POWERGEN UK PLC

GROUP REPORT AND ACCOUNTS

for the year ended 31 December 2002

Registered No: 2366970

Directors' report for the year ended 31 December 2002

The directors present their report and the audited accounts of Powergen UK plc ('the Company') and its subsidiaries ('the Group') for the year ended 31 December 2002.

Acquisition by E.ON AG

The recommended acquisition of Powergen Limited (until 6 January 2003 known as Powergen plc), of which Powergen UK plc is an indirect wholly owned subsidiary, by E.ON UK Limited (formerly 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 has been E.ON AG.

Principal activities, review of business and future developments

The Group's principal activities are electricity generation and distribution, and energy trading and retailing. The Group is one of the UK's leading integrated electricity and gas companies with a business built on

- Marketing electricity, gas, telephony and other 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 its distribution and generation asset businesses and build competitive trading and retail businesses. Both the level of business and financial position of the Group at 31 December 2002 were satisfactory and the Directors believe the present levels of activity in the UK will be sustained in the current year.

During October 2002, the Group acquired the UK retail business of TXU Europe Group plc ('TXU'), together with control of three TXU coal-fired generation plants and certain TXU gas supply contracts for £1.4 billion plus the acquisition of £0.2 billion of debt. This was a transforming deal that made the Group the UK's largest retail electricity supplier and number two in the retail energy sector. It also gave the Group a better balance between customer demand and generation output, reducing the impact of future fluctuations in UK wholesale electricity prices on UK business profitability.

The UK business is complemented by the Company's international power generation business, Asian Asset Management. Following the disposal of, or reduction in stake in, most of its international assets, at 31 December 2002 Asian Asset Management held a minority stake operating interest in independent power production activities in India, Australia and Indonesia.

The Company's technical development activities, carried out at its Powertechnology Centre are focused on supporting the Company's strategic business objectives and technology changes through delivery of R&D programmes, services and products, and growing profitable new income streams.

Directors' report for the year ended 31 December 2002 (continued)

Results and dividends

The profit attributable to shareholders for the financial year to 31 December 2002 was £516 million (compared with a profit of £136 million for the year ended 31 December 2001).

The directors do not recommend payment of a final dividend (year ended 31 December 2001 £nil). During the year, interim dividends of £64 million were paid (year ended 31 December 2001 £326 million).

Directors

During the year the following directors served on the Board:

	Date of appointment if during the year	Date of resignation if during the year
Edmund Wallis		19 February 2002
Dr Paul Golby	19 February 2002	
Graham Bartlett	19 February 2002	
Michael Söhlke	1 July 2002	
Powergen Directors Limited	1 July 2002	
Nicholas Baldwin		1 July 2002
Peter Hickson		1 July 2002
Dr David Li		19 February 2002
Sir Frederick Crawford		19 February 2002
Sydney Gillibrand CBE		19 February 2002

Information on directors' emoluments is given in Note 4 to the Accounts, on pages 27 and 28.

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

During the year, no director had an interest in the shares of the Company.

Of the directors who were directors of the Company at 31 December 2001 the following had interests in the ordinary shares of Powergen Limited, the Company's ultimate parent undertaking from the date of their appointment until 1 July 2002. On 1 July 2002 Powergen Limited was acquired by E.ON UK Limited, a wholly owned subsidiary of E.ON AG, by means of a Scheme of Arrangement.

	Beneficial holdings in ordinary shares		**Options over ordinary shares**	
	Date of appointment	**At 31 December 2002**	Date of appointment	**At 31 December 2002**
Dr Paul Golby	287	**-**	142,748	**-**
Graham Bartlett	152	**-**	114,783	**-**

Directors' report for the year ended 31 December 2002 (continued)

Except as disclosed above, there were no non-beneficial interests of the directors in the ordinary share capital of the Company.

No director had at any time during the period under report any interest (other than as a nominee on behalf of the Company) in the shares of any subsidiary company. Following the acquisition of the Group by E.ON AG, no director had at any time during the period under report any disclosable interest in the shares of any subsidiary company of E.ON AG.

Treasury management

In 2002 there were significant changes to the structure of treasury management, following the integration into the E.ON Group.

For the first six months of 2002, Powergen Limited and its subsidiaries, including Powergen UK plc ('the Powergen Group') had a central Group treasury department. It was 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 was an operational treasury team in the UK which serviced the treasury requirements of the Group. Treasury activities were carried out in accordance with Board approved treasury policies, and all treasury operations complied with detailed treasury procedures which were approved at Board level. All treasury interfaces with banks and other third parties were governed by dealing mandates, facility letters and other agreements. Within treasury there was segregation of front, middle and back office activities.

On 1 July 2002, the Powergen Group became part of the E.ON Group, and immediately began operating in accordance with the E.ON financial management and treasury policies and procedures. Significant advanced planning for this integration had been carried out, and a contingency plan was available if the merger had not completed. Close liaison with E.ON's treasury department had allowed Powergen Limited to continue to look ahead. Therefore the Powergen Group was able to easily fit into the well developed financial management and treasury structure of the E.ON Group.

E.ON has a central department that is responsible for financing and treasury strategy, policies and procedure throughout the E.ON Group. Major strategic financings and corporate finance actions are planned and executed by the corporate finance team at E.ON. There is also a treasury team which co-ordinates currency and interest risk management as well as cash management for the whole E.ON Group. Major subsidiaries within the E.ON Group also have their own treasury teams. These teams liaise closely with the local businesses to ensure that liquidity and risk management needs are met

Directors' report for the year ended 31 December 2002 (continued)

within the requirements of the E.ON policies and procedures. These treasury teams work closely with the treasury and corporate finance teams at E.ON AG.
Within the UK, the Group operates its own specific treasury procedures within the overall E.ON treasury framework.

E.ON's central financing strategy

E.ON's financing policy is to centralise external financing at the E.ON AG holding company level, and to reduce external debt in subsidiaries wherever possible. E.ON AG has the strongest credit rating in the E.ON Group, and this allows the finest terms for external finance to be negotiated. E.ON AG then funds its subsidiaries with inter-company finance. This finance may be in the form of equity or debt, as appropriate.

Since 1 July 2002, in accordance with its policy, E.ON has refinanced approximately £0.5 billion of short dated Group debt. At 31 December 2002 the Group had £0.5 billion of inter-group funding which is included in debt in these accounts and a further £2.5 billion of balances due to Powergen Limited which are included in creditors due within one year. In addition to the refinancing referred to above, E.ON has also financed the acquisition of TXU during October 2002 and the Group's ongoing general funding needs.

As a result of the availability of inter-group funding the Group cancelled its £1 billion and $1.7 billion bank facilities, and arranged formalised committed documented lines with E.ON AG for alternative sources of liquidity. The Group has also cancelled and repaid the UK trade receivables securitisation programme (£300 million). The Powergen UK plc ECP programme will also shortly be terminated.

The Group's treasury team employs a continuous forecasting and monitoring process to ensure that the Group complies with all its banking and other financial covenants, and also regulatory constraints that apply to the financing of the UK business. It works in close liaison with the various businesses within the 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. Information is submitted to E.ON for incorporation into E.ON Group forecasting processes on a monthly and quarterly basis.

The Group 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. Treasury activities are reviewed by internal audit on an annual basis.

The year end position described in more detail below is representative of the Group's current position in terms of its objectives, policies and strategies. These will continue to evolve as the Group's business

Directors' report for the year ended 31 December 2002 (continued)

develops in line with the requirements, objectives, policies and strategies of E.ON as the new ultimate parent company.

Directors' report for the year ended 31 December 2002 (continued)

Foreign exchange risk management

The Group operates within the framework of E.ON's guidelines for foreign exchange risk management. There are local 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). Policy is to hedge all contractually committed transaction exposures, as soon as the commitment arises. The Group 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 Group.

The Group'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 Group's foreign exchange contracts and swaps are set out in note 29 to the accounts.

Interest rate risk management

The Group operates within the E.ON framework for interest rate risk management. E.ON requires subsidiaries to maintain a fixed and floating ratio between 20 per cent and 80 per cent. The Group has a significant portfolio of debt, and is exposed to movements in interest rates. This exposure is to both Sterling and US Dollar interest rates, and these interest rate movements are managed primarily through the use of fixed and floating rate borrowings and interest rate swaps.

