

POWERGEN UK PLC

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2001



Registered No: 2366970

The directors present their report and the audited accounts of Powergen UK plc for the year ended 31 December 2001.

Offer from E.ON AG

The recommended acquisition of Powergen plc, of which Powergen UK plc is an indirect wholly owned subsidiary, by E.ON UK plc, a wholly-owned subsidiary of E.ON AG, ('E.ON') by means of a Scheme of Arrangement under Section 425 of the Companies Act 1985, was completed on 1 July 2002. From that date, the ultimate parent undertaking of Powergen UK plc is E.ON AG.

Principal activities, review of business and future developments

The Group's principal activities are electricity production and distribution, and energy trading and retailing. The UK Group's business is built on

- marketing electricity, gas, telephony and other essential services to domestic and business customers
- asset management in electricity production and distribution
- energy trading to support these activities

Its UK strategy is to sustain and develop asset businesses, build competitive trading and retail businesses, and to export its competencies to support Powergen UK's activities outside the UK. Both the level of business and financial position of the Group at 31 December 2001 were satisfactory and the Directors believe the present levels of activity in the UK will be sustained in the current year.

The UK business is complemented by the Company's international power generation business. During the year, Powergen has substantially completed the disposal of assets within the International business.

The Company's technical development activities, carried out at its Power Technology Centre, are focused on supporting the Company's main business objectives, providing innovative services and products, and developing profitable new income streams.

Results and dividends

The profit attributable to shareholders for the financial year to 31 December 2001 was £136 million (compared with a profit of £394 million for the year ended 31 December 2000).

The directors are not recommending payment of a final dividend (year ended 31 December 2000 £nil). During the year, interim dividends of £326 million were paid (year ended 31 December 2000 £240 million).

Directors

The following directors served during the financial year: Mr E A Wallis, Mr N P Baldwin, Sir Frederick Crawford*, Mr A J Habgood*, Mr P C F Hickson, Dr D K-P Li, Mr R Quarta^, Mr P Myners^ and Mr Sydney Gillibrand. On 19 February 2002, Mr G J Bartlett and Dr P Golby were appointed as directors.

*Resigned 31 January 2001

^Resigned 3 August 2001

+Resigned 19 February 2002

Directors' interests in the shares of the Company and the Group

None of the Directors had any interest in the shares of the Company during the year. A statement of their interests in, and options over, the ordinary shares of Powergen plc, the Company's ultimate holding company, is included in the consolidated financial statements of Powergen plc for the year ended 31 December 2001.

No director had any interest (other than as a nominee on behalf of the ultimate holding company) in the shares of any other member of the Group.

Treasury management

Group framework

Powergen UK plc and its subsidiaries form part of the Powergen Group, and operate within the context of Group determined treasury policies, which are described below.

Powergen has a central Group treasury department. It is responsible for treasury strategy, all funding requirements, the management of financial risks including interest rate and currency exposure, banking relationships, cash management and other treasury business throughout the Powergen Group. In addition, there is an operational treasury team in the UK that services the treasury requirements of the UK business. Powergen's treasury activities are carried out in accordance with Powergen Group Board approved treasury policies, and all treasury operations comply with detailed treasury procedures which are approved at Board level. All treasury interfaces with banks and other third parties are governed by dealing mandates, facility letters and other agreements. Within treasury there is a segregation of front, middle and back office activities.

Treasury employs a continuous forecasting and monitoring process to ensure that the Powergen Group complies with all its banking and other financial covenants, and also any regulatory constraints that apply to the financing of its businesses.

Powergen does not enter into speculative treasury arrangements in that all transactions in financial instruments are matched to an underlying business requirement, such as planned purchases or forecast debt requirements. All treasury operations and planned activities are reported and discussed at a monthly treasury committee that is chaired by the Group Finance Director. Treasury activities are internally audited several times each year.

Treasury works in close liaison with the various businesses within the Powergen Group, when considering hedging requirements on behalf of their activities. A group-wide cash forecasting and currency exposure reporting process exists which ensures regular reporting into treasury of future positions, both short and medium term.

Credit risk management

Powergen takes steps to limit its credit exposure to banks and other counter-parties. Exposure limits are set following credit analysis, and aggregate exposures are monitored on a group-wide basis.

Events in 2001, in particular the collapse of Enron, have increased the importance of careful credit risk management, and the Powergen Group has re-emphasised its credit risk procedures as a result. The year end position as described above is representative of the Powergen Group's current position in terms of its objectives, policies and strategies, which continue to evolve as the Powergen Group's business develops.

Foreign exchange risk management

During 2001, many of Powergen's international assets were disposed of, and this has reduced Powergen's exposure to several currencies.

Powergen has Board approved policies dealing with transaction exposures (typically trading cash flows which impact the profit and loss account) and translation exposures (the value of liabilities and assets in the balance sheet). Powergen's policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. Powergen also covers a proportion of forecast foreign currency cash flows, and will also hedge more uncertain cash flows if this is appropriate, using flexible financial instruments that do not commit the Powergen Group.

Powergen's policy towards translation exposures is to hedge these exposures where practicable, with the intention of protecting the Sterling net asset value. These hedges are normally achieved through a combination of borrowing in local currency, forward currency contracts or foreign currency swaps.

Where the foreign currency exposure is hedged, the value of the exposure is translated into Sterling at the exchange rate achieved in the associated hedging contracts. Details of the Powergen UK plc and its subsidiaries' (the Powergen UK Group) foreign exchange contracts and swaps are set out in note 29 to the accounts.

Interest rate risk management

Powergen has a significant portfolio of debt, and is exposed to movements in interest rates. Powergen manages these interest rate movements primarily through the use of a combination of fixed and floating rate borrowings and interest rate swaps. Powergen's policy is to target a ratio of fixed rate debt to floating rate debt of 50 per cent/50 per cent. However, this is managed within a 66 per cent/34 per cent and 34 per cent/66 per cent band for the UK portfolio.

During 2001, in anticipation of falls in interest rates, Powergen moved its debt portfolio towards a higher proportion of floating rate debt. This was achieved by issuing floating rate debt and through the use of interest rate swaps. At the year end the debt portfolio was 62% fixed and 38% floating.

The Powergen UK Group's main interest rate exposure is to Sterling, although there is a limited exposure to US Dollar and other interest rates, including Deutschmarks. Details of Powergen UK Group's interest rate swaps and fixed and floating debt are set out in note 29 to the accounts.

Group funding

Powergen's Board-approved policy towards funding is to ensure that the Powergen Group is not constrained by lack of funds at any time, and not unreasonably or imprudently bound by restrictive covenants, or liquidity risks. Within this objective, the Powergen Group seeks to manage its cost of borrowing to minimise interest charges, while maintaining a stable, long-term funding base.

The Powergen Group continues to manage its overall funding profile through a combination of committed bank term facilities, long-term capital market funding, and short-term uncommitted capital market and bank facilities.

Funding

At 31 December 2001, the Powergen UK Group had total borrowings of £2,181 million (31 December 2000 £2,542 million) including £1,458 million of long-term loans and £723 million of short-term loans and overdrafts.

The bank term loans referred to above contain financial covenants. In addition, the bank loans and bonds contain other conditions with which Powergen UK plc must comply. There are also constraints and financial covenants imposed by various regulatory authorities. None of these covenants or conditions is considered onerous, and treasury monitoring processes are in place to ensure compliance, as described above.

As part of a refinancing strategy designed to reduce the overall cost of debt, the Powergen UK Group has securitised its retail trade debtors through a £300 million programme. Details of this programme are set out in note 17 to these accounts. On 3 December 2001, Powergen UK plc jointly signed a new

bank facility with a fellow group undertaking, Powergen US Holdings Limited with improved terms and lower costs. Full details are set out in note 20 to these accounts. These refinancing benefits were achieved while maintaining fully adequate liquidity at all times.

At 31 December 2001 the Powergen UK Group had £106 million of cash and short-term investments (31 December 2000 £510 million). Powergen's policy is to place any surplus funds on short-term deposit with approved banks and financial institutions.

The Powergen UK Group's net borrowing position at 31 December 2001 therefore was £2,075 million, compared to £2,032 million at 31 December 2000. The overall interest rate for the year (excluding the interest free loan of £1,069 million from the Company to Powergen US Holdings Limited), when compared to average net borrowings, was 7.1 per cent compared with 6.7 per cent in the previous year.

Commodity risk management

As part of its operating activities the Powergen UK Group engages in asset based energy marketing in the gas and electricity markets to assist in the commercial risk management and optimisation of both UK electricity and gas assets, and to manage the price and volume risks associated with its UK retail business. The Powergen UK Group portfolio is strictly monitored and controlled through delegated authorities and procedures, including transaction limits and credit risk management, which ensure that changing levels of exposure are appropriately managed. To achieve this portfolio optimisation, the Powergen UK Group uses fixed price bilateral contracts, futures and options contracts traded on commodity exchanges and swaps and options traded in over the counter financial markets. In addition, the Powergen UK Group continues to develop new product structures to meet the requirements of new markets, including tailored structured transactions.

Employees

The Powergen Group provides an environment in which communication is open and constructive. There are well-established arrangements for communication and consultation with employees and their representatives at local and Group level covering a wide range of business and employment issues. The views of staff are both sought and taken into account, an Employee Opinion Survey being one way in which they are regularly measured.

The Powergen Group is committed to offering equal opportunities to both current and prospective employees. The Powergen Group continues to review and develop best practices and procedures to ensure that all staff are treated fairly in all aspects of employment. It also strives for a diverse environment that is supportive of all staff. Individual differences which do not relate to job performance such as gender, marital status, sexual orientation, race, colour, ethnic origin, nationality, religion, age or disability are respected.

The Powergen Group believes in ensuring that disabled people can compete fairly for job opportunities, training and development, through the promotion and development of best practices.

Links and contacts with external disability networks and organisations are maintained to identify best practices and to provide work experience placements for disabled people. In the event of existing employees becoming disabled, the Powergen Group will seek to maintain their employment through training, redeployment and adjustments to the job role and workplace, where it is reasonable and practicable to do so.

Training and development of staff remains a key priority in achieving Powergen UK's growth strategy and ensuring that all staff perform at the highest level.

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by the Company and its subsidiaries amounted to £189,399 (year ended 31 December 2000 £247,523).

No political donations were made.

