

Northern Gas Networks Limited

Annual Report and accounts
for the year ended 31 March 2016

Registered number: 05167070

Strategic report

For the year ended 31 March 2016

The directors present their Annual Report on the affairs of the company, together with the accounts and auditor's report, for the year ended 31 March 2016, and prior period being the 15 months ended 31 March 2015.

This is the first time the accounts are presented under Financial Reporting Standard 102 (FRS 102) which has meant restatement of our prior year figures. Details of the transition to FRS 102 are shown in note 22.

Review of the business

The company's purpose is to provide safe and secure gas supplies to the people and the businesses within the distribution network, being the North and North East of England. The company's vision of success is to be consistently benchmarked by the regulators, Ofgem and the Health and Safety Executive ("HSE") as being in the top two comparable utilities in safety management, efficiency and customer service, which in turn will generate value to the shareholders of the company.

Finance and operational review

Operating profit for the year is £199.6m compared to the prior period of £264.6m as a result of the difference in time period. On a comparable basis revenue has increased based on Ofgem allowances and costs have increased mainly due to depreciation.

The company has debt before financing costs of £1,255.4m (2015 - £1,220.2m) at the period end. This comprises:

- bank loans of £12.0m (2015 - £5.0m) which carry interest at LIBOR plus a margin of 0.4%;
- an intercompany loan of £198.2m (2015 - £198.2m) which carries interest at 5.875% and is repayable in 2019;
- an intercompany loan of £197.0m (2015 - £197.0m) which carries interest at 5.625% and is repayable in 2040;
- an intercompany loan of £505.0m (2015 - £505.0m) which carries interest at 4.875%, with £250.0m repayable in 2027 and £255.0m in 2035;
- loans of £303.2m (2015 - £275.0m) carrying interest at 3 month LIBOR plus a margin which varies by facility as detailed in note 14 to the accounts, £25.0m of which is repayable in 2023, £185.0m in 2024, £30.0m in 2027, £30.0m in 2028 and £33.2m in 2034; and
- a loan of £40.0m (2015 - £40.0m) which carries interest of 3.446% and is repayable in 2024.

This debt structure has given rise to finance charges of £49.9m in the year (2015 15 month period - £66.2m).

The tax credit for the year was £0.1m (2015 15 month period - £42.9m charge) which represents an effective tax rate of 0.0% (2015 15 month period - 21.6%). The effective tax rate is low in the year due to the impact of the adjustment of the deferred tax liability to reflect the changes in UK corporation tax rates from 20% to 18%.

Capital expenditure ("Capex") for the year was £154.6m (2015 period - £185.9m) principally focused on investment in network assets and new IT systems used to support many of the company's operational business activities.

The company has net assets of £554.8m at 31 March 2016 (2015 - £485.9m).

Strategic report (continued)

Key performance indicators (KPIs)

The key financial and non-financial performance indicators used by the Board of Directors in their monitoring of the company, focus on the areas of safety management, efficiency and customer service. Key financial and non-financial performance indicators include:

	Year ended 31 March 2016	15 months ended 31 March 2015
Financial performance (efficiency)		
Operating profit	£199.6m	£264.6m
Dividends paid	£80.0m	£76.6m
Senior net debt/Regulatory asset value	64.9%	64.3%
Customer services		
Quarterly customer satisfaction survey for repair, replacement and connections	9 out of 10**	9 out of 10**
Safety management		
Number of lost time injuries to employees and contractors	2	1
Reported injuries to members of the general public	1	0

**For the regulatory years ended 31 March 2016 and 31 March 2015.

All of the targets for the above KPI's have been achieved.

Environment

The company recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements and higher standards where possible. The company is committed to the protection of the environment in the region it serves. The company's environmental management systems are certified under ISO 14001 and OHSAS 18001. This helps the directors deal proactively with future environmental issues and legislation and assist in the development of environmentally beneficial projects.

Principal risks and uncertainties

The company's principal risks and uncertainties are set out below.

Regulatory environment, revenue and costs

The gas industry is subject to extensive legal and regulatory obligations and controls which Northern Gas Networks Limited ("NGN"), as the licensed entity, must comply with. The application and possible changes of these laws, regulations and regulatory standards could have an adverse effect on the operations and financial position of the group or in the case of misreporting, a potential fine.

Mitigation

NGN engages with the regulatory authority extensively at all levels of seniority to understand future plans and potential impacts on the business. The business respond to all potential changes which impact on the business and

Strategic report (continued)

seek to mitigate any adverse impacts. The business has in place an extensive set of policies and procedures to ensure compliance with legal and regulatory obligations.

Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or a member of the general public. Any such incident could have an adverse effect on the reputation of the company, or lead to potential prosecution or reduced productivity.

Mitigation

Health and Safety is our priority. The business has an Environment Health & Safety team that ensure compliance with our management safety system and monitor it on a monthly basis with key KPIs.

Network performance

If the network assets were to fail it could result in a loss in supply of gas to customers and associated adverse publicity and an unexpected increase in costs.

Mitigation

The company have a set of policies and procedures we adhere to ensure the integrity of the network and ensure that the people who work on the network are qualified and competent.

Employees

The success of the company depends to a significant extent on the contribution of its employees and the employees of operational contractors. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business. The ability to adapt in a climate of change is dependent on the appointment and retention of a high calibre, competent, flexible, quality conscious and customer focused workforce all of whom are committed to business success and are given appropriate training.

Mitigation

NGN's succession planning strategies mean that development of existing staff is crucial. Effective resourcing and selection processes also play a positive role in improving the image of the group in the community it serves.

The company, as an equal opportunities employer, ensures that no job applicant receives less favourable treatment because of his or her age, colour, disability, ethnic or national origin, gender, marital status or sexuality or is disadvantaged by conditions or requirements which are irrelevant to performance and the company's needs.

Financial risk management objectives and policies

The company's financial instruments, other than derivatives, comprise borrowings, cash, overdrafts and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the company's operations.

Strategic report (continued)

The company also enters into derivative transactions, principally interest rate swaps. The purpose of such transactions is to manage the interest rate risks arising from the company's sources of finance.

The main risks arising from the company's financial instruments are interest rate risk, currency risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

The long term approach adopted in minimising interest rate exposures on debt is as follows:

- To have a balanced debt portfolio comprising a mixture of nominal and index-linked debt aiming to achieve a degree of symmetry with the Regulator's broad approach to setting cost of debt allowances and so as to maintain a debt portfolio consistent with those of comparable utility companies; and
- To structure debt maturities and interest rate hedges in such a way as to provide protection against adverse movements in the indexed regulatory cost of debt allowance.

