14	Other amortisation	**1**	2
	Movement in working capital:		
	Increase in stocks	**(5)**	(29)
	(Increase)/decrease in debtors	**(25)**	19
	Decrease in creditors	**(13)**	(37)
	(Decrease)/increase in provisions	**(7)**	3
	Net cash inflow from operating activities	**184**	276

b) Dividends received from joint ventures and associates		
Dividends from joint ventures	**10**	12
Dividends from associates	**58**	72
Total dividends received from joint ventures and associates	**68**	84

c) Returns on investments and servicing of finance		
Other interest and dividends received	**26**	24
Debt and loan interest paid	**(105)**	(102)
Debt issue costs paid	**(3)**	(8)
Dividends paid to minority shareholders	**(2)**	(2)
Returns on investments and servicing of finance – ordinary	**(84)**	(88)
Returns on investments and servicing of finance – exceptional:		
Refinancing charges	**(4)**	(25)
Net cash outflow from returns on investments and servicing of finance	**(88)**	(113)

d) Capital expenditure and financial investment		
Purchase of tangible fixed assets:		
Maintenance	**(64)**	(48)
Growth	**(57)**	(96)
Purchase of tangible fixed assets	**(121)**	(144)
Receipts from sale of fixed assets	**1**	–
Compensation for long-term performance shortfalls	**56**	–
Purchase of shares for employee share schemes	**(2)**	(2)
Loan advanced to joint venture	**(8)**	–
Cash paid in respect of net investment hedges	**–**	(13)
Net cash outflow from capital expenditure and financial investment – ordinary	**(74)**	(159)
Net cash inflow from capital expenditure and financial investment – exceptional:		
Receipts from sale of fixed asset investment	**11**	–
Net cash outflow from capital expenditure and financial investment	**(63)**	(159)

		Year ended 31 December 2003 £m	Year ended 31 December 2002 £m
	e) Acquisitions and disposals		
	Purchase of subsidiary undertakings	–	(144)
	Acquisitions and disposals – ordinary	–	(144)
	Receipts from partial disposal of investment in HUBCO	**21**	–
	Receipts from sale of subsidaries	**3**	–
	Acquisitions and disposals – exceptional	**24**	–
	Net cash inflow/(outflow) from acquisitions and disposals	**24**	(144)
	f) Financing activities		
23	Share buyback	**(13)**	–
26	Bank loans	**(247)**	210
	Net cash (outflow)/inflow from financing activities	**(260)**	210

25 ACQUISITIONS

In April 2003, the Group acquired a 20% interest in Arabian Power Company (Umm Al Nar). A US$440 million equity bridge facility was provided to Arabian Power Company in July 2003. The Group's obligation under the facility at 31 December 2003 is a letter of credit for US$88 million.

26 NET DEBT

	1 January 2003 £m	Exchange differences £m	Other non-cash movements £m	Cash flow £m	31 December 2003 £m
Cash					
Cash at bank and in hand	**799**	10	–	(136)	**673**
Liquid resources					
Current asset investments	**43**	7	–	20	**70**
Debt financing					
Loans due within one year	**(847)**	56	63	197	**(531)**
Loans due after more than one year	**(576)**	(85)	(81)	38	**(704)**
Convertible bonds	**(231)**	23	(4)	12	**(200)**
Total debt financing	**(1,654)**	(6)	(22)	247	**(1,435)**
Total net debt	**(812)**	11	(22)	131	**(692)**

Notes to the accounts continued

27 FINANCIAL INSTRUMENTS

A discussion of the Group's objectives and policies with regard to risk management and the use of financial instruments can be found in the Operating and financial review. Financial instruments comprise net debt (see note 26) together with other instruments deemed to be financial instruments including long-term debtors, creditors and provisions for liabilities and charges.

a) Short-term debtors and creditors

Short-term debtors and creditors have been excluded from all the following disclosures other than the currency risk disclosures as relevant. The fair value of short-term debtors and creditors approximates to the carrying value because of their short maturity. In accordance with FRS 13 (Derivatives and other financial instruments), deferred tax has been excluded from the following disclosures.

b) Interest rate risk profile of financial liabilities

The interest rate profile of the financial liabilities of the Group as at 31 December 2003 was:

	31 December 2003			31 December 2002		
Currency	**Total £m**	**Floating rate financial liabilities £m**	**Fixed rate financial liabilities £m**	Total £m	Floating rate financial liabilities £m	Fixed rate financial liabilities £m
Sterling	**91**	**7**	**84**	171	59	112
US dollar	**767**	**128**	**639**	971	194	777
Australian dollar	**554**	**117**	**437**	487	110	377
Czech koruna	**46**	**9**	**37**	51	34	17
Others	**15**	**–**	**15**	17	1	16
Total	**1,473**	**261**	**1,212**	1,697	398	1,299

