Notes to the consolidated financial statements

FOR THE YEAR ENDED 31 DECEMBER 2006

1 ACCOUNTING POLICIES

a) General information

International Power plc (the Company) is a public limited company incorporated and domiciled in the United Kingdom. The address of its registered office is disclosed on the last page of this *Annual Report*. The consolidated financial statements of the Company for the year ended 31 December 2006 comprise the Company and its subsidiaries (together referred to as the Group) and the Group's interest in joint ventures and associates. The parent company financial statements present information about the Company as a separate entity and not about its Group. The principal activities of the Group are described in note 2.

b) Statement of compliance

European Union (EU) law (IAS Regulation EC 1606/2002) requires that the consolidated financial statements, for the year ended 31 December 2006, be prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the EU (Adopted IFRSs). These Group financial statements have been prepared and approved by the Directors in accordance with Adopted IFRSs.

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

c) Adopted IFRSs not yet applied

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

IFRS 7 (Financial Instruments: Disclosures) is applicable for years commencing on or after 1 January 2007. The application of IFRS 7 in 2006 would not have affected the results or net assets as the standard is concerned only with disclosure. The Group plans to adopt it in 2007.

IFRS 8 (Operating Segments) is applicable for years commencing on or after 1 January 2009. The application of IFRS 8 in 2006 would not have affected the results or net assets as the standard is concerned only with disclosure.

d) Basis of preparation

The consolidated financial statements have been prepared on the historical cost basis, except for derivative financial instruments and financial instruments held for trading, which are carried at fair value.

Exceptional items and specific IAS 39 mark to market movements

In order to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance, the Group presents its income statement in three columns such that it identifies (i) results excluding exceptional items and specific IAS 39 mark to market movements, (ii) the effect of exceptional items and specific IAS 39 mark to market movements and (iii) results for the year. For the purposes of clarity, in the explanation of the basis of preparation applied in these consolidated financial statements, we describe these columns as the 'left hand column', the 'middle column' and the 'right hand column' respectively.

Those items that the Group separately present as exceptional are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order to obtain a proper understanding of the financial information. The Group discloses exceptional items in the middle column.

The Group enters into derivative contracts to economically hedge certain of its physical and financial exposures. In relation to commodities trading, the Group considers economic hedges to be those which are asset backed, i.e. where the Group is either forward selling electricity from its own generation capacity or forward buying fuel for its own generation capacity. In respect of interest rate swaps and other treasury related derivatives the Group considers economic hedges to be those which hedge existing assets, liabilities and firm commitments.

Some of these economic hedges achieve the own use exemption under IAS 39 and are accounted for on an accruals basis. Some are accounted for as cash flow hedges under IAS 39 with fair value gains and losses recorded in the hedging reserve. Where derivative contracts do not achieve the own use exemption and the Group could not, or has not sought to, apply cash flow hedge accounting, IAS 39 requires the derivative contract to be measured at fair value (marked to market) with fair value gains and losses recognised in the income statement. The Group separately presents these mark to market movements on economic hedges, in the middle column, to assist the reader's understanding of underlying business performance and to provide a more meaningful presentation.

For economic hedges, where fair value gains and losses are recorded in the income statement, in the period in which the economically hedged transaction settles, the settlement amount of the derivative, being the cumulative fair value gains and losses recognised in the current and prior periods, is presented in the left hand column so that the transaction is measured at its contracted price (i.e. the spot price less the fair value gain or loss on the derivative contract at that date).

As the cumulative mark to market movements have already been recognised in the middle column in the current and prior periods, an equal but opposite amount is presented in the middle column so that cumulatively the amount recognised in the middle column in respect of such economic hedges is zero.

By presenting fair value gains and losses in this manner, the left hand column is not affected by mark to market movements and therefore reflects the underlying business performance at contracted prices.

The amortisation of derivatives, which are acquired with a fair value other than zero, is always recorded in the left hand column. This is achieved by presenting an equal but opposite amount in the middle column, such that specific IAS 39 mark to market movements presented in the middle column are shown net of the amortisation during the period.

Ineffectiveness in qualifying cash flow hedges under IAS 39 can arise from business combinations, where the fair value of the derivatives at acquisition is not equal to zero, or as a result of the difference between the contractual profile of the economic hedge and the profile of transactions defined as the hedged item. IAS 39 requires ineffectiveness in qualifying cash flow hedges to be recorded in the income statement, and therefore the Group records this ineffectiveness in the middle column when it relates to an economic hedge.

Mark to market movements of the fair value of embedded derivatives in convertible bonds, which relate to conversion features where the functional currency of the issuer and other factors preclude the conversion feature being treated as equity in the consolidated financial statements, are treated as specific IAS 39 mark to market movements and as such are presented in the middle column. The Directors consider the fair value gains and losses of these embedded derivatives should be appropriately disclosed within specific IAS 39 mark to market movements, in the middle column, so as to separately identify a non-cash movement which, if exercised, will ultimately be extinguished by the issue of equity.

Mark to market movements relating to proprietary trading activities, the revaluation of assets held for trading and amortisation of derivatives which are acquired with a fair value other than zero comprise part of the Group's underlying business performance and are appropriately, in the judgement of the Directors, included within the left hand column.

The right hand column presents the results for the year, showing all gains and losses recorded in the consolidated financial statements.

To the extent that exceptional items are separately identified in the income statement, they are also separately identified in the cash flow statement under the respective heading to which they relate.

Adjustments have been made to comparative figures to make them consistent with the current period in relation to the presentation of specific IAS 39 mark to market movements (refer note 8).

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

On acquisition, the assets, liabilities and contingent liabilities of a subsidiary are measured at their fair values at the date of acquisition. Any excess of the cost of acquisition over the fair values of the identifiable net assets acquired is recognised as goodwill. Any deficiency of the cost of acquisition below the fair values of the identifiable net assets acquired (i.e. discount on acquisition) is credited to the income statement in the period of acquisition.

The interest of minority shareholders is stated at the minority's proportion of the fair values of the assets, liabilities and contingent liabilities recognised. Subsequently, any losses applicable to the minority interest in excess of the minority interest in the subsidiary's equity are allocated against the interests of the parent, except when there is a binding obligation to fund those losses and the minority is in a position to do so.

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

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

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

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

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

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

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

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

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

(iii) as energy revenue in accordance with the contractual terms, to the extent that the capacity has been made available to the contracted offtaker during the period. Where the PPAs extend over more than one accounting period, energy revenue is recognised in each accounting period at the fair value of the Group's performance under the contract in each period.

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

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

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.

g) Foreign currencies
These Group financial statements are presented in sterling, which is the functional and presentational currency of the Company. The functional currencies of Group entities are principally determined by the primary economic environment in which the respective entity operates. Transactions entered into by Group entities are translated into the functional currencies of those entities at the exchange rate ruling at the date of transaction. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at the exchange rate ruling at the balance sheet date of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

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

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

The net assets of the Group's overseas subsidiaries, joint ventures and associates are translated at exchange rates prevailing on the balance sheet date. Income and expense items are translated at the average exchange rates for the period which approximates to actual rates.

Goodwill and fair value adjustments arising on the acquisition of a foreign entity are treated as assets and liabilities of the foreign entity and translated at the closing rate.

Exchange differences arising are recognised in the Group's translation reserve, which is a component of equity. Such translation differences are recognised as income or as expenses in the income statement in the period of disposal of the net investment in foreign operations.

In respect of foreign operations, any differences that have arisen before 1 January 2004, the date of transition to IFRSs, are presented as part of retained earnings.

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

Goodwill arising on acquisition of joint ventures and associates is included in the carrying amount of the investment.

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

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

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

i) Other intangible assets

Emission allowances An intangible asset is recognised on receipt of allocated emission allowances and recorded at the fair value on allocation. The fair value of the grant is also recognised on receipt and deducted from the value of the intangible asset. As a result no net asset or liability is shown on the balance sheet at initial recognition.

Emission allowances are recognised at cost when purchased. As emission allowances are utilised they are charged to the income statement within cost of sales. To the extent that these allowances were received by way of grant there is nil charge to the income statement for their utilisation.

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

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

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

j) Property, plant and equipment

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

Depreciation is calculated so as to write-down the cost of property, plant and equipment to its residual value evenly over its estimated useful life. Estimated useful lives, residual values and depreciation methods are reviewed periodically, taking into account commercial and technological obsolescence as well as normal wear and tear, provision being made where the carrying value exceeds the recoverable amount.

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

	Years
Civil works	25-80
Power stations and wind farms	20-60
Fixtures, fittings, tools and equipment	3-10
Computer equipment and software	3-5
Combined cycle gas turbine (CCGT) hot gas path parts, on average	2-4
Leasehold improvements	Life of lease

Freehold land is not depreciated.

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

k) Investments in joint ventures and associates

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

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

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

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

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

l) Other investments

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

m) Impairment of assets excluding goodwill

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

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

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

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

n) Non-current assets held for sale

Non-current assets classified as held for sale are measured at the lower of the asset's previous carrying amount and fair value less costs to sell. No depreciation is charged on assets classified as held for sale.

Non-current assets are classified as held for sale if their carrying amount will be recovered through a sale transaction rather than through continuing use. This condition is regarded as met only when the sale is highly probable and the asset is available for immediate sale in its present condition. Management must be committed to the sale, which should be expected to qualify for recognition as a completed sale within one year from the date of classification.

o) Derivative financial instruments

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

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

Derivative financial instruments are recognised initially, and are subsequently also measured, at fair value. The gain or loss on subsequent fair value measurement is recognised in the income statement unless the derivative qualifies for hedge accounting when recognition of any resultant gain or loss depends on the nature of the item being hedged (see below). Subsequent to initial recognition, the fair values of financial instruments measured at fair value that are quoted in an active market are based on bid prices for assets held and offer prices for liabilities held. If the market for a financial instrument is not active, its fair value is established by using valuation techniques. These valuation techniques include comparison with similar instruments where market observable prices exist, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants.

All regular way purchases and sales of financial assets are recognised on the trade date, being the date that the Group commits to purchase or sell the assets. Regular way transactions require delivery of assets within the time frame generally established by regulation or convention in the market place.

Cash flow hedges Changes in the fair value of derivative financial instruments that are designated and are effective as hedges of future cash flows are recognised directly in equity and the ineffective portion is recognised immediately in the income statement.

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

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

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

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

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

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

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

p) Leasing

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

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

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

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

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

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

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

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

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

q) Inventories

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

r) Cash and cash equivalents

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

s) Loans and bonds

Interest-bearing borrowings are recognised initially at fair value less attributable transaction costs. Subsequent to initial recognition, interest-bearing borrowings are stated at amortised cost with any difference between cost and redemption value being recognised in the income statement over the period of the borrowings on an effective interest basis.

t) Convertible bonds

Convertible bonds are regarded as compound instruments, consisting of a liability component and either an equity component or an embedded derivative component.

At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar non-convertible debt. The difference between the proceeds of issue of the convertible bonds and the fair value assigned to the liability component represents the value of either an equity component or an embedded derivative component attributable to the embedded option to convert the bonds into equity of the Group.

IAS 32 states that a derivative contract that will be settled by the entity receiving or delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. It also states that a contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. For the purposes of the consolidated financial statements, when making the assessment of whether a convertible bond, when exercised, gives rise to the exchange of a fixed or variable amount of cash, or other financial asset, the functional currency of the issuing company relative to the currency denomination of the bonds is considered in addition to other features within the bond.

For convertible bonds issued by the Group where there is a difference between the currency of the bond and the functional currency of the issuing company, the embedded option to convert the bonds is recorded as a derivative liability because it is not a contract to exchange a fixed number of shares for a fixed amount of bonds. The embedded derivative liability component is separately identified and measured at fair value through the income statement.

For convertible bonds issued by the Group where the currency of the bond and the functional currency of the issuing company are the same, i.e. where on conversion of the bonds a fixed number of shares is exchanged for a fixed amount of bonds, the value of the embedded option to convert the bonds is recorded within equity on initial recognition.

Issue costs are apportioned between the liability and embedded option components of the convertible bonds (recorded as equity or as a derivative liability) based on their relative carrying amounts at the date of issue.

The interest expense on the liability component is calculated by applying the prevailing market interest rate for similar non-convertible debt to the liability component of the instrument. This interest expense, recognised in the income statement, is calculated using the effective interest method, i.e. the difference between the interest expense on the liability component and the interest paid is added to the carrying amount of the convertible bond.

u) Borrowing costs

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

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

v) Provisions

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

w) Decommissioning costs

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

x) Environmental liabilities

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

y) Tax

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

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

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

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

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

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

z) Pension schemes

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

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

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

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

aa) Share-based payments

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

For the Group's Executive Share Option Plans the fair values are measured using the Black-Scholes pricing model. The expected lives used in these models have been adjusted, based on management's best estimate, for the effects of non-transferability, any exercise restrictions and behavioural considerations.

For conditional awards made under the 2002 Performance Share Plan without a market-related performance condition, the fair values have been calculated as the face value of the award, discounted for the non-entitlement to dividends during the vested period.

Where conditional awards, made under the 2002 Performance Share Plan, contain a market-related performance condition, the fair values are measured using a Monte Carlo simulation method.

2 SEGMENT REPORTING

The Group is a global energy business that operates solely in one business segment, that of electricity generation. The international operations are managed on a geographical basis, reflecting the different characteristics within each geographical market. The Group reports its primary segment information by geographic segment as this reflects how results are reported for management purposes in the day-to-day management of the business. In presenting information on the basis of geographical segments, segment revenues and segment assets are based in the geographical location of both customers and assets. There is no inter-segmental revenue.