Currency risk

No exposures are currently identified. Regular monitoring procedures will identify material risks as they arise. Currency risk management is only used to hedge underlying commercial exposures. Therefore trading in currency is prohibited and if an underlying exposure ceases to exist then the corresponding hedge is closed out immediately.

Any non-sterling borrowings and associated service costs are hedged into sterling at the time the commitment to draw down is made.

Liquidity risk

The maturities of all debt and committed debt facilities other than amortising loans, are managed such that at any one time all have a time to maturity of more than one year and that at least 50% by value have a time to maturity of more than two years. Debt and facility maturities are staggered to avoid excessive concentrations in any twelve month period as well as the period around regulatory reset dates where possible.

Future prospects

The directors expect the future prospects of the company to be consistent with performance shown within this Annual Report and accounts.

By order of the Board,

M J Horsley, Director

19 July 2016

Directors' report

For the year ended 31 March 2016

The directors present their annual report on the affairs of the company, together with the accounts and auditor's report for the year ended 31 March 2016. The following disclosures have been disclosed in the strategic report but are cross referenced here: business review including KPI's, principles risks and uncertainties, and future prospects.

Directors

The directors, who served throughout the period and subsequently except as noted, were as follows:

A Hunter	(Chairman)
M J Horsley	(Chief Executive Officer)
H L Kam	
C T Wan	
N McGee	
S Leong	
D Macrae	
L S Chan	
C C Tsai	
P Rogerson	(independent non-executive)
J Burnham	(independent non-executive)

The Board of Directors

The daily operations of the business are managed by a Senior Management Team ("SMT") and the Chief Executive Officer ("CEO"). All significant decisions are referred to the Board of Directors ("the Board").

The Board meets at least five times a year. The number of Board meetings held during the year and attendees (including alternates) at the Board meetings are detailed below:

Year ended 31 March 2016		15 months ended 31 March 2015	
Date	Attendees	Date	Attendees
28 April 2015	11 out of 11	21 January 2014	5 out of 9
4 August 2015	10 out of 11	25 March 2014	9 out of 9
27 October 2015	10 out of 11	20 May 2014	9 out of 11
3 November 2015	11 out of 11	25 July 2014	7 out of 11
26 January 2016	11 out of 11	5 August 2014	11 out of 11
26 April 2016	8 out of 11	23 September 2014	10 out of 11
		21 November 2014	11 out of 11
		27 January 2015	11 out of 11

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT. The Board is ultimately responsible for the system of internal controls and for the review of their overall effectiveness.

Directors' report (continued)

Dividends

The directors do not recommend payment of a final dividend. Interim dividends of £0.64 per share were paid on 19 June 2015 and of £2.65 per share were paid on 21 December 2015 making a total of £3.29 per share for the year (2015 15 month – £3.15).

Future developments and events

From 1 April 2013, the price control commenced, which gives NGN security over regulated revenue until 31 March 2021. The directors therefore expect the general level of activity to remain stable.

Financial instruments

Financial instruments have been disclosed within note 15 and associated risks discussed within the Strategic Reports.

Going concern

The company's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out above. In addition note 15 to the accounts includes further details of the company's net debt position and details of its derivatives and other financial instruments. The company is able to pay its liabilities as they fall due despite the net current asset position of the balance sheet at 31 March 2016, due to the reliability of regulated revenue under RIIO-GD1.

The directors have made enquiries and reviewed the forecasts, including sensitivity analysis, and in light of the facilities available, have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and accounts.

Disabled employees

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of employees becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of all other employees.

Employee consultation

The company places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the company. This is achieved through both formal and informal meetings. Employees are consulted regularly on a wide range of matters affecting their current and future interests. Some employees are eligible to receive an annual bonus related to the overall financial and operational performance of the company.

Directors' report (continued)

Auditor

Each of the directors at the date of approval of this report confirms that:

- so far as the director is aware, there is no relevant audit information of which the company's auditor is unaware; and
- the director has taken all the steps that he/she ought to have taken as a director to make himself/herself aware of any relevant audit information and to establish that the company's auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006.

Deloitte LLP have indicated their willingness to be reappointed for another term and appropriate arrangements have been put in place for them to be deemed reappointed as auditor.

Approval of reduced disclosure

The company, as a qualifying entity, has taken advantage, in respect of its separate financial statements, of the disclosure exemptions in FRS 102 paragraph 1.12. The company's shareholders have been notified in writing about the intention to take advantage of the disclosure exemption and no objections have been received.

The company also intends to take advantage of these exemptions in the financial statements to be issued in the following year. Objections may be served on the company by shareholders holding in aggregate 5% or more of the allocated shares in the company. They should be served no later than 31 December 2016.

Approved by the Board and signed on its behalf by:

1100 Century Way
Thorpe Park Business Park
Colton
Leeds
LS15 8TU
United Kingdom

By order of the Board,

M J Horsley

Director

19 July 2016

Directors' responsibilities statement

The directors are responsible for preparing the Annual Report and accounts in accordance with applicable law and regulations.

Company law requires the directors to prepare accounts for each financial period. Under that law the directors have elected to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law) including FRS 102, "The Financial Reporting standard applicable in the UK and Republic of Ireland". Under company law the directors must not approve the accounts unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these accounts, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and accounting estimates that are reasonable and prudent;
- state whether applicable UK Accounting Standards have been followed; and
- prepare the accounts on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the accounts comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditor's report

To the Members of Northern Gas Networks Limited

We have audited the accounts of Northern Gas Networks Limited for the year ended 31 March 2016 which comprise the profit and loss account, the statement of comprehensive income, the balance sheet, the statement of changes in equity, the statement of accounting policies and the related notes 1 to 22. The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards ("United Kingdom Generally Accepted Accounting Practice") including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland.

