

Northern Gas Networks Limited

Annual Report and accounts
for the year ended 31 March 2017

Registered number: 05167070

Strategic report

For the year ended 31 March 2017

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 2017.

The accounts are presented under Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

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 205.8m (2016 – £199.6m) with revenue increasing by £6.4m based on Ofgem allowances, and cost increases of £0.2m despite a depreciation increase of £3.7m with operating and head office costs reducing by £3.5m, due to management continuing to look at ways of reducing cost.

The company has debt before financing costs of £1,331.5m (2016 - £1,255.4m) at the year end. This comprises:

- bank loans due within one year of £nil (2016 - £12.0m) which carry interest at LIBOR plus a margin of 0.4%;
- an intercompany loan of £198.2m (2016 - £198.2m) which carries interest at 5.875% and is repayable in 2019;
- an intercompany loan of £197.0m (2016 - £197.0m) which carries interest at 5.625% and is repayable in 2040;
- an intercompany loan of £505.0m (2016 - £505.0m) which carries interest at 4.875%, with £250.0m repayable in 2027 and £255.0m in 2035;
- loans of £391.3m (2016 - £303.2m) 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, £40.0m in 2029 and £31.3m in 2034; and
- a loan of £40.0m (2016 - £40.0m) which carries interest of 3.446% and is repayable in 2024.

This debt structure has given rise to net finance charges of £46.0m in the year (2016 - £45.7m).

The tax charge for the year was £8.8m (2016 - £0.1m credit) which represents an effective tax rate of 5.4% (2016 – 0.0%). The effective tax charge in each year is low: (1) 2017 due to the impact of the adjustment of the deferred tax liability to reflect the changes in UK corporation tax rates from 18% to 17% and benefits from recognition of prior year capital allowance claims; (2) 2016 due to the adjustment of the deferred tax liability to reflect the change in UK corporation tax rates from 20% to 18%.

Capital additions ("Capex") for the year was £150.5m (2016 - £154.6m) principally focused on investment in network assets including replacement expenditure. The company has net assets of £590.6m at 31 March 2017 (2016 - £554.8m).

Strategic report (continued)

The net pension provision has increased by £11.6m mainly due to actuarial movements of £32.0m (net of tax) as detailed part offset by additional contributions (see note 19).

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 2017	Year ended 31 March 2016
Financial performance (efficiency)		
Operating profit	£205.8m	£199.6m
Dividends paid	£90.3m	£80.0m
External debt less cash/Regulatory asset value	65.8%	64.9%
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	3	2
Reported injuries to members of the general public	1	1

**For the regulatory years ended 31 March 2017 and 31 March 2016.

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.

Strategic report (continued)

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 responds to all potential changes which impact on the business and 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 has a set of policies and procedures that 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.

Strategic report (continued)

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.

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, credit 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.

Credit risk

Credit risk is the risk that a counterparty fails to discharge an obligation to the group. The group is exposed to this risk for various financial instruments including cash deposits and interest rate swaps. The group monitors the credit standing of counterparties to whom it has financial exposures and monitors the size of these exposures against Board-approved limits. If a counterparty's credit standing falls below a certain benchmark and/or exposure to a counterparty rises above a certain level no new transactions are entered into with that counterparty economic ways to reduce the exposure are explored.

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.

By order of the Board,



M J Horsley, Director

26 July 2017

Directors' report

For the year ended 31 March 2017

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 2017. 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 financial risk management objectives and policies.

Directors

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

A J Hunter	(Chairman)
M J Horsley	(Chief Executive Officer)
H L Kam	
C T Wan	
N D McGee	
S Leong	(resigned, 18 November 2016)
D N Macrae	
L S Chan	
C C Tsai	
S D Beer	(appointed, 23 December 2016)
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 2017 and April 17		Year ended 31 March 2016	
Date	Attendees	Date	Attendees
26 April 2016	8 out of 11	28 April 2015	11 out of 11
19 July 2016	10 out of 11	4 August 2015	10 out of 11
20 September 2016	9 out of 11	27 October 2015	10 out of 11
17 November 2016	11 out of 11	3 November 2015	11 out of 11
25 January 2017	10 out of 11	26 January 2016	11 out of 11
25 April 2017	6 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 £0.70 per share were paid on 20 June 2016 and of £3.01 per share were paid on 20 December 2016 making a total of £3.71 per share for the year (2016 – £3.29). See note 8 for details.