	Year ended 31 December 2006			Year ended 31 December 2005		
	Subsidiaries £m	**Share of joint ventures and associates £m**	**Total £m**	Subsidiaries £m	Share of joint ventures and associates £m	Total £m
a) Revenue (excluding exceptional items and specific IAS 39 mark to market movements)						
North America	**732**	**183**	**915**	527	171	698
Europe	**1,266**	**411**	**1,677**	1,014	397	1,411
Middle East	**51**	**99**	**150**	24	43	67
Australia	**378**	**107**	**485**	388	48	436
Asia	**25**	**393**	**418**	27	341	368
	2,452	**1,193**	**3,645**	1,980	1,000	2,980
Revenue (including exceptional items and specific IAS 39 mark to market movements)						
North America	**761**	**183**	**944**	523	171	694
Europe	**1,426**	**411**	**1,837**	990	397	1,387
Middle East	**51**	**99**	**150**	24	43	67
Australia	**321**	**113**	**434**	369	51	420
Asia	**25**	**393**	**418**	27	341	368
	2,584	**1,199**	**3,783**	1,933	1,003	2,936

	Subsidiaries £m	**Share of joint ventures and associates £m**	**Total £m**	Subsidiaries £m	Share of joint ventures and associates £m	Total £m
b) Profit from operations (excluding exceptional items and specific IAS 39 mark to market movements)						
North America	**73**	**28**	**101**	21	27	48
Europe	**381**	**69**	**450**	229	54	283
Middle East	**32**	**20**	**52**	12	12	24
Australia	**121**	**3**	**124**	136	4	140
Asia	**3**	**88**	**91**	6	94	100
	610	**208**	**818**	404	191	595
Corporate costs	**(45)**	**–**	**(45)**	(59)	–	(59)
	565	**208**	**773**	345	191	536
Exceptional items and specific IAS 39 mark to market movements included within profit from operations			**125**			75
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)			**898**			611
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)						
North America	**83**	**28**	**111**	20	29	49
Europe	**547**	**68**	**615**	315	55	370
Middle East	**32**	**20**	**52**	12	12	24
Australia	**64**	**10**	**74**	119	6	125
Asia	**3**	**88**	**91**	6	96	102
	729	**214**	**943**	472	198	670
Corporate costs	**(45)**	**–**	**(45)**	(59)	–	(59)
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)	**684**	**214**	**898**	413	198	611

2 SEGMENT REPORTING continued

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit from operations (including exceptional items and specific IAS 39 mark to market movements)	**898**	611
Disposal of investments – exceptional	**–**	10
Net finance costs – excluding exceptional items and specific IAS 39 mark to market movements	**(248)**	(202)
Net finance costs – exceptional items and specific IAS 39 mark to market movements	**(26)**	–
Profit before tax	**624**	419
Income tax expense – excluding exceptional items and specific IAS 39 mark to market movements	**(122)**	(68)
Income tax expense – exceptional items and specific IAS 39 mark to market movements	**(25)**	(21)
Profit for the year	**477**	330

An analysis of exceptional items and specific IAS 39 mark to market movements is included in note 8.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
c) Depreciation and amortisation expenses (excluding exceptional items)		
North America	**52**	35
Europe	**150**	84
Middle East	**3**	3
Australia	**63**	62
Asia	**2**	2
	270	186
Corporate costs	**3**	2
	273	188

Depreciation and amortisation expenses are included within profit from operations. An impairment reversal of £36 million, relating to Deeside power plant, has been recorded in the income statement in 2006 (refer note 8). In 2005 an impairment reversal of £52 million relating to Rugeley power plant was recorded in the income statement. These impairment reversals are not included within the Europe totals in the above table.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
d) Additions to property, plant and equipment		
North America	**62**	26
Europe	**83**	24
Middle East	**47**	159
Australia	**34**	53
Asia	**9**	4
	235	266
Corporate	**1**	1
	236	267

	Year ended 31 December 2006			Year ended 31 December 2005		
	Goodwill £m	**Commodity contracts £m**	**Emission allowances £m**	Goodwill £m	Commodity contracts £m	Emission allowances £m
e) Expenditure on goodwill and other intangible assets						
North America	**40**	**37**	**64**	–	–	–
Europe	**–**	**2**	**39**	2	234	25

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

	At 31 December 2006			At 31 December 2005		
	Segment assets	**Investments in joint ventures and associates**	**Total**	Segment assets	Investments in joint ventures and associates	Total
	£m	**£m**	**£m**	£m	£m	£m
f) Segment assets						
North America	**1,502**	**184**	**1,686**	773	199	972
Europe	**3,475**	**363**	**3,838**	2,972	341	3,313
Middle East	**366**	**92**	**458**	383	71	454
Australia	**1,972**	**43**	**2,015**	2,196	39	2,235
Asia	**194**	**582**	**776**	63	755	818
	7,509	**1,264**	**8,773**	6,387	1,405	7,792
Corporate	**601**	**–**	**601**	258	–	258
Total assets	**8,110**	**1,264**	**9,374**	6,645	1,405	8,050

The Asia region segment assets includes assets held for sale amounting to £128 million. In 2005 these assets were included in investments in joint ventures and associates (refer note 24).

	Segment liabilities	**Investments in joint ventures and associates**	**Total**	Segment liabilities	Investments in joint ventures and associates	Total
	£m	**£m**	**£m**	£m	£m	£m
g) Segment liabilities						
North America	**1,149**	**–**	**1,149**	588	–	588
Europe	**2,565**	**–**	**2,565**	2,102	–	2,102
Middle East	**340**	**–**	**340**	335	–	335
Australia	**1,504**	**–**	**1,504**	1,676	–	1,676
Asia	**95**	**–**	**95**	95	–	95
	5,653	**–**	**5,653**	4,796	–	4,796
Corporate	**981**	**–**	**981**	879	–	879
Total liabilities	**6,634**	**–**	**6,634**	5,675	–	5,675

The analysis of total assets and liabilities includes all attributable goodwill and excludes intercompany balances, which have been eliminated on consolidation. Corporate assets and liabilities include cash held at the corporate level, included in cash and cash equivalents; corporate borrowings, included in loans and bonds; and provisions and deferred tax liabilities included in non-current liabilities.

3 PROFIT FOR THE YEAR

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

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Profit for the year is stated after charging/(crediting):		
Amortisation of other intangible assets	**105**	40
Depreciation of property, plant and equipment	**168**	148
Development costs, net of recoveries and amounts capitalised	**3**	3
Operating exceptional items before tax (note 8)	**(55)**	(110)
Liquidated damages and insurance recoveries for property, plant and equipment	**6**	–
Property lease rentals payable (net of recoveries)	**3**	3
Auditors' remuneration		
Audit of these financial statements	**0.8**	0.7
Amounts receivable by auditors and their associates in respect of:		
Audit of financial statements of subsidiaries pursuant to legislation	**1.7**	1.1
Other services pursuant to such legislation	**1.4**	0.4
Other services relating to taxation	**0.1**	0.1
Services relating to corporate finance transactions entered into or proposed to be entered into by or on behalf of the Company or the Group	**0.2**	0.4
	4.2	2.7

'Other services pursuant to such legislation' in 2006 and 2005 relates principally to reporting to the Securities and Exchange Commission (SEC), interim reviews and additional audit work relating to the Group's compliance with the requirements of Section 404 of the Sarbanes-Oxley Act 2002 (which relate to internal controls over financial reporting).

'Services relating to corporate finance transactions' incorporate due diligence assistance on potential and completed acquisitions during the year and reviews of financial models for funding purposes.

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

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

4 FINANCE INCOME

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Group finance income		
Interest income	**51**	50
Net gain on re-measurement of assets held for trading	**2**	3
Total Group finance income	**53**	53

Interest income comprises interest earned from bank deposits and other financial assets. Included within share of results of joint ventures and associates is interest income of £21 million (2005: £16 million).

5 FINANCE EXPENSES

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Group finance expenses		
Interest on:		
Bank loans and overdrafts	**226**	211
Other loans and bonds	**83**	57
	309	268
Unwinding discount on provisions	**1**	1
Less: amounts capitalised in the cost of qualifying assets	**(9)**	(14)
Group finance costs excluding exceptional items and specific IAS 39 mark to market movements	**301**	255
Specific IAS 39 mark to market movements on derivative financial instruments	**26**	–
Total Group finance expenses	**327**	255

Included within share of results of joint ventures and associates is interest expense of £121 million (2005: £106 million). Specific IAS 39 mark to market movements included within interest expense of joint ventures and associates amount to an expense of £1 million (2005: an income of £7 million).

6 EMPLOYEE BENEFIT COSTS AND EMPLOYEE NUMBERS

Employee benefit costs, including Directors' remuneration, were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Wages and salaries	**129**	121
Share-based payments	**9**	6
Social security costs	**11**	10
Contributions to defined contribution plans	**4**	3
Charge for defined benefit plans (note 7)	**10**	7
Sub-total	**163**	147
Less: amount capitalised as part of property, plant and equipment	**(4)**	(2)
Total employee benefit costs	**159**	145

Details of Directors' remuneration along with information concerning shareholdings, options and retirement benefits are set out in the audited part of the Directors' remuneration report on pages 64 to 75. There are no personnel, other than the Directors, who as key management have authority and responsibility for planning, directing and controlling the activities, directly or indirectly, of International Power plc.

The average number of employees during the financial year, analysed by geographic segment was:

	Year ended 31 December 2006 Number	Year ended 31 December 2005 Number
North America	**276**	220
Europe	**1,196**	1,195
Middle East	**625**	615
Australia	**769**	742
Asia	**628**	633
Corporate and development	**177**	174
Average number of employees	**3,671**	3,579

7 PENSION SCHEMES

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

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

UK: The majority of pensions for UK employees are funded through the industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), which is a defined benefit scheme with assets invested in separate trustee administered funds. The ESPS is divided into sections, and the International Power Group of the ESPS was opened to members on 1 April 2002 and employees' past service rights were transferred into the Group later that year.

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

The liabilities and costs shown in the disclosures for the UK schemes are based on the most recent actuarial valuations at 31 March 2004. The results of these valuations have been updated to 31 December 2006 by independent qualified actuaries to take account of the requirements of IAS 19.

AUSTRALIA: Employees at Hazelwood and Loy Yang B participate in a standard Australian superannuation fund called Equipsuper. This plan provides benefits primarily for employees in the electricity, gas and water industry, and was developed from the scheme sponsored by the State Electricity Commission of Victoria. Employees at Synergen participate in the Electricity Industry Superannuation Scheme.

The liabilities and costs shown in the disclosures for the Australian schemes are based on the most recent actuarial valuations at 31 December 2006.

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

The charge for 2006 in respect of defined contribution plans was £4 million (2005: £3 million).

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

Financial assumptions	**31 December 2006**		31 December 2005		31 December 2004	
	UK %	**Australia %**	UK %	Australia %	UK %	Australia %
Discount rate	**5.1**	**4.9**	4.7	4.6	5.3	4.5
Rate of increase in salaries	**4.6**	**4.3**	4.4	4.0	4.4	4.0
Inflation rate	**3.1**	**3.0**	2.9	3.0	2.9	3.0
Increase to deferred benefits during deferment	**3.1**	**n/a**	2.9	n/a	3.0	n/a
Increases to pensions payments	**3.1**	**n/a**	2.9	n/a	2.9	n/a

7 PENSION SCHEMES continued

The amounts charged to profit from operations, recorded in the income statement, in relation to the defined benefit pension plans for the year ended 31 December 2006 were as follows:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Current service cost	**11**	9
Expected return on schemes' assets	**(13)**	(11)
Interest on schemes' liabilities	**10**	9
Curtailment cost	**2**	–
Total operating charge	**10**	7

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

	31 December 2006		31 December 2005		31 December 2004	
Long-term rate of return expected:	**UK %**	**Australia %**	UK %	Australia %	UK %	Australia %
Equities	**7.5**	**7.8**	7.1	7.5	7.5	7.3
Bonds	**4.7**	**4.6**	4.4	5.0	4.9	4.8
Other	**6.2**	**5.9**	6.0	5.9	6.0	5.5
Total long-term rate of return expected	**7.1**	**6.7**	6.6	6.7	7.0	6.5

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

	31 December 2006			31 December 2005			31 December 2004		
Assets in schemes:	**UK £m**	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Equities	**108**	**55**	**163**	84	52	136	66	44	110
Bonds	**17**	**15**	**32**	14	17	31	11	16	27
Other	**10**	**21**	**31**	16	15	31	12	10	22
Total market value of assets	**135**	**91**	**226**	114	84	198	89	70	159

Other assets principally comprise property and cash.

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

	31 December 2006			31 December 2005			31 December 2004		
	UK £m	**Australia £m**	**Total £m**	UK £m	Australia £m	Total £m	UK £m	Australia £m	Total £m
Total market value of assets	**135**	**91**	**226**	114	84	198	89	70	159
Present value of scheme liabilities	**(158)**	**(83)**	**(241)**	(151)	(79)	(230)	(114)	(70)	(184)
(Deficit)/surplus in the scheme	**(23)**	**8**	**(15)**	(37)	5	(32)	(25)	–	(25)
Unrecognised actuarial (gains)/losses	**–**	**(10)**	**(10)**	12	(7)	5	–	(4)	(4)
Unrecognised asset due to limit in IAS 19 para 58(b)	**–**	**–**	**–**	–	–	–	–	–	–
Pension liability before deferred tax	**(23)**	**(2)**	**(25)**	(25)	(2)	(27)	(25)	(4)	(29)

Movements in fair value of assets:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
At 1 January	**198**	159
Expected return on assets	**13**	11
Actuarial gains	**9**	16
Employer contributions	**12**	9
Scheme participants' contributions	**3**	3
Benefits paid	**(3)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Exchange differences	**(5)**	3
At 31 December	**226**	198

Movements in defined benefit obligations:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
At 1 January	**230**	184
Service cost	**11**	9
Interest cost	**10**	9
Actuarial (gains)/losses	**(6)**	25
Scheme participants' contributions	**3**	3
Benefits paid	**(3)**	(2)
Expenses, taxes and premiums paid	**(1)**	(1)
Settlements and curtailments	**2**	–
Exchange differences	**(5)**	3
At 31 December	**241**	230

History of asset experience gains and losses

The transition date for conversion to IFRS for International Power was 1 January 2004 and therefore the following historical data has been presented from that date. This will be built up into a rolling five-year record over the next two years.

	Year ended 31 December 2006	Year ended 31 December 2005	Year ended 31 December 2004
Difference between the actual and expected return on schemes' assets:			
Amount (£m)	**9**	16	9
Percentage of schemes' assets	**4%**	8%	6%
Experience (losses)/gains on schemes' liabilities*:			
Amount (£m)	**(2)**	11	7
Percentage of the present value of schemes' liabilities	**1%**	5%	4%

*Does not include the effect of changes in assumptions.

Contributions in 2007

The Group expects to make contributions of approximately £8 million to its defined benefit pension arrangements in 2007.