This report is made solely to the company's members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' responsibilities statement, the directors are responsible for the preparation of the accounts and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the accounts in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the accounts

An audit involves obtaining evidence about the amounts and disclosures in the accounts sufficient to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the company's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the directors; and the overall presentation of the accounts. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited accounts and to identify any information that is apparently materially incorrect based on or materially inconsistent with the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on accounts

In our opinion the accounts:

- give a true and fair view of the state of the company's affairs as at 31 March 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Independent auditor's report (continued)

Opinion on other matters prescribed by the Companies Act 2006

In our opinion the information given in the Strategic report and the Directors' report for the financial period for which the accounts are prepared is consistent with the accounts.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the accounts are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

Scott Bayne FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP
Chartered Accountants and Statutory Auditor
Leeds, United Kingdom

19 July 2016

Profit and loss account

For the year ended 31 March 2016

	Notes	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Turnover	1	415,761	511,346
Cost of sales		(13,396)	(19,655)
Gross profit		402,365	491,691
Other operating expenses	2	(202,727)	(227,127)
Operating profit		199,638	264,564
Finance charges (net)	3	(49,857)	(66,183)
Profit on ordinary activities before taxation	4	149,781	198,381
Tax on profit on ordinary activities	7	132	(42,937)
Profit for the financial year/period		149,913	155,444

The above results arise from continuing operations.

Profit for the year is all attributable to the equity shareholders of the company.

The accompanying notes are an integral part of this profit and loss account.

Statement of comprehensive income

For the year ended 31 March 2016

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Profit for the financial year/period	149,913	155,444
Re-measurement of net defined benefit liability	2,900	(20,146)
Cash flow hedges – losses arising during the year/period	(4,644)	(13,078)
Tax relating to components of other comprehensive income	753	8,737
Total recognised gains and losses relating to the year/period	148,922	130,957

Profit for the year is all attributable to the equity shareholders of the company.

The accompanying notes are an integral part of this statement of comprehensive income.

Balance sheet

As at 31 March 2016

	Notes	31 March 2016 £'000	31 March 2015 £'000
Fixed assets			
Intangible assets	9	119,917	124,028
Tangible fixed assets	10	2,249,825	2,157,528
Investments	11	2,209	2,209
		<u>2,371,951</u>	<u>2,283,765</u>
Current assets			
Debtors – amounts falling due within one year	12	53,937	51,720
amounts falling due after one year	12	324,915	313,520
Cash at bank and in hand		5,008	8,561
		<u>383,860</u>	<u>373,801</u>
Creditors: Amounts falling due within one year	13	<u>(143,627)</u>	<u>(122,224)</u>
Net current assets		<u>240,233</u>	<u>251,577</u>
Total assets less current liabilities		2,612,184	2,535,342
Creditors: Amounts falling due after more than one year	14	(1,712,874)	(1,659,179)
Provisions for liabilities	16	<u>(344,527)</u>	<u>(390,302)</u>
Net assets		<u>554,783</u>	<u>485,861</u>
Capital and reserves			
Called-up share capital	17	24,328	24,328
Hedging reserve		(30,136)	(26,482)
Profit and loss account		<u>560,591</u>	<u>488,015</u>
Shareholders' funds		<u>554,783</u>	<u>485,861</u>

The accompanying notes are an integral part of this balance sheet.

The accounts of Northern Gas Networks Limited, Registered number 05167070, were approved by the Board of Directors and authorised for issue on 19 July 2016 and signed on its behalf by:

M J Horsley

Director

19 July 2016

Statement of changes in equity

For the year ended 31 March 2016

	Called up share capital £'000	Hedging reserve £'000	Profit and loss account £'000	Total £'000
At 31 December 2013 as previously stated	-	-	60,015	60,015
Changes on transition to FRS 102 (see note 22)	-	(18,112)	365,273	347,161
At 1 January 2014 as restated	-	(18,112)	425,288	407,176
Release of group loan	24,328	-	-	24,328
Profit for the financial period	-	-	155,444	155,444
Remeasurement of net defined benefit liability	-	-	(16,117)	(16,117)
Net change in fair value of cash flow hedge transferred to the income statement	-	1,448	-	1,448
Net movement on cash flow hedges	-	(9,818)	-	(9,818)
Total comprehensive income, and share capital movement	24,328	(8,370)	139,327	155,285
Dividends paid on equity shares	-	-	(76,600)	(76,600)
At 31 March 2015 as restated	24,328	(26,482)	488,015	485,861
Profit for the financial year	-	-	149,913	149,913
Remeasurement of net defined benefit liability	-	-	2,663	2,663
Net change in fair value of cash flow hedge transferred to the income statement	-	1,159	-	1,159
Net movement on cash flow hedge	-	(4,813)	-	(4,813)
Total comprehensive income	-	(3,654)	152,576	148,922
Dividends paid on equity shares	-	-	(80,000)	(80,000)
At 31 March 2016	24,328	(30,136)	560,591	554,783

Statement of accounting policies

For the year ended 31 March 2016

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding period, subject to the changes following adoption of FRS 102 as detailed in note 22.

Basis of accounting

The accounts have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council. The prior year accounts were restated for material adjustments on adoption of FRS 102 in the current year. For more information see note 22.

The company is not required to prepare group accounts or a cash flow statement as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited (NGNH) which prepares consolidated accounts which are publicly available. The functional currency is considered to be pounds sterling because that is the currency of the primary economic environment in which the group operates. The financial statements are also presented in pound sterling.

Going concern

The Directors' report includes a note stating that the directors consider the business to be a going concern at the time of the approval of the Annual Report and accounts.

Intangible assets – goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment.

Intangible assets – licence

The Gas Transporter Licence (licence) has been recognised as a separately identifiable intangible asset, the value of which has been derived from an independent valuation. The licence has been capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes internal labour costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic lives of the assets. No residual value is estimated for assets. Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Statement of accounting policies (continued)

Tangible fixed assets (continued)

Gas mains & services	55 to 65 years
Gas storage	40 years
Plant & machinery	10 to 30 years
Freehold buildings	50 years
Leasehold land and buildings	Lesser of lease period and 50 years
Motor vehicles and office equipment	3 to 10 years
Replacement expenditure	60 years

Investments

Fixed asset investments are shown at cost less any provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

Stocks

Stocks are stated at the lower of cost and net realisable value. Provision is made for obsolete or defective items where appropriate.

Replacement expenditure (repex)

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing sections of pipe. This expenditure is principally undertaken to maintain the safety of the network and is capitalised following adoption of FRS 102 on 1 April 2015. Prior to adoption of FRS 102 this activity was expensed.

Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the UK tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the accounts. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Statement of accounting policies (continued)

Taxation (continued)

Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference. Deferred tax is measured on a non-discounted basis.

Decommissioning and environmental costs

Decommissioning and environmental costs, based on discounted future estimated expenditures, are provided for in full and where appropriate a corresponding tangible fixed asset is also recognised. The unwinding of the discount is included within the profit and loss account as a financing charge.