All the Group's creditors falling due within one year (other than bank and other borrowings) are excluded from the above tables 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 swaps was to classify £437 million of floating rate Australian dollar borrowings as fixed rate, £438 million of floating rate US dollar borrowings as fixed rate, £84 million of floating rate sterling borrowings as fixed rate and £37 million of floating rate Czech koruna borrowings as 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 borrowings 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 2003 Fixed rate financial liabilities		31 December 2002 Fixed rate financial liabilities	
Currency	**Weighted average interest rate %**	**Weighted average period for which rate is fixed Years**	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Sterling	**7.09**	**5**	7.09	6
US dollar	**6.16**	**2**	5.08	3
Australian dollar	**8.01**	**6**	8.01	7
Czech koruna	**3.98**	**3**	13.02	–
Others	**7.25**	**3**	7.25	4
Weighted average	**6.84**	**4**	6.23	4

c) Interest rate risk profile of financial assets

The Group had the following financial assets as at 31 December 2003:

	31 December 2003			31 December 2002		
Currency	**Total £m**	**Floating rate financial assets £m**	**Fixed rate financial assets £m**	Total £m	Floating rate financial assets £m	Fixed rate financial assets £m
Sterling	**412**	**412**	**–**	158	158	–
US dollar	**147**	**147**	**–**	266	266	–
Euro	**157**	**157**	**–**	307	307	–
Australian dollar	**2**	**2**	**–**	101	101	–
Czech koruna	**21**	**21**	**–**	6	6	–
Others	**7**	**7**	**–**	8	8	–
Total	**746**	**746**	**–**	846	846	–

The 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 stocks or treasury instruments. Letters of credit totalling £132 million are supported on a cash collateral basis at 31 December 2003.

d) Currency exposures

As explained on page 17 of the Operating and financial review, the Group's objective in managing the currency exposures arising during the normal course of business (in other words, its structural currency exposures) is to fully hedge all known contractual currency exposures, where possible. As at 31 December 2003 and 31 December 2002, these exposures were not considered to be material.

Currency exposures comprise the monetary assets and monetary liabilities of the Group that are not denominated in the operating (or 'functional') currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations. It is not Group policy to hedge currency translation through forward contracts or currency swaps.

e) Maturity of financial liabilities

The maturity profile of the Group's financial liabilities, other than short-term creditors and accruals, was as follows:

	31 December 2003 £m	31 December 2002 £m
In one year or less, or on demand	**531**	1,078
In more than one year but not more than two years	**97**	39
In more than two years but not more than five years	**249**	128
In more than five years	**596**	452
Total	**1,473**	1,697

As discussed in note 18, the Group is in discussions with bank groups in relation to claimed technical defaults on the non-recourse debt for the US merchant asset portfolio. Until these issues are resolved and documented, the debt at ANP is reported as current non-recourse debt in our accounts.

Notes to the accounts continued

27 FINANCIAL INSTRUMENTS continued

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The undrawn committed facilities available at 31 December 2003 in respect of which all conditions precedent have been met are detailed below.

	31 December 2003			31 December 2002	
	Facility £m	**Undrawn £m**	**Available £m**	Undrawn £m	Available £m
US$450 million Corporate revolving credit facility (October 2006)[1]	**251**	**129**	**129**	–	–
US$570 million Corporate revolving credit facility (October 2003)	**–**	**–**	**–**	279	279
US$1,215 million ANP Funding 1 construction and term loan (June 2006)[2]	**679**	**–**	**–**	110	–
US$120 million ANP Funding 1 revolving credit facility (June 2006)[2]	**67**	**50**	**–**	66	–
US$40 million ANP Funding 1 bank support facility (June 2006)[2]	**22**	**22**	**–**	25	–
Czk 1,000 million EOP revolving credit facility (May 2007)	**22**	**22**	**22**	17	17
Czk 2,000 million EOP term facility (May 2007)	**44**	**–**	**–**	–	–
US$99 million Al Kamil term facility (April 2017)	**55**	**–**	**–**	3	–
£30 million Corporate letter of credit facility[3]	**30**	**1**	**1**	1	1
£14 million Subsidiary facilities in various currencies	**14**	**7**	**3**	21	2
Total	**1,184**	**231**	**155**	522	299

1. The drawn element of the US$450 million Corporate revolving credit facility relates to letters of credit issued.

2. As disclosed in note 18, the Group is in discussions with bank groups in relation to non-recourse debt for ANP Funding 1. The undrawn portion of this facility has therefore been shown as unavailable in the above table, and will become substantially available when these issues have been formally resolved and documented.

3. 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 2003, £29 million of letters of credit had been drawn from this facility.