Off balance sheet finance

The Group has minority equity interests in a number of companies that are principally financed by debt. In each case the debt is secured against the assets of the project and has no, or very limited, recourse back to the Company. The Group also has small operating lease financings typical for a company of its size.

Liquidity planning, trends and risks

The acquisition by E.ON has significantly improved availability of liquidity. The Group has sufficient committed borrowing facilities, through E.ON Group resources, to meet planned liquidity needs, including facilities provided by its parent company E.ON at a lower cost than it could achieve externally. Falls in electricity prices have had some impact on operating cash flows, and as electricity generation is a capital intensive business, planned capital spending remains at significant levels. The level of operating cash is affected by the performance of the business, market prices and margins, amongst other things. Some of these factors are outside the Company's control.

Directors' report for the year ended 31 December 2002 (continued)

The Group's capital market bond financings do not have any significant financial covenants.

Borrowings and facilities

Details of the bank term facilities available to the Group at 31 December 2002, including the amounts undrawn on the facilities, and their expiry dates are fully set out in note 19 to the accounts. This note also sets out details of the Group's long-term and short-term bonds raised in the UK capital markets.

At 31 December 2002, the Powergen Group had total borrowings of £1,834 million (31 December 2001 £2,181 million) including £1,081 million of long-term loans and £753 million of short-term loans and overdrafts.

At 31 December 2002, the Group had £93 million of cash and short-term investments (31 December 2001 £106 million). The Group's policy is to place any surplus funds on short-term deposit with approved banks and financial institutions. Strict limits governing the maximum exposure to these banks and financial institutions are applied. These limits are co-ordinated across the E.ON Group.

The Group's net borrowing position at 31 December 2002 was therefore £1,741 million, compared to £2,075 million at 31 December 2001. The average interest rate for the year, when compared to average net borrowings, was 6.2 per cent compared with 7.1 per cent in the previous year.

Gearing (net debt as a percentage of net assets plus net debt) was 43 per cent at 31 December 2002 compared with 53 per cent at the end of 2001. The decrease year on year is largely due to the sell down of GPEC (see note 3) to an associated undertaking. The additional borrowing obtained to finance the acquisition of TXU is included within amounts owed to parent undertaking in creditors due within one year (see note 18).

Commodity risk management

As part of its operating activities, the Group engages in asset based energy marketing in the gas, electricity, coal and oil markets. This activity is primarily focused around 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, but also encompasses limited proprietary trading in the UK and some European energy markets.

Directors' report for the year ended 31 December 2002 (continued)

All of the Group's energy trading operations are subject to local and E.ON's risk management policies. These include value and profit at risk, credit limits, segregation of duties and an independent risk reporting system. To achieve its portfolio optimisation the Group uses fixed price bilateral contracts, futures and option contracts traded on commodity exchanges and swaps and options traded in over-the-counter financial markets.

Employees

The 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. In 2003 two representatives elected by Group employees will be joining the E.ON European Works Council, which provides a forum for consultation on major issues affecting E.ON Group companies in Europe.

The Group is committed to offering equal opportunities to both current and prospective employees. The 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 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 in the employment of people with disabilities and to provide work experience placements for disabled people. In the event of existing employees becoming disabled, the 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 the UK growth strategy and ensuring that all staff perform at the highest level.

Directors' report for the year ended 31 December 2002 (continued)

Contributions for political and charitable purposes

Donations to charitable organisations during the financial year by the Company and its subsidiaries amounted to £150,872 (year ended 31 December 2001 £189,399). No political donations were made.

Policy on payment of creditors

Where appropriate in relation to specific contracts, the 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 Group supports the Better Payments Practice Code, and has in place well developed arrangements with a view to ensuring that this is observed in all other cases. Group companies operating overseas are encouraged to adopt equivalent arrangements by applying local best practices. The average number of days taken to pay the Group's trade suppliers calculated in accordance with the requirements of the Companies Act is 29 days (31 December 2001 25 days).

Auditors

Following the conversion of our auditors PricewaterhouseCoopers to a Limited Liability Partnership ('LLP') from 1 January 2003, PricewaterhouseCoopers resigned on 14 March 2003 and the directors appointed its successor, PricewaterhouseCoopers LLP, as auditor. A resolution to re-appoint PricewaterhouseCoopers LLP as auditors to the Company will be proposed at the next annual general meeting.

Introduction of the Euro

The Group recognises the wide implications of the Euro for businesses, including impacts on commercial arrangements and financial systems. Within the UK, the Group's preparations recognise the uncertain position regarding possible UK entry to the single currency, and the situation is monitored closely.

Directors' report for the year ended 31 December 2002 (continued)

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 Group and of the profit or loss of the Group 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 Group 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 Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

By order of the Board

Fiona Stark
Company Secretary
Powergen UK plc
53 New Broad Street
London
EC2M 1SL

28 March 2003

Independent auditors' report to the members of Powergen UK plc

We have audited the financial statements which comprise the profit and loss account, the balance sheet, the statement of total recognised gains and losses, the principal accounting policies and the related notes.

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.

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. This report, including the opinion has been prepared for and only for the Company's members as a body in accordance with Section 235 of the Companies Act 1985 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or in to whose hands it may come save where expressly agreed by our prior consent in writing.

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. The other information comprises only the directors' report.

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.

Independent auditors' report to the members of Powergen UK plc (continued)

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 affairs of the Company and the Group at 31 December 2002 and of the profit of the Group for the year then ended and have been properly prepared in accordance with the Companies Act 1985.

PricewaterhouseCoopers LLP
Chartered Accountants and Registered Auditors
Birmingham
28 March 2003

POWERGEN UK PLC

CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2002

	Note	Year ended 31 December 2002 Before exceptional items £m	Exceptional items (note 3) £m	Total £m	Year ended 31 December 2001 Before exceptional items £m	Exceptional items (note 3) £m	Total £m
Turnover		**4,919**	**-**	**4,919**	4,212	-	4,212
Group's share of associates' and joint ventures' turnover		**(219)**	**-**	**(219)**	(197)	-	(197)
Group turnover	1	**4,700**	**-**	**4,700**	4,015	-	4,015
- continuing activities		**3,948**	**-**	**3,948**	4,015	-	4,015
- acquisitions		**752**	**-**	**752**	-	-	-
Operating costs	2,3	**(4,588)**	**(48)**	**(4,636)**	(3,726)	(129)	(3,855)
Other operating income	2	**111**	**-**	**111**	138	-	138
Group operating profit/(loss)	2	**223**	**(48)**	**175**	427	(129)	298
- continuing activities		**213**	**(48)**	**165**	427	(129)	298
- acquisitions		**10**	**-**	**10**	-	-	-
Group's share of associates' and joint ventures' operating profit	6	**75**	**-**	**75**	50	-	50
Profits less losses on disposal of fixed assets and investments	3	**-**	**-**	**-**	-	79	79
Profits less losses on disposal of businesses (including provisions)	3	**-**	**388**	**388**	-	(34)	(34)
Net interest payable							
– group	5	**(114)**	**-**	**(114)**	(149)	-	(149)
– associates and joint ventures		**(30)**	**-**	**(30)**	(46)	-	(46)
Profit/(Loss) on ordinary activities before taxation	6	**154**	**340**	**494**	**282**	**(84)**	**198**
Tax on profit/(loss)on ordinary activities	7	**(61)**	**84**	**23**	**(70)**	**5**	**(65)**
Profit/(Loss) on ordinary activities after taxation		**93**	**424**	**517**	**212**	**(79)**	**133**
Minority interest	27	**(1)**	**-**	**(1)**	**(3)**	**6**	**3**
Profit/(Loss) attributable to shareholders		**92**	**424**	**516**	**209**	**(73)**	**136**
Dividends	8			**(64)**			**(326)**
Retained profit/(loss) for the year	**25**			**452**			**(190)**

STATEMENT OF GROUP TOTAL RECOGNISED GAINS AND LOSSES
for the year ended 31 December 2002

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Profit attributable to shareholders	**516**	**136**
Revaluation of fixed assets and investments on acquisitions (note 10)	**16**	**-**
Currency translation differences on foreign currency net investments	**(13)**	**(4)**
Total recognised gains for the year	**519**	**132**
Prior year adjustment for the implementation of FRS 19	**-**	**(121)**
Total gains recognised since last annual report	**519**	**11**

CONSOLIDATED PROFIT AND LOSS ACCOUNT
for the year ended 31 December 2002

The accounting policies and the notes on pages 15 to 59 form part of these financial statements.