Policy on payment of creditors

Where appropriate in relation to specific contracts, the Powergen UK Group's practice is to:

- a) settle the terms of payment with the supplier when agreeing the terms of each transaction;
- b) ensure that those suppliers are made aware of the terms of payment by inclusion of relevant terms in the contracts; and
- c) pay in accordance with its contractual and other legal obligations.

The Powergen UK Group supports the Better Payments Practice Code, copies of which may be obtained from the Department of Trade and Industry, and has in place well developed arrangements with a view to ensuring that this is observed in all other cases. Overseas, Powergen UK Group companies are encouraged to adopt equivalent arrangements by applying local best practices.

The average number of days taken to pay the Powergen UK Group's trade suppliers calculated in accordance with the requirements of the Companies Act is 25 days (31 December 2000 28 days).

Close company status

The Company is not a close company within the meaning of the Income and Corporation Taxes Act 1988.

Auditors

A resolution to reappoint the auditors, PricewaterhouseCoopers, and to authorise the directors to fix their remuneration will be proposed at the forthcoming Annual General Meeting.

Euro

The Powergen Group recognises the wide implications of the Euro for businesses, including impacts on commercial arrangements and financial systems. Appropriate preparation has been made by Powergen entities resident in Euro-land countries. Within the UK, the Powergen Group's preparations recognise the uncertain position regarding possible UK entry to the single currency, and the situation is monitored closely.

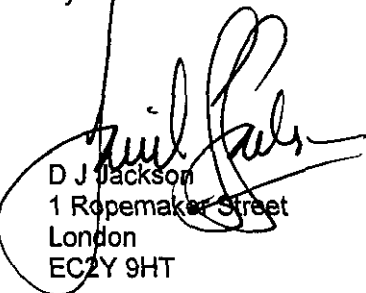
Directors' responsibilities

Company law requires the directors to prepare financial statements for each financial year that give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing those financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable accounting standards have been followed, subject to any material departure disclosed and explained in the financial statements; and
- prepare the financial statements on the going concern basis, unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the Company and enable them to ensure that the financial statements comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the Company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board



D J Jackson
1 Ropemaker Street
London
EC2Y 9HT

1 July 2002

Powergen UK plc
Independent auditors' report
to the members of Powergen UK plc
for the year ended 31 December 2001

We have audited the financial statements on pages 10 to 52.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the annual report and the financial statements in accordance with applicable United Kingdom law and accounting standards are set out in the statement of directors' responsibilities on page 8.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and United Kingdom Auditing Standards issued by the Auditing Practices Board.

We report to you our opinion as to whether the financial statements give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you if, in our opinion, the directors' report is not consistent with the financial statements, if the Company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and transactions is not disclosed.

We read the other information contained in the annual report and consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the financial statements.

Basis of audit opinion

We conducted our audit in accordance with Auditing Standards issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgements made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion the financial statements give a true and fair view of the state of the affairs of the Company and the Group at 31 December 2001 and of the Group's result for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers
Chartered Accountants and Registered Auditors
London
1 July 2002

PricewaterhouseCoopers

Powergen UK plc
Consolidated Profit and Loss Account
for the financial year ended 31 December 2001

	Note	Year ended 31 December 2001			Year ended 31 December 2000		
		Before exceptional items £m	Exceptional items (note 3) £m	Total £m	Before exceptional items £m	Exceptional items (note 3) £m	Total £m
Turnover		4,212	-	4,212	4,344	-	4,344
Group's share of associates' and joint ventures' turnover		(197)	-	(197)	(269)	-	(269)
Group turnover – continuing activities	1	4,015	-	4,015	4,075	-	4,075
Operating costs	2,3	(3,726)	(129)	(3,855)	(3,690)	(79)	(3,769)
Other operating income	2	138	-	138	182	-	182
Group operating profit – continuing activities	2	427	(129)	298	567	(79)	488
Group's share of associates' and joint ventures' operating profit		50	-	50	70	-	70
Profits less losses on disposal of fixed assets and investments	3	-	79	79	-	337	337
Profits less losses on disposal of businesses (including provisions)	3	-	(34)	(34)	-	(133)	(133)
Net interest payable							
- group	6	(149)	-	(149)	(134)	(79)	(213)
- associates and joint ventures		(46)	-	(46)	(58)	-	(58)
Profit/(Loss) on ordinary activities before taxation	7	282	(84)	198	445	46	491
Tax on profit on ordinary activities	8	(70)	5	(65)	(124)	38	(86)
Profit/(Loss) on ordinary activities after taxation		212	(79)	133	321	84	405
Minority interest	27	(3)	6	3	(11)	-	(11)
Profit attributable to shareholders		209	(73)	136	310	84	394
Dividends	8			(326)			(240)
Retained (loss)/profit for the year				(190)			154

Statement of Total Recognised Gains and Losses
for the financial year ended 31 December 2001

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Profit attributable to shareholders	136	394
Currency translation differences on foreign currency net investments	(4)	6
Total recognised gains for the year	132	400
Prior year adjustment for the implementation of FRS 19 (note 8)	(121)	
Total gains recognised since last annual report	11	

The accounting policies and the notes on pages 12 to 52 form part of these financial statements.

Powergen UK plc
Balance Sheets
as at 31 December 2001

		The Group		The Company	
	Note	31 December 2001 £m	31 December 2000 £m	31 December 2001 £m	31 December 2000 £m
Fixed assets					
Goodwill	12	1,101	1,181	-	-
Tangible assets	13	2,651	3,127	1,001	1,235
Investments	14	190	428	3,649	3,247
		3,942	4,736	4,650	4,482
Current assets					
Stocks	15	107	120	88	99
Debtors: amounts falling due after more than one year	16	53	56	46	48
Debtors: amounts falling due within one year		1,951	1,320	1,914	1,249
Less: securitisation		(166)	(152)	(77)	(118)
Net debtors falling due within one year	17	1,785	1,168	1,837	1,131
Cash and short-term deposits		106	510	42	496
		2,051	1,854	2,013	1,774
Creditors: amounts falling due within one year					
Loans and overdrafts	18	(723)	(709)	(442)	(142)
Trade and other creditors	19	(1,361)	(1,234)	(2,392)	(1,398)
Net current (liabilities)/assets		(33)	(89)	(821)	234
Total assets less current liabilities		3,909	4,647	3,829	4,716
Creditors: amounts falling due after more than one year					
Long-term loans	20	(1,458)	(1,833)	(1,071)	(1,070)
Other creditors	21	(230)	(342)	(550)	(1,469)
Provisions for liabilities and charges	23	(186)	(270)	(65)	(84)
Deferred tax	24	(191)	(176)	(127)	(117)
Net assets		1,844	2,026	2,016	1,976
Capital and reserves					
Called-up share capital	25	325	325	325	325
Share premium account	26	97	97	97	97
Capital reserve	26	474	474	474	474
Revaluation reserve	26	22	23	-	-
Capital redemption reserve	26	85	85	85	85
Profit and loss account	26	808	986	1,035	995
Equity shareholders' funds	28	1,811	1,990	2,016	1,976
Equity minority interests	27	33	36	-	-
		1,844	2,026	2,016	1,976

Approved by the Board on 1 July 2002

P C F Hickson

The accounting policies and the notes on pages 12 to 52 form part of these financial statements

P C F Hickson

Principal Accounting Policies

Nature of operations

The Powergen UK Group has two main businesses; UK Operations and International Operations. Powergen UK's principal business in the UK is the generation, distribution and sale of electricity and the sale of gas. Powergen UK's principal business overseas is the generation of electricity and associated energy-related businesses.

Basis of preparation of accounts

These financial statements are prepared under the historical cost convention, the accounting policies set out below and in accordance with applicable United Kingdom accounting. There is no difference between the profit on ordinary activities before taxation and the retained loss for the year stated on the face of the consolidated profit and loss account and their historical cost equivalents. Values of assets and liabilities vested in the Company on 31 March 1990 under the Transfer Scheme made pursuant to the Electricity Act 1989 (the Transfer Scheme) are based on their historical cost to the Central Electricity Generating Board (CEGB).

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting year. Actual results can differ from those estimates.

During the year Financial Reporting Standard 18 'Accounting policies' (FRS 18) has been adopted by Powergen. This has had no impact on the results for the year or on amounts disclosed in previous years. In addition, Financial Reporting Standard 19 'Deferred tax' (FRS 19) was adopted (see 'Deferred taxation' below and note 8). The adoption of this standard represents a change in accounting policy and comparatives have been restated accordingly. The transitional arrangements under FRS 17 'Retirement benefits' have been adopted as detailed in 'Pensions' below.

Basis of consolidation

The consolidated accounts include the financial statements of the Company and all of its subsidiary undertakings, together with the Group's share of the results and net assets of associated undertakings and joint ventures. The results of subsidiaries sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which control passes. Intra-group sales and profits are eliminated on consolidation.

Principal Accounting Policies (continued)

Associated undertakings and joint ventures

The Group's share of profits less losses of associated undertakings and joint ventures is included in the consolidated profit and loss account. The results of associates and joint ventures sold or acquired are included in the consolidated profit and loss account up to, or from, the date on which significant influence passes. These amounts are taken from the latest audited financial statements of the relevant undertakings, except where the accounting reference date of the undertaking is not coterminous with the parent company, where management accounts are used. The accounting reference dates of associated undertakings and joint ventures are set out in note 14. Where the accounting policies of associated undertakings and joint ventures do not conform to those of the Group, adjustments are made on consolidation where the amounts involved are material to the Group.

Turnover

Turnover, which excludes Value Added Tax, within the United Kingdom comprises sales of electricity under the New Electricity Trading Arrangements ('NETA'), revenue from the sale of electricity and gas to industrial and commercial customers; sales of electricity, gas and telephony services to domestic customers; revenue from the distribution of electricity and the sale of electricity and steam under combined heat and power schemes.

Income from the sale of electricity and gas to industrial, commercial and domestic customers is recognised when earned and reflects the value of units supplied, including an estimated value of units supplied to customers between the date of their last meter reading and the year end.

Restructuring costs

Amounts are set aside for the Group's restructuring programme that involves the reorganisation or future closure of power station and other sites and specific reductions in staff numbers, where the Group is demonstrably committed to such actions.