Turnover

Turnover represents income receivable for the distribution of gas and provision of other services in the normal course of business, net of Value Added Tax. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end. Turnover is recognised in the month the service is provided.

Pension costs

The company has obligations for a defined benefit scheme. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments which are included within operating costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total comprehensive income.

The defined benefit scheme is funded with the assets of the scheme held separately from those of the company, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the consolidated balance sheet. The company also operates defined contribution schemes. The amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the period. Differences between contributions payable in the period and contributions actually paid are shown as either accruals or prepayments in the balance sheet.

Leases

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful economic lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful economic lives.

Statement of accounting policies (continued)

Leases (continued)

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Financial instruments

Financial assets and financial liabilities are recognised when the company becomes a party to the contractual provisions of the instrument. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

Financial assets and liabilities

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value (which is normally the transaction price excluding transaction costs), unless the arrangement constitutes a financing transaction. If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Financial assets and liabilities are only offset in the statement of financial position when, and only when there exists a legally enforceable right to set off the recognised amounts and the company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Statement of accounting policies (continued)

Financial instruments (continued)

Debt instruments which meet the following conditions are subsequently measured at amortised cost using the effective interest method:

- a) The contractual return to the holder is (i) a fixed amount; (ii) a positive fixed rate or a positive variable rate; or (iii) a combination of a positive or a negative fixed rate and a positive variable rate.
- b) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged.
- c) The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that (i) the new rate satisfies condition (a) and the variation is not contingent on future events other than (1) a change of a contractual variable rate; (2) to protect the holder against credit deterioration of the issuer; (3) changes in levies applied by a central bank or arising from changes in relevant taxation or law; or (ii) the new rate is a market rate of interest and satisfies condition (a).
- d) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods.
- e) Contractual provisions that permit the issuer to prepay a debt instrument or permit the holder to put it back to the issuer before maturity are not contingent on future events, other than to protect the holder against the credit deterioration of the issuer or a change in control of the issuer, or to protect the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.
- f) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c).

Debt instruments that are classified as payable or receivable within one year on initial recognition and which meet the above conditions are measured at the undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

With the exception of some hedging instruments, other debt instruments not meeting these conditions are measured at fair value through profit or loss.

Commitments to make and receive loans which meet the conditions mentioned above are measured at cost (which may be nil) less impairment.

Statement of accounting policies (continued)

Financial instruments (continued)

Financial assets are derecognised when and only when a) the contractual rights to the cash flows from the financial asset expire or are settled, b) the company transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or c) the company, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party.

Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

Derivative financial instruments

The company only holds or issues derivative financial instruments to manage interest rate exposures or commodity price risks in respect of expected gas usage. The principal derivatives used are interest rate swaps. The company does not hold or issue any derivative financial instruments for speculative purposes.

Interest rate swaps are entered into for the purpose of matching or eliminating risk from potential movements in interest rates associated with the borrowing requirements of the company. The interest rate swaps are accounted for at fair value on the balance sheet with movements in fair value being recognised through either the profit and loss account or cash flow hedge reserve.

Fair value accounting

The best evidence of fair value is a quoted price for an identical asset in an active market. When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the market is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is estimated by using a valuation technique.

Hedge accounting

The company designates certain derivatives as hedging instruments in cash flow hedges. At the inception of the hedge relationship, the entity documents the economic relationship between the hedging instrument and the hedged item, along with its risk management objectives and clear identification of the risk in the hedged item that is being hedged by the hedging instrument. Furthermore, at the inception of the hedge the Company determines and documents causes for hedge ineffectiveness.

Amounts payable or receivable in respect of the interest rate swaps are recognised within net interest payable in the profit and loss account over the life of the financial instrument.

Statement of accounting policies (continued)

Critical accounting judgments and key sources of estimation uncertainty

Investments

The directors consider the value of the company investment to be supported by the value of future cash flows received and net assets of the investment.

Provisions

The valuation of provisions includes estimation of future cash outflows, the estimates and associated assumptions are based on historical experience and various factors that are believed to be reasonable under the circumstances, the results of which form the basis of making the judgements about the carrying values of liabilities that are not readily available. The estimates and underlying assumptions are reviewed on an ongoing basis and discussed in further details in note 16.

Fair value of financial instruments

Some of the group's assets and liabilities are measured at fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the group uses market-observable data to the extent it is available. Information about the valuation technique is disclosed in note 15.

Pension arrangements

Note 19 contains information about the principle actuarial assumptions used in the determination of defined benefit pension obligations. These key assumptions include discount rates, the expected return on net assets, inflation and mortality rates and have been determined following advice received from an independent qualified actuary.

Taxation

Liabilities recognised are determined by reference to the likelihood of settlement to be made wto tax authorities and tax assets represent the best estimate of recoverable amounts based on forecasts.

Accrued income

Revenue is billed in the month following the distribution of gas and provision for other services, an estimation of the month's revenue is calculated based using market-observable data and volumes. The estimation and underlying assumptions are reviewed on an ongoing basis and historical accuracy is tracked.

Notes to the accounts

For the year ended 31 March 2016

1 Turnover

The directors consider that the company has only one class of business. The company's turnover is generated wholly from within the UK.

2 Other operating expenses

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Distribution costs	167,002	191,243
Administrative expenses	35,725	35,884
	<u>202,727</u>	<u>227,127</u>

3 Finance charges (net)

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Interest payable and similar charges	45,731	55,421
Less: investment income	(515)	(485)
Other finance charges	4,641	11,247
	<u>49,857</u>	<u>66,183</u>

Interest payable and similar charges

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Bank loans and overdrafts	(1,519)	(4,081)
Intercompany interest payable	48,631	60,572
	<u>47,112</u>	<u>56,491</u>
Finance costs capitalised	(1,381)	(1,070)
	<u>45,731</u>	<u>55,421</u>

Finance costs have been capitalised based on a capitalisation rate of 3.79% (2015 15 month period – 3.69%).

