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

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

42 EXPLANATION OF TRANSITION TO IFRSs

As stated in note 1, these are the Group's first consolidated financial statements prepared in accordance with Adopted IFRSs.

The accounting policies set out in note 1 have been applied in preparing the consolidated financial statements for the year ended 31 December 2005, the comparative information presented in these consolidated financial statements for the year ended 31 December 2004 and in preparation of an opening IFRS balance sheet at 1 January 2004 (the Group's date of transition).

In preparing its opening IFRS balance sheet, the Group has adjusted amounts reported previously in consolidated financial statements prepared in accordance with its old basis of accounting (UK GAAP). An explanation of how the transition from UK GAAP to IFRSs has affected the Group's financial position and financial performance is set out in the following tables and the notes that accompany the tables.

The transition to IFRS has no impact on the cash flows of the Group.

Implementation of IAS 32 and IAS 39

The Group has taken the exemption from the requirement to restate comparative information for IAS 32 (Financial Instruments: Disclosure and Presentation) and IAS 39 (Financial Instruments: Recognition and Measurement) in accordance with IFRS 1 (First-time Adoption of International Financial Reporting Standards).

The Group has continued to apply UK GAAP in respect of financial instruments for the comparative period presented. If IAS 32 and IAS 39 had been adopted, the market value of derivative financial instruments would have been recognised on the face of the balance sheet with the movements accounted for through the income statement or hedging reserve as appropriate.

IAS 32 and IAS 39 have been implemented with effect from 1 January 2005.

	1 January 2004			31 December 2004		
	UK GAAP £m	Effect of transition to Adopted IFRSs £m	Adopted IFRSs excluding IAS 32 and IAS 39 £m	UK GAAP as restated £m	Effect of transition to Adopted IFRSs £m	Adopted IFRSs excluding IAS 32 and IAS 39 £m
Non-current assets						
Goodwill	1	6	7	2	195	197
Other intangible assets	–	–	–	9	–	9
Property, plant and equipment	2,048	–	2,048	3,545	(3)	3,542
Investments in joint ventures and associates	441	–	441	1,167	2	1,169
Other investments	95	–	95	86	–	86
Finance lease receivables	–	–	–	484	–	484
Other long-term receivables	3	–	3	101	–	101
Deferred tax assets	–	–	–	–	79	79
Total non-current assets	2,588	6	2,594	5,394	273	5,667
Current assets						
Inventories	65	–	65	91	–	91
Trade and other receivables	157	–	157	227	–	227
Finance lease receivables	–	–	–	11	–	11
Assets held for trading	47	–	47	47	–	47
Cash and cash equivalents	696	–	696	565	–	565
Total current assets	965	–	965	941	–	941
Total assets	3,553	6	3,559	6,335	273	6,608
Current liabilities						
Loans and bonds	531	–	531	100	–	100
Trade and other payables	229	–	229	398	(36)	362
Current tax liabilities	86	–	86	83	–	83
Total current liabilities	846	–	846	581	(36)	545
Non-current liabilities						
Loans and bonds	904	–	904	3,257	–	3,257
Trade and other payables	5	–	5	170	–	170
Retirement benefit obligations	–	15	15	15	14	29
Provisions	33	–	33	35	–	35
Deferred tax liabilities	205	26	231	215	299	514
Total non-current liabilities	1,147	41	1,188	3,692	313	4,005
Total liabilities	1,993	41	2,034	4,273	277	4,550
Net assets	1,560	(35)	1,525	2,062	(4)	2,058
Equity						
Share capital	554	–	554	737	–	737
Share premium reserve	289	–	289	392	–	392
Capital redemption reserve	145	–	145	145	–	145
Capital reserve	422	–	422	422	–	422
Hedging and translation reserves	–	–	–	–	(39)	(39)
Retained earnings	111	(35)	76	129	47	176
Total equity attributable to equity holders of the parent	1,521	(35)	1,486	1,825	8	1,833
Minority interests	39	–	39	237	(12)	225
Total equity	1,560	(35)	1,525	2,062	(4)	2,058

	31 December 2004		1 January 2005
	Adopted IFRSs excluding IAS 32 and IAS 39 £m	Effect of IAS 32 and IAS 39 adjustment £m	Adopted IFRSs including IAS 32 and IAS 39 £m
Non-current assets			
Goodwill	197	–	197
Other intangible assets	9	(9)	–
Property, plant and equipment	3,542	–	3,542
Investments in joint ventures and associates	1,169	(9)	1,160
Other investments	86	–	86
Finance lease receivables	484	–	484
Other long-term receivables	101	–	101
Deferred tax assets	79	2	81
Total non-current assets	5,667	(16)	5,651
Current assets			
Inventories	91	–	91
Trade and other receivables	227	(3)	224
Finance lease receivables	11	–	11
Derivative financial instruments	–	91	91
Assets held for trading	47	–	47
Cash and cash equivalents	565	–	565
Total current assets	941	88	1,029
Total assets	6,608	72	6,680
Current liabilities			
Loans and bonds	100	–	100
Derivative financial instruments	–	78	78
Trade and other payables	362	–	362
Current tax liabilities	83	–	83
Total current liabilities	545	78	623
Non-current liabilities			
Loans and bonds	3,257	(44)	3,213
Derivative financial instruments	–	221	221
Trade and other payables	170	(147)	23
Retirement benefit obligations	29	–	29
Provisions	35	–	35
Deferred tax liabilities	514	(1)	513
Total non-current liabilities	4,005	29	4,034
Total liabilities	4,550	107	4,657
Net assets	2,058	(35)	2,023
Equity			
Share capital	737	–	737
Share premium reserve	392	–	392
Capital redemption reserve	145	–	145
Capital reserve	422	–	422
Hedging and translation reserve	(39)	(12)	(51)
Retained earnings	176	(20)	156
Total equity attributable to equity holders of the parent	1,833	(32)	1,801
Minority interests	225	(3)	222
Total equity	2,058	(35)	2,023

The impact of deferred tax on the adjustments described above is set out in note 19.