Depreciation

Provision for depreciation of generating and other assets is made so as to write off, on a straight-line basis, the book value of tangible fixed assets. Assets are depreciated over their estimated useful lives or, in the case of leased assets, over the lease term if shorter. No depreciation is provided on freehold land or assets in the course of construction.

The estimated useful lives for the other principal categories of fixed assets are:

<i>Asset</i>	<i>Life in years</i>
Generating assets	20-40
Distribution and transmission networks	40-60
Other buildings	40
Other assets	3-15

Principal Accounting Policies (continued)

Overhaul of generation plant

Overhaul costs are capitalised as part of generating assets and depreciated on a straight-line basis over their estimated useful life, typically the period until the next major overhaul. That period is usually between four and six years.

Decommissioning

A fixed asset and related provision is recognised in respect of the estimated total discounted cost of decommissioning generating assets. The resulting fixed asset is depreciated on a straight-line basis, and the discount on the provision is amortised, over the useful life of the associated power stations.

Foreign exchange

Assets and liabilities expressed in foreign currencies, including those of subsidiaries, associated undertakings and joint ventures are translated to Sterling at rates of exchange ruling at the end of the financial year. The results of foreign subsidiaries, associated undertakings and joint ventures are translated to Sterling using average exchange rates.

Transactions denominated in foreign currencies are translated to Sterling at the exchange rate ruling on the date payment takes place unless related or matching forward foreign exchange contracts have been entered into when the rate specified in the contract is used. Differences on exchange arising from the re-translation of the opening net investment in, and results of, subsidiaries, associated undertakings and joint ventures are taken to reserves and, where the net investments are hedged, are matched with differences arising on the translation of related foreign currency borrowings and forward exchange contracts. Any differences arising are reported in the statement of total recognised gains and losses. All other foreign exchange differences are taken to the profit and loss account in the year in which they arise.

Deferred income

Amounts received in advance in respect of the provision of services under warranty arrangements are taken to deferred income and recognised in operating income over the period to which the warranty cover relates. Costs associated with the provision of services under the warranty arrangements are netted against the operating income, and are recognised when incurred.

Financial instruments

The Group uses a range of derivative instruments, including interest rate swaps, cross-currency swaps and energy-based options and futures contracts and foreign exchange contracts and swaps. Derivative instruments are used for hedging purposes, apart from energy-based options and futures contracts, which are used for trading purposes. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate.

Principal Accounting Policies (continued)

Accounting for foreign currency transactions is described in the foreign exchange policy set out above. Changes in the market value of options and futures trading contracts are reflected in the profit and loss account in the period in which the change occurs.

Debt instruments

Following the issue of Financial Reporting Standard 4 'Capital Instruments' all borrowings are initially stated at the fair value of consideration received after deduction of issue costs. The issue costs and interest payable on bonds are charged to the profit and loss account at a constant rate over the life of the bond. Any premium or discount arising on the early repayment of borrowings is written off to the profit and loss account as incurred.

Interest rate swaps

Interest rate swap agreements are used to manage interest rate exposures. Amounts payable or receivable in respect of these agreements are recognised as adjustments to interest expense over the period of the contracts. The cash flows from interest rate swaps and gains and losses arising on termination of interest rate swaps are recognised as returns on investments and servicing of finance.

Forward currency contracts

The Group enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to hedge its exposure to fluctuations in currency rates. Unrealised gains and losses on currency contracts are not accounted for until the maturity of the contract. The cash flows from forward purchase currency contracts are classified in a manner consistent with the underlying nature of the hedged transaction.

Currency swaps

Currency swap agreements are used to manage foreign currency exposures and are accounted for using hedge accounting. In order to qualify for hedge accounting the instrument must be identified to a specific foreign currency asset or liability and must be an effective hedge. Foreign currency loans, where the repayment of principal is hedged by currency swaps, are included in the balance sheet at the Sterling equivalent of the hedged rate. Interest on the loan is charged to the profit and loss account at the hedged rate.

Goodwill

Goodwill arising on consolidation represents the excess or shortfall of the fair value of the consideration given compared to the fair value of the identifiable net assets acquired. Purchased goodwill is capitalised in the balance sheet and amortised on a straight-line basis over its estimated minimum useful economic life, which is 20 years.

Principal Accounting Policies (continued)

Goodwill relating to associates and joint ventures is included within 'investments' in the consolidated balance sheet. Prior to the adoption of Financial Reporting Standard 10 'Goodwill and Intangible Assets' from 30 March 1998, goodwill arising was written off on acquisition against retained earnings. On disposal of trading entities, the goodwill previously written off to reserves is charged to the profit and loss account and matched by an equal credit to reserves. Goodwill arising on overseas acquisitions is regarded as a currency asset and is re-translated at each period end at the closing rate of exchange.

Tangible fixed assets

Tangible fixed assets are stated at original cost, net of customer contributions, less accumulated depreciation and any provision for impairment. Impairment losses are recognised in the period in which they are identified. In the case of assets constructed by the Company and its subsidiaries, directly related overheads and commissioning costs are included in cost.

Major assets in the course of construction are included in tangible fixed assets on the basis of expenditure incurred at the balance sheet date. Where borrowings are specifically financing the construction of a major capital project with a long period of development, interest payable, not exceeding the actual amount incurred during the relevant period of construction, is capitalised as part of the cost of the asset and written off over the operational life of the asset.

Operating leases

Rents payable under operating leases are charged to the profit and loss account evenly over the term of the lease. Income from operating leases is included within other operating income in the profit and loss account. Income is recognised on a straight-line basis except where income receipts vary with output or other factors. Any variable element is recognised as earned.

Fixed asset investments

The Group's share of the net assets of associated undertakings and joint ventures is included in the consolidated balance sheet. Other fixed assets investments are stated at cost less any provision for impairment in value. Investments in subsidiary undertakings are stated in the balance sheet of the parent company at cost, less any provision for impairment in value.

Fuel stocks and stores

Fuel stocks and general and engineering stores are stated at the lower of cost and net realisable value. In general stocks are recognised in the profit and loss account on a weighted average cost basis. The Companies Act 1985 requires stocks to be categorised between raw materials, work in progress and finished goods. Fuel stocks and stores are raw materials under this definition.

Principal Accounting Policies (continued)

Cash and short-term deposits

Short-term deposits include cash at bank and in hand, and certificates of tax deposit.

Deferred taxation

Deferred taxation arises in respect of items where there is a timing difference between their treatment for accounting purposes and their treatment for taxation purposes. Financial Reporting Standard 19 'Deferred tax' (FRS 19), which requires full provision for such timing differences, has been adopted with effect from 1 January 2001. As allowed by FRS 19, the provision required has been recognised on a discounted basis. The effect of this change in accounting policy on the retained profits and net assets of the Group is set out in note 8 to the accounts. Prior year figures have been restated. Previously provision for deferred taxation was made using the liability method, on a partial provisioning basis, and timing differences were only provided for to the extent that it was probable that a liability or asset would crystallise in the foreseeable future.

Pensions

The Group provides pension benefits through both defined benefit and defined contribution schemes. Pension costs are charged to the profit and loss account so as to spread the cost of pensions over employees' remaining working lives. The regular cost, and any variation from regular cost which is identified as a result of actuarial valuations, is amortised over the average expected remaining service lives of members. Differences between the amounts funded and the amounts charged to the profit and loss account are treated as either creditors or debtors in the balance sheet. Payments to defined contribution schemes are charged against profits as incurred.

Powergen has adopted the transitional provisions of Financial Reporting Standard 17 'Retirement benefits' (FRS 17) in these accounts. Full implementation of FRS 17 is required for accounting periods ending after 22 June 2003. The disclosures required by the transitional arrangements are set out in note 22 to the accounts.

Related party transactions

The Company is exempt under the terms of Financial Reporting Standard Number 8 from disclosing related party transactions with entities that are part of the Powergen plc group or investees of the Powergen plc group.

Cash flow statement

The company is a wholly owned subsidiary undertaking of Powergen plc and is included in the consolidated financial statements of Powergen plc. Consequently, the Company has taken advantage of the exemption from preparing a cash flow statement under the terms of Financial Reporting Standard Number 1 (revised).

1 Turnover

Turnover is analysed as follows:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
UK Operations		
Electricity and gas – wholesale and trading	1,839	1,893
Electricity – distribution	288	307
Electricity and gas – retail	1,738	1,726
Cogeneration	130	115
Internal charges from distribution to retail	(146)	(191)
	3,849	3,850
International Operations	166	225
	4,015	4,075

Turnover analysed by geographic destination is not materially different from the analysis by origin shown above.

2 Operating profit

Operating costs were as follows:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Fuel costs	411	678
Pool purchases and other costs of sales	2,528	2,156
Staff costs (note 4)	200	203
Depreciation, including exceptional charges	267	284
Goodwill amortisation	68	71
Other operating charges, including restructuring costs	381	377
Operating costs, after exceptional items	3,855	3,769
Operating costs, before exceptional items	3,726	3,690
Exceptional depreciation charge (note 3)	80	79
Exceptional operating charges (note 3)	49	-

The directors believe that the nature of the Group's business is such that the analysis of operating costs as set out in the Companies Act 1985 is not appropriate. As required by the Act, the directors have therefore adopted the presented format so that operating costs are disclosed in a manner appropriate to the Group's principal activities.

£24 million of foreign exchange gains were recognised in the profit and loss account (year ended 31 December 2000 £28 million losses).

2 Operating profit (continued)

Operating costs also include:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Repairs and maintenance costs	92	88
Research and development costs	3	4
Operating leases	13	11
Loss/(Profit) on disposal of fixed assets	14	(21)
Auditors' remuneration for audit (Company £0.3m, year ended 31 December 2000 £0.5 million)	0.5	0.6
Auditors' remuneration for non-audit services	5.5	0.9

Fees for non-audit services comprise due diligence, accounting advisory, tax advisory services and other general consultancy. Of the £5.5 million non-audit services for the year ended 31 December 2001, £3.5 million was in respect of a cost reduction programme in the UK distribution business.

Other operating income includes £33 million (year ended 31 December 2000 £60 million) of income from operating leases. It also includes the recognition of £99 million (year ended 31 December 2000 £99 million) of deferred income in respect of the provision of services under warranty arrangements associated with the disposal of Fiddlers Ferry and Ferrybridge C power stations to Edison Mission Energy during 1999. This figure represents £100 million of deferred income less £1 million of associated costs incurred, in each year.