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Investment income

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Income from fixed asset investments	(453)	(420)
Interest receivable and similar income	(62)	(65)
	<u>(515)</u>	<u>(485)</u>

Other finance charges (income)

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Fair value movement on financial investments	4,076	11,823
Exchange rate differences	10	(30)
Unwinding of discount on provisions (see note 16)	158	2,476
Net return on pension scheme (see note 19)	397	(3,022)
	<u>4,641</u>	<u>11,247</u>

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging (crediting):

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Depreciation and amounts written off tangible fixed assets (see note 10)		
- owned	64,785	64,339
- held under finance leases and hire purchase contracts	7	6
Amortisation of intangible fixed assets included in administrative expenses (note 9)	4,111	5,139
Profit on disposal of fixed assets	(553)	(1,501)
Operating lease rentals - other	43	45
Fees payable to the company's auditor for the audit of the company's annual accounts	70	68
	<u>70</u>	<u>68</u>

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated accounts of the parent company are required to disclose such fees on a consolidated basis.

Notes to the accounts (continued)

5 Staff costs

The average monthly number of employees (including executive directors) was:

	Year ended 31 March 2016 Number	15 months ended 31 March 2015 Number
Administration	125	103

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Wages and salaries	8,815	8,619
Social security costs	900	892
Other pension costs	9,994	571
	<u>19,709</u>	<u>10,082</u>

Their aggregate remuneration comprised:

Wages and salaries	8,815	8,619
Social security costs	900	892
Other pension costs	9,994	571
	<u>19,709</u>	<u>10,082</u>

Other pension costs include only those included within other operating expenses. Items reported elsewhere are excluded.

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	Non-Executive Directors		Executive Directors	
	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Emoluments	70	70	769	901
Amounts receivable (other than shares) under long-term incentive schemes	-	-	197	267
	<u>70</u>	<u>70</u>	<u>966</u>	<u>1,168</u>

The remuneration of non-executive directors as shown above relates to the independent non-executive directors that are required pursuant to the company's Public Gas Transportation Licence.

Notes to the accounts (continued)

Pensions

No directors were members of pension schemes in either the current year or prior period.

6 Directors' remuneration and transactions (continued)

Highest paid director

The above amounts for remuneration include the following in respect of the highest paid director:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Emoluments	<u>966</u>	<u>1,168</u>

Transactions

There have been no transactions with directors in the year (2015 15 month period – £nil) other than as set out above in respect of remuneration.

7 Tax on profit on ordinary activities

The tax charge comprises:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Current tax		
UK corporation tax	37,519	24,146
Adjustments in respect of prior periods	1,284	(593)
Total current tax	<u>38,803</u>	<u>23,553</u>
Deferred tax		
Current period - origination and reversal of timing differences	(6,816)	17,001
Adjustments in respect of prior periods	305	2,383
Effects of decrease in tax rate on opening liability	(32,424)	-
Total deferred tax	<u>(38,935)</u>	<u>19,384</u>
Total tax on profit on ordinary activities	<u>(132)</u>	<u>42,937</u>

Notes to the accounts (continued)

7 Tax on profit on ordinary activities (continued)

The differences between the total tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Profit on ordinary activities before tax	149,781	198,381
Tax on profit on ordinary activities at standard UK corporation tax rate of 20.0% (2015 15 month period – 21.4%)	29,956	42,454
Effects of:		
Expenses not deductible for tax purposes	1,084	928
Income not taxable in determining taxable profit	(1,046)	(691)
Differences in tax rates	(31,715)	(1,544)
Adjustments in respect of prior year	1,589	1,790
Total tax charge for the period	(132)	42,937

The company earns its profits in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 20.0% (2015 15 month period – 21.4%).

The company's planned level of capital investment is expected to remain at similar levels as current investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years, at a similar level to the current period.

Notes to the accounts (continued)

8 Dividends on equity shares

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Equity shares		
- interim dividend paid of £0.64 (2015 - £0.75) per ordinary share	15,500	18,250
- interim dividend paid of £2.65 (2015 - £2.40) per ordinary share	64,500	58,350
	<u>80,000</u>	<u>76,600</u>

9 Intangible assets

	Licence £'000	Goodwill £'000	Total £'000
Cost			
At 31 March 2015 and 31 March 2016	<u>161,200</u>	<u>3,257</u>	<u>164,457</u>
Amortisation			
At 1 April 2015	39,628	801	40,429
Charge for the year	4,030	81	4,111
At 31 March 2016	<u>43,658</u>	<u>882</u>	<u>44,540</u>
Net book value			
At 31 March 2016	<u>117,542</u>	<u>2,375</u>	<u>119,917</u>
At 31 March 2015	<u>121,572</u>	<u>2,456</u>	<u>124,028</u>

Notes to the accounts (continued)

10 Tangible fixed assets

	Land and buildings £'000	Gas distribution assets £'000	Motor vehicles £'000	Other equipment £'000	Assets in the course of construction £'000	Total £'000
Cost						
At 1 April 2015	3,589	2,396,888	18,164	106,041	31,747	2,556,429
Additions	541	115,357	2,279	8,576	30,491	157,244
Disposals	-	(396)	(4,146)	(3,998)	-	(8,540)
Transfers	642	12,832	1,874	5,925	(21,273)	-
At 31 March 2016	<u>4,772</u>	<u>2,524,681</u>	<u>18,171</u>	<u>116,544</u>	<u>40,965</u>	<u>2,705,133</u>
Depreciation						
At 1 April 2015	2,031	326,503	8,919	61,448	-	398,901
Charge for the period	603	51,053	1,710	11,426	-	64,792
Disposals	-	(261)	(4,125)	(3,999)	-	(8,385)
At 31 March 2016	<u>2,634</u>	<u>377,295</u>	<u>6,504</u>	<u>68,875</u>	<u>-</u>	<u>455,308</u>
Net book value						
At 31 March 2016	<u>2,138</u>	<u>2,147,386</u>	<u>11,667</u>	<u>47,669</u>	<u>40,965</u>	<u>2,249,825</u>
At 31 March 2015	<u>1,558</u>	<u>2,070,385</u>	<u>9,245</u>	<u>44,593</u>	<u>31,747</u>	<u>2,157,528</u>

Leased assets included above:

Net book value

At 31 March 2016	<u>175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>175</u>
At 31 March 2015	<u>184</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>184</u>

Undepreciated land equates to £774,000 (2015 - £774,000). Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £9,181,000 (2015 - £7,800,000).