Future developments and events

From 1 April 2013, the current price control (RIIO-GD1) period commenced, which gives the company security over regulated revenue until 31 March 2021. The directors therefore expect the general level of activity to remain stable. There are no material post balance sheet events.

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 in the Strategic Report and above. In addition note 15 to the accounts includes further details of the company's debt position and details of its derivatives and other financial instruments. The company is able to pay its liabilities as they fall due, due to the reliability of regulated revenue under RIIO-GD1. The company has significant liquid resources and uses long term debt instruments to mitigate any liquidity risk as detailed in the Strategic Report.

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 indemnities

The company has made qualifying third party indemnity provisions for the benefit of its directors which were made during the year and remain in force at the date of this report.

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.

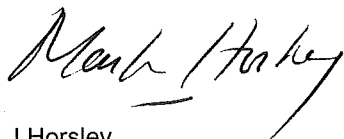
The directors will place a resolution before the annual general meeting to reappoint Deloitte LLP as auditor for the ensuing year.

Approval of reduced disclosure

The company, as a qualifying entity, has taken advantage of the disclosure exemptions in FRS 102 "reduced disclosure framework". The company's shareholders have been notified about the intention to take advantage of the disclosure exemptions and no objections have been received. The company also intends to take advantage of these exemptions in the accounts to be issued in the following year. Objections may be served on shareholders holding in aggregate 5 per cent or more of the total allocated shares in the company at any time.

By order of the Board,

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



M J Horsley

Director

26 July 2017

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements 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 financial statements 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 financial statements, the directors are required to:

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

The directors are responsible for keeping 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 financial statements 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 financial statements of Northern Gas Networks Limited for the year ended 31 March 2017 which comprise the profit and loss account, statement of comprehensive income, balance sheet, statement in changes in equity and the related notes 1 to 21. 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 financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements 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 financial statements sufficient to give reasonable assurance that the financial statements 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 financial statements. In addition, we read all the financial and non-financial information in the annual report to identify material inconsistencies with the audited financial statements 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 2017 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 based on the work undertaken in the course of the audit:

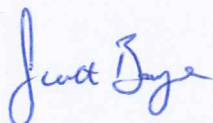
- the information given in the Strategic report and the Directors' report for the financial year for which the accounts are prepared is consistent with the accounts; and
- the Strategic Report and the Directors' Report have been prepared in accordance with applicable legal requirements.

In the light of the knowledge and understanding of the company and its environment obtained in the course of the audit, we have not identified any material misstatements in the Strategic report and the Directors' report.

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

Statutory Auditor

Leeds, United Kingdom

26 July 2017

Profit and loss account

For the year ended 31 March 2017

	Notes	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Turnover	1	422,195	415,761
Cost of sales		(12,290)	(13,396)
Gross profit		<u>409,905</u>	<u>402,365</u>
Other operating expenses	2	(204,066)	(202,727)
Operating profit		<u>205,839</u>	<u>199,638</u>
Finance charges (net)	3	(43,004)	(49,857)
Profit on ordinary activities before taxation	4	<u>162,835</u>	<u>149,781</u>
Tax on profit on ordinary activities	7	(8,819)	132
Profit for the financial year		<u><u>154,016</u></u>	<u><u>149,913</u></u>

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 2017

	Year ended 31 March 2017 £'000	Year ended 31 March 2016 £'000
Profit for the financial year	154,016	149,913
Re-measurement of defined benefit liability (note 19)	(42,099)	2,900
Cash flow hedges – losses arising during the year	(754)	(4,644)
Tax relating to components of other comprehensive income	6,575	753
Comprehensive income relating to the year	117,738	148,922

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

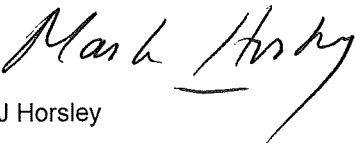
The accompanying notes are an integral part of this statement of comprehensive income.