3 Exceptional items

Exceptional items comprise:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Charged against operating profit	(129)	(79)
Charged against interest costs	-	(79)
Profits less losses on disposal of fixed assets and investments	79	337
Profits less losses on disposal of businesses (including provisions)	(34)	(133)
	<u>(84)</u>	<u>46</u>

Charged against operating profit

Year ended 31 December 2001

UK Operations

During 2001, a business transformation and restructuring programme has been established within UK Operations. £22 million has been charged in these accounts in respect of that programme, which primarily comprises committed severance and related payments to approximately 240 employees. A tax credit of £6 million arises in respect of this programme.

3 Exceptional items (continued)

In the year ended 31 December 2001, following a review in the year ended 31 December 2000 described below, a further review of the Group's UK CHP plant portfolio was made, on the same basis as the review in the previous year. The cash flows used in this impairment review were discounted at Powergen's cost of capital for CHP Operations. A further impairment provision of £80 million has consequently been recorded in these accounts. A tax credit of £16 million arises in respect of this item.

Corporate

On 9 April 2001, E.ON announced a pre-conditional cash offer for the whole of the issued share capital of Powergen plc. The acquisition of Powergen plc's shares by E.ON completed on 1 July 2002 and accordingly, Powergen has provided for the anticipated total cost of advisors' and other fees associated with the successful completion of the transaction, of £27 million, in these accounts. No tax credit arises on these costs.

Year ended 31 December 2000

UK Operations

In the year ended 31 December 2000, an impairment provision of £79 million was made in respect of the Group's UK CHP plant portfolio in the light of changes in wholesale electricity and gas prices. The cash flows used in this impairment review were discounted at Powergen's cost of capital for CHP Operations. A tax credit, which has now been restated following the implementation of FRS 19, of £17 million arose on this item.

Charged against interest costs

Year ended 31 December 2000

UK Operations

On 28 December 2000, Powergen repaid three Sterling Eurobonds originally issued by East Midlands Electricity plc (now East Midlands Electricity Distribution plc). The repayment of these bonds facilitated the financial separation of its distribution and supply business, which took place subsequently on 1 October 2001. The consideration paid to bond holders and the unwinding of hedging costs totalled £493 million. At 28 December 2000 the carrying value of these bonds was £427 million, giving a premium payable to buy out the bonds of £66 million. A tax credit, which has now been restated following the implementation of FRS 19, of £25 million arose on these costs.

Corporate

During the year ended 31 December 2000 the Company entered into an interest rate swaption arrangement to cap the interest rate payable on the \$4,000 million term and revolving credit facility put in place by Powergen US Holdings Ltd. This facility was required to finance the acquisition of LG&E Energy Corp. by the Powergen group. The premium payable for this swap was £13 million. A tax credit of £4 million arose on these costs.

3 Exceptional Items (continued)

Profit less losses on disposal of fixed assets and investments

Year ended 31 December 2001

UK Operations

On 8 March 2001, Powergen's UK Operations completed the sale of Rye House power station and transfer of its associated gas contract to Scottish Power UK plc, for £217 million in cash. Net assets disposed of, together with disposal and other related costs, totalled £178 million giving rise to an exceptional profit of £39 million. A tax charge of £7 million arises on this disposal.

International Operations

On 27 February 2001, Powergen completed the sale of its Australian interests to a joint venture company that is 80 per cent owned by CLP Power International (CLP) and 20 per cent owned by Powergen. This gave the joint venture a 92 per cent stake in the holding company for Yallourn power station. Powergen therefore retains an effective stake of 18.4 per cent in Yallourn. Sale proceeds totalled £69 million in cash. Net assets disposed of, together with disposal and related hedging and swap costs totalled £70 million, giving rise to an exceptional loss on disposal of £1 million. A £1 million tax charge arises on this disposal.

On 27 April 2001, Powergen completed the sale of its German assets to NRG Energy, Inc. Sale proceeds totalled £50 million in cash. Net assets disposed of, together with related disposal costs, totalled £112 million, giving rise to an exceptional loss on disposal charged against profits of £62 million. No tax charge arises on this disposal.

On 11 May 2001, Powergen completed the sale of its Portuguese assets to RWE Power for £131 million in cash. Net assets disposed of, together with related disposal costs totalled £27 million. After writing back £12 million of goodwill previously charged directly against reserves, this transaction resulted in an exceptional profit on disposal of £92 million. No tax charge arises on this disposal.

On 7 August 2001, CLP acquired an option for first refusal from Powergen to purchase Powergen's Indonesian assets, PT Jawa Power, at a future date. Powergen received £14 million in cash for this option. After charging £3 million of associated costs, this transaction resulted in an exceptional profit of £11 million. A £4 million tax charge arises on this item.

Year ended 31 December 2000

UK Operations

On 31 December 2000, Powergen completed the sale of Cottam power station to Societe C2, a subsidiary company of London Electricity Group plc, for £398 million in cash. At the same time Powergen entered into arrangements to supply coal to the station for a 27 month period on terms consistent with Powergen's overall coal commitments.

3 Exceptional items (continued)

Net assets disposed of, together with disposal costs, totalled £61 million, giving rise to an exceptional profit on disposal of £337 million. A £12 million tax charge, which has now been restated following the implementation of FRS 19, arose on this disposal.

Profits less losses on disposal of businesses (including provisions)

Year ended 31 December 2001

UK Operations

On 20 February 2001, Powergen completed the sale of its East Midlands Electricity metering business to Siemens Metering Limited for £40 million in cash. Net assets disposed of, together with disposal costs and unamortised goodwill totalled £25 million leading to an exceptional profit on disposal of £15 million. A tax charge of £6 million arises on this disposal. The sale did not include non half-hourly meters.

International Operations

On 29 June 2001, Powergen completed the sale of its Hungarian assets to NRG Energy, Inc. Sale proceeds totalled £80 million in cash. Net assets disposed of, together with related disposal costs, totalled £59 million, giving rise to an exceptional profit on disposal of £21 million. No tax charge arises on this disposal.

On 21 December 2001, Powergen finalised the terms of the sale of its 88 per cent stake in Gujarat Powergen Energy Corporation (GPEC) to a joint venture company that is 80 per cent owned by CLP Power International and 20 per cent owned by Powergen. During 2002, Powergen will purchase the remaining 12 per cent stake in GPEC from the other minority shareholders, and this stake will then be sold on to the joint venture company. As a result of these transactions, the joint venture will hold 100 per cent of GPEC and Powergen will retain a 20 per cent stake in the company. The value of Powergen's investment in GPEC has been further reduced by £66 million to reflect the value implicit in this sale arrangement. No tax credit arises on this item. The sale of the 88 per cent stake completed on 20 February 2002, see note 31.

During the year ended 31 December 2001, Powergen incurred £4 million of costs in connection with the disposal of its International business, including office closure costs. Tax credits totalling £1 million arise on these costs.

Corporate

On 1 October 2001, Ergon Insurance Limited was sold by the Company to Powergen Group Investments Limited. Sale proceeds totalled £140 million in cash. Net assets disposed of totalled £140 million, giving rise to neither a profit nor a loss. No tax charge arises on this disposal.

3 Exceptional items (continued)

Year ended 31 December 2000

International Operations

During the year ended 31 December 2000, the carrying value of the Group's international asset portfolio was reviewed. The value of its Indian and Australian assets was reduced by £107 million, including goodwill written off of £48 million, to reflect the value implicit in the sale of these assets as part of the arrangement with CLP Power International described above. No tax credits arose on this item.

During the year ended 31 December 2000, an amount of £26 million was charged against profits in respect of the closure of these International Operations, principally in respect of employee severance costs. £4 million of tax credits arose on this item.

4 Employee information

The average number of persons employed by the Group, including directors, analysed by activity was:

	Year ended 31 December 2001	Year ended 31 December 2000
UK Operations	5,530	5,903
International Operations	543	830
	<u>6,073</u>	<u>6,733</u>

The salaries and related costs of employees, including directors, were:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Wages and salaries	184	186
Social security costs	15	16
Other pension costs (note 22)	12	16
	<u>211</u>	<u>218</u>
Capitalised in fixed assets	(11)	(15)
Charged in profit and loss account as staff costs	<u>200</u>	<u>203</u>

5 Directors' emoluments

The aggregate emoluments of the directors was £1,834,040 (year ended 31 December 2000 £1,903,767). The highest paid director received emoluments (excluding pension contributions) of £552,628 (year ended 31 December 2000 £562,333) and performance related bonuses of £130,000 (year ended 31 December 2000 £220,000). The amount of the accrued pension of the highest paid director was £367,600 (31 December 2000 £346,700). One director exercised share options during the year ended 31 December 2001, realising a gain of £16,058 (year ended 31 December 2000, no exercises).

5 Directors' emoluments (continued)

The number of directors who were members of a defined benefit pension scheme was three (31 December 2000 three). Further details of the shareholdings and share options of the directors are set out in the consolidated financial statements of Powergen plc for the year ended 31 December 2001.

6 Net interest payable – Group

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Investment income	1	1
Interest receivable from associates and joint ventures	4	7
Interest receivable and similar income	4	35
Interest receivable from fellow group undertakings	17	-
	26	43
Interest payable on loans		
Bank loans and overdrafts	(32)	(33)
Interest payable to fellow group undertakings	(2)	-
Other borrowings	(137)	(141)
	(171)	(174)
Net interest payable before unwinding of discount	(145)	(131)
Unwinding of discount in provisions	(4)	(3)
	(149)	(134)
Exceptional interest costs (note 3)	-	(79)
	(149)	(213)

7 Profit on ordinary activities before taxation

	Year ended 31 December 2001	Year ended 31 December 2000
	£m	£m
UK Operations		
Electricity and gas – wholesale and trading	136	288
Electricity – distribution	118	116
Electricity and gas – retail	49	42
Cogeneration	32	18
Lease and other income and charges	104	182
	439	646
International Operations	111	121
Intra-group foreign exchange differences	14	(12)
Corporate costs	(19)	(47)
Net interest payable - Group	(149)	(134)
- Associates and joint ventures	(46)	(58)
Profit before goodwill amortisation and exceptional items	350	516
Goodwill amortisation	(68)	(71)
Exceptional items (note 3)	(84)	46
	198	491

The net assets of the Group are analysed as follows:

	At 31 December 2001 £m	At 31 December 2000 £m
UK Operations	2,683	3,476
International Operations	342	571
Unallocated net liabilities	(1,181)	(2,021)
	1,844	2,026

Powergen had previously announced asset disposals in India that had not completed by 31 December 2001. These disposals included net assets of International Operations of £262 million. See note 31 for details of the transaction related to the Indian assets which completed after 31 December 2001.