POWERGEN UK PLC

BALANCE SHEETS
as at 31 December 2002

	Note	The Group 31 December 2002 £m	The Group 31 December 2001 £m	The Company 31 December 2002 £m	The Company 31 December 2001 £m
Fixed assets					
Goodwill	11	**2,808**	1,101	**32**	-
Tangible assets	12	**2,474**	2,651	**990**	1,001
Investments	13	**253**	190	**2,560**	3,649
		5,535	3,942	**3,582**	4,650
Current assets					
Stocks	14	**110**	107	**103**	88
Debtors: amounts falling due after more than one year	15	**17**	53	**3**	46
Debtors: amounts falling due within one year		**2,999**	1,951	**5,312**	1,914
Less: securitisation		**-**	(166)	**-**	(77)
Net debtors falling due within one year	16	**2,999**	1,785	**5,312**	1,837
Cash and short-term deposits		**93**	106	**55**	42
		3,219	2,051	**5,473**	2,013
Creditors: amounts falling due within one year					
Loans and overdrafts	17	**(753)**	(723)	**(803)**	(442)
Trade and other creditors	18	**(3,979)**	(1,361)	**(4,826)**	(2,392)
Net current liabilities		**(1,513)**	(33)	**(156)**	(821)
Total assets less current liabilities		**4,022**	3,909	**3,426**	3,829
Creditors: amounts falling due after more than one year					
Long-term loans	19	**(1,081)**	(1,458)	**(821)**	(1,071)
Other creditors	20	**(156)**	(230)	**(435)**	(550)
Provisions for liabilities and charges	22	**(343)**	(186)	**(82)**	(65)
Deferred tax	23	**(172)**	(191)	**(120)**	(127)
Net assets		**2,270**	1,844	**1,968**	2,016
Capital and reserves					
Called-up share capital	24	**325**	325	**325**	325
Share premium account	25	**97**	97	**97**	97
Capital reserve	25	**474**	474	**474**	474
Revaluation reserve	25	**16**	22	**-**	-
Capital redemption reserve	25	**85**	85	**85**	85
Profit and loss account	25	**1,269**	808	**987**	1,035
Equity shareholders' funds	27	**2,266**	1,811	**1,968**	2,016
Equity minority interests	26	**4**	33	**-**	-
		2,270	1,844	**1,968**	2,016

Approved by the Board on 28 March 2003

Graham Bartlett

The accounting policies and the notes on pages 15 to 59 form part of these financial statements

Principal Accounting Policies

Nature of operations

The Group has two main businesses; UK Operations and Asian Asset Management. The principal business in the UK is the generation, distribution and sale of electricity and the sale of gas. The 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 standards and the Companies Act 1985 except for the accounting policies for commodity instruments (see financial instruments below) and customer contributions (see tangible fixed assets below) and accounting for subsidiaries which were previously accounted for as associated undertakings (see note 10). There have been no changes in accounting policies during the year.

There is no difference between the profit on ordinary activities before taxation and the retained profit 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.

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, profits, and balances 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 13. 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 within the United Kingdom comprises wholesaling of electricity; 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. Turnover excludes Value Added Tax.

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. Estimated useful lives are reviewed periodically. 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:

Asset	*Life in years*
Generating assets	20-45
Distribution and transmission networks	40-60
Other assets	3-40

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 four 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 realised 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.

Principal Accounting Policies (continued)

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. The accounting policy for each instrument is set out below. Interest differentials on derivative instruments are charged to the profit and loss account as interest costs in the period to which they relate.

Accounting for foreign currency transactions is described in the foreign exchange policy 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’ (FRS4) 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.

Forward currency contracts

The Group enters into forward currency contracts for the purchase and/or sale of foreign currencies in order to manage its exposure to fluctuations in currency rates. With the exception of contracts used for translation hedging purposes, 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.

Principal Accounting Policies (continued)

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.

Commodity Instruments

Within the UK, the Group makes use of energy trading derivative financial instruments. These instruments are traded in an established and liquid market place. The Companies Act states that the contracts should be held at the lower of cost or net realisable value. The directors consider that this would not give a true and fair view and consider it appropriate to mark the open derivative positions to market since the marketability of the instruments enables management to decide whether to hold or sell the instruments.

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 assets and liabilities acquired. Purchased goodwill is capitalised in the balance sheet and amortised on a straight-line basis through the profit and loss account over a period in line with the directors' view of its estimated minimum useful economic life.

Goodwill relating to associates and joint ventures is included within 'investments' in the consolidated balance sheet. 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 and any subsequent reversals 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.

Principal Accounting Policies (continued)

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.

Customers' contributions towards distribution network assets are credited to the profit and loss account over the life of the distribution network assets to which they relate. The contributions are deducted from the cost of the fixed assets. This is a departure from the Companies Act 1985 which requires fixed assets to be included at their purchase price or production cost and therefore any contribution to be presented as deferred income. However, it is the opinion of the directors that the treatment adopted is necessary to give a true and fair view as contributions relate directly to the cost of fixed assets used in the distribution network.

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 asset 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.

Cash and short-term deposits

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

Principal Accounting Policies (continued)

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. Full provision is made for such timing differences as required under Financial Reporting Standard 19 'Deferred tax' (FRS 19) on a discounted basis. Such timing differences arise primarily from the differing treatment for taxation and accounting purposes of provisions and depreciation of fixed assets.

Deferred tax liabilities are recognised in respect of all timing differences that have originated but not reversed at the balance sheet date. Deferred tax assets are only recognised to the extent that their recovery is probable.

Pensions

The Group provides pension benefits through both defined benefit and defined contribution schemes. Defined benefit pension scheme 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. Details of these actuarial valuations, including the frequency and methodology, are set out in note 21. 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.

The Group has adopted the transitional provisions of Financial Reporting Standard 17 'Retirement benefits' (FRS 17) in these accounts. In accordance with the transitional arrangements under FRS 17 full implementation of the standard has been deferred. The transitional disclosures are set out in note 21 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 E.ON Group or investees of the E.ON Group.

Cash flow statement

The Company is a wholly owned subsidiary undertaking of E.ON AG, the ultimate parent undertaking of the E.ON Group, and is included in the publicly available consolidated financial statements of E.ON AG. 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 1996).

Notes to the financial statements for the year ended 31 December 2002

1 Turnover

Turnover is analysed as follows:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**2,104**	1,969
Electricity – distribution	**289**	288
Electricity and gas – retail	**2,417**	1,738
Internal charges from distribution to retail	**(125)**	(146)
	4,685	3,849
Asian Asset Management	**15**	166
	4,700	4,015

The Group's share of associates' and joint ventures' turnover is analysed as follows:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations	**99**	84
Asian Asset Management	**120**	113
	219	197

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

2 Operating profit

Operating costs were as follows:

	Continuing Activities £m	**Acquisitions £m**	**Year ended 31 December 2002 £m**	Year ended 31 December 2001 £m
Fuel costs	**349**	**17**	**366**	411
Pool purchases and other costs of sales	**2,652**	**661**	**3,313**	2,528
Staff costs (note 4)	**193**	**10**	**203**	200
Depreciation, including exceptional charges	**167**	**-**	**167**	267
Goodwill amortisation	**68**	**22**	**90**	68
Other operating charges, including restructuring costs	**465**	**32**	**497**	381
Operating costs, after exceptional items	**3,894**	**742**	**4,636**	3,855
Operating costs, before exceptional items	**3,846**	**742**	**4,588**	3,726
Exceptional depreciation charge (note 3)	**-**	**-**	**-**	80
Exceptional operating charges (note 3)	**48**	**-**	**48**	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.

Notes to the financial statements
for the year ended 31 December 2002 (continued)

2 Operating profit (continued)

£72 million of foreign exchange losses were recognised in the profit and loss account (year ended 31 December 2001 £24 million gains).

Operating costs also include:	**Year ended 31 December 2002 £m**	Year ended 31 December 2001 £m
Repairs and maintenance costs	**98**	92
Research and development costs	**2**	3
Operating leases	**17**	13
Loss on disposal of fixed assets	**2**	14
Auditors' remuneration for audit (Company £0.3m, year ended 31 December 2001 £0.3 m)	**0.6**	0.5
Auditors' remuneration for non-audit services	**3.2**	5.5

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 £1 million (year ended 31 December 2001 £33 million) of income from operating leases. It also includes the recognition of £100 million (year ended 31 December 2001 £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 recognised less £nil of associated costs incurred (year ended 31 December 2001 £100 million of deferred income less £1 million of associated costs incurred).