Uncommitted facilities available at 31 December 2003 were:

	31 December 2003			31 December 2002		
Facility	**Total £m**	**Drawn £m**	**Undrawn £m**	Total £m	Drawn £m	Undrawn £m
Bank borrowings and overdraft facilities	**25**	**–**	**25**	37	–	37
Thai National Power working capital facility	**1**	**–**	**1**	1	–	1
Pelican Point working capital facility	**4**	**–**	**4**	3	–	3
Total	**30**	**–**	**30**	41	–	41

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 book values and fair values of all the Group's financial assets and liabilities as at 31 December 2003.

	31 December 2003		31 December 2002	
Primary financial instruments held or issued to finance the Group's operations	**Book value £m**	**Fair value £m**	Book value £m	Fair value £m
Short-term borrowings and current portion of long-term borrowings	**(531)**	**(531)**	(1,078)	(1,078)
Long-term borrowings	**(942)**	**(953)**	(619)	(621)
Cash deposits and current asset investments	**746**	**746**	846	846

Derivative financial instruments held to manage the interest rate, currency profile and exposure to energy prices	Year ended 31 December 2003 Book value £m	Fair value £m	Gain/ (loss) £m	Gross gain £m	Gross (loss) £m	Year ended 31 December 2002 Gross gain £m	Gross (loss) £m
Interest rate swaps and similar instruments	–	(38)	(38)	–	(38)	–	(71)
Currency swaps	–	–	–	–	–	–	–
Forward foreign currency contracts	–	–	–	–	–	–	(1)
Energy derivatives	–	37	37	100	(63)	69	(39)

The methods and assumptions used to estimate fair values of financial instruments are as follows:

i) For investments of up to three months, trade debtors, other debtors and prepayments, trade creditors, other current liabilities, long-term and short-term borrowings, the book value approximates to fair value because of their short maturity.

ii) The fair value of investments maturing after three months has been estimated using quoted market prices.

iii) The fair value of long-term borrowings and interest rate swaps has been calculated using market prices when available or the net present value of future cash flows arising.

iv) 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.

v) The fair value of energy derivatives is measured using market based methodologies that provide a consistent measure across diverse energy products. Within the above fair values, only the financial assets and liabilities have been marked-to-market as defined by the requirements of the accounting standard.

h) Hedges

As explained on page 17 of the Operating 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.

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.

Gains and losses on instruments used for hedging are 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 2003	(71)	(1)	30	(42)
Gains and (losses) arising in previous years that were recognised in the year ended 31 December 2003	(1)	(1)	25	23
Gains and (losses) arising in previous years that were not recognised in the year ended 31 December 2003	(70)	–	5	(65)
Gains and (losses) arising in the year ended 31 December 2003 that were not recognised in the year	32	–	32	64
Unrecognised gains and (losses) on hedges at 31 December 2003	(38)	–	37	(1)
Of which:				
Gains and (losses) expected to be recognised in the year ended 31 December 2004	(3)	–	30	27
Gains and (losses) expected to be recognised in the year ended 31 December 2005 or later	(35)	–	7	(28)

The hedging of structural currency exposures associated with foreign currency net investments is recognised in the consolidated balance sheet.

28 COMMITMENTS

a) Lease and capital commitments		Group 31 December 2003 £m	Group 31 December 2002 £m	Company 31 December 2003 £m	Company 31 December 2002 £m
Capital commitments: contracted but not provided		**75**	54	**–**	–
Property leases (annual commitment):	expiring within one year	**1**	1	**–**	–
	expiring between one and five years	**–**	–	**–**	–
	expiring after five years	**5**	5	**5**	5

b) Fuel purchase and transportation commitments
The Group has contracts with fuel suppliers for the supply and transportation of fuel to its power stations. The expiry of these contracts ranges from 2004 to 2021.

29 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.

Innogy 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 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 members of NALOO. An appeal against the Commission findings was brought by a faction of SWSMA, which was initially ruled out of time, but an appeal was reinstated. Progress with this claim will be influenced by the outcome of the NALOO appeal. The European Court has ruled that the Commission is under an obligation to investigate the complaint by NALOO. The Company, PowerGen plc, British Coal Corporation and the Commission have appealed against the ruling to the European Court of Justice which delivered a judgement on 2 October 2003 for the main part dismissing the appeal. The ruling confirmed 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. The Commission ruled on the complaint in 1998 and did not make any findings against the Company.

Innogy 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 unlikely 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. The principal exposures where significant amounts of tax could arise are in respect of potential exposures relating to the UK tax losses generated from the acquisition of Australian subsidiaries and related financing arrangements. Discussions are continuing with the UK Inland Revenue to reach agreement on these issues.

The Directors are of the opinion, having regard to the professional advice received, that adequate provision has been made for the settlement of any taxation liabilities that might arise.

c) Bonds and guarantees

Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Company totalling £424 million. £11 million of this is in respect of the loan facilities of its Elcogas investment which was provided for in the year ended 31 December 2001. In February 2004 , this guarantee and the Company's loan obligations have been cancelled following the disposal of the investment.

