

# Corporate governance

## PRINCIPLES OF GOOD GOVERNANCE

International Power is committed to high standards of corporate governance. In line with the Rules of the UK Listing Authority, the following report explains how the Group has applied the 'Principles of Good Governance' and Code of Best Practice contained in the Combined Code and reports the Group's compliance with the provisions contained in the Code.

## The Board

The Board met on seven occasions during the year. A balance between Executive and Non-Executive Directors underpinned the effectiveness of the Company's Board.

In addition to the Chairman, the Board currently consists of two Executive Directors and four Non-Executive Directors. For 2002 the Board consisted of the Chairman, three Executive Directors and three Non-Executive Directors.

Three Non-Executive Directors (Tony Isaac, Jack Taylor and Adri Baan) are considered to be independent. Peter Giller is not deemed to be independent owing to his previous role as Chief Executive Officer of the Company.

In accordance with the Combined Code and the Company's Articles of Association, all Directors submit themselves for re-election at least every three years and newly appointed Directors are subject to election by shareholders at the first opportunity after their appointment. Newly appointed Directors receive comprehensive briefing, and training where appropriate, on the Company and their roles, to ensure that they are fully conversant with their responsibilities.

The Board has responsibility for defining strategy, ensuring the successful implementation of approved projects/proposals and for the financial

policies of the Group. It maintains a schedule of all matters requiring specific Board approval. Throughout 2002 this included all strategy decisions and significant capital investment proposals.

The Board receives information on capital expenditure projects and investment proposals in advance of Board meetings, as well as management reports on the operational and financial performance of the business. Financial performance is monitored on a monthly basis and the overall performance of the Group is reviewed against approved budgets.

All of the Directors have access to the advice and services of the Company Secretary and to independent advice should they so wish.

The Company has established the following committees: the Audit Committee, the Remuneration and Appointments Committee and the Risk Committee.

**The Audit Committee** (comprising the Chairman and all independent Non-Executive Directors) is responsible for selecting and fixing the remuneration of the external auditors. The Committee also ensures policies and procedures are in place to ensure the external auditors remain independent. In addition to reviewing the Group's accounts, results announcements, risk management and accounting policies, the Committee monitors the effectiveness

Left: Bellingham, US

Right: Milford, US



of internal control systems for the Board. The Committee monitors the work of the internal audit function and its progress against the Group's annual internal audit plan, and also reviews reports from the external auditors. The Audit Committee meets at least three times a year. The Chairman of the Audit Committee is Tony Isaac. He is a fellow of the Chartered Institute of Management Accountants and, before becoming Chief Executive of The BOC Group plc, was its group finance director.

### **The Remuneration and Appointments Committee**

(comprising the Chairman and all independent Non-Executive Directors) was responsible throughout 2002, on behalf of the Board, for monitoring the performance of the Executive Directors of the Company against targets and making recommendations to the Board on remuneration, appointments and matters of management succession. Dennis Hendrix was Chairman of the Committee until his retirement as a Director on 23 May 2002, at which time Sir Neville Simms chaired the Committee until Adri Baan succeeded him in 2003. The Remuneration and Appointments Committee met six times during the year.

From January 2003, separate Remuneration and Appointments Committees, comprising all independent Non-Executive Directors and the Chairman, have been established and are chaired by Adri Baan and Sir Neville Simms respectively.

**The Risk Committee** (comprising the Chief Executive Officer, the Chief Financial Officer and senior managers) has responsibility, on behalf of the Board, for monitoring the effectiveness of the Group's risk management arrangements. The Committee is also responsible for monitoring health, safety and environmental performance in the Group, although a separate management committee is being established to oversee these issues. The Chairman of the Risk Committee is Philip Cox.

### **Relations with shareholders**

The Board is accountable to shareholders for the performance and activities of the Group.

International Power ensures that its Annual General Meeting (AGM) provides shareholders with an opportunity to receive comprehensive information on all aspects of the Group's business activities, and to question senior management about business issues and prospects.

All proxy votes are counted and the level of proxy votes lodged for each resolution is reported at the AGM. In line with best practice, the Company aims to ensure that the Notice of the AGM and the Annual Report are sent to shareholders at least 20 working days before the AGM.

International Power also runs, within the terms of the regulatory framework, frequent contact programmes with institutional investors, to discuss matters of strategy and financial performance. All results presentations and all Stock Exchange announcements are available to shareholders on the Company's website, [www.ipplc.com](http://www.ipplc.com), in the investor relations section.

### **Accountability and audit**

The Board is mindful of its responsibility to present a balanced and understandable assessment of International Power's financial position and prospects, in all reports, both to investors and regulatory authorities. *The Annual Report*, interim and quarterly results are the principal means of achieving this objective.

An explanation of the respective responsibilities of the Directors and auditors in connection with the financial statements is set out on page 49. The Directors set out on page 48 the basis for their view that the Group is a going concern.

During 2002 the Board carried out a review of its performance. This review will take place on an annual basis.

### **Internal control**

The Board has responsibility for the Group's system of internal control and for monitoring and reviewing its effectiveness.

Systems are in place to meet the requirements of the Combined Code and the Turnbull Guidance.

Any system of internal control is designed to manage, rather than eliminate, the risk of failure to achieve business objectives. The system can only provide reasonable, and not absolute, assurance against material financial misstatement or loss. The principal features of the Group's systems of internal control are:

#### **Control environment**

The Board encourages a culture of integrity and openness. The Company has an organisational structure with clear lines of accountability and authority across its worldwide operations, supported by appropriate reporting procedures. Each of the regional businesses is accountable to the Chief Executive and is managed within the strategic guidelines and delegated authorities adopted by the Board.