Balance sheet
As at 31 March 2017

	Notes	31 March 2017 £'000	31 March 2016 £'000
Fixed assets			
Intangible assets	9	115,805	119,917
Tangible fixed assets	10	2,331,798	2,249,825
Investments	11	2,209	2,209
		<u>2,449,812</u>	<u>2,371,951</u>
Current assets			
Debtors – amounts falling due within one year	12	55,312	53,937
amounts falling due after one year	12	345,509	324,915
Cash at bank and in hand		8,242	5,008
		<u>409,063</u>	<u>383,860</u>
Creditors: Amounts falling due within one year	13	<u>(116,901)</u>	<u>(143,627)</u>
Net current assets		<u>292,162</u>	<u>240,233</u>
Total assets less current liabilities		2,741,974	2,612,184
Creditors: Amounts falling due after more than one year	14	(1,828,310)	(1,712,874)
Provisions for liabilities	16	<u>(331,443)</u>	<u>(344,527)</u>
Net assets		<u>582,221</u>	<u>554,783</u>
Capital and reserves			
Called-up share capital	17	24,328	24,328
Hedging reserve		(31,185)	(30,136)
Profit and loss account		589,078	560,591
		<u>582,221</u>	<u>554,783</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 26 July 2017 and signed on its behalf by:


M J Horsley

Director

26 July 2017

Statement of changes in equity

For the year ended 31 March 2017

	Called up share capital £'000	Hedging reserve £'000	Profit and loss account £'000	Total £'000
At 31 March 2015	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
Cash flow hedges:				
losses arising during the year	-	(4,813)	-	(4,813)
reclassification to profit and loss	-	1,159	-	1,159
Total comprehensive income	-	(3,654)	152,576	148,922
Dividends paid on equity shares (note 8)	-	-	(80,000)	(80,000)
At 31 March 2016	24,328	(30,136)	560,591	554,783
Profit for the financial year	-	-	154,016	154,016
Remeasurement of defined benefit liability	-	-	(42,099)	(42,099)
Tax on remeasurement of defined benefit liability	-	-	6,870	6,870
Cash flow hedges:				
losses arising during the year	-	(295)	-	(295)
reclassification to profit and loss	-	(754)	-	(754)
Total comprehensive income	-	(1,049)	118,787	117,738
Dividends paid on equity shares (note 8)	-	-	(90,300)	(90,300)
At 31 March 2017	24,328	(31,185)	589,078	582,221

Statement of accounting policies

For the year ended 31 March 2017

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

Basis of accounting

Northern Gas Network Limited is a company incorporated in the United Kingdom under the companies act. The company is a private company limited by shares and is registered in England and Wales. The address of the company is 1100 Century Way, Leeds, LS8 1NF. 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. Principle activities and nature of operations are shown in the strategic report.

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 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 in the Strategic Report and above. In addition note 15 to the accounts includes further details of the company's debt position and details of its derivatives and other financial instruments. The company is able to pay its liabilities as they fall due, due to the reliability of regulated revenue under RII0-GD1. The company has significant liquid resources and uses long term debt instruments to mitigate any liquidity risk as detailed in the Strategic Report. 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.

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.

Statement of accounting policies (continued)

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:

Gas distribution assets	
Gas mains & services	55 to 65 years
Gas storage	40 years
Plant & machinery	10 to 30 years
Replacement expenditure	60 years
Land and buildings	Lesser of lease period and 50 years
Motor vehicles and other equipment	3 to 10 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.

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.

Stocks

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

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.

Statement of accounting policies (continued)

Taxation (continued)

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.

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.