Notes to the accounts (continued)

11 Investments

	31 March 2016 £'000	31 March 2015 £'000
Subsidiary undertakings	2,105	2,105
Other investments	104	104
	<u>2,209</u>	<u>2,209</u>

The company has an investment in the following subsidiary undertakings:

Subsidiary undertaking	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Finance Plc ("NGNF")	England & Wales	Financing	49,999 ordinary shares of £1	100
Northern Gas Networks Operations Limited ("NGNOL")	England & Wales	Gas network operations	2 ordinary shares of £1	100
Northern Gas Networks Pensions Trustee Limited ("NGNPT")	England & Wales	Pension scheme trustee	1 ordinary share of £1	100

The other investment represents a 10.38% holding in xoserve Limited, which provides information, data processing, invoicing and supply point administration services to the company. Xoserve Limited is registered in England & Wales.

The company also holds 1 ordinary share of £1 in Smart Energy Code Company Limited (registered in England & Wales) which represents a holding of 1.15%.

Subsidiary undertakings

	£'000
Cost and net book value	
At 1 April 2015 and 31 March 2016	<u>2,105</u>

Other investments

	£'000
Cost and net book value	
At 1 April 2015 and 31 March 2016	<u>104</u>

Notes to the accounts (continued)

12 Debtors

	31 March 2016 £'000	31 March 2015 £'000
Amounts falling due within one year		
Trade debtors	1,335	780
Other debtors	2	80
Prepayments and accrued income	49,656	49,305
Derivative financial assets (see note 15)	2,944	1,555
	<u>53,937</u>	<u>51,720</u>
Amounts falling due after more than one year		
Derivative financial assets (see note 15)	324,915	313,520
	<u>324,915</u>	<u>313,520</u>
	<u>378,852</u>	<u>365,240</u>

13 Creditors: Amounts falling due within one year

	31 March 2016 £'000	31 March 2015 £'000
Bank loans	11,403	4,600
Payments received on account	3,065	1,001
Trade creditors	959	386
Amounts owed to group undertakings	40,329	53,073
Other taxation and social security	6,957	3,230
Accruals and deferred income	12,752	9,398
UK corporation tax	53,028	34,930
Derivative financial liabilities (see note 15)	15,134	15,606
	<u>143,627</u>	<u>122,224</u>

Bank loans comprise a revolving capital facility of £12.0m repayable on 29 April 2016. This facility is available to be redrawn until 28 October 2020 and carries interest at LIBOR plus a margin of 0.4%. At 31 March 2016 bank loans include unamortised fees of £597,000.

Notes to the accounts (continued)

14 Creditors: Amounts falling due after more than one year

	31 March 2016 £'000	31 March 2015 £'000
Bank loans	343,124	314,962
Amounts owed to group undertakings	900,130	900,130
Deferred income	94,891	90,405
Derivative financial liabilities (see note 15)	374,729	353,682
	<u>1,712,874</u>	<u>1,659,179</u>

At 31 March 2016 bank loans include unamortised fees of £2,127,000. The bank loans comprise eight loans as detailed below.

Principal value (£m)	Interest terms	Repayable on
25.0	3 month LIBOR + 0.36%	23 January 2023
100.0	3 month LIBOR + 0.62%	30 March 2024
25.0	3 month LIBOR + 0.55%	24 June 2024
60.0	3 month LIBOR + 0.46%	30 July 2024
40.0	Fixed rate of 3.446%	20 December 2024
33.2	3 month LIBOR + 0.86%	25 March 2034
30.0	3 month LIBOR + 0.53%	31 March 2027
30.0	3 month LIBOR + 0.63%	29 February 2028

The amounts owed to group undertakings are an interest bearing loan of £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035 with interest of 4.875% plus a margin to cover related costs, an interest bearing loan of £198.2m repayable in 2019 with interest of 5.875% plus a margin to cover related costs and an interest bearing loan of £197.0m repayable in 2040 with interest of 5.625% plus a margin to cover related costs.

Notes to the accounts (continued)

15 Derivatives and other financial instruments

The carrying values of the company's financial assets and liabilities are summarised by category below:

	31 March 2016 £'000	31 March 2015 £'000
Financial assets		
Measured at fair value through the profit and loss account		
- Derivative financial assets	210,356	209,200
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial assets	117,503	105,875
Measured at undiscounted amount receivable		
- Trade and other debtors (see note 12)	1,337	860
Equity instruments measured at cost less impairment		
- Fixed asset investments (see note 11)	2,209	2,209
	<u>331,405</u>	<u>318,144</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	31 March 2016 £'000	31 March 2015 £'000
Financial liabilities		
Measured at fair value through the profit and loss account		
- Derivative financial liabilities	235,779	231,909
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial liabilities	24,048	18,828
- Other financial liabilities – bonds	130,036	118,551
Measured at amortised cost		
- Loans payable (see notes 13 and 14)	354,527	319,562
Measured at undiscounted amount payable		
- Trade and other creditors (see note 13)	4,024	1,387
- Amounts owed to group undertakings (notes 13 and 14)	940,459	953,203
	<hr/> 1,688,873	<hr/> 1,643,440

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The company's income, expense, gains and losses in respect of financial instruments are summarised below:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Interest income and expense on items at amortised cost		
- Total interest payable on financial liabilities at amortised cost	52,778	65,615
- Total interest receivable on financial assets measured at amortised cost	(62)	(65)
Interest income and expense on derivatives		
- Total interest receivable on financial assets measured at fair value through the P&L	(34,184)	(43,484)
- Total interest payable on financial liabilities measured at fair value through the P&L	21,363	27,419
- Total interest payable on financial assets designated in an effective hedging relationship	-	28
- Total interest payable on financial liabilities designated in an effective hedging relationship	5,334	4,859
Fair value gains and losses		
- On financial assets measured at fair value through the profit and loss account	3,978	(76,409)
- On financial liabilities measured at fair value through the profit and loss account	(81)	77,486
- On derivative financial assets designated in an effective hedging relationship	113	(86,991)
- On derivative financial liabilities designated in an effective hedging relationship	66	97,737
	<u>49,305</u>	<u>66,195</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The maturity of the carrying value of the company's derivatives in hedging relationships split between less than 1 year and greater than 1 year.

	Current (less than 1 year)		Greater than 1 year	
	31 March 16	31 March 15	31 March 16	31 March 15
	£'000	£'000	£'000	£'000
Derivatives that are designated and effective as hedging instruments carried at fair value				
Assets	-	6	117,503	105,869
Interest rate swaps				
Liabilities				
Interest rate swaps	-	-	(24,048)	(18,828)
	-	6	93,455	87,041

Interest rate swaps are valued at present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates, adjusted for the Group's own credit risk when determining the fair value of derivatives liabilities and for counterparty credit risk when determining the fair value of derivatives assets.