3 Exceptional items

Exceptional items comprise:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Charged against operating profit	**(48)**	(129)
Profits less losses on disposal of fixed assets and investments	**-**	79
Profits less losses on disposal of businesses (including provisions)	**388**	(34)
	340	(84)

3 Exceptional items (continued)

Charged against operating profit

Year ended 31 December 2002

UK Operations and Corporate

Following the acquisition of the Group by E.ON on 1 July 2002 a number of senior directors and employees left the Powergen Group. At the time, certain restructuring initiatives were undertaken. This has resulted in costs being incurred within UK Operations (£32 million) and within the Corporate Centre (£16 million). The UK Operations reorganisation is still ongoing and further costs will arise in 2003 following the TXU acquisition. A tax credit of £9 million arose as a result of these transactions.

Year ended 31 December 2001

UK Operations

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

In the year ended 31 December 2001, a review of the Group's UK CHP plant portfolio was made. The cash flows used in this impairment review were discounted at the Group's cost of capital for CHP Operations. A further impairment provision of £80 million was consequently recorded. A tax credit of £16 million arose 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 Limited. In anticipation of this acquisition, the Company provided for the total cost of advisors' and other fees associated with the successful completion of the transaction, of £27 million. No tax credit arose on these costs.

Profit less losses on disposal of fixed assets and investments

Year ended 31 December 2001

UK Operations

On 8 March 2001, the Group'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 arose on this disposal.

3 Exceptional items (continued)

Asian Asset Management

On 27 February 2001, the Group completed the sale of its Australian interests to a 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 arose on this disposal.

On 27 April 2001, the Group 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 arose on this disposal.

On 11 May 2001, the Group 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 arose on this disposal.

On 7 August 2001, CLP acquired an option for first refusal from the Group to purchase its Indonesian assets, PT Jawa Power, at a future date. The Group received £14 million in non-refundable 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 arose on this item. This option was subsequently terminated during 2002.

Profits less losses on disposal of businesses (including provisions)

Year ended 31 December 2002

Asian Asset Management

On 28 February 2002, the Group completed the sale of its 88 per cent stake in Gujarat Paguthan Energy Corporation Pvt. Limited ('GPEC') to CLP Powergen India Limited (CPIL), a company that is 80 per cent owned by CLP and 20 per cent owned by the Powergen UK Group. Proceeds received were £202 million. Net assets disposed of, together with related disposal costs, were £209 million giving rise to a loss on disposal of £7 million.

On 20 February 2002, the Group acquired the remaining 12 per cent of GPEC it did not previously own and, on 23 October 2002, sold this stake to CPIL. Proceeds received were £21 million and the book value of assets disposed of including provisions were £25 million, giving rise to a loss of £4 million.

3 Exceptional items (continued)

On 8 November 2002, the Group finalised the terms of sale of its investment in CPIL to CLP. The value of the Group's investment has been impaired by £18 million to reflect the value implicit in this agreement. No tax charge arose as a result of this series of transactions.

Corporate

On 13 June 2002, the Group sold a subsidiary undertaking, Powergen Investments Limited, to Powergen Group Investments Limited, the immediate parent undertaking. Consideration received was £1 and net liabilities disposed of were £417 million giving rise to an exceptional profit of £417 million. No tax credit arose as a result of this transaction.

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 arose on this disposal. The sale excluded non half-hourly meters.

Asian Asset Management

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 arose on this disposal.

On 21 December 2001, Powergen finalised the terms of the sale of its 88 per cent stake in GPEC to CPIL as detailed above. During 2002, Powergen purchased the remaining 12 per cent stake in GPEC from the other minority shareholders, and this stake was then sold on to CPIL. During the year ended 31 December 2001, the value of Powergen's investment in GPEC was reduced by £66 million to reflect the value implicit in those sale arrangements. No tax credit arose on this item.

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 arose on these costs.

3 Exceptional items (continued)

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 arose on this disposal.

Tax credit

Year ended 31 December 2002

UK Operations

In addition to the tax charges and credits detailed above, during March 2002 the Group reached agreement with the Inland Revenue with regard to the principles for the valuation of certain power stations for capital gains tax purposes. As a result of this agreement, £75 million of tax previously provided for on the disposal in 1999 of Fiddler's Ferry and Ferrybridge C power stations has been released as an exceptional profit through the tax line in these accounts.

4 Employee information, including directors' remuneration

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

	Year ended 31 December 2002	Year ended 31 December 2001
UK Operations (including Corporate Centre)	**5,959**	5,530
Asian Asset Management	**364**	543
	6,323	6,073

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

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Wages and salaries	**176**	184
Social security costs	**15**	15
Other pension costs (note 21)	**20**	12
	211	211
Capitalised in fixed assets	**(8)**	(11)
Charged in profit and loss account as staff costs	**203**	200

Notes to the financial statements for the year ended 31 December 2002 (continued)

4 Employee information, including directors' remuneration (continued)

The total remuneration of the Company's directors, together with details of the individual remuneration of the highest paid director are as follows:

All directors	Year ended 31 December 2002 £	Year ended 31 December 2001 £
Aggregate emoluments	**1,244,221**	1,834,040
Compensation for loss of office	**6,044,716**	-
	7,288,937	1,834,040

Retirement benefits are accruing to two directors under a defined benefit pension scheme (31 December 2001: three). During the year two (2001:one) directors exercised options over shares they were awarded for services to the Powergen Group.

Highest paid director	Year ended 31 December 2002 £	Year ended 31 December 2001 £
Total emoluments, excluding gains on the exercise of share options and benefits under long-term incentive schemes	**447,258**	682,628
Defined benefit pension scheme:		
- Accrued pension at end of year	**47,980**	367,600

5 Net interest payable – Group

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Investment income	**-**	1
Interest receivable from associates and joint ventures	**6**	4
Interest receivable from fellow group undertakings	**23**	17
Other interest receivable	**13**	4
Total interest receivable and similar items	**42**	26
Interest payable		
Bank loans and overdrafts	**(7)**	(32)
Loans from fellow group undertakings	**(16)**	(2)
Other loans	**(131)**	(137)
Total interest payable and similar items	**(154)**	(171)
Net interest payable before unwinding of discount	**(112)**	(145)
Unwinding of discount in provisions	**(2)**	(4)
	(114)	(149)

Notes to the financial statements for the year ended 31 December 2002 (continued)

6 Profit on ordinary activities before taxation

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations		
Electricity and gas – wholesale and trading	**91**	168
Electricity – distribution	**129**	118
Electricity and gas – retail	**105**	49
Lease and other income and charges	**83**	104
	408	439
Asian Asset Management	**65**	111
Intra-group foreign exchange differences	**(73)**	14
Corporate costs	**(12)**	(19)
Net interest payable – Group	**(114)**	(149)
- Associates and joint ventures	**(30)**	(46)
	244	350
Goodwill amortisation – UK Operations	**(90)**	(68)
Exceptional items (note 3)	**340**	(84)
	494	198

The Group's share of associates' and joint ventures' operating profit can be analysed as follows:

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
UK Operations	**16**	14
Asian Asset Management	**59**	36
	75	50

The net assets of the Group are analysed as follows:

	At 31 December 2002 £m	At 31 December 2001 £m
UK Operations	**3,882**	2,683
Asian Asset Management	**138**	342
Unallocated net liabilities	**(1,750)**	(1,181)
	2,270	1,844

The profits and net assets analysed by geographic destination is not materially different from the analyses by origin shown above.

Notes to the financial statements for the year ended 31 December 2002 (continued)

7 Tax on profit on ordinary activities

	Year ended 31 December 2002 £m	Year ended 31 December 2001 £m
Current tax:		
United Kingdom Corporation tax at 30% (2001:30%)	**18**	48
Under/(Over) provision in prior year	**(86)**	(7)
Overseas taxation	**1**	6
Total current tax (credit)/charge	**(67)**	47
Deferred tax (note 23):		
Origination and reversal of timing differences	**22**	15
Decrease in discount	**11**	-
	33	15
Associates and joint ventures	**11**	3
Tax (credit)/charge on profit on ordinary activities	**(23)**	65

The effective tax rate is expected to increase in future periods as a result of the conclusion of the period covered by the major parts warranty given to the purchaser on the disposal of Fiddler's Ferry and Ferrybridge C power stations in 1999. Part of the proceeds on the disposal was deferred and is recognised in the profit and loss account over the period covered by the warranty. This deferred income was subject to tax when actually received and is therefore not subject to tax when recognised in the profit and loss account. The effective rate of tax will increase in 2004 and subsequent periods as a result of the warranty period coming to an end.