8 EXCEPTIONAL ITEMS AND SPECIFIC IAS 39 MARK TO MARKET MOVEMENTS

In accordance with the basis of preparation outlined in note 1, the Group separately discloses exceptional items and specific IAS 39 mark to market movements to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance.

Those items that the Group separately presents as exceptional are items which, in the judgement of the Directors, need to be disclosed separately by virtue of their size or incidence in order to obtain a proper understanding of the financial information.

The Group enters into derivative contracts to economically hedge certain of its physical and financial exposures. Where these contracts do not achieve the own use exemption, hedge accounting or wholly effective hedge effectiveness under IAS 39, the Group separately presents the mark to market movements on these contracts, recorded within the income statement to allow an understanding of underlying business performance.

Mark to market movements on convertible bonds, where the conversion option, if exercised, will ultimately be extinguished by the issue of equity are also separately presented to allow an understanding of the underlying business performance.

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Mark to market movements	**132**	(47)
Amounts recognised in revenue	**132**	(47)
Impairment reversal of Deeside plant	**36**	–
Impairment reversal of Rugeley plant	**–**	52
Mark to market movements	**(68)**	5
Amounts recognised in cost of sales	**(32)**	57
Compensation in respect of the tolling agreement with TXU	**14**	58
Compensation in respect of breach of contract	**5**	–
Amounts recognised in other operating income	**19**	58
Mark to market movements	**6**	7
Amounts recognised in share of results of joint ventures and associates	**6**	7
Profit on disposal of Tri Energy	**–**	4
Profit on disposal of shares in Interconnector UK	**–**	3
Profit on disposal of land in Thailand	**–**	3
Amounts recognised in disposal of investments	**–**	10
Mark to market movements	**(26)**	–
Amounts recognised in finance expenses	**(26)**	–
Taxation on Deeside plant impairment reversal	**(11)**	–
Taxation on Rugeley plant impairment reversal	**–**	(16)
Taxation on compensation in respect of the tolling agreement with TXU	**(4)**	(17)
Taxation on disposal of shares in Interconnector UK and on disposal of land in Thailand	**–**	(1)
Taxation on mark to market movements	**(10)**	13
Taxation on exceptional items and specific IAS 39 mark to market movements	**(25)**	(21)
Total exceptional items and specific IAS 39 mark to market movements after attributable taxation	**74**	64

In the year ended 31 December 2006, Rugeley Power received further payments from the TXU Administrators amounting to £16 million. An exceptional gain of £14 million has been recorded, net of payments to creditors.

In June 2006 the Company received a settlement of £10 million following the conclusion of an international arbitration action under ICC rules for breach of a contract entered into in 2000 to transfer operating rights over three power plants in Turkey. An exceptional gain of £5 million has been recorded, net of cost recoveries.

At the end of 2006 the Group carried out a review of the recoverable amount of its Deeside power plant based on its estimated value in use. This led to the full impairment reversal of the remaining £36 million impairment charge previously booked against this asset (refer note 14).

In order to separately identify specific IAS 39 mark to market movements, these adjustments are separately identified within the table, described as 'mark to market movements'. For the year ended 31 December 2006 the impact of these adjustments on profit before tax is a profit of £44 million and on tax expense a charge of £10 million. For the year ended 31 December 2005 the impact of these adjustments on profit before tax is an expense of £35 million and on tax expense a credit of £13 million.

The mark to market movement recognised within finance expenses includes a charge of £28 million (2005: £nil) in respect of the fair value gains and losses on the 3.25% convertible euro bonds 2013. The conversion feature of the 3.75% convertible US dollar bonds 2023 is recognised in equity (refer note 25).

9 TAX

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
a) Income tax expense for the year		
Current tax charge		
UK corporation tax charge	**52**	25
Foreign tax	**40**	27
Adjustments in respect of prior years	**6**	2
Total current tax charge for the year	**98**	54
Deferred tax charge		
Origination and reversal of temporary differences	**64**	43
Benefits of tax losses recognised	**(15)**	(8)
Total deferred tax charge for the year	**49**	35
Income tax expense excluding exceptional items and specific IAS 39 mark to market movements	**122**	68
Income tax expense on exceptional items and specific IAS 39 mark to market movements	**25**	21
Total income tax expense for the year	**147**	89

Included in the income tax expense are the following amounts relating to exceptional items and specific IAS 39 mark to market movements, included in:

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Revenue (deferred tax)	**33**	(14)
Cost of sales (deferred tax)	**(4)**	18
Other operating income (current tax)	**4**	17
Share of results of joint ventures and associates (deferred tax)	**–**	(1)
Disposal of investments (current tax)	**–**	1
Finance expenses (deferred tax)	**(8)**	–
Income tax expense on exceptional items and specific IAS 39 mark to market movements	**25**	21

The deferred tax charge is derived as follows: £46 million from UK operations (2005: £11 million) and £3 million from foreign operations (2005: £24 million).

	Year ended 31 December 2006 £m	Year ended 31 December 2005 £m
Income tax charged to:		
Income statement	**147**	89
Equity	**(43)**	(46)
	104	43

9 TAX continued

	Year ended 31 December 2006		Year ended 31 December 2005	
	Results excluding exceptional items and specific IAS 39 mark to market movements £m	**Results including exceptional items and specific IAS 39 mark to market movements £m**	Results excluding exceptional items and specific IAS 39 mark to market movements £m	Results including exceptional items and specific IAS 39 mark to market movements £m
b) Reconciliation of income tax expense to accounting profit				
Profit before tax (before exceptional items and specific IAS 39 mark to market movements)	**525**	**525**	334	334
Exceptional items and specific IAS 39 mark to market movements	**–**	**99**	–	85
Profit before tax	**525**	**624**	334	419
Tax at domestic income tax rate of 30% (2005: 30%)	**158**	**187**	100	126
Tax effect of:				
Different tax rates of subsidiaries operating in other jurisdictions	**14**	**14**	23	23
Share of results of joint ventures and associates	**(38)**	**(38)**	(37)	(39)
Tax holidays	**(10)**	**(10)**	(12)	(12)
(Income not taxable)/expenses not deductible in determining taxable profit	**(4)**	**(6)**	16	13
Utilisation of tax losses not previously recognised	**(4)**	**(6)**	(24)	(24)
Adjustment to prior year provisions	**6**	**6**	2	2
Income tax expense for the year	**122**	**147**	68	89

Included in profit before tax excluding exceptional items and specific IAS 39 mark to market movements is a tax charge of £55 million (2005: £53 million) relating to the Group's share of results of joint ventures and associates. The £38 million shown above (2005: £37 million) represents 70% (2005: 70%) of this tax charge. The remaining 30% is already included within the tax charge calculated at the domestic income tax rate.

Included in profit before tax including exceptional items and specific IAS 39 mark to market movements is a tax charge of £54 million (2005: £56 million) relating to the Group's share of results of joint ventures and associates. The £38 million shown (2005: £39 million) above represents 70% of this tax charge (2005: 70%). The remaining 30% is already included within the tax charge calculated at the domestic income tax rate.

10 DIVIDENDS

At the Company's Annual General Meeting (AGM) held on 17 May 2006, shareholders approved the payment of a final dividend of 4.5p (2005: 2.5p) per Ordinary Share to shareholders registered on the Company share register on 26 May 2006. This dividend amounted to £67 million (2005: £37 million) and was paid on 23 June 2006. In respect of the current year, the Directors propose a dividend of 7.9p per Ordinary Share, to be paid on 26 June 2007. The dividend is subject to approval by shareholders at the Group's AGM and has not been included as a liability at 31 December 2006. There are no income tax consequences to the Company from the estimated total dividend to be paid of £118 million.

11 EARNINGS PER SHARE (EPS)

Earnings per share is presented both before exceptional items and specific IAS 39 mark to market movements and after exceptional items and specific IAS 39 mark to market movements in order to allow a better understanding of the financial information presented, and specifically the Group's underlying business performance. Further details of the exceptional items and specific IAS 39 mark to market movements can be found in note 8 to these consolidated financial statements.

	Year ended 31 December 2006 pence	Year ended 31 December 2005 pence
a) Earnings per share (basic)		
Before exceptional items and specific IAS 39 mark to market movements	**22.4**	14.6
After exceptional items and specific IAS 39 mark to market movements	**27.6**	19.4
b) Earnings per share (diluted)		
Before exceptional items and specific IAS 39 mark to market movements	**21.3**	14.0
After exceptional items and specific IAS 39 mark to market movements	**26.2**	18.5
c) Basis of calculation (basic) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**332**	214
Exceptional items and specific IAS 39 mark to market movements (net of tax and minority interests)	**78**	71
Profit attributable to equity holders of the parent after exceptional items and specific IAS 39 mark to market movements	**410**	285
d) Basis of calculation (diluted) – earnings	**£m**	£m
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**332**	214
After tax dilutive effect of interest on convertible bonds	**7**	7
Profit attributable to equity holders of the parent before exceptional items and specific IAS 39 mark to market movements	**339**	221
Exceptional items and specific IAS 39 mark to market movements (net of tax and minority interests)	**78**	71
Profit attributable to equity holders of the parent after exceptional items and specific IAS 39 mark to market movements	**417**	292
e) Basis of calculation (basic) – number of Ordinary Shares	**Million**	Million
Weighted average number of issued Ordinary Shares for the purposes of basic EPS	**1,486.2**	1,473.5
Weighted average number of shares held by Employee Share Ownership Plans (ESOPs)	**(1.4)**	(2.8)
Weighted average number of shares	**1,484.8**	1,470.7
f) Basis of calculation (diluted) – number of Ordinary Shares	**Million**	Million
Weighted average number of shares – basic	**1,484.8**	1,470.7
Dilutive potential Ordinary Shares:		
Employee share schemes	**14.0**	19.8
Convertible bond	**91.1**	89.1
Weighted average number of Ordinary Shares for the purposes of diluted EPS	**1,589.9**	1,579.6

In July 2006 the Group issued 3.25% convertible euro bonds 2013, which in 2006 were anti-dilutive and have therefore been excluded from the diluted earnings per share calculation. In future periods this financial instrument could potentially dilute basic earnings per share.

12 GOODWILL

	31 December 2006 £m	31 December 2005 £m
Cost		
At 1 January	**189**	197
Acquired through business combinations	**40**	2
Eliminated on partial disposal of a subsidiary	**–**	(9)
Exchange differences	**(3)**	(1)
At 31 December	**226**	189

The addition of £40 million in 2006 relates to the acquisition of Coleto Creek (refer note 31(a)).

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

	31 December 2006 £m	31 December 2005 £m
First Hydro (UK)	**153**	153
Coleto Creek (US)	**38**	–
Turbogás (Portugal)	**26**	27
IPO (Czech Republic)	**8**	7
Others	**1**	2
	226	189

The Group tests goodwill for impairment annually or when there is an indication that goodwill might be impaired. The cash generating units' recoverable amounts are determined from value in use calculations. These are based on projected cash flows, which may extend forward as much as 40 years, from individual project whole life asset models. These cash flows have been discounted using rates in the range 6% to 13% on a pre-tax basis. Key assumptions include the discount rates and market prices for electricity and fuel costs over the lives of the assets. These market prices are considered in the light of forward price curves (which represent the Group's view as to prices at which customers would currently contract for delivery or settlement of commodities, such as power or gas, at future dates) and forecast demand and supply growth over the lives of the assets. The projected cash flows extend over the whole of the assets' expected lives as this best reflects the long-term nature of the returns generated by the long-life assets. Pre-tax risk adjusted discount rates take into account current market assessments of the time value of money and risks specific to the respective cash generating unit.

13 OTHER INTANGIBLE ASSETS

	31 December 2006 £m	31 December 2005 £m
Intangible assets		
Commodity contracts	**131**	194
Emission allowances	**58**	–
Carrying amount at 31 December	**189**	194

The above intangible assets balance can be analysed as follows:

	31 December 2006 £m	31 December 2005 £m
Intangible assets – commodity contracts		
Cost		
At 1 January	**234**	–
Acquisition of subsidiaries	**39**	234
Exchange differences	**(1)**	–
At 31 December	**272**	234
Accumulated amortisation		
At 1 January	**40**	–
Charge for the year	**101**	40
At 31 December	**141**	40
Carrying amount		
At 1 January	**194**	–
At 31 December	**131**	194
Intangible assets – emission allowances		
Carrying amount		
At 1 January	**–**	–
Additions	**39**	25
Acquisition of subsidiaries	**64**	–
Charge for the year	**(4)**	–
Disposals	**(39)**	(25)
Exchange differences	**(2)**	–
At 31 December	**58**	–

Commodity contracts are amortised over the period in which benefits are expected to arise. The addition in 2006 relates to commodity contracts acquired as part of the acquisitions of Coleto Creek and Indian Queens.

The Group has recognised any allocated emission allowances net of the fair value of the grant. As a result, no net asset or liability is shown on the balance sheet at initial recognition. The amortisation of any emission allowances purchased or acquired through business combinations is charged to cost of sales in the income statement over the period in which benefits are expected to arise. Emission allowances acquired as part of the acquisition of Coleto Creek amount to £64 million.

As part of the European Union (EU) Emissions Trading Scheme (EUETS), designed to reduce greenhouse gas emissions in the EU over the medium term, the Group was granted emission allowances amounting to £49 million in respect of the year ended 31 December 2006 (2005: £55 million).

14 PROPERTY, PLANT AND EQUIPMENT

	Land and buildings £m	Plant, machinery and equipment £m	Assets in course of construction £m	Total £m
Cost				
At 1 January 2005	174	3,865	161	4,200
Additions	5	78	184	267
Acquisition of subsidiaries	–	365	–	365
Disposals	(2)	(9)	–	(11)
Disposal of subsidiaries	–	(54)	–	(54)
Reclassifications and transfers	–	54	(54)	–
Exchange differences	3	241	25	269
At 31 December 2005	180	4,540	316	5,036
Additions	3	169	64	236
Acquisition of subsidiaries	5	653	54	712
Disposals	–	(13)	–	(13)
Reclassifications and transfers	(20)	(19)	(314)	(353)
Exchange differences	(4)	(254)	(36)	(294)
At 31 December 2006	**164**	**5,076**	**84**	**5,324**
Accumulated depreciation				
At 1 January 2005	25	633	–	658
Depreciation charge for the year	11	137	–	148
Disposals	(2)	(9)	–	(11)
Disposal of subsidiaries	–	(3)	–	(3)
Impairment reversal	–	(52)	–	(52)
Exchange differences	–	89	–	89
At 31 December 2005	34	795	–	829
Depreciation charge for the year	10	158	–	168
Disposals	–	(8)	–	(8)
Impairment reversal	–	(36)	–	(36)
Reclassifications and transfers	(7)	7	–	–
Exchange differences	(1)	(53)	–	(54)
At 31 December 2006	**36**	**863**	**–**	**899**
Carrying amount				
At 1 January 2005	149	3,232	161	3,542
At 31 December 2005	146	3,745	316	4,207
At 31 December 2006	**128**	**4,213**	**84**	**4,425**

At the end of the year the Group carried out a review of the recoverable amount of its UK power plants. This led to the recognition of an impairment reversal of £36 million for Deeside, based on the estimated value in use of this asset. The post-tax risk adjusted discount rate used in measuring value in use was 8%. The post-tax risk adjusted discount rate which was used at the time of the initial impairment in 2002 was 8%. The impairment reversal has been included in cost of sales.