8 Tax on profit on ordinary activities

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Current tax:		
UK Corporation Tax on profits/(losses) for the year	48	22
(Over)/Under provision in prior year	(7)	9
Overseas taxation	6	3
Total current tax charge	47	34
Deferred tax (note 24):		
Origination and reversal of timing differences	15	30
Decrease in discount	-	15
Total deferred tax charge	15	45
Associates and joint ventures	3	7
Tax charge on profit on ordinary activities	65	86

The difference between the current tax on the profit on ordinary activities for the year and the tax assessed on the profit on ordinary activities for the year assessed at the standard rate of corporation tax in the UK (30%) can be explained as follows:

	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
Profit on ordinary activities before tax	198	491
Tax charge on profit on ordinary activities at 30%	59	147
Effects of:		
Prior year adjustment	(7)	9
Origination and reversal of timing differences	7	9
Expenses not deductible for tax purposes	91	71
Non-taxable income	(87)	(176)
Net effect of different rates of tax in overseas businesses	(16)	(26)
	47	34

The tax impact of exceptional items is given in note 3.

Financial Reporting Standard 19 'Deferred tax' was adopted from 1 January 2001. This standard requires full provision to be made for deferred tax assets and liabilities, subject to certain exceptions. The Powergen UK Group has chosen to discount the full provision required, as permitted by the standard. Previously, deferred tax was provided for in respect of timing differences only to the extent that it was probable that a liability would crystallise in the foreseeable future. As a result of the adoption of this standard in these accounts, prior year figures have been restated in the profit and loss account, balance sheet and notes to the accounts.

8 Tax on profit on ordinary activities (continued)

The impact on the Powergen UK Group's previously reported results and opening net assets is as follows:

	31 December 2000 £m
Retained profits as previously reported	191
Effect of implementation of FRS 19	(37)
Retained profits as restated	154

	At 31 December 2000 £m	At 2 January 2000 £m
Net assets as previously reported	2,147	1,979
Effect of implementation of FRS 19	(121)	(84)
Net assets as restated	2,026	1,895

As a result of this change in accounting policy, retained profits for the year ended 31 December 2001 have been reduced by £15 million.

9 Dividends

	Pence per ordinary share			
	Year ended 31 December 2001	Year ended 31 December 2000	Year ended 31 December 2001 £m	Year ended 31 December 2000 £m
First interim dividend paid	13.1p	11.4p	85	74
Second interim dividend paid	9.2p	8.6p	60	56
Third interim dividend declared	-	17.0p	-	110
Third interim dividend paid	27.9p	-	181	-
	50.2p	37.0p	326	240

10 Profit of the Company

The profit for the financial year of the Group includes £366 million profit (year ended 31 December 2000 £395 million profit, restated for the impact of FRS 19) attributable to the Company. The Company is not publishing a separate profit and loss account as permitted by Section 230 of the Companies Act 1985.

11 Revision to provisional fair values

The calculation of fair values of net assets and the goodwill arising on the acquisitions of Gujarat Powergen Energy Corporation, Corby Power Limited and TeleCentric Solutions Limited was provisional in the accounts for the year ended 31 December 2000. These amounts have been finalised in the year ended 31 December 2001, as permitted by FRS 7. Revisions to the original values were only necessary in respect of Corby Power Limited, where the provisional fair value of assets acquired was reduced by £23 million from £50 million to £27 million due to a revision in estimates of contract assets and liabilities. Goodwill arising was consequently increased by £23 million, from negative goodwill arising of £16 million to positive goodwill arising of £7 million.

12 Goodwill

The Group

	£m
Cost	
At 31 December 2000	1,396
Disposals	(16)
31 December 2001	1,380
Amortisation	
At 31 December 2000	215
Charge for the year	66
Disposals	(2)
At 31 December 2001	279
Net book value at 31 December 2001	1,101
Net book value at 31 December 2000	1,181

13 Tangible fixed assets

The Group	Generating assets	Distribution and transmission networks	Other operating and short-term assets	Total
	£m	£m	£m	£m
Cost				
At 31 December 2000	3,666	1,579	648	5,893
Foreign exchange movements	8	-	-	8
Additions	39	67	71	177
Transfers	3	16	(19)	-
Disposals	(426)	(22)	(36)	(484)
At 31 December 2001	3,290	1,640	664	5,594
Depreciation				
At 31 December 2000	1,931	545	290	2,766
Charge for the year	110	37	40	187
Transfers	3	-	(3)	-
Disposals	(118)	(12)	(13)	(143)
Exceptional write down	53	-	80	133
At 31 December 2001	1,979	570	394	2,943
Net book value at 31 December 2001	1,311	1,070	270	2,651
Net book value at 31 December 2000	1,735	1,034	358	3,127

The Company	Generating assets	Assets in course of construction	Other assets	Total
	£m	£m	£m	£m
Cost				
At 31 December 2000	3,051	25	120	3,196
Additions	35	-	3	38
Transfers	(2)	-	-	(2)
Disposals	(289)	(2)	(3)	(294)
At 31 December 2001	2,795	23	120	2,938
Depreciation				
At 31 December 2000	1,850	-	111	1,961
Charge for the year	86	-	5	91
Disposals	(112)	-	(3)	(115)
At 31 December 2001	1,824	-	113	1,937
Net book value at 31 December 2001	971	23	7	1,001
Net book value at 31 December 2000	1,201	25	9	1,235

13 Tangible fixed assets (continued)

Group assets include freehold land and buildings with a net book value of £133 million (at 31 December 2000 £189 million). Group and Company assets also include assets held for use under operating leases with a cost of £132 million and accumulated depreciation of £132 million at both 31 December 2001 and 31 December 2000.

No interest was capitalised during the year (year to 31 December 2000 £7 million). In the year ended 31 December 2000 this interest was capitalised at a rate of 8.6%. Accumulated interest capitalised gross of tax relief, included in the total cost for the Group, amounts to £61 million at 31 December 2001 (31 December 2000 £72 million).

Company assets include freehold land and buildings with a net book value of £104 million (year ended 31 December 2000 £140 million).

14 Fixed asset investments

The Group	Net assets		Loans		Other investments	Total
	Joint ventures	Associates	Joint ventures	Associates		
	£m	£m	£m	£m	£m	£m
At 31 December 2000	60	252	32	20	71	435
Revision to provisional fair values (see note 11)	(23)	-	-	-	-	(23)
Additions	-	2	2	37	26	67
Disposals	-	(173)	(7)	(41)	(75)	(296)
Retained profits	2	(4)	-	-	-	(2)
Foreign exchange movements	-	-	-	(1)	(4)	(5)
At 31 December 2001	39	77	27	15	18	176
Goodwill						
At 31 December 2000	(7)	-				(7)
Revisions to provisional fair values (see note 11)	23	-				23
Amortisation	(2)	-				(2)
At 31 December 2001	14	-				14
At 31 December 2001 – Net assets and goodwill	53	77	27	15	18	190
At 31 December 2000 – Net assets and goodwill	53	252	32	20	71	428

Additions to associates and joint ventures represent equity investments in, and loans to, associates and joint ventures respectively.

Other investments include investments listed on a recognised stock exchange of £nil million (year ended 31 December 2000 £69 million) set aside by subsidiary companies for certain medium and long-term insurance liabilities. At 31 December 2000, the market value of these investments was £3 million in excess of cost.

14 Fixed asset investments (continued)

Ergon Insurance Limited is the company which holds the listed investments referred to above. Ergon Insurance Limited was sold to Powergen Group Investments Limited, a fellow Group undertaking, on 1 October 2001. (see note 3, Profits less losses on disposal of businesses (including provisions) – Corporate).

The Company

	Group Undertakings £m	Associates £m	Joint ventures £m	Total £m
At 31 December 2000	3,166	28	53	3,247
Additions	1,347	8	2	1,357
Disposals	(870)	(34)	(5)	(909)
Provision	(46)	-	-	(46)
At 31 December 2001	3,597	2	50	3,649

The Company holds 49,998 fully paid up £1 redeemable preference shares in its ultimate holding company, Powergen plc. The preference shares are redeemable at par at the option of Powergen plc. The holders of the limited-voting redeemable preference shares are not entitled to receive or participate in any of the profits of that company available for distribution by way of dividend or otherwise.

The Company's investments of £3,649 million (31 December 2000 £3,247 million) include loans to group undertakings of £1,242 million (31 December 2000 £1,440 million) and loans to associates and joint ventures of £27 million (31 December 2000 £60 million).

At 31 December 2001, a provision of £46 million was made against the value of the Company's investments in Group undertakings following a review of the recoverable amount of the underlying international assets and CHP plant portfolio. This was incremental to a provision of £220 million made at 31 December 2000 following a similar review.

Interests in Group subsidiary undertakings

Details of the Group's principal investments in subsidiary undertakings are set out below. Principal subsidiaries are those which in the opinion of the directors significantly affect the amount of profit and assets and liabilities shown in these accounts. The directors consider that those companies not listed are not significant in relation to Powergen UK as a whole.