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 2002 £m	Year ended 31 December 2001 £m
Profit on ordinary activities before tax	**494**	198
Tax charge on profit on ordinary activities at 30%	**148**	59
Effects of:		
Prior year adjustment	**(86)**	(7)
Origination and reversal of timing differences	**(9)**	7
Expenses not deductible for tax purposes	**45**	91
Non-taxable income	**(161)**	(87)
Net effect of different rates of tax in overseas businesses	**(4)**	(16)
	(67)	47

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

Notes to the financial statements
for the year ended 31 December 2002 (continued)

8 Dividends

	Pence per ordinary share			
	Year ended 31 December 2002	Year ended 31 December 2001	**Year ended 31 December 2002 £m**	Year ended 31 December 2001 £m
First interim dividend paid	**9.9p**	13.1p	**64**	85
Second interim dividend paid	**-**	9.2p	**-**	60
Third interim dividend paid	**-**	27.9p	**-**	181
	9.9p	50.2p	**64**	326

9 Profit of the Company

The profit attributable to shareholders for the financial year of the Company is £16 million (year ended 31 December 2001 £366 million). The Company is not publishing a separate profit and loss account as permitted by Section 230 of the Companies Act 1985.

10 Acquisitions

On 21 October 2002, the Group acquired the UK retail energy business, certain gas supply contracts, and control of three power stations from TXU Europe Group plc (TXU). Two of the three power stations were already owned by the Company and had been leased to TXU. The third power station was purchased as part of the transaction. The consideration payable totalled £1,627 million in cash, including acquisition costs of £10 million and the repurchase of securitised debtors of £247 million. Net liabilities acquired were £138 million, leading to goodwill arising of £1,765 million. The transaction has been acquisition accounted.

On 18 October 2002, the Group acquired an additional 50 per cent stake in Powergen Renewables Limited (PG Renewables), formally a joint venture with Abbot Group plc. This purchase, which has been acquisition accounted, gave the Group full ownership of PG Renewables and subsequent to this acquisition, PG Renewables has been treated as a subsidiary undertaking by the Group. Cash consideration for the acquisition was £58 million and net assets acquired were £26 million, giving rise to goodwill of £32 million.

10 Acquisitions (continued)

Details of the acquisitions during the year are set out as follows:

	Book value	Revaluation [1]	Other fair value adjustments [2]	Fair value to the Powergen Group
	£m	£m	£m	£m
Net assets acquired:				
TXU				
Tangible fixed assets	13	5	-	18
Stocks	24	(9)	-	15
Deferred taxation	-	56	-	56
Other working capital	237	(245)	(38)	(46)
Provisions	-	(166)	(15)	(181)
	274	(359)	(53)	(138)
PG Renewables				
Tangible fixed assets	59	27	-	86
Investments	4	5	-	9
Other working capital	(17)	-	12	(5)
Net borrowings	(38)	-	-	(38)
	8	32	12	52
Share of net assets acquired (50%)				26
Total net liabilities acquired				(112)
Goodwill				1,797
Consideration, including costs of acquisition				1,685

(1) Revaluation adjustments principally comprise:

- Valuations of certain properties and generation plant at realisable amount.
- Other working capital provisions of £139 million of redundant debtor balances and associated write-off together with £57 million of pension provisions.
- Deferred tax on the above items.
- Provision for an out of the money outsourced retail service contract (£157 million).

(2) Other fair value adjustments principally comprise the release of pre-existing commitments with TXU cancelled as part of the acquisition.

There was no adjustment required in order to align TXU's accounting policies with those of the Group.

Amortisation of goodwill for the two months to 31 December 2002 totalled £22 million and £0.3 million in respect of TXU and PG Renewables respectively. Of the goodwill arising of £1,765 million in respect of the acquisition of TXU, £1,315 million is being amortised over its expected useful life of 20 years. The remaining £450 million which is directly related to the value of the acquired customer base is being amortised over a shorter period of 10 years which represents the directors' view of its expected useful life. The total amount of goodwill in respect of PG Renewables is being amortised over its expected useful life of 20 years.

10 Acquisitions (continued)

Key financial extracts from the unaudited management accounts for the two acquired businesses for the pre-acquisition period are as follows:

	TXU	PG Renewables
	1 January to 21 October 2002 £m	1 January to 18 October 2002 £m
Turnover	2,534	6
Operating profit	344	1
Profit/(Loss) before tax	344	(1)
Taxation	(103)	1
Minority interest	-	-

During the year ended 31 December 2001, TXU had profits after tax of £379 million and PG Renewables had profits of £nil. Neither business had any minority interests.

The figures for TXU for the period from 1 January to 21 October 2002 and for the year ended 31 December 2001 are derived from unaudited management accounts. They contain certain allocated costs from TXU's parent company for central costs and power purchases. These figures were therefore prepared on a different basis from the figures for the period from 21 October to 31 December 2002 when TXU was part of the Group. The tax figures for the pre-acquisition periods reflect the UK statutory tax rate of 30%.

Prior to becoming a subsidiary undertaking, PG Renewables was accounted for as an associated undertaking. In accordance with Financial Reporting Standard 2 'Accounting for Subsidiary Undertakings', and in order to give a true and fair view, purchased goodwill has been calculated as the sum of the goodwill arising on each separate purchase of shares in PG Renewables. Goodwill arising represents the difference at the date of each purchase between the fair value of the consideration given and the fair value of the identifiable assets and liabilities attributable to the interest purchased. This represents a departure from the statutory method, under which goodwill is calculated as the difference between cost and fair value on the date that PG Renewables became a subsidiary undertaking. The statutory method would not give a true and fair view because it would result in the Group's share of PG Renewables' retained reserves, during the period that it was an associated undertaking, being re-characterised as goodwill. The effect of this departure is to create a revaluation reserve of £16 million and to increase purchased goodwill by £16 million, but there was no impact on retained earnings.

10 Acquisitions (continued)

The Company

As part of the TXU acquisition, the Company purchased certain assets and liabilities of the TXU business. The consideration paid by the Company was £3 million and the fair value of liabilities acquired was £29 million leading to goodwill of £32 million which is being amortised over its expected useful economic life of 20 years. The transaction has been acquisition accounted. Details of the acquisition are as follows:

	Book value £m	Revaluation £m	Other fair value adjustments £m	Fair value £m
Net assets acquired:				
Fixed assets	-	3	-	3
Stock	24	(9)	-	15
Other working capital	35	(29)	(38)	(32)
Provisions	-	-	(15)	(15)
	59	(35)	(53)	(29)
Goodwill arising				32
Consideration				3

The revaluations and Other fair value adjustments are consistent with those shown above.

11 Goodwill

The Group

	£m
Cost	
At 31 December 2001	1,380
Sell-down of GPEC to an associated undertaking	(52)
Acquisitions (note 10)	1,797
31 December 2002	**3,125**
Amortisation	
At 31 December 2001	279
Sell-down of GPEC to an associated undertaking	(52)
Charge for the year	90
At 31 December 2002	**317**
Net book value at 31 December 2002	**2,808**
Net book value at 31 December 2001	1,101

Notes to the financial statements
for the year ended 31 December 2002 (continued)

11 Goodwill (continued)

The Company

	£m
Cost	
At 31 December 2001	-
Acquisitions (note 10)	32
31 December 2002	**32**
Amortisation	
At 31 December 2001 and 31 December 2002	-
Net book value at 31 December 2002	**32**
Net book value at 31 December 2001	-

12 Tangible fixed assets

The Group	Generating assets £m	Distribution and transmission networks £m	Other operating and short-term assets £m	Total £m
Cost				
At 31 December 2001	3,290	1,640	664	5,594
Foreign exchange movements	(4)	-	-	(4)
Additions	61	68	34	163
Acquisitions	99	-	18	117
Disposals	(440)	-	(18)	(458)
At 31 December 2002	**3,006**	**1,708**	**698**	**5,412**
Depreciation				
At 31 December 2001	1,979	570	394	2,943
Foreign exchange movement	(1)	-	-	(1)
Charge for the year	74	38	34	146
Acquisitions	13	-	-	13
Disposals	(156)	-	(7)	(163)
At 31 December 2002	**1,909**	**608**	**421**	**2,938**
Net book value at 31 December 2002	**1,097**	**1,100**	**277**	**2,474**
Net book value at 31 December 2001	1,311	1,070	270	2,651

Group assets include freehold land and buildings with a net book value of £126 million (at 31 December 2001 £133 million).