Interest capitalised in the year was £9 million (2005: £14 million). On a cumulative basis, after taking into account exchange differences and depreciation, the carrying amount of interest capitalised is £80 million (2005: £80 million).

The total value of land, included within land and buildings, that is not depreciated is £46 million (2005: £49 million).

Property, plant and equipment with a carrying amount of £4,163 million (2005: £3,924 million) is subject to fixed and floating charges from banks providing borrowing facilities which are non-recourse to the Company.

Reclassifications and transfers consist of amounts moved from assets in course of construction to finance lease receivables and inventories.

15 INVESTMENTS IN JOINT VENTURES AND ASSOCIATES

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

	31 December 2006 £m	31 December 2005 £m
a) Joint ventures' net assets (including goodwill)		
Non-current assets	**1,220**	1,362
Current assets	**316**	280
Total assets	**1,536**	1,642
Current liabilities	**(204)**	(188)
Non-current liabilities	**(588)**	(743)
Total liabilities	**(792)**	(931)
Net assets	**744**	711
Group's share of joint ventures' net assets	**365**	349
b) Associates' net assets (including goodwill)		
Non-current assets	**5,630**	7,690
Current assets	**1,247**	1,755
Total assets	**6,877**	9,445
Current liabilities	**(695)**	(840)
Non-current liabilities	**(3,788)**	(5,401)
Total liabilities	**(4,483)**	(6,241)
Net assets	**2,394**	3,204
Group's share of associates' net assets	**899**	1,056
c) Results of joint ventures		
Revenue	**771**	631
Profit for the year	**124**	104
Group's share of results of joint ventures		
Share of revenue	**379**	309
Share of profit for the year	**59**	50
d) Results of associates		
Revenue	**2,501**	2,024
Profit for the year	**460**	449
Group's share of results of associates		
Share of revenue	**820**	694
Share of profit for the year	**155**	148

At 31 December 2006 the Group's investments that are listed on a recognised stock market are those in The Hub Power Company Limited (HUBCO), Kot Addu Power Company Limited (KAPCO) and Malakoff Berhad. HUBCO and KAPCO are considered associates and International Power continues to equity account for HUBCO despite its shareholding being less than 20% (refer note 40). The Group's share of HUBCO and KAPCO was valued at £46 million (2005: £45 million) and £108 million (2005: £149 million), respectively, on the major Pakistan stock markets and the Group's share in Malakoff Berhad was valued at £236 million (2005: £203 million) on the Kuala Lumpur stock market. Market values for Group shareholdings in these investments were in excess of the respective carrying amounts at the year end.

A subsidiary, Al Kamil, is listed on the Muscat Securities Market and was valued at £14 million on 31 December 2006 (2005: £15 million). The Group owns 65% of Al Kamil.

The reporting period of Malakoff Berhad does not coincide with International Power's financial year. Consequently, the results of Malakoff Berhad for the period 1 December to 30 November have historically been equity accounted by the Group each year as adjusted for any significant events in December. This treatment prevents Malakoff's results being made publicly available before its own shareholders have received the information through dissemination by Malakoff Berhad. The Group's shareholding in Malakoff is now recognised as an asset held for sale (refer note 24).

Included within the Group's share of net assets of joint ventures and associates is net debt of £1,524 million (2005: £1,625 million). These obligations are generally secured by the assets of the respective joint venture or associate borrower and are not guaranteed by International Power plc or any other Group company.

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

16 OTHER INVESTMENTS

	31 December 2006 £m	31 December 2005 £m
Investments available for sale	**26**	4

The Group owns debt instruments and minority shareholdings in a number of businesses related to power generation and fuel supply activities in Europe and Asia. The debt instruments are stated at fair value based on an estimate of the discounted cash flows. The equity instruments are not quoted but are shares in privately owned companies. Therefore the fair value of the equity instruments cannot be measured reliably and the carrying amount has been determined by using the cost of acquiring the shares in these companies.

17 FINANCE LEASE RECEIVABLES

			Present value of minimum lease payments	
	31 December 2006 £m	31 December 2005 £m	**31 December 2006 £m**	31 December 2005 £m
Minimum lease payments:				
Within one year	**110**	48	**33**	12
Later than one year and not later than five years	**428**	192	**144**	57
After five years	**1,398**	649	**834**	391
	1,936	889	**1,011**	460
Add: unguaranteed residual value (after five years)	**75**	–		
Gross investment in the lease	**2,011**	889		
Less: unearned finance income	**(925)**	(429)		
Total finance lease receivables	**1,086**	460		
Analysed as:				
Non-current finance lease receivables (recoverable after 12 months)	**1,053**	448		
Current finance lease receivables (recoverable within 12 months)	**33**	12		
Total finance lease receivables	**1,086**	460		
Analysed as:				
Present value of minimum lease payments	**1,011**	460		
Add: unguaranteed residual value	**75**	–		
Total finance lease receivables	**1,086**	460		

Rentals receivable under finance leases by the Group during the year amounted to £63 million (2005: £48 million). Excluding assets which are constructed by the Group, the cost of assets acquired by the Group during the year for onward finance leasing was £281 million (2005: £nil).

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

Unguaranteed residual values of assets leased under finance leases at the balance sheet date are estimated at £75 million (2005: £nil).

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

The fair value of the Group's finance lease receivables as at 31 December 2006 is estimated at £1,114 million (2005: £460 million) based on discounting estimated cash flows at the market rate.

18 OTHER LONG-TERM RECEIVABLES

	31 December 2006 £m	31 December 2005 £m
Total other long-term receivables	**94**	67

19 DEFERRED TAX

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

	31 December 2006 £m	31 December 2005 £m
Deferred tax liabilities:		
Property, plant and equipment accelerated capital allowances	**(569)**	(552)
Other temporary differences	**(271)**	(238)
Dividends of overseas subsidiaries	**(57)**	(40)
Total deferred tax liabilities	**(897)**	(830)

	31 December 2006 £m	31 December 2005 £m
Deferred tax assets:		
Provisions	**43**	42
Tax losses	**161**	161
Other temporary differences	**245**	299
Total gross deferred tax assets	**449**	502
Less: deferred tax assets not recognised	**(155)**	(151)
Total deferred tax assets	**294**	351
Net deferred tax liabilities	**(603)**	(479)

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

Of the £161 million (2005: £161 million) deferred tax asset in respect of tax losses, £106 million (2005: £102 million) can be carried forward for a period of between 10 and 19 years. The balance can be carried forward indefinitely. No deferred tax asset in relation to the £106 million of losses has been recognised (2005: £nil).

At the balance sheet date, the aggregate amount of temporary differences associated with undistributed earnings of subsidiaries, associates and joint ventures was £888 million (2005: £634 million). At 31 December 2006 a deferred tax provision of £57 million (2005: £40 million) has been recognised in respect of temporary differences which are likely to reverse in the near future or where the Group is unable to control the reversal of the timing difference.

Calculation of the potential deferred tax liability for the total aggregate undistributed earnings has not been undertaken as the Group is in a position to control the timing of the reversal of the temporary differences and it is probable that the differences will not reverse in the foreseeable future. If the temporary differences were to reverse in the future, it is probable that the majority of the potential tax liability would be covered by tax credits in respect of tax paid locally.

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

	31 December 2006 £m	31 December 2005 £m
Deferred tax liabilities	**(696)**	(557)
Deferred tax assets	**93**	78
Net deferred tax liabilities	**(603)**	(479)

19 DEFERRED TAX continued

Movement in temporary differences during the year:

	1 January 2006 £m	Recognised in income £m	Other balance sheet movements £m	Recognised in equity £m	Acquisition of subsidiaries £m	31 December 2006 £m
Property, plant and equipment	306	(17)	–	–	35	**324**
Other temporary differences	133	49	(3)	43	–	**222**
Dividends of overseas subsidiaries, associates and joint ventures	40	17	–	–	–	**57**
	479	49	(3)	43	35	**603**

	1 January 2005 £m	Recognised in income £m	Other balance sheet movements £m	Recognised in equity £m	Acquisition/ disposal of subsidiaries £m	31 December 2005 £m
Property, plant and equipment	316	(10)	–	–	–	306
Other temporary differences	100	21	7	(46)	51	133
Dividends of overseas subsidiaries, associates and joint ventures	16	24	–	–	–	40
	432	35	7	(46)	51	479

20 INVENTORIES

	31 December 2006 £m	31 December 2005 £m
Plant spares	**26**	22
Fuel inventories	**55**	37
Consumables	**60**	51
Total inventories	**141**	110

Inventories with a carrying amount of £116 million (2005: £50 million) are subject to fixed and floating charges of project finance facilities at various power plant subsidiaries. These project finance facilities are non-recourse to International Power plc.

21 TRADE AND OTHER RECEIVABLES

	31 December 2006 £m	31 December 2005 £m
Trade receivables	**139**	163
Other receivables	**157**	108
Prepayments and accrued income	**103**	125
Total amounts falling due within one year	**399**	396

The Directors consider that the carrying amount of trade and other receivables approximates to their fair value. Trade and other receivables are stated net of allowance for irrecoverable amounts.

22 DERIVATIVE FINANCIAL INSTRUMENTS

	31 December 2006		31 December 2005	
	Assets £m	**Liabilities £m**	Assets £m	Liabilities £m
Energy derivatives	**236**	**362**	267	661
Interest rate swaps	**15**	**9**	1	26
Options over equity	**30**	**59**	–	–
	281	**430**	268	687
Current	**243**	**204**	268	496
Non-current	**38**	**226**	–	191
	281	**430**	268	687

The Group utilises interest rate swaps to manage its interest rate exposures by swapping an element of its borrowings from floating rates to fixed rates. As at 31 December 2006, the total notional value of interest rate swaps was £2,007 million (2005: £1,416 million).

The Group utilises foreign currency exchange contracts to manage its foreign exchange rate exposures. As at 31 December 2006, the total notional value of these contracts was £45 million (2005: £6 million) and the mark to market was £nil (2005: £nil).

The Group owns purchased call options over the equity of various energy related businesses. The Group already has an equity interest in some of these businesses. The Group has convertible bonds which can convert into Ordinary Shares of International Power plc. The conversion feature in the 3.25% convertible euro bond is accounted for as an embedded derivative (refer note 25).

23 CASH AND CASH EQUIVALENTS

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

	31 December 2006 £m	31 December 2005 £m
Cash and cash equivalents in the cash flow statement	**980**	620

The total cash and cash equivalents balance includes £211 million (2005: £71 million) of cash which is considered to be 'restricted' as it is primarily to secure amounts required for debt repayments and letters of credit.

24 ASSETS HELD FOR SALE

On 22 December 2006, the shareholders of Malakoff Berhad approved the sale of their wholesale power generating business to MMC, another Malaysian corporate, for 10.35 Malaysian ringgits per share. The sale process is expected to be completed in the first half of 2007. The estimated proceeds, from the sale of International Power's shareholding in Malakoff Berhad, are significantly more than the 31 December 2006 carrying amount of £128 million. As at 22 December 2006, the carrying amount was reclassified from investments in joint ventures and associates to non-current assets classified as held for sale. The asset held for sale is included within the Asia region segmental assets shown in note 2. International Power's share of Malakoff's earnings are included within the Asia region segmental results.

25 LOANS AND BONDS

	31 December 2006 £m	31 December 2005 £m
a) Interest-bearing loans and bonds (current)		
Current portion of secured bank loans	**231**	187
Secured bonds	**10**	–
	241	187
b) Interest-bearing loans and bonds (non-current)		
Secured bank loans	**3,209**	2,721
Secured bonds	**668**	445
Preferred equity facility	**152**	173
3.75% Convertible US dollar bonds 2023	**113**	125
3.25% Convertible euro bonds 2013	**124**	–
	4,266	3,464
Total interest-bearing loans and bonds	**4,507**	3,651

25 LOANS AND BONDS continued

Secured bank loans and secured bonds
The bank loans and bonds with a carrying amount of £4,118 million are secured by fixed and floating charges over the assets of certain subsidiaries. Substantially all of the Group's power stations, generating assets and other operating assets are financed under facilities which are non-recourse to International Power plc and secured solely on the assets of the subsidiary concerned.

Preferred equity facility
The preferred equity facility comprises US$300 million in preference shares which were issued by Impala Magpie Limited to Mitsui Power Ventures Limited for the purposes of financing the acquisition of the EME portfolio which was completed in December 2004.

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

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

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

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

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

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 173p at any time up to 12 August 2023. Each US$1,000 principal amount of notes will entitle the holder to convert into a US$1,000 paid-up value of preference shares of International Power (Jersey) Limited. The notes may be redeemed at the holder's option at their principal amount, together with accrued interest, to the date fixed for redemption.

The convertible bonds mature in August 2023 but with bondholders having the right to put the bond back to the Group in August 2010, 2013, 2018 and 2023.

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.

Following the extinguishment of a cash settlement option on 17 January 2005, the remaining conversion feature, being an equity call option held by the bondholders was recognised in equity. The remaining debt element of the convertible bond accretes to par value over the life of the bond at a constant periodic rate based on its carrying amount.

The interest charged for the year is calculated by applying an effective interest rate of 3.65% to the liability component for the period since the convertible US dollar bond was issued. This is in addition to the coupon interest rate of 3.75% per annum.