14 Fixed asset investments (continued)

Name	Proportion of nominal value of issued equity shares and voting rights held by the Group or the Company %	Country of incorporation or registration	Principal business activities
East Midlands Electricity Distribution plc (formerly Powergen Energy plc) +	100	England and Wales	Distribution of electricity
Powergen International Ltd *	100	England and Wales	Holding company for international activities
Powergen CHP Limited *	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Cogeneration Limited*	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Gas Limited *	100	England and Wales	Transportation and marketing of gas in the UK
Powergen Retail Limited +	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Gujarat Powergen Energy Corporation Limited (GPEC)+	88	India	Generation and sale of electricity

* direct interest

+ indirect interest

14 Fixed asset investments (continued)

Associates and joint ventures

Details of the Group's principal investments in associates and joint ventures are as follows:

	Accounting reference date	Country of incorporation or registration	Shares held	Percentage of capital held directly or indirectly by the Company
PT Jawa Power	31 December	Indonesia	Indonesian rupees ordinary shares	35%
Corby Power Limited *	30 September	England and Wales	Ordinary shares	50%
Cottam Development Centre Limited *	31 December	England and Wales	Ordinary shares	50%
TeleCentric Solutions Limited *	31 December	England and Wales	Ordinary shares	50%

* treated as joint ventures in the Group's accounts

The principal activities of these associates and joint ventures are:

PT Jawa Power	-	Generation and sale of electricity from coal-fired power station
Corby Power Limited	-	Generation and sale of electricity from gas-fired power station
Cottam Development Centre Limited	-	Construction and operation of gas-fired power station plant and operation of a generator turbine testing facility
TeleCentric Solutions Limited	-	Retail of telecommunications services and development of multi-utility billing system

Group share of aggregate associates' and joint ventures' balance sheets

	At 31 December 2001		At 31 December 2000	
	Joint ventures £m	Associates £m	Joint ventures £m	Associates £m
Share of assets:				
Share of fixed assets	103	403	80	1,456
Share of current assets	65	46	89	136
	<u>168</u>	<u>449</u>	<u>169</u>	<u>1,592</u>
Share of liabilities:				
Amounts falling due within one year	(18)	(20)	(15)	(117)
Amounts falling due after more than one year	(97)	(352)	(101)	(1,223)
	<u>(115)</u>	<u>(372)</u>	<u>(116)</u>	<u>(1,340)</u>
Share of net assets	<u>53</u>	<u>77</u>	<u>53</u>	<u>252</u>
Turnover	<u>79</u>	<u>118</u>	<u>27</u>	<u>242</u>
Operating profit	<u>13</u>	<u>37</u>	<u>8</u>	<u>62</u>

15 Stocks

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
Fuel stocks	76	61	64	46
Stores	31	59	24	53
	<u>107</u>	<u>120</u>	<u>88</u>	<u>99</u>

16 Debtors: amounts falling due after more than one year

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
Other debtors	<u>53</u>	<u>56</u>	<u>46</u>	<u>48</u>

Other debtors include £5 million in respect of pensions (31 December 2000 £4 million) and £46 million (31 December 2000 £51 million) in respect of income under operating leases.

17 Debtors: amounts falling due within one year

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
Trade debtors	581	568	252	311
Less: securitisation	(166)	(152)	(77)	(118)
Net trade debtors	415	416	175	193
Other debtors	130	173	118	202
Prepayments and accrued income	71	36	55	11
Amounts due from fellow group undertakings	1,169	543	1,489	725
	<u>1,785</u>	<u>1,168</u>	<u>1,837</u>	<u>1,131</u>

17 Debtors: amounts falling due within one year (continued)

Other debtors include £38 million (31 December 2000 £31 million) in respect of income under operating leases.

During 2001 the Powergen UK Group renewed a revolving-period £300 million securitisation programme to sell all of its rights, title and interest in certain billed and unbilled trade debtors (for electricity, gas and telephony retail customers) to Kittyhawk Funding Corporation, a trust established for the purpose of purchasing trade debtors including those from Powergen. The trust issued commercial paper to investors and loans the proceeds to Powergen. Interest is charged on the amounts borrowed under the securitisation programme at a margin above LIBOR, and is payable monthly. The Powergen UK Group is not obliged to support any loss suffered by the trust or the related investors as a result of the securitisation programme, and does not intend to do so. The trust has agreed not to seek recourse against any other assets, apart from the identified billed and unbilled trade debtors. The Powergen UK Group has an option, but no obligation, to repurchase defaulted debt from the trust for a nominal sum.

At 31 December 2001, amounts advanced by the trust to the Powergen UK Group totalled £300 million (at 31 December 2000 £300 million), of which £166 million (year ended 31 December 2000 £152 million) was backed by billed and unbilled trade debtor balances. The Powergen UK Group retains the responsibility for servicing these trade debtors. The remaining £134 million (at 31 December 2000 £148 million) advanced by the trust is included in loans and overdrafts within creditors due within one year.

At 31 December 2001, amounts advanced by the trust to the Company totalled £141 million (at 31 December 2000 £216 million), of which £77 million (year ended 31 December 2000 £118 million) was backed by billed and unbilled trade debtor balances. The remaining £64 million (at 31 December 2000 £98 million) advanced by the trust is included in loans and overdrafts within creditors due within one year.

18 Loans and overdrafts

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
Bank overdrafts	17	3	80	43
Commercial paper	284	-	284	-
7.1% US Dollar Yankee Bond 2002	281	-	-	-
Intra-Group swaps	(31)	-	-	-
	250	-	-	-
Other short-term loans	172	706	78	99
	<u>723</u>	<u>709</u>	<u>442</u>	<u>142</u>

18 Loans and overdrafts (continued)

Included in other short-term loans at 31 December 2000 was a £535 million draw down on a £1,000 million five year revolving credit facility which was cancelled on 3 December 2001.

The US Dollar Yankee Bonds referred to above and in note 20 are held by Powergen (East Midlands) Investments ('PEMI'), a wholly-owned direct subsidiary of the Company. In April 2001, PEMI redeemed the external swaps previously used to hedge the two Yankee Bonds. These external swaps were replaced by new swaps under the same terms with Powergen UK plc, and in turn, by Powergen UK plc with Powergen US Holdings Limited, a company outside the Powergen UK plc group. The net assets and results of both Powergen UK plc, the Company and the Powergen UK plc group remain unaffected as a result of these transactions.

The Powergen UK Group has a Euro Commercial Paper programme which allows it to issue paper in various currencies for maturities of seven to 364 days up to a maximum of US \$500 million or equivalent at LIBOR rates. At 31 December 2001, £284 million was drawn down under this programme. There was no commercial paper outstanding at 31 December 2000.

The weighted average interest rate on all short-term loans during the year was 6.0% (year ended 31 December 2000 8.4%).

19 Trade and other creditors falling due within one year

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
Trade creditors	471	479	353	375
Amounts owed to parent undertaking and fellow subsidiaries	167	76	340	71
Amounts owed to subsidiaries	-	-	1,301	447
Corporation tax	133	109	119	103
Other taxation and social security	17	70	7	62
Accruals and other creditors	473	290	172	130
Deferred income	100	100	100	100
Proposed dividend	-	110	-	110
	<u>1,361</u>	<u>1,234</u>	<u>2,392</u>	<u>1,398</u>

Accruals and other creditors include accruals for rationalisation and restructuring costs of the Group.

The Powergen UK Group is not committed to significant payments under operating or finance leases during the next financial year.

20 Long term loans

	The Group		The Company	
	At 31 December 2001 £m	At 31 December 2000 £m	At 31 December 2001 £m	At 31 December 2000 £m
7.1% US Dollar Yankee Bond 2002	-	252	-	-
8.875% Sterling Bond 2003	250	250	250	250
8.5% Sterling Bond 2006	250	250	250	250
7.45% US Dollar Yankee Bond 2007	290	260	-	-
Inter-Group swaps	(31)	-	-	-
	259	260	-	-
Loan notes 2007	3	4	-	-
5% Euro Eurobond 2009	326	326	326	326
6.25% Sterling Eurobond 2024	245	244	245	244
Bank loans in overseas subsidiaries	125	247	-	-
	<u>1,458</u>	<u>1,833</u>	<u>1,071</u>	<u>1,070</u>

None of the bonds described above has any financial covenants.

The maturity profile of the Group's financial liabilities, including overdrafts and long-term loans, is as follows:

	At 31 December 2001 £m	At 31 December 2000 £m
In one year or less, or on demand	723	709
In more than one year but not more than two years	269	277
In more than two years but not more than five years	302	320
In more than five years	887	1,236
	<u>2,181</u>	<u>2,542</u>

The undrawn committed borrowing facilities available to the Group are as follows:

	At 31 December 2001 £m
Expiring in one year or less	400
Expiring in more than two years but not more than five years	600
	<u>1,000</u>

20 Long term loans (continued)

On 3 December 2001, The Company jointly signed with Powergen US Holdings Limited (a fellow group undertaking) a new £1,000 million term and revolving credit facility which expires on 3 December 2006. The credit facility bears interest at variable rates, fixed in advance for periods up to six months by reference to the relevant LIBOR rate. This facility replaces the previous Sterling term facility expiring in 2003 which was cancelled on 3 December 2001. There is an associated US Dollar 1,700 million term and revolving credit facility which likewise expires on 3 December 2006, but can only be drawn down by Powergen US Holdings Limited.

Facility	Total Facility £m	Amount undrawn at 31 December 2001 £m	Expiry date	Fees	Covenants
2006 term and revolving credit facility					Powergen UK plc consolidated sub-group: Minimum UK GAAP EBITDA to interest ratio of 2.0 times Consolidated Powergen Group: Minimum UK GAAP EBITDA to interest ratio of 2.25 times. Adjusted US GAAP capitalisation ratio not to exceed 70%
Sterling 1,000 million:					
- 364 day extendable loan	400	400	2 December 2002	13.8 bps	
- 5 year revolving credit facility	600	600	3 December 2006	21.4 bps	
	<u>1,000</u>	<u>1,000</u>			

21 Other creditors falling due after more than one year

	The Group		The Company	
	At 31 December 2001	At 31 December 2000	At 31 December 2001	At 31 December 2000
	£m	£m	£m	£m
Accruals and other creditors	90	102	91	101
Deferred income	140	240	140	240
Amounts due to subsidiary undertakings	-	-	319	1,128
	<u>230</u>	<u>342</u>	<u>550</u>	<u>1,469</u>

Accruals and other creditors shown above include £65 million in respect of pensions (31 December 2000 £67 million).

22 Pension scheme arrangements

The Powergen UK Group participates in the industry wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. The Group has two separate funds with the ESPS, the Powergen UK plc fund and the East Midlands Electricity plc fund. The Powergen UK Group also operates a smaller statutorily approved defined contribution plan.

An actuarial valuation of the ESPS is normally carried out every three years by the Scheme's independent, professionally qualified actuary, who recommends the rates of contribution payable by each group participating in the scheme. In intervening years the actuary reviews the continuing appropriateness of the rates.

The latest published actuarial valuation of the ESPS now available is at 31 March 2001. Particulars of this actuarial valuation are shown below. The details of the actuarial valuation at 31 March 1998 are also shown because this was the latest available valuation at 31 December 2001, and formed the basis for the determination of the pension cost included in these accounts.