Notes to the financial statements
for the year ended 31 December 2002 (continued)

12 Tangible fixed assets (continued)

The Company	Generating assets £m	Other assets £m	Total £m
Cost			
At 31 December 2001	2,812	126	2,938
Additions	58	8	66
Acquisitions	-	3	3
Disposals	(15)	(3)	(18)
At 31 December 2002	**2,855**	**134**	**2,989**
Depreciation			
At 31 December 2001	1,824	113	1,937
Charge for the year	65	4	69
Disposals	(6)	(1)	(7)
At 31 December 2002	**1,883**	**116**	**1,999**
Net book value at 31 December 2002	**972**	**18**	**990**
Net book value at 31 December 2001	988	13	1,001

Company assets include freehold land and buildings with a net book value of £100 million (year ended 31 December 2001 £104 million).

Notes to the financial statements for the year ended 31 December 2002 (continued)

13 Fixed asset investments

Group	Net assets Joint ventures	Net assets Associates	Loans Joint ventures	Loans Associates	Other investments	**Total**
	£m	£m	£m	£m	£m	**£m**
Net assets excluding goodwill						
At 31 December 2001	39	77	27	15	18	176
Additions	-	42	9	3	15	69
Sell-down of GPEC to an associated undertaking	-	50	-	-	-	50
Reclassification of GPEC to a trade investment	-	(29)	-	-	29	-
Acquisitions	-	9	-	-	-	9
Disposals	-	(45)	(1)	(6)	-	(52)
Impairment	-	(18)	(3)	-	-	(21)
Retained profits	4	28	-	-	-	32
Foreign exchange movements	-	(16)	-	-	-	(16)
At 31 December 2002	**43**	**98**	**32**	**12**	**62**	**247**
Goodwill						
At 31 December 2001	14	-				14
Amortisation	(8)	**-**				(8)
At 31 December 2002	**6**	**-**				**6**
At 31 December 2002 – Net assets and goodwill	**49**	**98**	**32**	**12**	**62**	**253**
At 31 December 2001 – Net assets and goodwill	53	77	27	15	18	190

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

Other investments includes a 20% stake in GPEC and a 18.4% stake in Yallourn. These investments are accounted for as trade investments as the directors consider that the Group does not have significant influence over their operations.

Company	Subsidiary investment Equity	Subsidiary investment Loans	Associate investment Equity	Associate investment Loans	Other Investments	Total
	£m	£m	£m	£m	£m	£m
At 31 December 2001	2,358	1,242	22	27	-	3,649
Additions	46	-	59	15	16	136
Disposals	(87)	(36)	(36)	(2)	-	(161)
Transfer	-	-	(3)	-	3	-
PG Renewables acquisition	70	-	(18)	(5)	-	47
Impairment	-	-	(12)	-	-	(12)
Reclassify as short term assets	-	(1,099)	-	-	-	(1,099)
At 31 December 2002	**2,387**	**107**	**12**	**35**	**19**	**2,560**

Notes to the financial statements for the year ended 31 December 2002 (continued)

13 Fixed asset investments (continued)

The Company holds 49,998 fully paid up £1 redeemable preference shares in it's parent company, Powergen Limited. The preference shares are redeemable at par at the option of Powergen Limited. 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.

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 the Group as a whole.

Name	Class of share capital	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 +	Ordinary shares	100	England and Wales	Distribution of electricity
Powergen International Limited *	Ordinary shares	100	England and Wales	Holding company for international activities
Powergen CHP Limited *	Ordinary and preference shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Cogeneration Limited*	Ordinary shares	100	England and Wales	Sale of energy services involving the construction of combined heat and power (CHP) plant
Powergen Gas Limited *	Ordinary shares	100	England and Wales	Transportation and marketing of gas in the UK
Powergen Retail Limited +	Ordinary shares	100	England and Wales	Supply of electricity and supply, trading and shipping of gas in the UK
Powergen Renewables Holdings Limited *	Ordinary shares	100	England and Wales	Holding company for renewable activities
TXU Europe (AHGD) Limited +	Ordinary and preference shares	100	England and Wales	Sale of gas and electricity

* direct interest + indirect interest

Notes to the financial statements for the year ended 31 December 2002 (continued)

13 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%

* 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

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

	At 31 December 2002		At 31 December 2001	
	Joint ventures £m	**Associates £m**	Joint ventures £m	Associates £m
Share of assets:				
Share of fixed assets	**124**	**360**	103	403
Share of current assets	**21**	**56**	65	46
	145	**416**	168	449
Share of liabilities:				
Amounts falling due within one year	**(8)**	**(24)**	(18)	(20)
Amounts falling due after more than one year	**(88)**	**(294)**	(97)	(352)
	(96)	**(318)**	(115)	(372)
Share of net assets	**49**	**98**	53	77
Turnover	**68**	**151**	79	118
Operating profit	**14**	**61**	13	37

Notes to the financial statements for the year ended 31 December 2002 (continued)

14 Stocks

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
Fuel stocks	**77**	76	**76**	64
Stores	**33**	31	**27**	24
	110	107	**103**	88

15 Debtors: amounts falling due after more than one year

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
Other debtors	**17**	53	**3**	46

16 Debtors: amounts falling due within one year

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
Trade debtors	**1,046**	581	**199**	252
Less: securitisation	**-**	(166)	**-**	(77)
Net trade debtors	**1,046**	415	**199**	175
Other debtors	**80**	130	**59**	118
Prepayments and accrued income	**60**	71	**70**	55
Amounts due from fellow group undertakings	**1,813**	1,169	**4,984**	1,489
	2,999	1,785	**5,312**	1,837

Notes to the financial statements for the year ended 31 December 2002 (continued)

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

During 2001 and 2002 the Group had 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 the Group. The trust issued commercial paper to investors and loaned the proceeds to the Group. Interest was charged on the amounts borrowed under the securitisation programme at a margin above LIBOR, and is payable monthly. The Group was not obliged to support any loss suffered by the trust or the related investors as a result of the securitisation programme. The trust had no right to seek recourse against any other assets, apart from the identified billed and unbilled trade debtors. The Group had 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 Group totalled £300 million, of which £166 million was loaned against billed and unbilled trade debtor balances. The Group retained the responsibility for servicing these trade debtors. The remaining £134 million advanced by the trust was included in loans and overdrafts within creditors due within one year (note 18).

On 2 December 2002 this programme was cancelled and all balances drawn were repaid in full.

17 Loans and overdrafts

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
Bank overdrafts	**12**	17	**62**	80
Commercial paper	**-**	284	**-**	284
7.1% US Dollar Yankee Bond 2002	**-**	281	**-**	-
Intra-Group swaps	**-**	(31)	**-**	-
	-	250	**-**	-
Short term loans from E.ON Group companies	**491**	-	**491**	-
Other short-term loans	**250**	172	**250**	78
	753	723	**803**	442

Notes to the financial statements
for the year ended 31 December 2002 (continued)

17 Loans and overdrafts (continued)

The 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 2002, no amounts were drawn down under this programme (31 December 2001: £284 million). Following the acquisition by E.ON, short-term funding has been provided through inter-company facilities rather than using the external commercial paper programme.

The weighted average interest rate on all short-term loans during the year was 5.6% (year ended 31 December 2001 6.0%).

18 Trade and other creditors falling due within one year

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
Trade creditors	**770**	471	**481**	353
Amounts owed to parent undertaking and fellow subsidiaries	**2,468**	167	**1,968**	340
Amounts owed to subsidiaries	**-**	-	**2,054**	1,301
Corporation tax	**63**	133	**58**	119
Other taxation and social security	**8**	17	**4**	7
Accruals and other creditors	**570**	473	**161**	172
Deferred income	**100**	100	**100**	100
	3,979	1,361	**4,826**	2,392

Accruals and other creditors include accruals for rationalisation and restructuring costs of the Group. The Group is not committed to significant payments under operating or finance leases during the next financial year.