Statement of accounting policies (continued)

Pension costs (continued)

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.

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.

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

Statement of accounting policies (continued)

Financial instruments (continued)

- 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. 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).
- c) 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.
- d) 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.
- e) 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.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss. Amounts previously recognised in other comprehensive income and accumulated in equity are reclassified to profit or loss in the periods in which the hedged item affects profit or loss or when the hedging relationship ends.

Statement of accounting policies (continued)

Financial instruments (continued)

Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. Any gain or loss accumulated in equity at that time is reclassified to profit or loss when the hedged item is recognised in profit or loss. When a forecast transaction is no longer expected to occur, any gain or loss that was recognised in other comprehensive income is reclassified immediately to profit or loss.

Critical accounting judgments and key sources of estimation uncertainty

In the application of the Group's accounting policies, which are described in the statement of accounting policies, the directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying the group's accounting policies

There are no critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the group's accounting policies.

Key sources of estimation uncertainty

The following are the critical judgements, apart from those involving estimations (which are dealt with separately below), that the directors have made in the process of applying the Group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

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 company uses market-observable data to the extent it is available, using an individual trade basis provided by an external reporting system meaning no assumptions are applied by the company. This method generates a fair value difference of £11m compared to using a portfolio basis.

Pension arrangements

Note 19 contains information about the principal 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.

Notes to the accounts

For the year ended 31 March 2017

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, principally being from gas distribution in the North of England.

2 Other operating expenses

	2017 £'000	2016 £'000
Distribution costs	151,560	147,296
Administrative expenses	52,506	55,431
	<u>204,066</u>	<u>202,727</u>

The allocation between distribution costs and administrative expenses has changed in the year due to how costs are coded within the business. The 2016 split of other operating expenses has been restated to best replicate the 2017 coding methodology.

3 Finance charges (net)

	2017 £'000	2016 £'000
Interest payable and similar charges	46,036	45,731
Less: investment income	(34)	(515)
Other finance (income) charges	(2,998)	4,641
	<u>43,004</u>	<u>49,857</u>

Interest payable and similar charges

	2017 £'000	2016 £'000
Bank loans and overdrafts	(1,027)	(1,519)
Intercompany interest payable	48,560	48,631
	<u>47,533</u>	<u>47,112</u>
Finance costs capitalised	(1,497)	(1,381)
	<u>46,036</u>	<u>45,731</u>

Finance costs have been capitalised based on a cost of debt capitalisation rate of 3.75% (2016 – 3.79%).

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Investment income

	2017 £'000	2016 £'000
Income from fixed asset investments	-	(453)
Interest receivable and similar income	(34)	(62)
	<u>(34)</u>	<u>(515)</u>

Other finance (income) charges

	2017 £'000	2016 £'000
Fair value movement on financial investments	(3,235)	4,076
Exchange rate differences	(11)	10
Unwinding of discount on provisions (see note 16)	199	158
Net return on pension scheme (see note 19)	49	397
	<u>(2,998)</u>	<u>4,641</u>

4 Profit on ordinary activities before taxation

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

	2017 £'000	2016 £'000
Depreciation and amounts written off tangible fixed assets (see note 10)		
- owned	68,492	64,785
- held under finance leases and hire purchase contracts	4	7
Amortisation of intangible fixed assets included in administrative expenses (note 9)	4,112	4,111
Profit on disposal of fixed assets	(15)	(553)
Operating lease rentals - vehicles	1,151	780
Operating lease rentals - property	1,091	1,213
Fees payable to the company's auditor for the audit of the company's annual accounts	70	70
	<u>70</u>	<u>70</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 below disclosures relate to staff within Northern Gas Networks Operations Limited, a subsidiary of the company who recharges all its payroll costs to the company. The company itself has no employees.