#### **Control procedures**

Control procedures have been established in each of the Company's operations to safeguard the Group's assets from loss or misuse and to ensure appropriate authorisation and recording of financial transactions. Risk management procedures are in place for the Company's operations, including its energy marketing and trading activities, which are overseen by the Global Risk Manager. The Group treasury function operates under defined policies and the Treasury Committee, chaired by the Chief Financial Officer, monitors its activities. All acquisition and investment decisions are subject to disciplined investment appraisal processes.

### Performance reporting and information

**Corporate plan** Executive management submits an annual corporate plan to the Board for approval. The plan for each business unit is the quantified assessment of its planned operating and financial performance for the next financial year, together with strategic reviews for the following four years. Group management review the plans with each operational team. The individual plans are based on key economic and financial assumptions and incorporate an assessment of the risks and sensitivities underlying the projections.

**Performance monitoring** Monthly performance and financial reports are produced for each business unit, with comparisons to budget. Reports are consolidated for overall review by executive management, together with forecasts for the profit and loss account and cash flow. Detailed reports are presented to the Board on a regular basis.

**Performance review** Each business unit is subject to a performance review with group management regularly during the year. Actual results are compared to budget and to financial forecasts. Key operational and financial results are reviewed together with the risk profile and business environment of the reporting unit.

**Investment projects** These are subject to formal review and authorisation procedures with designated levels of authority, including a review by an investment appraisal committee comprising the Executive Directors and senior managers. Major projects are subject to Board review and approval.

### Risk identification and management

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

As part of the annual business planning process, the key risks associated with achievement of principal objectives are identified and their impact quantified. During the year, significant changes in the risk profile are highlighted through the business performance reports. The principal risks are reviewed by the Risk Committee, which provides reports to the Board and the Audit Committee.

### Energy marketing and trading

The principal objective of the Group's energy marketing and trading operations is to maximise the return from selling the physical output of its plants.

For each of the businesses that operate in merchant energy markets, local risk committees have been established to oversee the management of the market, operational and credit risks arising from the marketing and trading activities. These committees are chaired by the Global Risk Manager and comprise Executive Directors and senior managers.

The Group hedges its physical generating capacity by selling forward its electrical output, and purchasing its fuel input, as and when commercially appropriate and

within approved control limits. This is accomplished through a range of physical offtake and supply arrangements. Our limited proprietary trading operations use a range of financial and physical products.

Energy market risk on our asset and proprietary portfolios is measured using value at risk and other methodologies. Value at risk provides a fair estimate of the net losses or gains which could be recognised on our portfolios over a certain period and given a certain probability; it does not provide an indication of actual results. It is routinely checked for accuracy against actual movements in the portfolio value. In addition to using value at risk measures, we perform scenario analyses to estimate the economic impact of sudden market movements on the value of our portfolios. This supplements the value at risk methodology and captures additional market risks.

### Monitoring

The Board reviews the effectiveness of established internal controls through the Audit Committee, which receives reports from management, the Risk Committee, the Group's internal audit function and the external auditors on the systems of internal control and risk management arrangements.

Internal audit reviews the effectiveness of internal controls and risk management through a work programme which is based on the Company's objectives and risk profile and is agreed with the Audit Committee. Findings are reported to operational and executive management, with periodic reporting to the Audit Committee.

Left: Deeside Education Centre, UK  
Right: Malakoff, Malaysia



Business unit managers provide annual self-certification statements of compliance with procedures. These statements give assurance that controls are in operation and confirm that programmes are in place to address any weaknesses in internal control. The certification process embraces all areas of material risk. Internal Audit reviews the statements and reports any significant issues to the Audit Committee.

### Compliance with the Combined Code

On 1 October 2000 Peter Giller became Chief Executive Officer on a fixed three-year service contract. This contract was terminated on 31 December 2002. During the period of Peter Giller's service as Chief Executive Officer, the Board considered that the service contract was appropriate given the stage of the Company's development and Peter Giller's experience and knowledge of the market in which the Group operates. His remuneration was paid entirely in shares as described in the remuneration report.

On 1 January 2003, Peter Giller became Deputy Chairman and a Non-Executive Director. This contract can be terminated by the Company on or after 31 December 2003. On termination Peter Giller is entitled to enter into a two-year consultancy

contract with the Company. The Board considers that this arrangement is appropriate as it ensures Peter Giller's experience and knowledge are still available to the Company.

In all other respects, the Company has complied with the provisions of the Combined Code throughout the period of the review.

### Future developments

We have reviewed the reports from Derek Higgs on the role and effectiveness of Non-Executive Directors and from the Financial Reporting Council led by Sir Robert Smith on audit committees, both of which were published recently and after our year end. We believe that our present governance arrangements meet many of the recommendations of the reports and most of the exceptions simply require the inclusion of further information within our *Annual Report* or would require small changes to achieve compliance.

The compositions and roles of our Board committees meet the requirements of the Higgs and Smith reports in most respects, although the Chairman currently leads the Appointments Committee and all Non-Executive Directors are members of each of the committees. The Higgs Report recommends that the Appointments

Committee should be chaired by an independent Non-Executive Director and that no one Non-Executive Director should sit on all three principal Board committees. The Higgs Report, however, recognises that practical considerations mean that compliance with certain recommendations may take time to achieve.

The recommendations of the Higgs Report are expected to be incorporated in the Combined Code and we will make the necessary disclosures in our next *Annual Report*.



Left: Hartwell, US

Right: Hazelwood, Australia