Notes to the financial statements for the year ended 31 December 2002 (continued)

19 Long term loans

	The Group		The Company	
	At 31 December 2002 £m	At 31 December 2001 £m	**At 31 December 2002 £m**	At 31 December 2001 £m
8.875% Sterling Bond 2003	**-**	250	**-**	250
8.5% Sterling Bond 2006	**250**	250	**250**	250
7.45% US Dollar Yankee Bond 2007	**262**	290	**-**	-
Inter-Group swaps	**(5)**	(31)	**-**	-
	257	259	**-**	-
Loan notes 2007	**3**	3	**-**	-
5% Euro Eurobond 2009	**326**	326	**326**	326
6.25% Sterling Eurobond 2024	**245**	245	**245**	245
Bank loans in overseas subsidiaries	**-**	125	**-**	-
	1,081	1,458	**821**	1,071

None of the bonds outstanding at 31 December 2002 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 2002 £m	At 31 December 2001 £m
In one year or less, or on demand	753	723
In more than one year but not more than two years	-	269
In more than two years but not more than five years	510	302
In more than five years	571	887
	1,834	2,181

At 31 December 2002 there were £275 million of undrawn committed borrowing facilities available to the Group, all of which were inter-company facilities which did not contain any material covenant restrictions and expire within 12 months from the balance sheet date. These facilities comprise:

Facility	Total facility £m	Amount undrawn at 31 December 2002 £m	Expiry date	Fees
Powergen UK plc – 360 day committed facility from E.ON AG	400	275	7 July 2003	10bps

Notes to the financial statements
for the year ended 31 December 2002 (continued)

20 Other creditors falling due after more than one year

	The Group		The Company	
	At 31 December 2002	At 31 December 2001	**At 31 December 2002**	At 31 December 2001
	£m	£m	**£m**	£m
Accruals and other creditors	**116**	90	**76**	91
Deferred income	**40**	140	**40**	140
Amounts due to subsidiary undertakings	**-**	-	**319**	319
	156	230	**435**	550

21 Pension scheme arrangements

At 31 December 2002, Powergen had both statutorily approved defined benefit pension schemes and several smaller statutorily approved defined contribution schemes.

Powergen participates in the UK industry-wide scheme, the Electricity Supply Pension Scheme (ESPS), for the majority of its UK based employees. This is a funded scheme of the defined benefit type, with assets invested in separate trustee administered funds. The Group has three separate funds with the ESPS, the Powergen UK plc fund, the East Midlands Electricity plc fund and since the acquisition of TXU during the year, the TXU fund. 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 was at 31 March 2001. Particulars of this actuarial valuation are shown below. The 2001 valuation revealed surpluses of £237 million in respect of the Powergen fund, £116 million in respect of the East Midlands Electricity fund and £56 million in respect of the TXU fund. Details of the market value of assets implicit in these valuations, and the major assumptions used in the preparation of these actuarial valuations were:

Notes to the financial statements for the year ended 31 December 2002 (continued)

21 Pension scheme arrangements (continued)

	At 31 March 2001		
	Powergen UK fund	East Midlands Electricity fund	TXU fund
Market value of assets*	£1,604m	£954m	£1,074m
Funding level	117%	114%	106%
– average nominal rate of return on investments (pre-retirement)	6.3%	6.3%	6.6%
– average nominal rate of return on investments (post-retirement)	5.3%	5.3%	5.6%
– average nominal rate of annual increase in salaries	3.8%	3.8%	3.3%
– average nominal rate of annual increase in pensions	2.5%	2.5%	2.5%
Inflation rate	2.3%	2.3%	2.3%
Method of valuation used	Projected unit	Projected unit	Projected unit

* Assets are taken at a smoothed asset valuation for SSAP 24 purposes. The smoothed value of assets at 31 March 2001 was 102%, 100% and 101% of the market value of the assets for the Powergen UK, East Midlands Electricity, and TXU funds respectively.

The funding policy differs from the accounting policy in that it uses a more conservative basis for valuation.

Pension costs for the Group

In the financial year ended 31 December 2002, the normal pension cost for the Group amounted to £20 million (year ended 31 December 2001 £12 million). Surpluses and deficits are spread as a fixed percentage of total pensionable salaries over the average remaining service lives of members.

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 additional disclosure requirements.

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. The disclosures required which are designed to illustrate the entries which would have been made if the measurement principles of FRS 17 has been applied, are set out below.

Notes to the financial statements
for the year ended 31 December 2002 (continued)

21 Pension scheme arrangements (continued)

In calculating these disclosures, the figures shown for liabilities have been measured by updating valuations which were performed at 31 March 2001 and various dates between 31 March 2001 and 31 December 2002. The updates were performed by an independent, professionally qualified actuary.

The major assumptions used in these calculations of liabilities were:

	31 December 2002	31 December 2001
Average nominal rate of annual increase in salaries	3.75%	4.00%
Average nominal rate of annual increase in pensions	2.25%	2.50%
Discount rate	5.75%	5.50%
Inflation rate	2.25%	2.50%

The fair market value of the assets of the main defined benefit schemes were:

	31 December 2002	31 December 2001
Bonds and gilts	**865**	424
Equities	**1,563**	1,831
Other	**221**	158
Total market value of assets	**2,649**	2,413
Present value of scheme liabilities	**(3,151)**	(2,285)
(Deficit)/Surplus in the scheme	**(502)**	128
Related deferred tax asset/(liability)	**81**	(38)
Net pension (liability)/asset	**(421)**	90

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

	UK Funds 31 December 2002 %	UK Funds 31 December 2001 %
Bonds and gilts	**5.20**	5.00
Equities	**8.25**	7.00
Other	**4.00**	4.00

Notes to the financial statements
for the year ended 31 December 2002 (continued)

21 Pension scheme arrangements (continued)

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

	31 December 2002 £m	31 December 2001 £m
Net assets excluding SSAP 24 asset	**2,329**	1,888
Pension and other post-retirement benefit liability under FRS 17	**(421)**	90
Net assets including pension and other post-retirement benefit liability under FRS 17	**1,908**	1,978
Profit and loss reserve excluding SSAP 24 pension asset	**1,328**	852
Pension liability under FRS 17	**(421)**	90
Profit and loss reserve including pension liability under FRS 17	**907**	942

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's profit and loss account:

	£m
Operating profit	
Current service cost	18
Past service cost	48
Total operating charge	**66**
Other finance income	
Expected return on pension scheme assets	163
Interest on pension scheme liabilities	(131)
Net return	**32**

If FRS 17 had been adopted in the financial statements, the following would have been included in the Group's STRGL:

	Year ended 31 December 2002
Actual return less expected return on pension scheme assets	(539)
Experience losses arising on the scheme liabilities	(66)
Gains resulting from changes in assumptions underlying the present value of the scheme liabilities	178
Actuarial loss recognised in the STRGL	**(427)**

21 Pension scheme arrangements (continued)

The movement from a surplus to a deficit in the year is analysed as follows:

	£m
Surplus at the beginning of the year	128
Fair value on the acquisition of TXU	(188)
Current service cost	(18)
Employer contributions	19
Past service costs	(48)
Other finance income	32
Actuarial loss recognised in the STRGL	(427)
Deficit in the schemes at the end of the year	**(502)**

The details of experience gains and losses under FRS 17 for the year ended 31 December 2002 are as follows:

Differences between the expected and actual return on scheme assets:	
Amount	£(539)m
Percentage of scheme assets at year end	(20)%
Experience gains and losses of scheme liabilities:	
Amount	£(66)m
Percentage of the present value of the scheme liabilities at the year end	(2)%
Total amount recognised in the statement of total recognised gains and losses:	
Amount	£(427)m
Percentage of the present value of the scheme liabilities at the year end	(14)%

Notes to the financial statements
for the year ended 31 December 2002 (continued)

22 Provisions for liabilities and charges

Movements on provisions comprise:

The Group	31 December 2001 £m	Charged to profit and loss account £m	Acquisitions £m	Amortisation of discount £m	Provisions utilised £m	**31 December 2002 £m**
Liability and damage claims	10	1	-	-	-	**11**
Contract provisions	122	-	157	-	(27)	**252**
Decommissioning	54	-	24	2	-	**80**
	186	1	181	2	(27)	**343**

At 31 December 2002, the provisions in the Company's accounts were as follows:

The Company	31 December 2001 £m	Acquisitions £m	Amortisation of discount £m	**31 December 2002 £m**
Liability and damage claims	11	-	-	**11**
Decommissioning	54	15	2	**71**
	65	15	2	**82**

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 include two items. The first of these relates to out of money electricity purchase contracts, which were acquired on the purchase of East Midlands Electricity and will be utilised over the period to 2008, when the contracts terminate. The second contract provision was acquired with the purchase of TXU on 21 October 2002 and relates to an out of money outsourced retail service contract arrangement. This provision will be utilised over the period to 2005 when the contract becomes due for renewal.