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

	2017 Number	2016 Number
Administration	171	181
Operations	1,281	1,332
Total	<u>1,452</u>	<u>1,513</u>

	2017 £'000	2016 £'000
Their aggregate remuneration comprised:		
Wages and salaries	53,841	60,045
Social security costs	5,835	5,915
Pension costs	7,722	17,767
	<u>67,398</u>	<u>83,727</u>

Pension costs include only those included within other operating expenses. 2016 costs are above expectation due to one off restructuring provision costs incurred during that year (see note 16 for details).

Notes to the accounts (continued)

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	Non-Executive Directors		Executive Directors	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Emoluments	70	70	813	769
Amounts receivable (other than shares) under long-term incentive schemes	-	-	213	197
	<u>70</u>	<u>70</u>	<u>1,026</u>	<u>966</u>

The remuneration of non-executive directors as shown above relates to the independent non-executive directors of the company, paid through the subsidiary company Northern Gas Networks Operations Limited, and that are required by that company pursuant to its Public Gas Transportation Licence. Only one executive director is remunerated, again through the subsidiary company Northern Gas Networks Operations Limited, with the rest being remunerated by other companies within the ownership group. It is not possible to allocate a share of this cost to the company.

Pensions

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

Highest paid director

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

	2017 £'000	2016 £'000
Emoluments	<u>1,026</u>	<u>966</u>

Transactions

There have been no transactions with directors in the year (2016 – £nil) other than as set out above in respect of remuneration.

Notes to the accounts (continued)

7 Tax on profit on ordinary activities

The tax charge comprises:

	2017 £'000	2016 £'000
Current tax		
UK corporation tax	32,352	37,519
Adjustments in respect of prior periods	(9,084)	1,284
Total current tax	<u>23,268</u>	<u>38,803</u>
Deferred tax		
Current period - origination and reversal of timing differences	406	(6,816)
Adjustments in respect of prior periods	1,517	305
Effects of decrease in tax rate on opening liability	(16,372)	(32,424)
Total deferred tax	<u>(14,449)</u>	<u>(38,935)</u>
Total tax on profit on ordinary activities	<u>8,819</u>	<u>(132)</u>

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:

	2017 £'000	2016 £'000
Profit on ordinary activities before tax	<u>162,835</u>	<u>149,781</u>
Tax on profit on ordinary activities at standard UK corporation tax rate of 20.0% (2016 – 20.0%)	32,567	29,956
Effects of:		
Expenses not deductible for tax purposes	1,256	1,084
Income not taxable in determining taxable profit	(478)	(1,046)
Differences in tax rates	(16,960)	(31,715)
Adjustments in respect of prior year	(7,566)	1,589
Total tax credit for the period	<u>8,819</u>	<u>(132)</u>

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% (2016 – 20.0%).

Notes to the accounts (continued)

7 Tax on profit on ordinary activities (continued)

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. The Finance Act 2015 included provisions to reduce the rate of UK corporation tax to 19% with effect from 1 April 2017. The Finance Act 2016 included provisions to further reduce the rate of UK corporation tax to 17% with effect from 1 April 2020. Deferred taxation is measured at tax rates that are expected to apply in the periods in which temporary timing differences are expected to reserve based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date. Accordingly 17% has been applied when calculating deferred tax assets and liabilities as at 31 March 2017.

8 Dividends on equity shares

	2017 £'000	2016 £'000
Equity shares		
- interim dividend paid of £0.70 (2016 - £0.64) per ordinary share	17,000	15,500
- interim dividend paid of £3.01 (2016 - £2.65) per ordinary share	73,300	64,500
	<u>90,300</u>	<u>80,000</u>

9 Intangible assets

	Licence £'000	Goodwill £'000	Total £'000
Cost			
At 31 March 2016 and 31 March 2017	161,200	3,257	164,457
Amortisation			
At 1 April 2016	43,658	882	44,540
Charge for the year	4,031	81	4,112
At 31 March 2017	47,689	963	48,652
Net book value			
At 31 March 2017	113,511	2,294	115,805
At 31 March 2016	117,542	2,375	119,917