The Directors estimate the fair value of the liability component of the convertible US dollar bonds at 31 December 2006 to be approximately £114 million (31 December 2005: £125 million). This fair value has been determined by reference to the market price at 31 December 2006.

3.25% Convertible euro bonds 2013
On 20 July 2006, International Power Finance (Jersey) II Limited, a wholly-owned subsidiary company incorporated in Jersey, issued €230 million 3.25% convertible notes due 2013, convertible into preference shares of International Power Finance (Jersey) II Limited at the holder's option, immediately exchangeable for Ordinary Shares of, and unconditionally guaranteed by, International Power plc.

The notes are convertible into Ordinary Shares of International Power plc at a conversion price of 391p at any time up to 20 July 2013. Each €50,000 principal amount of notes will entitle the holder to convert into a €50,000 paid-up value of preference shares of International Power Finance (Jersey) II 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 20 July 2013 at a redemption price equivalent to their principal amount.

	31 December 2006 £m
Net proceeds of convertible euro bonds issued	152
Embedded derivative component	(30)
Liability component at date of issue	122
Interest charged	2
Liability component at 31 December	**124**

The net proceeds received from the issue of the convertible bond have been split between the debt element and an embedded derivative component. This embedded derivative component represents the fair value of the equity conversion call option held by the bondholders.

The interest charged for the year is calculated by applying an effective interest rate of 3.39% to the liability component for the period since the convertible euro bond was issued. This is in addition to the coupon interest rate of 3.25% per annum.

The Directors estimate the fair value of the liability component of the convertible euro bonds at 31 December 2006 to be approximately £133 million. This fair value has been determined by reference to the market price at 31 December 2006.

26 TRADE AND OTHER PAYABLES (CURRENT)

	31 December 2006 £m	31 December 2005 £m
Trade payables	**85**	118
Other payables	**226**	153
Accruals	**218**	240
Total trade and other payables	**529**	511

The Directors consider the carrying amounts of trade and other payables approximate to their fair value.

27 OTHER PAYABLES (NON-CURRENT)

	31 December 2006 £m	31 December 2005 £m
Other payables	**40**	14
Loans from minority interests	**81**	81
Total other payables	**121**	95

28 PROVISIONS

	Retirement benefit obligations £m	Commodity contracts £m	Other £m	Total £m
At 1 January 2006	27	–	41	68
Acquisitions	–	156	3	159
Provisions made during the year	10	–	14	24
Provisions used during the year	(12)	(16)	(5)	(33)
Exchange differences	–	(7)	(2)	(9)
At 31 December 2006	**25**	**133**	**51**	**209**

Commodity contracts added in 2006 relate to 'out of the money' power sales contracts acquired as part of the acquisition of Coleto Creek. The provisions utilised are credited to revenue in the income statement and are expected to be fully utilised by 2014.

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

29 SHARE CAPITAL

	Authorised Ordinary Shares of 50p		Issued and fully paid Ordinary Shares of 50p	
	Number	£m	Number	£m
At 1 January 2006	2,266,000,000	1,133	1,474,736,637	737
Issue of shares under Executive Share Option Plan	–	–	13,073,207	6
Issue of shares under the Sharesave Plan	–	–	1,196,959	1
Issue of shares under Performance Share Plan	–	–	3,046,107	2
At 31 December 2006	**2,266,000,000**	**1,133**	**1,492,052,910**	**746**

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

Ordinary Shares

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

29 SHARE CAPITAL continued

Deferred shares

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

Unclassified share

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

Employee share schemes

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

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

			Number of Ordinary Shares	
	Option price range	Date exercisable	Year ended 31 December 2006	Year ended 31 December 2005
Sharesave Plans	70.33p-200.00p	2006-2011	**5,889,678**	4,783,486
Executive Share Option Plans	62.32p-343.73p	2000-2016	**21,294,173**	32,687,124
2002 Performance Share Plan	74.79p	2003 onwards	**1,230,108**	4,276,215
Total options outstanding			**28,413,959**	41,746,825

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

i) Sharesave Plans

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

Option price	Date exercisable	Number of Ordinary Shares Year ended 31 December 2006	Year ended 31 December 2005
167.37p	2006	–	10,082
178.06p	2006-2007	**6,631**	6,631
80.12p	2005-2006	–	253,314
80.12p	2007-2008	**2,578,756**	2,673,050
97.93p	2006-2007	**79,672**	104,158
97.93p	2008-2009	**69,582**	69,582
70.33p	2006	–	800,205
70.33p	2008	**568,855**	654,658
97.93p	2007	**94,277**	107,329
97.93p	2009	**99,331**	104,477
200.00p	2009	**1,311,675**	–
200.00p	2011	**1,080,899**	–
		5,889,678	4,783,486

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

	Year ended 31 December 2006		Year ended 31 December 2005	
	Number of Ordinary Shares	**Weighted average exercise price pence**	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**4,783,486**	**78.90**	5,963,482	79.18
Granted during the year	**2,481,799**	**200.00**	–	–
Exercised during the year	**(1,196,959)**	**74.24**	(858,892)	80.67
Expired during the year	**(178,648)**	**140.10**	(321,104)	79.45
Options outstanding at end of the year	**5,889,678**	**129.02**	4,783,486	78.90
Options exercisable at end of the year	**86,303**		253,314	

The weighted average share price at the date of exercise for Sharesave Plan share options exercised during the year was 287.15 pence (2005: 240.43 pence). The share options outstanding at the end of the year have exercise prices in a range from 70.33 pence to 200.00 pence as outlined in the table above.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 2.36 years (2005: 2.12 years).

ii) Executive Share Option Plans

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

		Number of Ordinary Shares	
Option price	**Date exercisable**	**Year ended 31 December 2006**	Year ended 31 December 2005
287.76p	1999-2006	**–**	416,298
343.73p	2000-2007	**440,687**	499,572
313.92p	2001-2008	**586,630**	712,903
277.55p	2003-2010	**1,527,844**	2,574,081
209.22p	2004-2011	**631,668**	1,612,812
193.19p	2004-2011	**49,959**	136,076
174.50p	2005-2012	**3,329,619**	3,673,817
62.32p	2006-2013	**622,483**	10,626,586
123.53p	2007-2014	**6,228,318**	6,845,144
179.25p	2008-2015	**5,215,424**	5,589,835
281.00p	2009-2016	**2,661,541**	–
		21,294,173	32,687,124

The number and weighted average exercise prices of Executive Share Options are as follows:

	Year ended 31 December 2006		Year ended 31 December 2005	
	Number of Ordinary Shares	**Weighted average exercise price pence**	Number of Ordinary Shares	Weighted average exercise price pence
Options outstanding at beginning of the year	**32,687,124**	**145.14**	29,770,835	141.65
Granted during the year	**2,671,718**	**281.00**	5,589,835	179.25
Exercised during the year	**(13,073,207)**	**104.51**	(608,679)	142.02
Expired during the year	**(991,462)**	**156.52**	(2,064,867)	187.83
Options outstanding at end of the year	**21,294,173**	**186.60**	32,687,124	145.14
Options exercisable at end of the year	**7,188,890**		9,625,559	

29 SHARE CAPITAL continued

The weighted average share price at the date of exercise for Executive Share Options exercised during the year was 293.26 pence (2005: 232.62 pence). The share options outstanding at the end of the year have exercise prices in a range from 62.32 pence to 343.73 pence.

For these share options outstanding at the end of the year the weighted average remaining contractual life is 6.8 years (2005: 7.1 years).

iii) 2002 Performance Share Plan

Under this Plan, Directors and certain senior managers of the Group are awarded conditional awards over Ordinary Shares in the Group. These conditional awards may vest three years after the awards have been made subject to the satisfactory performance of a performance condition (determined at the time that the conditional awards are made). In 2003 the Group granted to the Trustee of the International Power Employee Share Ownership Trust an option to acquire 3,807,057 Ordinary Shares in the Group at an option price of 84 pence per share. Following the Rights Issue in 2004, the number of shares under option was increased to 4,276,215 and the option exercise price was adjusted to 74.79 pence per share. This option can only be exercised to the extent required to satisfy conditional awards made under the Performance Share Plan. These conditional awards can only vest after the end of the relevant performance period and only to the extent to which the performance conditions have been satisfied.

During 2006 the Trustee exercised this option to the extent of 3,046,107 shares in respect of Performance Share Plan awards released in March 2006. At 31 December 2006 there remained 1,230,108 options outstanding and exercisable at an exercise price of 74.79 pence per share.

The life of this option is open-ended. It is anticipated that this share option will be utilised to satisfy the release of awards made under the 2002 Performance Share Plan from 2007 onwards. Assuming full vesting of the awards made as at 31 December 2006, it is estimated that this option will have been fully exercised by the end of 2008.

b) Fair value of options under Share Option Plans

i) Sharesave plans

The estimated fair value of the options granted during the year was 82 pence per share (2005: None granted).

These fair values were calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

	2006	2005
Weighted average share price	**250p**	n/a
Weighted average exercise price	**200p**	n/a
Expected volatility	**30%**	n/a
Expected life	**4 years**	n/a
Risk free rate	**4.16%**	n/a
Expected dividend yield	**2.36%**	n/a

ii) Executive Share Options Plans

The estimated fair value of the options granted during the year was 61 pence per share (2005: 47 pence per share).

These fair values were calculated using the Black-Scholes option pricing model. The inputs into the model were as follows:

	2006	2005
Weighted average share price	**269p**	179p
Weighted average exercise price	**281p**	179p
Expected volatility	**30%**	30%
Expected life	**4 years**	4 years
Risk free rate	**4.39%**	4.84%
Expected dividend yield	**2.36%**	1.94%

Expected volatility was determined by calculating the historical volatility of the Company's share price over the previous six years. The expected life used in the model has been adjusted, based on management's best estimate, for the effects of non-transferability, exercise restrictions and behavioural considerations.

iii) 2002 Performance Share Plan

No performance share plan options were granted during the current or prior year.

c) Managers' share bonus arrangements

During 2004, 571,710 Ordinary Shares in International Power plc were acquired in respect of a project incentive arrangement for staff for a consideration of £887,497. These shares have been placed in an Employee Share Ownership Trust. No additional purchases were made during 2006 in respect of this plan (2005: nil).

d) Employee Share Ownership Trust

A number of International Power plc Ordinary Shares are held in Employee Share Ownership Trusts (ESOTs). These shares are held by the ESOTs to meet awards made under the Group's 2002 Performance Share Plan. At 31 December 2006, the ESOTs held a total of 1,241,452 International Power plc Ordinary Shares (2005: 2,081,573). At 31 December 2006 the market value of these shares was £4,739,243 (2005: £4,985,367). The maximum number of Ordinary Shares required to meet all outstanding awards (assuming full vesting of those awards) as at 31 December 2006 was 6,444,745 (2005: 7,522,005).

30 SHARE CAPITAL AND RESERVES

	Attributable to equity holders of the parent							
	Share capital £m	**Share premium account £m**	**Capital redemption reserve £m**	**Capital reserve £m**	**Hedging reserve £m**	**Translation reserve £m**	**Retained earnings £m**	**Total equity £m**
At 1 January 2006	737	394	145	422	(118)	49	463	2,092
Profit for the year	–	–	–	–	–	–	410	410
Other recognised income and expenses relating to the year (net)	–	–	–	–	124	(127)	–	(3)
Issue of shares	9	8	–	–	–	–	–	17
Distributions	–	–	–	–	–	–	(67)	(67)
Other movements	–	–	–	–	–	–	13	13
At 31 December 2006	**746**	**402**	**145**	**422**	**6**	**(78)**	**819**	**2,462**

	Attributable to equity holders of the parent							
	Share capital £m	Share premium account £m	Capital redemption reserve £m	Capital reserve £m	Hedging reserve £m	Translation reserve £m	Retained earnings £m	Total equity £m
At 1 January 2005	737	392	145	422	(12)	(39)	156	1,801
Profit for the year	–	–	–	–	–	–	285	285
Other recognised income and expenses relating to the year (net)	–	–	–	–	(106)	88	–	(18)
Recognition of equity component in 3.75% convertible US dollar bond	–	–	–	–	–	–	50	50
Issue of shares	–	2	–	–	–	–	–	2
Distributions	–	–	–	–	–	–	(37)	(37)
Other movements	–	–	–	–	–	–	9	9
At 31 December 2005	737	394	145	422	(118)	49	463	2,092

The share capital represents the authorised Ordinary Shares in the Company issued at par which carry a right to participate in the distribution of dividends or capital of the Company.

The share premium account represents the difference between the issue price and the nominal value of shares issued.

The capital redemption reserve was created in March 1995 when the Company purchased and then cancelled approximately 98 million of its Ordinary Shares in conjunction with HM Treasury's sale of its remaining 40% shareholding in the Company. The reserve was subsequently increased in the years ended 31 March 1996, 31 March 2000 and 31 December 2003 when further share purchases were made and these shares were cancelled. The capital redemption reserve is not distributable.

The capital reserve was vested in the Company at 31 March 1990 under the Transfer Scheme whereby the net assets of the Central Electricity Generating Board (CEGB) were divided among the CEGB successor companies. It is not distributable.

The hedging reserve comprises the effective portion of the cumulative net change in the fair value of cash flow hedging instruments related to hedged transactions that have not yet occurred.

The translation reserve comprises all foreign exchange differences arising from the translation of the financial statements of foreign operations that are not integral to the operations of the Company, as well as from the translation of liabilities that hedge the Company's net investment in foreign operations.

On 17 January 2005, the Group waived its option to cash settle the conversion option of the 3.75% convertible US dollar bonds 2023. This election transferred the fair value of the embedded derivative to reserves, recognising the mark to market carrying amount as an equity component of the bond.

£527 million (2005: £124 million) of the Group's retained earnings is not distributable as it arose from unrealised gains on intra-group transfers.

Set off against retained earnings at 31 December 2006 are treasury shares of £1 million (2005: £1 million).

31 ACQUISITIONS AND DISPOSALS

a) Coleto Creek

On 7 July 2006 American National Power Inc, a wholly-owned subsidiary of International Power, acquired the 632 MW coal fired Coleto Creek power generation facility in Texas from Topaz Power Group, a joint venture between Carlyle/Riverstone and Sempra Generation, for cash consideration, including acquisition costs, of £621 million (US$1.14 billion). The result of Coleto Creek has been consolidated as a subsidiary from this date using the acquisition method.