42 EXPLANATION OF TRANSITION TO IFRSs continued

a) IAS 12 (Income Tax)

Deferred tax is recognised on the difference between the tax and book values of an asset or liability that existed at the date of acquisition in a business combination.

The tax charge in the income statement is affected by the inclusion of the share of joint ventures' and associates' tax charge in the Group's profit from operations.

b) IAS 19 (Employee Benefits)

The pension schemes' surpluses and deficits were recognised in full at 1 January 2004, with a corresponding adjustment to reserves. The corridor method is applied in recognising future actuarial gains and losses. These will be recognised in the income statement to the extent they exceed the greater of 10% of the gross assets or gross liabilities of the schemes. The amount recognised in the following year is the excess amortised over the remaining average service lives of the employees in the schemes.

c) IFRS 2 (Share-based Payments)

A charge is made for both employee share ownership plans (ESOPs) and other share-based schemes based on actuarial valuations of the fair value of the option or scheme at the time of grant or inception.

d) IAS 10 (Events after the Balance Sheet Date)

Dividends are not accrued until they are approved at the Annual General Meeting.

e) IAS 36 (Impairment of Assets)

Positive goodwill is not subject to amortisation but is evaluated annually for impairment or whenever changes in circumstances indicate that goodwill might be impaired. Negative goodwill arising on future acquisitions will be recognised directly in the income statement.

f) IAS 32 and IAS 39 (Financial Instruments)

Financial assets and financial liabilities are recognised on the Group's balance sheet when the Group becomes a party to the contractual provisions of the instrument.

Financial liabilities and equity instruments
Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements into which the Group has entered. An equity instrument is any contract that evidences a residual interest in the assets of the Group after deducting all of its liabilities.

Other investments
Other investments are classified as either held for trading or available for sale, and are measured at subsequent reporting dates at fair value. Where quoted market prices in an active market are not available, and where fair value cannot be reliably measured, unquoted equity instruments are measured at cost. Where securities are held for trading purposes, gains and losses arising from changes in fair value are included in net income for the year.

Available for sale investments are initially recorded at cost and then remeasured at subsequent reporting dates to fair value. Unrealised gains and losses on available for sale investments are recognised directly in equity. However, impairment losses, foreign exchange gains and losses and interest calculated using the effective interest method are recognised in the income statement. On disposal or impairment of the investments, the gains and losses in equity are recycled into the income statement.

Convertible bonds
Split accounting is applied to the convertible debt, whereby the debt component is separated from any equity component or embedded derivative. The resulting discounted value of debt is accreted to the redemption value at maturity, increasing the annual interest charge. An equity component of a convertible bond is held in equity and not revalued unless and until the bond is converted. Any embedded derivative would be marked to market through the income statement at reporting year ends.

There is no impact on the results for 2004 as IAS 32 and IAS 39 are implemented prospectively with no restatement to comparatives. The embedded derivative option was closed out in January 2005 and no future mark to market adjustment is required as the bond is now considered a debt instrument with an equity component only.

Derivative financial instruments and hedge accounting
All qualifying derivatives are recognised at fair value on the balance sheet. Gains and losses on derivatives that do not meet the hedge accounting criteria are recognised in the income statement. Gains and losses on derivatives that qualify for cash flow hedge accounting are initially recognised as a separate component of equity (to the extent that the hedge is effective) and subsequently recycled to the income statement as the hedged item impacts earnings. Any ineffective element of these hedges is immediately recognised in the income statement.

There is no impact on the results for 2004 as IAS 32 and IAS 39 are implemented prospectively with no restatement to comparatives.

i) The effect of the transition to IFRS on retained earnings

	1 January 2004 £m	31 December 2004 £m
Goodwill	6	8
Share-based payments	2	5
Employee benefits	(11)	(10)
Events after balance sheet date	–	37
Deferred tax	(31)	(42)
Other	(1)	(2)
Total adjustment to retained earnings	(35)	(4)
Attributable to:		
Minority interests	–	(12)
Equity holders of the parent	(35)	8

j) Reconciliation of the income statement for 2004

	UK GAAP £m	Effect of transition to IFRSs £m	IFRSs excluding IAS 32 and IAS 39 £m
Revenue: group and share of joint ventures and associates	1,267	–	1,267
Less: share of joint ventures' revenue	(144)	–	(144)
Less: share of associates' revenue	(355)	–	(355)
Group revenue	768	–	768
Cost of sales	(637)	–	(637)
Gross profit	131	–	131
Other operating income	56	–	56
Other operating expenses	(66)	(1)	(67)
Share of results of joint ventures and associates	111	2	113
Profit from operations	232	1	233
Disposal of investments	4	–	4
Finance income	30	–	30
Finance costs	(138)	–	(138)
Net financing costs	(108)	–	(108)
Profit before tax	128	1	129
Income tax expense	(28)	3	(25)
Profit for the year	100	4	104
Attributable to:			
Minority interests	6	–	6
Equity holders of the parent	94	4	98
Earnings per share:			
Basic	7.2p		7.5p
Diluted	7.1p		7.4p

The UK GAAP numbers have been re-presented using an IFRS format.