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 2016	4,772	2,524,681	18,171	116,544	40,965	2,705,133
Additions	245	118,286	2,330	7,747	21,907	150,515
Disposals	-	(191)	(917)	(1,947)	-	(3,055)
Transfers	1,252	21,978	1,822	3,812	(28,864)	-
At 31 March 2017	<u>6,269</u>	<u>2,664,754</u>	<u>21,406</u>	<u>126,156</u>	<u>34,008</u>	<u>2,852,593</u>
Depreciation						
At 1 April 2016	2,634	377,295	6,504	68,875	-	455,308
Charge for the period	759	53,563	2,000	12,174	-	68,496
Disposals	-	(183)	(879)	(1,947)	-	(3,009)
At 31 March 2017	<u>3,393</u>	<u>430,675</u>	<u>7,625</u>	<u>79,102</u>	<u>-</u>	<u>520,795</u>
Net book value						
At 31 March 2017	<u>2,876</u>	<u>2,234,079</u>	<u>13,781</u>	<u>47,054</u>	<u>34,008</u>	<u>2,331,798</u>
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>

Leased assets included above:

Net book value

At 31 March 2017	<u>175</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>175</u>
At 31 March 2016	<u>179</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>179</u>

Undepreciated land equates to £774,000 (2016 - £774,000). Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £10,678,000 (2016 - £9,181,000).

Notes to the accounts (continued)

11 Investments

	2017 £'000	2016 £'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

All subsidiaries have a registered address of 1100 Century Way, Leeds, LS15 8TU.

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

Cost and net book value	£'000
At 1 April 2016 and 31 March 2017	<u>2,105</u>

Other investments

Cost and net book value	£'000
At 1 April 2016 and 31 March 2017	<u>104</u>

Notes to the accounts (continued)

12 Debtors

	2017 £'000	2016 £'000
Amounts falling due within one year		
Trade debtors	1,248	1,335
Other debtors	1	2
Prepayments and accrued income	51,003	49,656
Derivative financial assets (see note 15)	3,060	2,944
	<u>55,312</u>	<u>53,937</u>
Amounts falling due after more than one year		
Derivative financial assets (see note 15)	345,509	324,915
	<u>345,509</u>	<u>324,915</u>
	<u>400,821</u>	<u>378,852</u>

13 Creditors: Amounts falling due within one year

	2017 £'000	2016 £'000
Bank loans	-	11,403
Payments received on account	1,645	3,065
Trade creditors	419	959
Amounts owed to group undertakings	49,660	40,329
Other taxation and social security	16,280	6,957
Accruals and deferred income	3,527	12,752
UK corporation tax	28,840	53,028
Derivative financial liabilities (see note 15)	16,530	15,134
	<u>116,901</u>	<u>143,627</u>

Amounts owed to group undertakings are interest free and repayable on demand.

Notes to the accounts (continued)

14 Creditors: Amounts falling due after more than one year

	2017 £'000	2016 restated £'000
Bank loans	431,316	343,124
Amounts owed to group undertakings	1,043,081	1,030,166
Deferred income	105,301	94,891
Derivative financial liabilities (see note 15)	248,612	244,693
	<u>1,828,310</u>	<u>1,712,874</u>

The 2016 restatement is a classification change between amounts owed to group undertakings and derivative financial liabilities (see below for further details). At 31 March 2017 bank loans include unamortised fees of £1,906,000 (2016 - £2,127,000). The bank loans comprise ten 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
30.0	3 month LIBOR + 0.53%	31 March 2027
30.0	3 month LIBOR + 0.63%	29 February 2028
50.0	3 month LIBOR + 0.86%	20 December 2028
40.0	3 month LIBOR + 0.834%	29 March 2029
31.3	3 month LIBOR + 0.934%	25 March 2034

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.

The amount outstanding on the amounts owed to group undertakings at amortised cost is £900.1m (2016: £900.1m). The difference between the amount outstanding on the debt at amortised cost and the carrying value is represents the fair value adjustments on the portion of the loan from Northern Gas Networks Finance Plc that is in a Fair Value hedge relationship (the proceeds of bonds maturing in 2027 and 2035). These adjustments are substantially offset by a corresponding amount in debtors relating to the fair value of the interest rate swaps that are in the Fair Value hedge relationship with this intercompany debt.