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.

23 Deferred tax

An analysis of the full provision and discounted provision for deferred tax recognised at 31 December 2002 is as follows:

The Group	**At 31 December 2002 £m**	At 31 December 2001 £m
Accelerated capital allowances	**424**	420
Other timing differences	**(122)**	(88)
Undiscounted provision for deferred tax	**302**	332
Discount	**(130)**	(141)
Discounted provision for deferred tax	**172**	191
Provision at start of year	**191**	176
Acquisitions	**(52)**	-
Deferred tax charge for year (note 7)	**33**	15
Provision at end of year	**172**	191

The Company	**At 31 December 2002 £m**	At 31 December 2001 £m
Accelerated capital allowances	**213**	236
Other timing differences	**(41)**	(45)
Undiscounted provision for deferred tax	**172**	191
Discount	**(52)**	(64)
Discounted provision for deferred tax	**120**	127

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

24 Share capital

The share capital of the Company comprises:

Authorised	At 31 December 2002 £m	At 31 December 2001 £m
Nil (31 December 2001: 1,000) 'A' ordinary shares of 50p each	**-**	-
Nil (31 December 2001: 1,049,999,002) 'B' ordinary shares of 50p each	**-**	525
1,050,000,002 (31 December 2001: nil) ordinary shares of 50p each	**525**	-
	525	525
Allotted, called-up and fully paid		
Nil (31 December 2001: 1,000) 'A' ordinary shares of 50p each	**-**	-
Nil (31 December 2001: 649,240,799) 'B' ordinary shares of 50p each	**-**	325
649,241,799 (31 December 2001: nil) ordinary shares of 50p each	**325**	-
	325	325

On 25 November 2002, the 1,000 'A' ordinary shares and the 1,049,999,002 'B' ordinary shares were converted and redesignated as ordinary shares of 50 pence each. Prior to the conversion, the two classes of ordinary share capital carried the same rights except that the 'A' shares carried all of the voting rights.

25 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 2001	97	474	22	85	808
Currency translation differences on foreign currency net investments	-	-	-	-	(13)
Transfer on sell-down of GPEC to associate	-	-	(22)	-	22
Acquisitions (note 10)	-	-	16	-	-
Retained profit for the year	-	-	-	-	452
At 31 December 2002	**97**	**474**	**16**	**85**	**1,269**

Notes to the financial statements
for the year ended 31 December 2002 (continued)

25 Reserves (continued)

The Company	Share premium account £m	Special capital reserve £m	Capital redemption reserve £m	Profit and loss account £m
At 31 December 2001	97	474	85	1,035
Loss for year	-	-	-	(48)
At 31 December 2002	**97**	**474**	**85**	**987**

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.

26 Equity minority interests

The Group	**31 December 2002 £m**	31 December 2001 £m
Opening equity minority interests	**33**	36
Acquisition of GPEC minorities	**(34)**	-
Partial sale of subsidiaries (see below)	**4**	-
Profit and loss account – pre-exceptional	**1**	3
Profit and loss account – exceptional	**-**	(6)
Closing equity minority interests	**4**	33

On 14 May 2002 , the Company sold 4,000,000 £1 preference shares issued by Ergon Properties Limited (EPL), a subsidiary undertaking, to Ergon Insurance Limited, a fellow group undertaking. Proceeds received were £41,000,000. On 27 June 2002, EPL paid a special dividend on these shares of £37,178,300 which left the value of these shares at the par value of £4,000,000, as shown above.

Notes to the financial statements
for the year ended 31 December 2002 (continued)

27 Reconciliation of movements in shareholders' funds

	31 December 2002 £m	31 December 2001 £m
Profit for the financial year	**516**	136
Dividends	**(64)**	(326)
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	**(13)**	(4)
Revaluation reserve arising on acquisition (note 10)	**16**	-
Net increase/(reduction) in shareholders' funds for the year	**455**	(179)
Opening shareholders' funds	**1,811**	1,990
Closing shareholders' funds	**2,266**	1,811

28 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.

Notes to the financial statements for the year ended 31 December 2002 (continued)

28 Financial instruments (continued)

Foreign exchange risk management

The 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 Directors' Report. The net Sterling notional amounts of each foreign currency the Group has contracted to purchase (or sell) are as follows:

	At 31 December 2002 £m	At 31 December 2001 £m
US Dollars	**(17)**	7
Euros	**-**	1
Australian dollars	**(17)**	(17)
	(34)	(9)

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

	At 31 December 2002 £m	At 31 December 2001 £m
Euros	**-**	1
Indian rupees	**(22)**	(34)
	(22)	(33)

The weighted average time to maturity of foreign exchange contracts is two months (31 December 2001 two months).

The notional amounts of foreign currency swaps are as follows:

	At 31 December 2002 £m	At 31 December 2001 £m
Foreign currency swaps into Sterling	**580**	826

Notes to the financial statements
for the year ended 31 December 2002 (continued)

28 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 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 notional amounts of these instruments used can be summarised as follows:

	At 31 December 2002 £m	At 31 December 2001 £m
Interest rate swap contracts	**603**	749

The weighted average time to maturity of interest rate swap contracts is 4.1 years. (31 December 2001 4.1 years)

Interest rate risk profile of financial liabilities

			Fixed rate financial liabilities		
	Total £m	Floating rate financial liabilities £m	£m	Weighted average interest rate %	Weighted average period for which rate is fixed Years
At 31 December 2002					
Sterling	**1,834**	**1,095**	**739**	**8.3**	**7.0**
At 31 December 2001					
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.

28 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 Sterling LIBOR.

In addition to the above, the Group's provisions include £252 million (31 December 2001 £122 million) for contract provisions (see note 22) 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 2002, the Group held £89 million (31 December 2001 £36 million) of financial assets in the form of Sterling bank deposits, £1 million (31 December 2001 £3 million) in US Dollar deposits, and £3 million (31 December 2001 £67 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

Translation hedging instruments are recorded at fair value in these accounts. The fair value of all other 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 2002 £m	31 December 2001 £m
Foreign currency contracts	**(4)**	(2)
Foreign currency swaps	**9**	34
Interest rate swaps	**26**	10

Notes to the financial statements for the year ended 31 December 2002 (continued)

28 Financial instruments (continued)

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

	Note	31 December 2002 Carrying amount £m	31 December 2002 Fair value £m	31 December 2001 Carrying amount £m	31 December 2001 Fair Value £m
Assets					
Cash and short-term deposits	1	93	93	106	106
Investments	2	62	62	18	18
Liabilities					
Short-term debt	3,5	(753)	(753)	(723)	(723)
Long term debt	4,5	(1,081)	(1,171)	(1,458)	(1,481)

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.

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 2001	77	(35)	42
(Gains)/Losses on hedges arising in previous periods that were recognised during the year	(37)	2	(35)
Gains/(Losses) on hedges arising before 31 December 2001 that were not recognised during the year	40	(33)	7
Gains/(Losses) on hedges arising during 2002 that were not recognised during the year	(2)	26	24
Unrecognised gains/(losses) on hedges at 31 December 2002	**38**	**(7)**	**31**
Of which:			
Gains/(Losses) expected to be recognised in 2003	6	(4)	2
Gains/(Losses) expected to be recognised in 2004 or later	32	(3)	29

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

29 Commitments and contingent liabilities

a) At 31 December 2002, the Group had commitments contracted but not provided of £45 million (31 December 2001 £107 million) for capital expenditure.

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) 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 2002 the Group's future commitments for the supply of coal under all its contractual arrangements totalled £313 million (at 31 December 2001 £429 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 2002 the estimated minimum commitment for the supply of gas under all these contracts totalled £3,270 million (at 31 December 2001 £2,898 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.

30 Ultimate holding company

The immediate parent undertaking is Powergen Group Investments Limited. The ultimate parent undertaking and controlling party is E.ON AG, which is the parent company of the largest group to consolidate these financial statements. The smallest group to consolidate these financial statements is that of which Powergen Limited 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:

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