The details of the transaction, results and fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Goodwill	–	40	40
Other intangible assets	20	81	101
Property, plant and equipment	199	424	623
Inventories	9	1	10
Trade and other receivables	12	–	12
Trade and other payables	(9)	–	(9)
Provisions	–	(156)	(156)
Total assets acquired	**231**	**390**	**621**

Components of cost of acquisition	
Cash	617
Directly attributable acquisition costs	4
Consideration (including acquisition costs) and cash outflow to the Group	**621**

In the period from 7 July 2006 to 31 December 2006, Coleto Creek contributed £74 million of revenue and £26 million to the Group's profit from operations (both excluding exceptional items and specific IAS 39 mark to market movements). Including exceptional items and specific IAS 39 mark to market movements, it contributed £77 million of revenue and £29 million to the Group's profit from operations. It also contributed £34 million to the Group's net operating cash flows and paid £22 million in respect of net interest and £nil in respect of tax.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of sulphur dioxide allowances, included as intangible assets; the recognition of the plant at fair value, included as property, plant and equipment; and the fair value of out of the money power purchase agreements (agreements to sell power), included as provisions. Goodwill arises on the acquisition of Coleto Creek as a result of the fair value of property, plant and equipment being restricted to the lower of depreciated replacement cost and value in use. As the depreciated replacement cost of the Coleto Creek power plant is lower than its value in use and all other assets and liabilities and contingent liabilities have been identified, then goodwill arises.

It is impracticable to state what the impact would have been on Group revenue and profit for the year had the acquisition been completed on 1 January 2006 due to the difficulty in ascertaining the valuation of commodity contracts, at that time, reflected in the fair value balance sheet acquired as intangible assets and provisions, and their respective corresponding amortisation charge and credit to the income statement during that period.

b) Levanto

On 1 November 2006, International Power plc, through its wholly-owned subsidiary International Power Levanto Holdings BV, completed the purchase of the Levanto portfolio of onshore wind farms, predominantly located in France and Germany, from Christofferson Robb & Company (CRC) for £129 million, including acquisition costs. This comprises the acquisition of 100% of the issued share capital of Levanto Structured Energy (Lux) S.a.r.l. and Levanto GSEF (Lux) S.a.r.l. Levanto GSEF (Lux) S.a.r.l. owns bonds issued by the lender of finance to one of the wind farm owning entities. At the date of acquisition the Levanto wind farms comprised 286 MW of capacity in operation, 126 MW under construction, which is due to commence operation in 2007, and 24 MW of fully permitted capacity, which is planned to commence operation in 2008. As required, the results of the Levanto group of businesses have been consolidated as subsidiaries from this date using the acquisition method.

The details of the transaction, results and provisional fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Assets in course of construction	54	–	54
Finance lease receivables – non-current	184	94	278
Finance lease receivables – current	3	–	3
Trade and other receivables	14	–	14
Cash and cash equivalents	104	–	104
Loans and bonds – current	(34)	–	(34)
Trade and other payables	(16)	–	(16)
Loans and bonds – non-current	(243)	–	(243)
Deferred tax liabilities	–	(28)	(28)
Provisions	(3)	–	(3)
Total assets acquired	**63**	**66**	**129**
Components of cost of acquisition			
Cash			67
Vendor subordinated loan			60
Directly attributable acquisition costs			2
Consideration (including acquisition costs)			**129**
Satisfied by:			
Cash consideration paid (including acquisition costs)			69
Amount owed to vendor as a subordinated loan			60
Cash and cash equivalents acquired			(104)
Net cash outflow to the Group			**25**

In the period from 1 November 2006 to 31 December 2006, Levanto contributed immaterial amounts of revenue, profit from operations and net operating cash flows to the Group results.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of the finance lease receivables and associated deferred tax on the temporary timing difference created by the fair value adjustment. Due to the proximity of the date of acquisition to the year end and the complexity of the business acquired the fair values attributed to the acquired assets and liabilities are provisional and may be revised.

Similarly, for the same reasons, it is impracticable to state what the impact would have been on Group revenue and profit for the year had the acquisition been completed on 1 January 2006 due to the difficulty in ascertaining the valuation of assets and liabilities at that time.

31 ACQUISITIONS AND DISPOSALS continued

c) Indian Queens

On 18 September 2006 International Power plc, through a wholly-owned subsidiary, completed the purchase of 100% of the share capital of Indian Queens Power Limited and Indian Queens Operations Limited, the owner and operating companies respectively of the Indian Queens oil fired OCGT peaking plant in Cornwall, England from AES for £32 million. The results of both Indian Queens businesses have been consolidated as subsidiaries from this date using the acquisition method.

The details of the transaction, results and fair value adjustments arising from the change in ownership are shown below:

	Acquiree's carrying amount £m	Fair value adjustments £m	Fair value to the Group £m
Intangible assets	–	2	2
Property, plant and equipment	24	11	35
Inventories	1	–	1
Trade receivables	2	–	2
Cash and cash equivalents	24	–	24
Finance lease payable – current	(2)	–	(2)
Trade payables	(2)	–	(2)
Finance lease payable – non-current	(26)	5	(21)
Deferred tax liabilities	(1)	(6)	(7)
Total assets acquired	**20**	**12**	**32**
Satisfied by:			
Cash consideration paid (including acquisition costs)			32
Cash and cash equivalents acquired			(24)
Net cash outflow to the Group			**8**

In the period 18 September 2006 to 31 December 2006, Indian Queens contributed £3 million of revenue and £1 million to the Group's profit from operations. It also contributed £2 million to the Group's net operating cash flows and paid £2 million in respect of net interest and nil in respect of tax.

The fair value adjustments are made to reflect the fair value of the net assets acquired and principally represent the recognition of the fair value of the property, plant and equipment, the fair value of the finance lease payable and the associated deferred tax adjustments on the temporary timing differences created.

If the acquisition of Indian Queens had taken place on 1 January 2006, Indian Queens would have contributed £13 million of revenue (and Group revenue would have been £2,594 million) for the year ended 31 December 2006 and the profit from operations contributed by Indian Queens would have been £3 million (and Group profit from operations would have been £900 million).

d) Acquisition of subsidiaries net of cash and cash equivalents acquired

In addition to the net cash outflow to the Group of £621 million on the acquisition of Coleto Creek, the cash outflows of £25 million relating to the acquisition of Levanto and £8 million relating to Indian Queens, a £1 million cash outflow arose on acquisition of the remaining 1% shareholding in International Power Opatovice, in the Czech Republic, and a £5 million cash inflow arose from amounts received from Calpine relating to the acquisition of Saltend in 2005.

e) Acquisition of investments in associates

The following acquisitions took place in 2006:

Hidd

On 22 January 2006 Hidd Power Company BSC(c), a company owned 40% by International Power, 30% by Suez-Tractebel SA and 30% by Sumitomo Corporation, signed an agreement to acquire the Hidd independent power and water project in Bahrain, and signed a 20-year power and water purchase agreement with the Ministry of Electricity and Water for its output. Hidd Power Company took over operation of the plant on 23 January 2006, which was the effective date of acquisition, and the transaction was completed on 11 July 2006.

Opus

On 10 May 2006 International Power Retail UK Limited, a wholly-owned subsidiary of International Power plc, completed the purchase of 30% of the share capital of Oxford Power Holdings Limited for £7 million. Its principal subsidiary is Opus Energy Limited, an independent supplier of electricity in the UK that focuses on the small business sector.

32 NET DEBT

Analysis of changes in net debt

	1 January 2006 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2006 £m
Cash and cash equivalents	620	(26)	–	–	386	**980**
Assets held for trading	52	(3)	–	2	(9)	**42**
Total funds	672	(29)	–	2	377	**1,022**
Loans due within one year	(187)	5	(26)	(96)	73	**(231)**
Loans due after more than one year	(2,721)	224	(40)	84	(756)	**(3,209)**
Secured bonds	(445)	(2)	(234)	3	–	**(678)**
Preferred equity facility	(173)	21	–	–	–	**(152)**
Convertible bonds	(125)	16	–	24	(152)	**(237)**
Total debt	(3,651)	264	(300)	15	(835)	**(4,507)**
Net debt	(2,979)	235	(300)	17	(458)	**(3,485)**

	1 January 2005 £m	Exchange differences £m	On acquisition of subsidiaries (excluding cash) £m	Other non-cash movements £m	Cash flow £m	31 December 2005 £m
Cash and cash equivalents	565	18	–	–	37	620
Assets held for trading	47	2	–	3	–	52
Total funds	612	20	–	3	37	672
Loans due within one year	(71)	–	–	(73)	(43)	(187)
Loans due after more than one year	(2,503)	(145)	–	63	(136)	(2,721)
Secured bonds	(449)	–	–	4	–	(445)
Preferred equity facility	(154)	(18)	–	(1)	–	(173)
Convertible bonds	(136)	(17)	–	(3)	31	(125)
Total debt	(3,313)	(180)	–	(10)	(148)	(3,651)
Net debt	(2,701)	(160)	–	(7)	(111)	(2,979)

33 FINANCIAL INSTRUMENTS

a) Energy trading risk, energy market risk and hedge accounting

The Group hedges exposures that arise from the ownership and operation of power plants and related sales of electricity and purchases of fuel and utilises derivatives to optimise the return achieved from these assets. The Group enters into derivative commodity financial instruments to convert floating or indexed electricity and fuel prices to fixed prices in order to lessen its vulnerability to reductions in electricity prices for the electricity it generates and to increases in fuel prices for the fuel it consumes in its power plants. Commodity derivative financial instruments also provide a way to meet customers' pricing requirements while achieving a price structure consistent with the Group's overall pricing strategy.

The Group accounts for certain energy sales and fuel purchases as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

b) Treasury policy

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

c) Risk identification and management

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

33 FINANCIAL INSTRUMENTS continued

d) Interest rate risk and hedge accounting

The Group's policy is to fix interest rates for a significant portion of its debt. This equates to 71%, as at 31 December 2006, using forward rate or interest rate swap agreements. Significant interest rate management programmes and instruments require the specific approval of the Board. The weighted average interest rate of fixed rate debt was 7%. Where project finance is utilised, our policy is to align the maturity of the debt with the contractual terms of the customer offtake agreement. The Group accounts for certain interest rate swaps as cash flow hedges where the forecast transaction is highly probable and the hedge is assessed as effective.

Effective interest rates and maturity analysis

The following is a table illustrating the effective interest rates of interest earning financial assets and interest bearing financial liabilities and the periods in which they mature:

	31 December 2006							
	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
Financial assets								
Finance lease receivable:								
Euro	7.5%	798	26	27	28	29	30	658
US dollars	10.0%	288	7	7	8	8	7	251
Assets held for trading:								
Australian dollars	6.1%	42	42	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	6.1%	80	80	–	–	–	–	–
Czech koruna	2.4%	15	15	–	–	–	–	–
Euro	3.6%	149	149	–	–	–	–	–
Sterling	5.1%	549	549	–	–	–	–	–
US dollars	5.2%	179	179	–	–	–	–	–
Other currencies	4.5%	8	8	–	–	–	–	–
Total financial assets		**2,108**	**1,055**	**34**	**36**	**37**	**37**	**909**
Financial liabilities								
Secured bank loans:								
Australian dollars	7.5%	987	27	39	54	38	45	784
Effect of interest rate swap	*0.2%*	*(796)*	*(43)*	*(111)*	*(20)*	*(250)*	*(358)*	*(14)*
Czech koruna	3.3%	49	49	–	–	–	–	–
Effect of interest rate swap	*0.1%*	*(7)*	*(7)*	–	–	–	–	–
Euro	5.9%	456	64	32	27	45	36	252
Effect of interest rate swap	*0.1%*	*(35)*	*(5)*	*(20)*	*(10)*	–	–	–
Sterling	7.1%	511	54	43	36	37	33	308
Effect of interest rate swap	*(0.2)%*	*(300)*	*19*	*14*	*(125)*	*(141)*	*(67)*	–
US dollars	8.1%	1,404	35	29	33	490	40	777
Effect of interest rate swap	*(0.2)%*	*(869)*	*(20)*	*(21)*	*(175)*	*(271)*	*(195)*	*(187)*
Other currencies	7.3%	33	2	3	3	3	3	19
Sub-total of secured bank loans	7.4%	3,440	231	146	153	613	157	2,140
Sub-total of effect of interest rate swaps	*0.1%*	*(2,007)*	*(56)*	*(138)*	*(330)*	*(662)*	*(620)*	*(201)*
Secured bonds:								
Euro	5.4%	236	10	11	12	12	12	179
Sterling	8.1%	442	–	–	–	–	–	442
Preferred equity facility:								
US dollars	7.4%	152	–	152	–	–	–	–
Convertible bonds[(1)]:								
Euro	6.6%	124	–	–	–	–	–	124
US dollars	7.4%	113	–	–	–	113	–	–
Sub-total of loans and bonds included in net debt		4,507	241	309	165	738	169	2,885
Loans from minority interests:								
US dollars	8.0%	25	16	3	4	2	–	–
Sterling	5.7%	56	–	–	–	–	–	56
Total financial liabilities		**4,588**	**257**	**312**	**169**	**740**	**169**	**2,941**

								31 December 2005
	Effective interest rate	Carrying amount £m	Maturity less than 12 months £m	Maturity 1-2 years £m	Maturity 2-3 years £m	Maturity 3-4 years £m	Maturity 4-5 years £m	Maturity more than 5 years £m
Financial assets								
Finance lease receivable:								
Euro	7.9%	460	12	12	14	15	16	391
Assets held for trading:								
Australian dollars	5.5%	52	52	–	–	–	–	–
Cash and cash equivalents:								
Australian dollars	5.4%	109	109	–	–	–	–	–
Czech koruna	1.9%	4	4	–	–	–	–	–
Euro	2.4%	55	55	–	–	–	–	–
Sterling	4.5%	331	331	–	–	–	–	–
US dollars	4.3%	109	109	–	–	–	–	–
Other currencies	3.2%	12	12	–	–	–	–	–
Total financial assets		1,132	684	12	14	15	16	391
Financial liabilities								
Secured bank loans:								
Australian dollars	6.7%	1,108	40	41	80	71	46	830
Effect of interest rate swap	*0.7%*	*(701)*	*(17)*	*(160)*	*(169)*	*(71)*	*(266)*	*(18)*
Czech koruna	2.8%	55	8	47	–	–	–	–
Effect of interest rate swap	*0.8%*	*(40)*	*–*	*(40)*	*–*	*–*	*–*	*–*
Euro	4.8%	371	21	22	24	23	27	254
Effect of interest rate swap	*0.4%*	*(43)*	*(5)*	*(5)*	*(8)*	*(21)*	*(4)*	*–*
Sterling	6.8%	335	85	17	15	22	17	179
Effect of interest rate swap	*(0.3)%*	*(192)*	*(19)*	*(12)*	*(10)*	*(15)*	*(136)*	*–*
US dollars	7.2%	1,013	31	33	37	31	540	341
Effect of interest rate swap	*0.2%*	*(440)*	*56*	*(23)*	*(24)*	*(200)*	*(17)*	*(232)*
Other currencies	7.7%	26	2	2	2	3	3	14
Sub-total of secured bank loans	6.6%	2,908	187	162	158	150	633	1,618
Sub-total of effect of interest rate swaps	*0.4%*	*(1,416)*	*15*	*(240)*	*(211)*	*(307)*	*(423)*	*(250)*
Secured bonds:								
Sterling	8.3%	445	–	–	–	–	–	445
Preferred equity:								
US dollars	7.2%	173	–	–	173	–	–	–
Convertible bond[(1)]:								
US dollars	7.4%	125	–	–	–	–	125	–
Sub-total of loans and bonds included in net debt		3,651	187	162	331	150	758	2,063
Loans from minority interests:								
US dollars	8.0%	81	–	21	–	–	60	–
Total financial liabilities		3,732	187	183	331	150	818	2,063

(1) The effective interest rates for the convertible bonds represent the coupon on the par value of the bond and the accretion of the liability element which excludes the equity or embedded derivative components (refer note 25).