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.

Some of the company assets and liabilities are measured at fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the company uses market-observable data to the extent it is available, using an individual trade basis provided by an external reporting system meaning no assumptions are applied by the company. This method generates a fair value difference of £11m compared to a portfolio basis.

	2017 £'000	2016 £'000
Financial assets		
Measured at fair value through the profit and loss account		
- Derivative financial assets	228,491	210,356
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial assets	120,078	117,503
Measured at undiscounted amount receivable		
- Trade and other debtors (see note 12)	1,249	1,337
Equity instruments measured at cost less impairment		
- Fixed asset investments (see note 11)	2,209	2,209
	<u>352,027</u>	<u>331,405</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	2017 £'000	2016 £'000
Financial liabilities		
Measured at fair value through the profit and loss account		
- Derivative financial liabilities	239,024	235,779
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial liabilities	26,119	24,048
- Other financial liabilities – amounts owed to group undertakings	1,043,081	1,030,166
Measured at amortised cost		
- Loans payable (see notes 13 and 14)	431,316	354,527
Measured at undiscounted amount payable		
- Trade and other creditors (see note 13)	2,064	4,024
- Amounts owed to group undertakings (notes 13)	49,660	40,329
	<hr/>	<hr/>
	1,791,264	1,688,873
	<hr/>	<hr/>

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:

	2017 £'000	2016 £'000
Interest income and expense on items at amortised cost		
- Total interest payable on financial liabilities at amortised cost	52,687	52,778
- Total interest receivable on financial assets measured at amortised cost	(34)	(62)
Interest income and expense on derivatives		
- Total interest receivable on financial assets measured at fair value through the P&L	(33,368)	(34,184)
- Total interest payable on financial liabilities measured at fair value through the P&L	20,644	21,363
- Total interest payable on financial assets designated in an effective hedging relationship	-	-
- Total interest payable on financial liabilities designated in an effective hedging relationship	6,212	5,334
Fair value gains and losses		
- On financial assets measured at fair value through the profit and loss account	7,474	3,978
- On financial liabilities measured at fair value through the profit and loss account	(10,770)	(81)
- On derivative financial assets designated in an effective hedging relationship	159	113
- On derivative financial liabilities designated in an effective hedging relationship	(97)	66
	<hr/>	<hr/>
	42,907	49,305
Other net finance costs	97	552
	<hr/>	<hr/>
	43,004	49,857

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	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Derivatives that are designated and effective as hedging instruments carried at fair value				
Assets	-	-	120,078	117,503
Interest rate swaps				
Liabilities				
Interest rate swaps	(8)	-	(26,111)	(24,048)
	<u>(8)</u>	<u>-</u>	<u>93,967</u>	<u>93,455</u>

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	
	2017	2016	2017	2016	2017	2016
	%	%	£'000	£'000	£'000	£'000
Outstanding receive floating pay fixed contracts						
Less than 1 year	0.41	-	20,000	-	4	-
1 to 2 years	-	-	-	-	-	-
2 to 5 years	-	-	-	-	-	-
5 years plus	2.21	2.51	371,316	305,000	(26,115)	(24,048)
			<u>391,316</u>	<u>305,000</u>	<u>(26,111)</u>	<u>(24,048)</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	
	2017	2016	2017	2016	2017	2016
	%	%	£'000	£'000	£'000	£'000
Outstanding pay floating receive fixed contracts						
5 years plus	4.88	4.88	420,000	490,000	120,078	117,503
			<u>420,000</u>	<u>490,000</u>	<u>120,078</u>	<u>117,503</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 (which are the basis of the intercompany loan) that are attributable to changes in interest rates.