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The following table details the notional principal amounts and remaining terms of interest rate swap contracts outstanding:

Interest rate swap contracts designated as hedges of variable interest rate risk of recognised financial liabilities:

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2016	2015	2016	2015	2016	2015
	%	%	£'000	£'000	£'000	£'000
Outstanding receive floating pay fixed contracts						
Less than 1 year						
1 to 2 years	-	0.56	-	72,500	-	6
2 to 5 years	-	-	-	-	-	-
5 years plus	-	-	-	-	-	-
	2.51	2.96	305,000	202,500	(24,048)	(18,828)
			<u>305,000</u>	<u>275,000</u>	<u>(24,048)</u>	<u>(18,822)</u>

The interest rate swaps settle on a quarterly basis. The floating rate on the interest rate swaps is three month LIBOR. The company will settle the difference between the fixed and floating interest rate on a net basis.

The receive floating pay fixed contracts that are designated as hedges are designed to swap the floating rate on various loans from the European Investment Bank to fixed rate for periods of up to ten years.

The hedged cash flows are expected to occur and to affect profit or loss over the period to maturity of the interest rate swaps.

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2016	2015	2016	2015	2016	2015
	%	%	£'000	£'000	£'000	£'000
Outstanding pay floating receive fixed contracts						
5 years plus	4.88	4.88	490,000	505,000	117,503	105,869
			<u>490,000</u>	<u>505,000</u>	<u>117,503</u>	<u>105,869</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The forward-starting interest rate swaps settle on a semi-annual basis in the case of the floating rate legs and on an annual basis in the case of the fixed rate leg. The floating rate on the interest rate swaps is six month LIBOR.

Interest will be settled on a gross basis as the settlement dates for the fixed and floating rate legs do not coincide.

The swaps hedge the exposure to changes in the fair value of the underlying bonds that are attributable to changes in interest rates.

16 Provisions for liabilities excluding pension liability

	Restructuring £'000	Deferred tax £'000	Environmental restoration £'000	Contractor claims £'000	Other £'000	Total £'000
At 1 April 2015	8,691	349,366	9,327	601	6,768	374,753
Charged to profit and loss account	7,821	(38,935)	-	-	300	(30,814)
Deferred tax in relation to pension scheme	-	(2,096)	-	-	-	(2,096)
Utilised in the year	(2,444)	-	(528)	(601)	(602)	(4,175)
Adjustment arising from discounting	-	-	124	-	34	158
At 31 March 2016	14,068	308,335	8,923	-	6,500	337,826
Provision for net defined benefit scheme deficit (see note 19)						6,701
						344,527

Notes to the accounts (continued)

16 Provisions for liabilities excluding pension liability (continued)

Deferred tax

Deferred tax is provided as follows:

	31 March 2016 £'000	31 March 2015 £'000
Accelerated capital allowances	76,771	82,220
Other timing differences	231,564	267,146
	<u>308,335</u>	<u>349,366</u>

Provision for deferred tax

Deferred tax is only recognised in respect of timing differences where transactions or events have occurred, that result in an obligation to pay more or less tax in the future, at the balance sheet date.

Restructuring

Estimated costs of an over 55 early retirement programme offered to employees. The restructuring provision value represents the net present value of anticipated liabilities at the balance sheet date. The timing of the utilisation of the other provision is inherently uncertain although the directors expect that such utilisation will occur mainly within two year from the balance sheet date.

Environmental restoration

Estimated environmental restoration costs are provided where the company has a legal obligation to restore sites at the balance sheet date. The provision represents the estimated net present value for statutory decontamination of old gas sites. It also reflects the obligations associated with other environmental damage. The timing of the utilisation of the environmental restoration provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

Contractor claims

The provision for contractor claims relates to claims received from primary contractors in respect of work variations and final invoice valuations upon closing out contracts and represents the best estimate of the amounts required to settle these claims.

Other

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability events. The timing of the utilisation of the other provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

Notes to the accounts (continued)

17 Called-up share capital

	31 March 2016 £000	31 March 2015 £000
<i>Allotted, called-up and fully-paid</i>		
24,328,476 ordinary shares of £1 each	24,328	24,328
	<hr/>	<hr/>

18 Financial commitments

Total future commitments under non-cancellable operating leases are as follows:

Property leases	<u>Land and Buildings</u>	
	31 March 2016 £'000	31 March 2015 £'000
Expiry date		
- within one year	12	406
- between one and two years	134	38
- between two and five years	492	493
- after five years	6,930	5,360
	<hr/>	<hr/>
	7,568	6,297
	<hr/>	<hr/>

The company has entered into a Guarantee and Reimbursement Agreement with FGIC UK Limited ("FGIC") in conjunction with its subsidiary Northern Gas Networks Finance Plc ("the Issuer") in relation to the bonds issued by that company in November 2005 of £505.0m. The company guarantees the punctual payment of any and all sums and fees due to FGIC and undertakes to pay any amount due from the Issuer but not paid by it. The company also indemnifies FGIC against any loss or liability suffered, if any obligation guaranteed by FGIC is, or becomes, unenforceable, invalid or illegal. The amount of the loss or liability under the indemnity is equal to the amount FGIC would otherwise have been entitled to recover.

Notes to the accounts (continued)

19 Pension arrangements

The company has obligations for a defined benefit pension scheme.

The amounts recognised in the balance sheet are as follows:

	31 March 2016 £'000	31 March 2015 £'000
Present value of funded obligations	427,139	440,181
Fair value of plan assets	(418,967)	(420,745)
Deficit	8,172	19,436
Related deferred tax asset	(1,471)	(3,887)
Net liability	<u>6,701</u>	<u>15,549</u>
Amounts in the balance sheet		
- Liabilities	<u>6,701</u>	<u>15,549</u>

The total amounts recognised in the profit and loss account are as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
<i>Amount charged to operating profit</i>		
Current service costs	5,919	8,198
Past service costs	3,810	1,547
	<u>9,729</u>	<u>9,745</u>
<i>Amount credited to net finance charges</i>		
Interest costs	14,267	20,126
Expected cost return on plan assets	(13,870)	(23,148)
Net return on pension scheme (see note 3)	397	(3,022)
Total	<u>10,126</u>	<u>6,723</u>

The total amounts recognised in the statement of comprehensive income are as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Actuarial gains (losses)	<u>2,900</u>	<u>(20,146)</u>

Notes to the accounts (continued)