The 1998 valuation revealed a surplus of £89 million in respect of the Powergen fund and £32 million in respect of the East Midlands Electricity fund. The 2001 valuation revealed a surplus of £237 million in respect of the Powergen fund and £116 million in respect of the East Midlands Electricity fund. The 1998 actuarial valuations used the discounted cashflow approach, whereas the 2001 actuarial valuations used the market value approach. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these actuarial valuations were:

	At 31 March 2001		At 31 March 1998	
	Powergen UK fund	East Midlands Electricity fund	Powergen UK fund	East Midlands Electricity fund
Market value of assets	£1,604m	£954m	£1,631m	£881m
Funding level	117%	114%	108%	105%
– average nominal rate of return on investments	6.3%	6.3%	8.5%	8.5%
– average nominal rate of annual increase in salaries	3.8%	3.8%	6%	6%
– average nominal rate of annual increase in pensions	2.5%	2.5%	4.5%	4.5%
– average nominal rate of equity dividend growth	N/A	N/A	4.75%	4.75%
Inflation rate	2.3%	2.3%	4.5%	4.5%
Method of valuation used	Projected unit	Projected unit	Projected unit	Attained age

22 Pension scheme arrangements (continued)

Pension costs under current accounting standard SSAP 24 'Accounting for Pension Costs'

In the financial year ended 31 December 2001, the normal pension cost for the Group amounted to £16 million (year ended 31 December 2000 £21 million) and was determined in accordance with the advice of an independent, professionally qualified actuary. A net credit of £4 million (year ended 31 December 2000 £5 million) is required to the pension charge in the accounts in respect of the experience surplus which is being recognised over 13 years, the average remaining service lives of members. The accounts include a prepayment of £27 million (31 December 2000 £23 million) representing the excess of the amounts funded over the pension cost for the year.

Amounts set aside in other creditors for the Company's rationalisation and restructuring programme include costs associated with the early retirement of employees. An element of these costs is likely to be payable to the ESPS to meet early retirement costs.

Impact of FRS 17

SSAP 24 disclosure and measurement principles have been applied in accounting for pensions and post-retirement benefits in these financial statements. However, FRS 17 'Retirement benefits' introduces new disclosure requirements for the first time in these accounts.

The aim of FRS 17 is to move to a market-based approach in valuing the assets and liabilities arising from an employer's retirement benefit obligations and any associated funding. The changes in accounting required to move from a SSAP 24 basis to a market value basis are substantial, and consequently FRS 17 allows a phased implementation of these changes over a three year period. The disclosures required in this first transitional year, which are designed to illustrate the pension assets and liabilities that would have been booked if the measurement principles of FRS 17 has been applied, are set out below.

In calculating these disclosures, the figures shown for liabilities have been measured by updating valuations which were performed at various dates between 31 March 1998 and 31 March 2001. The update was performed by an independent, professionally qualified actuary.

The major assumptions used in these calculations of liabilities were:

	Powergen UK fund	East Midlands Electricity funds
Average nominal rate of annual increase in salaries	4.00%	4.00%
Average nominal rate of annual increase in pensions	2.50%	2.50%
Discount rate applied to nominal increases	5.50%	5.50%
Inflation rate	2.50%	2.50%

22 Pension scheme arrangements (continued)

The fair market value of the assets of the main defined benefit schemes at 31 December 2001 were:

	Powergen UK fund £m	East Midlands Electricity fund £m
Bonds and gilts	217	207
Equities	1,230	601
Other	32	126
Total market value of assets	1,479	934
Present value of scheme liabilities	(1,409)	(876)
Surplus in the scheme	70	58
Related deferred tax liability	(21)	(17)
Net pension asset	49	41

The long-term rate of return assumed on these assets were as follows:

	Powergen UK fund %	East Midlands Electricity fund %
Bonds and gilts	5.00	5.00
Equities	7.00	7.00
Other	4.00	4.00

If FRS 17 had been adopted in the financial statements, the Powergen UK Group's net assets and profit and loss reserve at 31 December 2001 would be as follows:

	31 December 2001 £m
Net assets excluding SSAP 24 asset	1,888
Pension asset under FRS 17	90
Net assets including pension asset under FRS 17	1,978
Profit and loss reserve excluding SSAP 24 pension asset	852
Pension asset under FRS 17	90
Profit and loss reserve including pension asset under FRS 17	942

23 Provisions for liabilities and charges

Movements on provisions comprise:

The Group	31 December 2000	Charged to profit and loss account	Amortisation of discount	Provisions utilised	Provisions released or disposed	31 December 2001
	£m	£m	£m	£m	£m	£m
Liability and damage claims	60	3	-	(2)	(50)	11
Contract provisions	137	-	-	(15)	-	122
Decommissioning	73	-	4	-	(23)	54
	270	3	4	(17)	(73)	186

At 31 December 2001, the provisions in the Company's accounts were as follows:

The Company	31 December 2000	Amortisation of discount	Provisions released	31 December 2001
	£m	£m	£m	£m
Liability and damage claims	11	-	-	11
Decommissioning	73	4	(23)	54
	84	4	(23)	65

The liability and damage claims provision includes reserves in respect of potential claims for industrial related diseases and gradual pollution. Given the inherent uncertainty surrounding the timing of any potential claims, it is not possible to estimate when these amounts will crystallise. Contract provisions, which relate to out of money electricity purchase contracts, were acquired on the purchase of East Midlands Electricity and will be utilised over the period to 2008, when the contracts terminate. Decommissioning provisions comprise amounts set aside for the estimated costs of terminating power station grid connections, decommissioning power stations and subsequent site restoration costs at UK power stations which will be utilised as each power station closes.

Ergon Insurance Limited is the company which records the £50 million of liability and damage claims shown as a disposal above. Ergon Insurance Limited was sold to Powergen Group Investments Limited, a fellow Group undertaking, on 1 October 2001 (see note 3, Profits less losses on disposal of businesses (including provisions) – Corporate).

24 Deferred tax

An analysis of the full potential liability and the net deferred tax liability recognised at 31 December 2001 is as follows:

The Group	At 31 December 2001 £m	At 31 December 2000 £m
Accelerated capital allowances	420	417
Other timing differences	(88)	(100)
Undiscounted full provision for deferred tax	332	317
Discount	(141)	(141)
Discounted provision for deferred tax	191	176
Provision at start of year	176	
Deferred tax charge for year (note 8)	15	
Provision at end of year	191	

The Company	At 31 December 2001 £m	At 31 December 2000 £m
Accelerated capital allowances	236	235
Other timing differences	(45)	(52)
Undiscounted full provision for deferred tax	191	183
Discount	(64)	(66)
Discounted provision for deferred tax	127	117

The liability in respect of accelerated capital allowances and other timing differences is calculated at 30% in both periods.

25 Share capital

The share capital of the Company comprises:

	At 31 December 2001 £m	At 31 December 2000 £m
Authorised		
1,000 (31 December 2000: 1,000) 'A' ordinary shares of 50p each	-	-
1,049,999,002 (31 December 2000: 1,049,999,002) 'B' ordinary shares of 50p each	525	525
	<u>525</u>	<u>525</u>
Allotted, called-up and fully paid		
1,000 (31 December 2000: 1,000) 'A' ordinary shares of 50p each	-	-
649,240,799 (31 December 2000: 649,240,799) 'B' ordinary shares of 50p each	325	325
	<u>325</u>	<u>325</u>

The two classes of ordinary share capital carry the same rights except that the 'A' shares carry all of the voting rights. On 3 December 2001, the ordinary 'A' shares were transferred at par value from Powergen plc to Powergen Group Investments Limited, both fellow group undertakings.

26 Reserves

The Group	Share premium account £m	Special capital reserve £m	Revaluation reserve £m	Capital redemption Reserve £m	Profit and loss account £m
At 31 December 2000	97	474	23	85	1,107
Prior year adjustment (see note 8)	-	-	-	-	(121)
At 31 December 2000 (as restated)	97	474	23	85	986
Currency translation differences on foreign currency net investments	-	-	-	-	(4)
Transfers	-	-	(1)	-	1
Goodwill transferred to the profit and loss account related to disposals of fixed assets and investments	-	-	-	-	15
Retained loss for the year	-	-	-	-	(190)
At 31 December 2001	<u>97</u>	<u>474</u>	<u>22</u>	<u>85</u>	<u>808</u>

Aggregate goodwill written off directly to the Group profit and loss reserve totals £nil million (31 December 2000 £15 million).

26 Reserves (continued)

The Company	Share premium account £m	Special capital reserve £m	Capital redemption reserve £m	Profit and loss account £m
At 31 December 2000	97	474	85	1,098
Prior year adjustment	-	-	-	(103)
At 31 December 2000 (as restated)	-	-	-	995
Retained profit for year	-	-	-	40
At 31 December 2001	97	474	85	1,035

The share premium account, special capital reserve and capital redemption reserve are not available for distribution. The special capital reserve was determined in accordance with the Transfer Scheme made pursuant to the Electricity Act 1989, under which the CEGB's net assets were vested in its successor companies.

27 Equity minority interests

	31 December 2001 £m	31 December 2000 £m
Opening equity minority interests	36	65
Increased stake in subsidiaries	-	(40)
Profit and loss account – pre-exceptional	3	
Profit and loss account - exceptional	(6)	11
Closing minority interest	33	36

The exceptional movement in minority interest relates to the write-down of Gujarat Powergen Energy Corporation (GPEC), see note 3 (Profits less losses on disposal of businesses (including provisions) – International Operations).

28 Reconciliation of movements in shareholders' funds

	31 December 2001 £m	31 December 2000 £m
Profit for the financial year	136	394
Dividends	(326)	(240)
Goodwill transferred to the profit and loss account related to disposals of fixed assets and investments	15	-
Currency translation differences on foreign currency net investments	(4)	6
Net increase in shareholders' funds for the year	(179)	160
Opening shareholders' funds as previously stated	-	1,914
Prior year adjustment (see note 8)	-	(84)
Opening shareholders' funds as restated for prior year adjustment	1,990	1,830
Closing shareholders' funds	1,811	1,990

29 Financial instruments

Financial instruments and risk management

As part of the financing of its normal operating activities, the Group uses a variety of financial instruments. These may be assets, liabilities or related commitments depending on requirements. These instruments are denominated in Sterling or foreign currencies and have various maturities and interest rates. The Group is exposed to movements in market interest rates and foreign currency exchange rates. Active steps are taken to manage these risks, both by management of the portfolio of financial instruments themselves, and by the use of derivative financial instruments, which are primarily used where there is an underlying exposure.