Energy trading activities relating to merchant plant are supported by letters of credit and guarantees totalling £110 million.

30 RELATED PARTY TRANSACTIONS

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 associated undertakings. During the year the Group derived income of £37 million (year ended 31 December 2002: £16 million) from these arrangements. Included in creditors is £nil (2002: creditor – £2 million) in relation to these contracts.

31 POST BALANCE SHEET EVENTS

In February 2004, the Group sold its investment in Elcogas, Spain. This investment had been fully provided against and the release of a guarantee will result in an exceptional gain in the first quarter of 2004.

32 DETAILS OF PRINCIPAL SUBSIDIARY UNDERTAKINGS, ASSOCIATES AND JOINT VENTURES

Subsidiary undertakings

Name and nature of business	Country of incorporation and registration		Percentage shareholding
Hazelwood Power Partnership (power generation) *	Australia	Partners' Capital	92%
Elektrárny Opatovice AS (power generation) *	Czech Republic	Ordinary Shares	99%
International Power Global Developments Limited (project development – overseas)	England and Wales	Ordinary Shares	100%
Pelican Point Power Limited (power generation) *	England and Wales ‡	Ordinary Shares	100%
Rugeley Power Limited (power generation)	England and Wales	Ordinary Shares	100%
Deeside Power Development Company Limited (power generation)	England and Wales	Ordinary Shares	100%
International Power Fuel Company Limited (fuel supplies)	England and Wales	Ordinary Shares	100%
National Power International Holdings BV (investment holding company) *	The Netherlands **	Ordinary Shares	100%
Synergen Power Pty Limited (power generation) *	Australia	Ordinary Shares	100%
Thai National Power Company Limited (power generation) *	Thailand	Ordinary Shares	100%
Midlothian Energy Limited Partnership (power generation) *	US	Partners' Capital	100%
Milford Power Limited Partnership (power generation) *	US	Partners' Capital	100%
ANP Funding 1 LLC (financing company) *	US	Ordinary Shares	100%
International Power (Cayman) Limited (financing company)	Cayman Islands **	Ordinary Shares	100%
IPR Insurance Company Limited (insurance captive) *	Guernsey	Ordinary Shares	100%
International Power (Jersey) Limited (financing company)	Jersey **	Ordinary Shares	100%
International Power (Finance) Limited (financing company)	England and Wales	Ordinary Shares	100%
ANP Blackstone Energy Company, LLC (power generation) *	US	Ordinary Shares	100%
ANP Bellingham Energy Company, LLC (power generation) *	US	Ordinary Shares	100%
Hays Energy Limited Partnership (power generation) *	US	Partners' Capital	100%
International Power Holdings Limited (investment holding company)	England and Wales	Ordinary Shares	100%
Advanced Turbine Products LLC (manufacturer of turbine parts) *	US	Partners' Capital	82%
Al Kamil Power Company SAOC (power generation) *	Oman	Ordinary Shares	100%
Tihama Power Generation Company Limited (power generation)	Saudi Arabia	Ordinary Shares	60%
International Power Australia Holdings (1) Limited (investment holding company) *	England and Wales	Ordinary Shares	100%

All subsidiary undertakings operate in their country of incorporation, except as indicated below. All subsidiary undertakings have 31 December year ends. The Group also has a number of overseas branch offices.

Associates

Name and nature of business	Country of incorporation, registration and operation	Accounting period end		Percentage shareholding
Malakoff Berhad (power generation) *	Malaysia	31 August	Ordinary Shares	18%
The Hub Power Company Limited (power generation) *	Pakistan	30 June	Ordinary Shares	21%
Carbopego – Abastecimento de Combustiveis, SA (fuel supplies) *	Portugal	31 December	Ordinary Shares	33%
Pegop-Energia Electrica, SA (power station operations) *	Portugal	31 December	Ordinary Shares	45%
Tejo Energia – Producao e Distribuicao de Energia Electrica, SA (power generation) *	Portugal	31 December	Ordinary Shares	45%
Shuweihat CMS International Power Company PJSC (power generation) *	UAE	31 December	Ordinary Shares	20%
Uni-Mar Enerji Yatirimlari AS (power generation) *	Turkey	31 December	Ordinary Shares	33%
Arabian Power Company PJSC (power generation)	UAE	31 December	Ordinary Shares	20%

Joint ventures

Name and nature of business	Country of incorporation, registration and operation	Accounting period end		Percentage shareholding
Pražská Teplárenská AS (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%
South East Australia Pty Limited (gas pipeline) *	Australia	31 December	Ordinary Shares	33%

* Held by an intermediate subsidiary undertaking. ‡ Operates in Australia. ** Operates in the UK.