The effect of interest rate swaps refers to the amortisation profile in the notional amount of the interest rate swap, and are included in the above table to identify to which financial liability they relate. They are not included within total financial liabilities shown above as they are recognised as derivative financial instruments in the balance sheet.

The effect of the Group interest rate swaps effectively replaced £796 million (2005: £701 million) of floating rate Australian dollar borrowings, £869 million (2005: £440 million) of floating rate US dollar borrowings, £300 million (2005: £192 million) of floating rate sterling borrowings, £7 million (2005: £40 million) of floating rate Czech koruna borrowings and £35 million (2005: £43 million) of floating rate euro borrowings with fixed rate borrowings.

Management estimates that a one percentage point increase in interest rates would have the effect of decreasing the Group's profit before tax by approximately £3 million (2005: £8 million).

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.

33 FINANCIAL INSTRUMENTS continued

e) Currency exposures

Currency translation exposure

The results of the Group's foreign operations are translated into sterling at the average exchange rates for the period concerned. The balance sheets of foreign operations are translated into sterling at the closing exchange rates. In order to hedge the net assets of foreign operations, borrowings are generally in the same currency as the underlying investment. The Group aims to hedge a reasonable proportion of its non-sterling assets in this way. It is our policy not to hedge currency translation through foreign exchange contracts or currency swaps.

Currency transaction exposure

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

Currency exposures comprise the monetary assets and liabilities of the Group that are not denominated in the functional currency of the operating unit involved, other than certain non-sterling borrowings treated as hedges of net investments in overseas operations.

Management estimates that a one percentage point strengthening of sterling against all currencies would reduce the Group's profit before tax by approximately £3 million.

f) Borrowing facilities

The Group has substantial borrowing facilities available to it. The undrawn committed facilities available at 31 December 2006 in respect of which all conditions precedent have been met at that date amount to £667 million (2005: £441 million).

	31 December 2006			31 December 2005		
	Facility £m	Undrawn £m	Available £m	Facility £m	Undrawn £m	Available £m
US dollar Corporate revolving credit facility (October 2009)[1]	327	322	322	373	142	142
US dollar ANP Funding 1 revolving credit facility (May 2010)[2]	56	40	40	64	34	34
US dollar Tihama term facility (December 2021)	249	–	–	284	72	72
Australian dollar Canunda facility (December 2014)	37	–	–	39	12	12
Sterling Rugeley FGD construction facility (July 2014)	145	129	129	–	–	–
Sterling Rugeley working capital and credit facility (July 2014)	195	100	100	–	–	–
Czech koruna IPO revolving credit facility (May 2007)	24	24	24	24	20	20
Sterling Corporate working capital facility (January 2006)[3]	–	–	–	60	60	60
Sterling Corporate letter of credit facilities[4]	324	11	11	94	1	1
Subsidiary facilities in various currencies	110	41	41	153	100	100
Total	**1,467**	**667**	**667**	1,091	441	441

(1) The drawn element of the US dollar Corporate revolving credit facility relates to letters of credit issued of £5 million.

(2) The ANP Funding 1 revolving credit facility includes a US$50 million supported and US$60 million unsupported working capital credit facility with capacity to issue letters of credit. At 31 December 2006, £4 million (2005: £8 million) and £12 million (2005: £22 million) of letters of credit had been drawn from each of these facilities respectively.

(3) The Corporate working capital facility could have been utilised to draw cash and issue letters of credit in relation to merchant trading support. It was not renewed when it expired in January 2006.

(4) The Corporate letter of credit facilities can be utilised to issue letters of credit. At 31 December 2006, £347 million of letters of credit had been drawn from these facilities (2005: £93 million) and £212 million of cash and cash equivalents was used as collateral in relation to these facilities (2005: £28 million).

Uncommitted facilities available at 31 December 2006 were:

	31 December 2006			31 December 2005		
	Total £m	Drawn £m	Undrawn £m	Total £m	Drawn £m	Undrawn £m
Facility						
Bank borrowing and overdraft facilities	35	–	35	36	18	18
Subsidiary facilities in various currencies	4	2	2	11	2	9
	39	**2**	**37**	47	20	27

Bank borrowing facilities are normally reaffirmed by the banks annually although they can theoretically be withdrawn at any time.

g) Fair values of financial assets and liabilities

Set out below is a comparison by category of the carrying amounts and fair values of all the Group's financial assets and liabilities as at 31 December 2006:

	31 December 2006		31 December 2005	
	Carrying amount £m	**Fair value £m**	Carrying amount £m	Fair value £m
Financial assets				
Other investments	**26**	**26**	4	4
Finance lease receivables	**1,086**	**1,114**	460	460
Other long-term receivables	**29**	**29**	–	–
Trade receivables (current)	**139**	**139**	163	163
Other receivables (current)	**157**	**157**	108	108
Derivative financial assets	**281**	**281**	268	268
Assets held for trading	**42**	**42**	52	52
Cash and cash equivalents	**980**	**980**	620	620
Total financial assets	**2,740**	**2,768**	1,675	1,675
Financial liabilities				
Trade payables (current)	**303**	**303**	358	358
Other payables (current)	**226**	**226**	153	153
Other payables (non-current)	**40**	**40**	14	14
Derivative financial liabilities	**430**	**430**	687	687
Secured bank loans	**3,440**	**3,439**	2,908	2,928
Preferred equity facility	**152**	**152**	173	173
Convertible bonds	**237**	**247**	125	125
Secured bonds	**678**	**727**	445	480
Loans from minority interests	**81**	**81**	81	81
Provisions	**43**	**43**	33	33
Total financial liabilities	**5,630**	**5,688**	4,977	5,032

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

(i) Other investments comprise equity held in privately owned, unquoted companies as well as debt instruments in which there is no active market available to value them. Therefore fair value cannot be reliably measured. The fair value has thus been based on the cost amount.

(ii) The fair value of finance lease receivables and other long-term receivables have been estimated by discounting estimated cash flows.

(iii) Trade and other receivables (current) and trade and other payables (current) are stated at fair value, set equal to book value, because of their short maturity.

(iv) The fair value of energy derivatives is measured by reference to forward price curves using discounted cash flows and other similar quantification techniques (refer note 41).

(v) The fair value of the Group's forward exchange contracts, foreign currency swaps and foreign currency options have been calculated using market rates in effect at the balance sheet dates.

(vi) Assets held for trading have been estimated using quoted market prices and discounted cash flows.

(vii) All loans and bonds have been calculated using market prices where available or the present value of future cash flows arising.

h) Hedges

As explained on pages 15 to 17 of the business and financial review, the Group's policy is to hedge the following exposures:

(i) Energy price fluctuations – using physical hedges through the operation of energy supply and trading activities together with financial products.

(ii) Interest rate risk – using interest rate swaps, options and forward rate agreements.

(iii) Structural and transactional currency exposures – using currency borrowings, forward foreign currency contracts, currency options and swaps.

(iv) Currency exposures on future expected sales – using currency swaps, forward foreign currency contracts, currency options and swaps.

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

33 FINANCIAL INSTRUMENTS continued

i) Cash flow hedging reserve movements

The cash flow hedging reserve balance at 31 December 2006 and the periods in which the cash flows are expected to occur are as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	**Interest rate swaps £m**	**Total £m**	Energy derivatives £m	Interest rate swaps £m	Total £m
Unrecognised gains/(losses) at 31 December 2006	**3**	**3**	**6**	(103)	(15)	(118)
Cash flows expected in:						
Less than 12 months	**22**	**(1)**	**21**	(67)	(2)	(69)
1-2 years	**(12)**	**–**	**(12)**	(27)	(1)	(28)
2-3 years	**(4)**	**(1)**	**(5)**	(10)	(1)	(11)
3-4 years	**(3)**	**(1)**	**(4)**	1	(1)	–
4-5 years	**–**	**–**	**–**	–	(4)	(4)
More than 5 years	**–**	**6**	**6**	–	(6)	(6)
	3	**3**	**6**	(103)	(15)	(118)

Gains and losses recognised in the hedging reserve during the year were as follows:

	Year ended 31 December 2006			Year ended 31 December 2005		
	Energy derivatives £m	**Interest rate swaps £m**	**Total £m**	Energy derivatives £m	Interest rate swaps £m	Total £m
Gains and (losses) recognised in the hedging reserve during the year	**39**	**16**	**55**	(104)	7	(97)
Gains and (losses) arising in previous years that were recognised during the year	**67**	**2**	**69**	(7)	(2)	(9)
Amount removed from hedging reserve and included within the income statement during the year due to settlement of contracts	**(4)**	**–**	**(4)**	(33)	3	(30)
Cash settlement of derivatives during the year	**4**	**1**	**5**	33	(8)	25
Amount removed from hedging reserve and included within a non-financial item during the year	**–**	**(1)**	**(1)**	–	5	5
	106	**18**	**124**	(111)	5	(106)

j) Hedge of a net investment

An economic foreign currency exposure arises from net investments in Group entities whose functional currency differs from the parent's. An accounting exposure arises from differences between the functional currency of the net investments and the Group's presentation currency. Changes in exchange rates between the functional currency of the net investment and that of its parent will cause the amount of the net investment to vary.

In the absence of hedge accounting the foreign exchange gains and losses on retranslating the net assets of the foreign operation would be taken to reserves, whilst those on the loan would be recognised in the income statement. This creates a mismatch in foreign currency translation. When net investment hedging is applied, this mismatch is eliminated.

The Group, as part of its hedging strategy, has therefore chosen to borrow some debt denominated in foreign currencies in order to hedge the net investments in certain assets within its portfolio. As the hedging instrument is foreign currency borrowings rather than a derivative, no fair value for this instrument is included within the fair value of derivatives disclosed on the balance sheet.

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

We are exposed to credit-related losses in the event that counterparties to traded contracts and financial instruments do not perform according to the terms of the contract or instrument. This is mitigated by the fact that for the majority of the Group's commodity trading arrangements there is a legally enforceable right of set-off that reduces the credit exposure of the Group in the event of counterparty default.

Where possible the Group will also enter into master netting agreements that further serve to mitigate its credit exposure.

With regard to financial instruments subject to credit risk, we select counterparties with appropriate ratings for the size, type and duration of the instrument involved. A small proportion of counterparties trading energy are below investment grade. For those energy market transactions with counterparties below investment grade, and which are not supported by appropriate collateral, reserves are carried against the trading risk. Exposures within this band are restricted and closely monitored within narrow limits. We do not expect any significant credit loss to result from non-performance of instruments or traded contracts.

The immediate credit exposure of financial instruments is represented by those financial instruments that have a net positive fair value by counterparty at 31 December 2006. At 31 December 2006, the exposures for interest rate swaps, currency swaps and forward exchange contracts were not considered to be material. Contracts for differences also involve a degree of credit risk. This risk is controlled by appropriate authorisation and monitoring procedures.

34 COMMITMENTS

Lease and capital commitments

	31 December 2006 £m	31 December 2005 £m
Capital commitments: contracted but not provided	**174**	82
Future minimum lease payments under non-cancellable operating leases:		
Within one year	**7**	6
Between one and five years	**23**	21
After five years	**24**	27
	54	54
Offset by future minimum receipts under non-cancellable operating subleases	**(5)**	(8)

Operating lease payments substantially represent rentals payable by the Group for office properties and wind turbine equipment.

Fuel purchase and transportation commitments
At 31 December 2006, the Group's subsidiaries had contractual commitments to purchase and/or transport coal and fuel oil. Based on contract provisions, which consist of fixed prices, subject to adjustment clauses in some cases, these minimum commitments are currently estimated to aggregate to £385 million (2005: £301 million) expiring within one year, £1,373 million (2005: £978 million) expiring between one and five years and £880 million (2005: £915 million) expiring after more than five years.

35 CONTINGENT LIABILITIES

a) Legal proceedings against the Company

The Company is aware of the following matters, which involve or may involve legal proceedings against the Group:

(i) Claims and potential claims by or on behalf of current and former employees, including former employees of the Central Electricity Generating Board (CEGB), and contractors in respect of industrial illness and injury.

RWE npower has agreed to indemnify International Power plc on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings to the extent such liability is not insured by Electra Insurance Limited.