The objectives, policies and strategies connected with the use of financial instruments are discussed in the 'Treasury management' section of the Directors' Report.

The Group may be exposed to credit related loss in the event of non-performance by counter-parties under these instruments. However, the Group does not anticipate any non-performance given the high credit rating of the established banks and financial institutions that form these counter-parties. The Group controls this credit risk through credit approvals, strict exposure limits, monitoring procedures and specific controls depending on the size of individual transactions. There are no significant concentrations of credit risk. The Group does not usually require collateral or other security to support financial instruments with credit risks.

29 Financial instruments (continued)

Foreign exchange risk management

The Powergen UK Group enters into foreign exchange contracts and options in accordance with its hedging policies. These policies are discussed under 'Foreign exchange risk management' in the Financial Review. The net Sterling amounts of each foreign currency the Powergen UK Group has contracted to purchase (or sell), and has options to sell are as follows:

	Foreign exchange contracts		Foreign exchange options	
	At 31 December 2001 Notional amount £m	At 31 December 2000 Notional amount £m	At 31 December 2001 Notional amount £m	At 31 December 2000 Notional amount £m
US Dollars	7	119	-	-
Euros	1	(139)	-	-
Australian dollars	(17)	(52)	-	(11)
	<u>(9)</u>	<u>(72)</u>	<u>-</u>	<u>(11)</u>

Some contracts involve purchases or sales of US Dollars against other, non-Sterling currencies. The Sterling equivalent amounts are as follows:

	At 31 December 2001 Notional amount £m	At 31 December 2000 Notional amount £m
Korean won	-	(1)
Euros	1	(84)
Indian rupees	(34)	(35)
	<u>(33)</u>	<u>(120)</u>

The weighted average time to maturity of foreign exchange contracts is two months (31 December 2000 two months).

The notional amounts of foreign currency swaps are as follows:

	At 31 December 2001 Notional amount £m	At 31 December 2000 Notional amount £m
Foreign currency swaps into Sterling	<u>826</u>	<u>826</u>

29 Financial instruments (continued)

There are no material monetary assets or liabilities of the Group that are not denominated in the functional currency of the entity concerned, other than certain non-Sterling borrowings treated as hedges of net investments in overseas operations.

Interest rate risk management

The Powergen UK Group has a portfolio of fixed and floating interest rate debt and, in order to mitigate interest rate risk, arranges interest rate hedges to achieve a desired mix of fixed and floating interest rates, with a range of different maturities, as described in the Directors' Report. The instruments used can be summarised as follows:

	At 31 December 2001 Notional amount £m	At 31 December 2000 Notional amount £m
Interest rate swap contracts	749	764

The weighted average time to maturity of interest rate swap contracts is 4.1 years. (31 December 2000 4.9 years)

In addition at 31 December 2000 there were interest rate swaptions with a notional principal amount of £1,674 million and fair value of £nil. These swaptions capped the interest payable on part of the US Dollar term facility (see note 3) and expired in February 2001.

Interest rate risk profile of financial assets and liabilities

At 31 December 2001	Total £m	Floating rate financial liabilities £m	Fixed rate financial liabilities		
			£m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Sterling	2,032	1,225	807	8.6	5.0
US Dollar	6	6	-	-	-
Deutschmark	118	118	-	-	-
Indian rupee	25	4	21	20.0	5.6
	2,181	1,353	828	8.9	5.0

The figures in the above table are stated after taking account of relevant interest rate swap contracts.

29 Financial instruments (continued)

The floating rate financial liabilities bear interest at variable rates, in some cases fixed in advance for periods up to one year. The floating rates are determined with reference to the following rates:

Currency	Rate
Sterling	LIBOR
US Dollar	LIBOR
Deutschmark	LIBOR, FIBOR
Indian Rupee	Banks' Prime Lending Rates

In addition to the above, the Group's provisions include £122 million (31 December 2000 £137 million) for contract provisions (see note 23) which meet the definition of financial liabilities. These financial liabilities are considered to be floating rate liabilities as, in establishing the provisions, the cash flows have been discounted. The discount rate is re-appraised at each reporting date to ensure that it reflects current market assessments of the time value of money and the risks specific to the liability.

At 31 December 2001, the Group held £36 million (31 December 2000 £442 million) of financial assets in the form of Sterling bank deposits, £3 million (31 December 2000 £29 million) in US Dollar deposits, and £67 million (31 December 2000 £39 million) in other currency deposits. These deposits earn interest at floating rates, fixed in advance for periods up to three months, by reference to Sterling LIBID and short-term US Treasuries for the Sterling and US Dollar deposits respectively.

Fair value

The fair value of all these financial instruments, which reflects the estimated amounts Powergen would receive or pay to terminate the contracts at the year end based on market values, is shown below. The fair values therefore reflect current unrealised gains/(losses) on all open contracts.

	31 December 2001 Fair value £m	31 December 2000 Fair value £m
Foreign currency contracts	(2)	(12)
Foreign currency swaps	34	13
Interest rate swaps	10	5

29 Financial instruments (continued)

The estimated fair values of the Group's financial assets and liabilities are as follows:

	Note	31 December 2001		31 December 2000	
		Carrying amount £m	Fair value £m	Carrying amount £m	Fair Value £m
Assets					
Cash and short-term deposits	1	106	106	510	510
Investments	2	18	18	69	72
Liabilities					
Short-term debt	3,5	(723)	(723)	(709)	(709)
Long term debt	4,5	(1,458)	(1,481)	(1,833)	(1,780)

1. The fair value of short-term deposits approximates to carrying value due to the short maturity of instruments held.
2. The fair value of investments listed on a recognised stock exchange is estimated at quoted market price. Others are valued at cost.
3. The fair value of short-term debt approximates to the carrying value as the balance represents short-term loans and bank overdrafts.
4. The fair value of the long-term debt at the reporting date has been estimated at quoted market rates.
5. The fair values shown for short and long-term debt do not take account of the fair values of cross currency swaps shown above.

Short-term debtors and creditors are not included in these disclosures.

The movement in unrecognised gains and losses on instruments used for hedging is as follows:

	Gains £m	Losses £m	Total net gains £m
Unrecognised gains/(losses) on hedges at 31 December 2000	51	(45)	6
(Gains)/Losses on hedges arising in previous periods that were recognised during the year	(6)	18	12
Gains/(Losses) on hedges arising before 31 December 2001 that were not recognised during the year	45	(27)	18
Gains/(Losses) on hedges arising during 2001 that were not recognised during the year	32	(8)	24
Unrecognised gains/(losses) on hedges at 31 December 2001	77	(35)	42
Of which:			
Gains/(Losses) expected to be recognised in 2002	37	(2)	35
Gains/(Losses) expected to be recognised in 2003 or later	40	(33)	7

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

29 Financial instruments (continued)

Contracts for differences

Prior to the introduction of NETA the Powergen UK Group used contracts for differences ('Cfds') to minimise exposure to Pool price. These Cfds were considered to be derivative instruments, which related directly to the underlying purchase and sale of electricity to and from the Pool. With the introduction of NETA on 27 March 2001, these contracts were re-negotiated into bilateral contracts for the physical delivery or receipt of energy, and as such these contracts are not classified as financial instruments under FRS 13. At 31 December 2000, the fair value of Cfds outstanding was estimated at £22 favourable.

30 Commitments and contingent liabilities

- a) At 31 December 2001, the Group had commitments of £107 million (31 December 2000 £91 million) for capital expenditure, of which £nil million (31 December 2000 £5 million) related to expenditure to be incurred after one year.
- b) The Group is aware of claims in respect of current and former employees, including former employees of the CEGB, and contractors in respect of industrial illness and injury and other potential claims which involve or may involve legal proceedings against the Group.

The directors are of the opinion, having regard to legal advice received, the Group's insurance arrangements and provisions held, as appropriate, that it is unlikely that the matters referred to above will have a material effect on the Group's financial position, results of operations or liquidity.

- c) Future purchase commitments

The Group has in place a portfolio of fuel contracts of varying volume, duration and price, reflecting market conditions at the time of commitment. These contracts are with UK and international suppliers of coal and are backed by transport contracts for rail, road, canal and sea movements. At 31 December 2001 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £429 million (at 31 December 2000 £540 million).

The Group is also committed to purchase gas under various long term gas supply contracts including the supply of gas to the Group's three UK power stations. At 31 December 2001 the estimated minimum commitment for the supply of gas under all these contracts totalled £2,898 million (at 31 December 2000 £2,646 million).

- d) In the normal course of business the Group gives certain other indemnities and guarantees which are not considered to be material in the context of these financial statements and on which no losses are anticipated to arise.

31 Post balance sheet events

On 20 February 2002, Powergen completed the sale of its 88 per cent holding in Gujarat Powergen Energy Corporation (GPEC) to a joint venture company that is 80 per cent owned by CLP Power International and 20 per cent owned by Powergen. At 31 December 2001, the value of Powergen's investment in GPEC was written down to an amount consistent with the value implicit in the sale agreements. A loss of £7 million, recorded in the first quarter of 2002, arose on completion due to deal costs. No tax credit was recorded in the first quarter of 2002 on this transaction.

On 1 July 2002, the entire ordinary share capital of Powergen plc including share options was acquired by E.ON UK plc, a wholly owned subsidiary of E.ON AG. The acquisition was effected by way of a Scheme of Arrangement between E.ON UK plc, and Powergen plc and its shareholders under Section 425 of the UK Companies Act 1985 sanctioned by the High Court of Justice on 28 June 2002.

32 Ultimate holding company

The immediate parent undertaking is Powergen Group Investments Limited. Until 1 July 2002, the ultimate parent undertaking was Powergen plc, the parent company of the smallest and largest group to consolidate these financial statements. With effect from 1 July 2002, the ultimate parent undertaking became E.ON AG, a company incorporated in Germany, which is now the parent company of the largest group to consolidate these financial statements. The smallest group to consolidate these financial statements will remain that of which Powergen plc is the parent undertaking. Copies of E.ON AG's Annual Report are available from the offices of E.ON AG at the following address:

E.ON AG
E.ON-Platz 1
D-40479
Düsseldorf
Germany