19 Pension arrangements (continued)

The cumulative amount of actuarial gains and losses recognised in the statement of total recognised gains and losses is as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Actuarial losses	<u>(61,450)</u>	<u>(64,350)</u>

Changes in the present value of the defined benefit obligation are as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Opening defined benefit obligation	440,181	354,933
Service cost	5,919	8,198
Past service cost	3,810	1,547
Interest cost	14,267	20,126
Member contributions	465	681
Actuarial losses	(17,756)	70,800
Benefits paid	(19,730)	(15,141)
Expenses paid	(17)	(963)
Closing defined benefit obligation	<u>427,139</u>	<u>440,181</u>

Changes in the fair value of plan assets are as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Opening fair value of plan assets	420,745	343,411
Expected return	13,870	23,148
Actuarial gains	(14,856)	50,654
Employer contributions	18,490	18,955
Member contributions	465	681
Benefits paid	(19,730)	(15,141)
Expenses paid	(17)	(963)
	<u>418,967</u>	<u>420,745</u>

Notes to the accounts (continued)

19 Pension arrangements (continued)

The major categories of plan assets as a percentage of the total plan assets are as follows:

	31 March 2016 %	31 March 2015 %
Equity securities	18.1	23.9
Bond securities	63.8	50.5
Property	9.3	8.0
Other	8.8	17.6

To determine the overall expected rate of return on plan assets the company considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the assets are invested and the expectations for future returns of each asset class in the plan. The expected return for each asset class was then weighted, based on the asset allocation in the plan to develop the assumption for the expected rate of return on plan assets.

The actual return on plan assets is as follows:

	Year ended 31 March 2016 £'000	15 months ended 31 March 2015 £'000
Actual return on plan assets	<u>(986)</u>	<u>73,802</u>

Principal actuarial assumptions at the balance sheet date (expressed as weighted averages) are:

	31 March 2016	31 March 2015
Discount rate	3.6%	3.3%
Future salary increases	3.5%	3.4%
Future pension increases	3.0%	2.9%
Inflation	3.0%	2.9%
Life expectancy - member aged 65 (retiring today)	22.2 years	22.0 years
- member aged 45 (retiring in 20 years)	24.4 years	24.2 years

The company also operates defined contribution schemes for which the pension charge for the period amounted to £474,000 (2015 15 month period - £428,000). At 31 March 2016 unpaid contributions amounted to £4,000 (2015 - £3,000).

Notes to the accounts (continued)

20 Related party transactions

The company is a wholly owned subsidiary and utilises the exemption contained in FRS 102 section 33 2.2, "Related Party Disclosures", not to disclose any transactions with entities that are part of the group.

Balances with members of the NGNH group are detailed in notes 13 and 14.

21 Ultimate controlling party

The directors regard Northern Gas Networks Holdings Limited, a company incorporated in England and Wales, as the ultimate parent company and the ultimate controlling party.

Northern Gas Networks Holdings Limited is the parent company of the largest and smallest group of which the company is a member and for which group accounts are drawn up. Copies of the accounts are available from 1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU.

The Shareholders of Northern Gas Networks Holdings Limited are a consortium comprising of:

PG (April) Limited (47.1%)

Beta Central Profits Limited (41.3%)

SAS Trustee Corporation (11.6%)

22 Explanation of transition to FRS 102

This is the first year that the company has presented its financial statements under FRS 102 issued by the Financial Reporting Council. The following disclosures are required in the year of transition. The last financial statements were under previous UK GAAP were for the period ended 31 March 2015 and the date of transition to FRS 102 was therefore 1 January 2014. As a consequence of adopting FRS 102, a number of accounting policies have changed to comply with that standard.

Repex

The group's network of metallic pipes is being replaced with polyethelene pipes. This activity, referred to as repex, is treated as capital expenditure under FRS 102 whereas it was expensed under the previous UK GAAP.

Diversions

Diversions have previously been accounted for on a net basis (cost less contribution) within repex expenditure. Under FRS 102, consistent with repex the cost is now treated as a fixed asset with the contribution being a deferred contribution in creditors. The depreciation of the asset and the amortisation of the contribution is then charged / credited to the profit and loss account over the life of the relevant asset.

Financial instruments (IAS 39)

On transition to FRS 102, NGN adopted IAS 39 for its financial instrument reporting to ensure continuity with the shareholder reporting. The adjustments on transition are to recognise the fair value of NGN's interest rate swaps and hedged bonds as at 1 January 2014.

Notes to the accounts (continued)

22 Explanation of transition to FRS 102 (continued)

The future movements in the fair value of the instruments are then charged / credited to the profit and loss account or hedging reserve on a quarterly basis. In respect of the swaps and bonds with a fair value at transition the related reserve and hedging reserve balances will fall to zero as each instrument matures.

Deferred tax on opening asset valuation

Under FRS 102 there is a requirement to account for the balance of the deferred tax on the fair value uplift of fixed assets acquired on acquisition of the gas transportation licence in 2005, which is then amortised over 40 years since acquisition, consistent with the treatment of intangible assets.

Intangible Asset – Gas Transporter Licence

The value of the Gas Transporter Licence (licence) has previously been included within the total value of goodwill. Under FRS 102 intangible assets acquired can be recognised separately if the fair value can be measured reliably. NGN have undertaken an exercise to value the licence and as such the licence is now disclosed as an intangible asset. There is no impact on shareholder funds as a result of this change and therefore it is not listed as an adjustment in the table below.

Reconciliation of equity

	At 31 March 2015 £'000	At 1 January 2014 £'000
Equity shareholders fund under previous UK GAAP	57,770	60,015
Repex	594,259	501,392
Diversions costs	30,325	26,985
Diversions income	(25,823)	(23,100)
Financial instruments (IAS 39)	(43,370)	(25,541)
Deferred tax on opening asset valuation	(127,300)	(132,575)
	<u>428,091</u>	<u>347,161</u>
Equity shareholders funds under FRS 102	<u>485,861</u>	<u>407,176</u>

Notes to the accounts (continued)

22 Explanation of transition to FRS 102 (continued)

Notes to the reconciliation

Reconciliation of profit or loss for the 15 month period ended 31 March 2015

	£'000
Profit for the financial period under previous UK GAAP	66,144
Repex	92,867
Diversions costs	3,340
Diversions income	(2,723)
Financial instruments (IAS 39)	(9,459)
Deferred tax on opening asset revaluation	5,275
Profit for the financial period under FRS 102	<u>155,444</u>