(ii) In 1994 separate complaints were made by the National Association of Licensed Opencast Operators (NALOO) and the South Wales Small Miners Association (SWSMA) to the European Commission against the Company, PowerGen plc, British Coal Corporation and HM Government. The complaint alleges violations of EU competition law arising out of the coal purchasing arrangements entered into by the CEGB prior to 1 April 1990 and requests the Commission to find that the CEGB's practices violated EU law. NALOO and SWSMA allege that such a finding would be grounds for a claim for damages in the English courts by their respective members. The Commission ruled on the complaint in 1998 and did not make any findings against the Company. Appeals against the Commission's findings were brought by NALOO and SWSMA. The SWSMA appeal was initially ruled out of time, but on appeal a faction was allowed to proceed. Progress with this claim will be influenced by the outcome of the NALOO appeal. At first instance, the European Court ruled that the Commission is under an obligation to investigate the complaint by NALOO. The Company, PowerGen plc, British Coal Corporation and the Commission appealed against the ruling to the European Court of Justice which delivered a judgment on 2 October 2003 for the main part dismissing the appeal. In its judgment, the court decided that the Commission has the power to investigate and the matter is now with the Commission for consideration. It is not practicable to estimate legal costs or possible damages, at this stage. RWE npower has agreed to indemnify International Power on an after-tax basis to the extent of 50% of any liability that the Company may incur whether directly or indirectly as a consequence of those proceedings.

The Directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions carried in the balance sheet, that it is remote that the matters referred to above will, in aggregate, have a material effect on the Group's financial position, results of operations or liquidity.

b) Taxation

The Company is aware of a number of issues which are, or may be, the subject of disputes with the tax authorities in the territories where the Group has operations, including its joint ventures and associates. The Directors are of the opinion, having regard to the professional advice received, that adequate provision has been made for the settlement of any tax liabilities that might arise.

c) Bonds and guarantees

Various growth and expansion projects are supported by bonds, letters of credit and guarantees issued by the Group totalling £442 million.

Energy trading activities relating to merchant plant are supported by letters of credit and guarantees issued by the Group totalling £487 million.

d) Joint ventures and associates

(i) Bonds and guarantees

The Group's joint ventures and associates also have various growth and expansion projects that are supported by bonds, letters of credit and guarantees. The Group's share of these bonds, letters of credit and guarantees amount to £70 million. These obligations are normally secured by the assets of the respective joint venture or associate. Any amounts guaranteed by International Power plc or any other Group subsidiary are included within bonds and guarantees disclosed in note 35(c).

(ii) Legal proceedings

A number of the Group's joint ventures and associates, particularly in the Middle East, are involved in major construction projects. The Company is aware of a number of issues which may be the subject of disputes with the EPC contractors responsible for the construction projects. The Directors are of the opinion, having regard to professional advice received, that adequate provision has been made for the settlement of any liabilities that may arise out of these disputes.

36 RELATED PARTY TRANSACTIONS

The key management personnel of International Power plc comprises the Chairman, Executive Directors and Non-Executive Directors. The compensation of key management personnel can be found in the Directors' remuneration report set out on pages 64 to 75 of the *Annual Report*.

(i) Operations and maintenance contracts
In the course of normal operations, the Group has contracted on an arm's length basis to provide power station operation and maintenance services to joint ventures and associates. During the year the Group derived income of £50 million (2005: £69 million) from these arrangements. Included in trade receivables is £8 million (2005: £6 million) in relation to these contracts.

(ii) Retail supply contracts
In the course of normal operations, the Group has contracted on an arm's length basis to provide power and gas to its retail joint ventures. During the year the Group derived income of £34 million (2005: £8 million) from these arrangements. Included in trade receivables is £3 million (2005: £1 million) in relation to these contracts.

(iii) Transportation contracts
In the course of normal operations, the Group has contracts in place, in relation to fuel transportation, with one of its joint ventures. During the year, the Group incurred costs of £8 million (2005: £8 million) in relation to these contracts. There was no trade payable or receivable in relation to these contracts at 31 December 2006 (2005: £nil).

37 EVENTS AFTER THE BALANCE SHEET DATE

There are no events after the balance sheet date to report.

38 EVENTS SUBSEQUENT TO THE DATE OF THE AUDITOR'S REPORT

There are no events to report subsequent to the date of the auditor's report.

39 SUBSIDIARIES

The Group has the following significant investments in subsidiaries.

Name and nature of business	Country of incorporation and registration	Type of share	Group effective shareholding
Canunda Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
Gippsland Power Pty Limited* (power generation)	Australia	Ordinary Shares	70%
Hazelwood Power Partnership* (power generation)	Australia	Partners' Capital	92%
Latrobe Power Partnership* (power generation)	Australia	Partners' Capital	70%
Perth Power Partnership* (power generation)	Australia	Partners' Capital	49%
Synergen Power Pty Limited* (power generation)	Australia	Ordinary Shares	100%
International Power Opatovice A.S.* (power generation)	Czech Republic	Ordinary Shares	100%
Deeside Power Development Company Limited (power generation)	England and Wales	Ordinary Shares	100%
First Hydro Company* (power generation)	England and Wales	Ordinary Shares	70%
First Hydro Finance plc* (financing company)	England and Wales	Ordinary Shares	70%
Indian Queens Power Limited* (power generation)	England and Wales	Ordinary Shares	100%
IPM Eagle LLP* (investment holding company)	England and Wales	Partners' Capital	70%
Normanglade 4 LLP* (financing company)	England and Wales	Partners' Capital	70%
Pelican Point Power Limited* (power generation)	England and Wales(1)	Ordinary Shares	100%
Rugeley Power Limited (power generation)	England and Wales	Ordinary Shares	100%
Saltend Cogeneration Company Limited* (power generation)	England and Wales	Ordinary Shares	70%
International Power Levanto Holdings BV (investment holding company)	Netherlands(2)	Ordinary Shares	100%
IPR Insurance Company Limited* (insurance captive)	Guernsey	Ordinary Shares	100%
International Power (Jersey) Limited (financing company)	Jersey(3)	Ordinary Shares	100%
International Power Finance (Jersey) II Limited (financing company)	Jersey(3)	Ordinary Shares	100%
Al Kamil Power Company SAOG* (power generation)	Oman	Ordinary Shares	65%
Turbogás – Produtora Enérgetica S.A* (power generation)	Portugal	Ordinary Shares	60%
Tihama Power Generation Company Limited* (power generation)	Saudi Arabia	Ordinary Shares	60%
Electro Metalurgica del Ebro SL* (power generation)	Spain	Ordinary Shares	64%
Ibérica de Enérgías SL* (power generation)	Spain	Ordinary Shares	70%
Thai National Power Company Limited* (power generation)	Thailand	Ordinary Shares	100%
ANP Bellingham Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Blackstone Energy Company, LLC* (power generation)	US	Ordinary Shares	100%
ANP Funding I, LLC* (financing company)	US	Ordinary Shares	100%
Coleto Creek Power LLC* (power generation)	US	Ordinary Shares	100%
Hays Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Midlothian Energy Limited Partnership* (power generation)	US	Partners' Capital	100%
Milford Power Limited Partnership* (power generation)	US	Partners' Capital	100%

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

* Held by an intermediate subsidiary

(1) Operates in Australia

(2) International Power Levanto Holdings BV owns indirectly, through wholly-owned subsidiaries, equity and bonds relating to the Levanto wind farm portfolio. As required, we consolidate 100% of the results of the Levanto wind farm portfolio.

(3) Operates in the UK

40 JOINT VENTURES AND ASSOCIATES

The Group has the following significant investments in joint ventures and associates.

Name and nature of business	Country of incorporation, registration and operation	Accounting period end	Type of share	Group effective shareholding
Joint ventures				
EA – IPR Retail Partnership* (retail supplier)	Australia	31 December	Partners' Capital	50%
South East Australia Gas Pty Limited* (gas pipeline)	Australia	30 June	Ordinary Shares	33%
EcoEléctrica LP* (power generation)	Bermuda**	31 December	Partners' Capital	35%
Prazská Teplárenská A.S.* (power generation)	Czech Republic	31 December	Ordinary Shares	49%
Hartwell Energy Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Oyster Creek Limited Partnership* (power generation)	US	31 December	Partners' Capital	50%
Associates				
Hidd Power Company BSC(c)* (power generation)	Bahrain	31 December	Ordinary Shares	40%
Derwent Cogeneration Limited* (power generation)	England and Wales	31 March	Ordinary Shares	23%
Opus Energy Limited (retail supplier)	England and Wales	31 March	Ordinary Shares	30%
PT Paiton Energy Company* (power generation)	Indonesia	31 December	Ordinary Shares	31%
ISAB Energy Srl* (power generation)	Italy	31 December	Ordinary Shares	34%
Kot Addu Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	36%
Uch Power Limited* (power generation)	Pakistan	31 December	Ordinary Shares	40%
The Hub Power Company Limited* (power generation)	Pakistan	30 June	Ordinary Shares	17%
Carbopego – Abastecimento de Combustiveis, S.A.* (fuel supplies)	Portugal	31 December	Ordinary Shares	50%
Pegop – Energia Electrica, S.A.* (power station operations)	Portugal	31 December	Ordinary Shares	50%
Tejo Energia – Producao e Distribuicao de Energia Electrica, S.A.* (power generation)	Portugal	31 December	Ordinary Shares	50%
Q Power QSC* (power generation)	Qatar	31 December	Ordinary Shares	40%
Uni-Mar Enerji Yatirimlari A.S.* (power generation)	Turkey	31 December	Ordinary Shares	33%
Arabian Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%
Shuweihat CMS International Power Company PJSC* (power generation)	UAE	31 December	Ordinary Shares	20%

International Power continues to equity account for HUBCO, despite its shareholdings being less than 20%, as it continues to exert and has the power to exert significant influence over the entity. At HUBCO, International Power continues to have significant board representation.

* Held by an intermediate subsidiary

** Operates in Puerto Rico

41 CRITICAL ACCOUNTING JUDGEMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

The Group's accounting policies are set out in note 1 to these financial statements. Management is required to exercise significant judgement in the application of these policies. Areas which management believe require the most critical accounting judgements are as follows (apart from those policies involving estimation which are outlined in (b) below).

a) Critical accounting judgements in applying the Group's accounting policies

Cash flow hedge accounting

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

Income recognition from long-term PPAs

When power plants sell their output under long-term PPAs it is usual for the power plant owning company to receive payment (known as a 'capacity payment') for the provision of electrical capacity whether or not the offtaker requests electrical output. In these situations, where there is a long-term contract to purchase electricity output and electrical capacity, it is necessary for the Group to evaluate the contractual arrangements and determine whether they constitute a form of lease or a service contract.

For those arrangements determined to be or to contain leases, further judgements are required to determine whether the arrangement is a finance or operating lease. This assessment requires an evaluation of where the substantial risks and rewards of ownership reside. For finance leases it is necessary to calculate the proportion of total capacity payments which should be treated as finance income, capital repayment and as a fee for service provision. For operating leases it is necessary to determine the allocation of total capacity payments between rental payments and fees for service provision.

Evaluation of levels of control and influence

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

Where the Group owns between 20% and 50% of the equity of an entity and is in a position to exercise significant influence over the entity's operating and financial policies, we treat the entity as a joint venture or an associate. Equally, where the Group holds a substantial interest (but less than 20%) in an entity and has the power to exert significant influence over its operations, we treat it as a joint venture or an associate. This treatment is applied to our interest in The Hub Power Company in Pakistan of which we own 17% (refer note 40). Where the Group has the power to control the operations of an entity, and it has less than 50% of the equity, we treat the entity as a subsidiary when required.

Exceptional items

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

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

(i) disposals of investments;

(ii) discontinued operations;

(iii) impairments and impairment reversals.

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

Taxation

The level of current and deferred tax recognised is dependent on subjective judgement as to the outcome of decisions to be made by the tax authorities in the various tax jurisdictions around the world in which International Power operates. It is necessary to consider the extent to which deferred tax assets should be recognised based on an assessment of the extent to which they are regarded as recoverable.

b) Key sources of estimation uncertainty

Useful economic lives of property, plant and equipment
The original cost of greenfield developed power plant and other assets includes relevant borrowings and development costs:

(i) Interest on borrowings relating to major capital projects with long periods of development is capitalised during construction and then amortised over the useful life of the asset;

(ii) Project development costs (including appropriate direct internal costs) are capitalised when it is virtually certain that the contract will proceed to completion and income will be realised.

Depreciation of plant and other assets is charged so as to write down the value of those assets to their residual value over their respective estimated useful lives. The Directors are required to assess the useful economic lives and residual values of the assets so that depreciation is charged on a systematic and proportionate basis to the current carrying amount. It is Group policy to depreciate gas plant over 30 years to a 10% residual value, unless the circumstances of the project or life of specific components indicate a shorter period or a lower residual value. Coal plants, hydro plants and wind farms are considered on an individual basis.

Fair values of energy derivatives
The Group has presented its financial statements in accordance with the requirements of IAS 32 "Financial Instruments: Presentation and Disclosure" and IAS 39 "Financial Instruments: Recognition and Measurement". In accordance with IAS 39, the Group records its derivative contracts on its balance sheet at fair value (unless they qualify for the 'own use' exemption). Changes in the value of its derivative contracts in each period are recorded in earnings unless strict hedge accounting criteria are met which allow the movement in fair value to be recorded within equity. The Group estimates the fair value of its energy derivative contracts by reference to forward price curves. A forward price curve represents the Group's view as to the prices at which customers would currently contract for delivery or settlement of commodities, such as power or gas, at future dates. Generally the forward price curve is derived from published price quotations in an active market, over the short-term horizon period, and from valuation techniques over the more distant horizon period. The assumptions used during the application of valuation techniques will directly impact the shape of the forward price curve. The forward price curves are only estimates of future prices and thus possess inherent uncertainty and subjectivity.

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

Impairment analysis
Management regularly considers whether there are any indications of impairment to the carrying amounts of its power plants and other long life assets. This includes a review of market conditions in both the short-term and long-term. Impairment reviews are generally based on pre-tax risk adjusted discounted cash flow projections that require estimates of discount rates and future market prices over the remaining lives of the assets. We benchmark the results of this testing against post-tax risk adjusted cash flows, discounted on a post-tax basis. At each balance sheet date, consideration is also given as to whether there is any indication that an impairment loss recognised in prior periods has reversed. During the year the Group reversed the impairment of its Deeside plant in the UK (refer note 14).

Provisions
Within the Group there are a number of long-term provisions. The carrying amount of these provisions is estimated based on assumptions about such items as the risk adjustment to cash flows or discount rates used, future changes in prices and estimates of costs. For example, the pensions liability is based on assumptions relating to discount rates used, future changes in salaries and future changes in prices affecting other costs. A change in estimates could have a material impact on the carrying amount of these provisions.