16 Provisions for liabilities excluding pension liability

	Restructuring £'000	Deferred tax £'000	Environmental restoration £'000	Other £'000	Total £'000
At 1 April 2016	14,068	308,335	8,923	6,500	337,826
Charged to profit and loss account	1,000	(19,043)	(2,523)	533	(20,033)
Charged to hedge reserve	-	295	-	-	295
Adjustments arising from discounting	-	-	-	199	199
Utilised in the year	(3,549)	-	(857)	(748)	(5,154)
At 31 March 2017	11,519	289,587	5,543	6,484	313,133
Provision for net defined benefit scheme deficit (see note 19)					18,310
					331,443

Notes to the accounts (continued)

16 Provisions for liabilities excluding pension liability (continued)

Deferred tax

Deferred tax is provided as follows:

	2017 £'000	2016 £'000
Accelerated capital allowances	65,622	76,771
Other timing differences	223,965	231,564
	<u>289,587</u>	<u>308,335</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 cash flow assumption is based on agreed retirement dates with employees and a discounted rate of 6.5% is applied. Where a date has not been formally agreed, a probability of 65% has been applied based on historical take up rates and this accounts for £1.6m of the total provision, meaning a 1.0% move from this percentage assumption would move the provision by £25,000

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. The provision has been calculated using the probability of cashflows method and management have used an expert to assess the probability of a restoration event and the potential cost. The cash exposure based on a worst case scenario is an expense of £22.8m but this is deemed highly unlikely based on historic trends. Sensitivity analysis has not been performed due to the number of variables in the probability calculation.

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 and reserves

Share capital

	2017 £000	2016 £000
<i>Allotted, called-up and fully-paid</i>		
24,328,476 ordinary shares of £1 each	24,328	24,328
	<hr/>	<hr/>

Profit and loss account

This is the accumulative earnings retained by the company.

Hedging reserve

This represents the cumulative amount of gains and losses on hedging instruments deemed effective in cash flow hedges.

18 Financial commitments

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

Property leases	<u>Land and Buildings</u>	
	2017 £'000	2016 £'000
Expiry date		
- within one year	1,080	1,173
- between one and two years	900	1,080
- between two and five years	1,847	2,346
- after five years	2,097	2,499
	<hr/>	<hr/>
	5,924	7,098
	<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. During the year a valuation of the pension scheme was carried out by a third party actuarial firm. The present value of the defined benefit obligations, the current service costs and past service costs were measured using the projected unit credit method.

The amounts recognised in the balance sheet are as follows:

	2017 £'000	2016 £'000
Present value of funded obligations	517,084	427,139
Fair value of plan assets	(495,024)	(418,967)
Deficit	22,060	8,172
Related deferred tax asset	(3,750)	(1,471)
Net liability	<u>18,310</u>	<u>6,701</u>
Amounts in the balance sheet		
- Liabilities	<u>18,310</u>	<u>6,701</u>

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

	2017 £'000	2016 £'000
<i>Amount charged to operating profit</i>		
Current service costs	4,060	5,919
Past service costs	720	3,810
	<u>4,780</u>	<u>9,729</u>
<i>Amount credited to net finance charges</i>		
Interest costs	14,890	14,267
Expected cost return on plan assets	(14,841)	(13,870)
Net return on pension scheme (see note 3)	49	397
Total	<u>4,829</u>	<u>10,126</u>

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

	2017 £'000	2016 £'000
Actuarial gains (losses)	<u>(42,099)</u>	<u>2,900</u>

Notes to the accounts (continued)

19 Pension arrangements (continued)

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

	2017 £'000	2016 £'000
Actuarial losses	<u>(103,549)</u>	<u>(61,450)</u>

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

	2017 £'000	2016 £'000
Opening defined benefit obligation	427,139	440,181
Service cost	4,060	5,919
Past service cost	720	3,810
Interest cost	14,890	14,267
Member contributions	670	465
Actuarial losses	97,660	(17,756)
Benefits paid	(28,055)	(19,730)
Expenses paid	-	(17)
Closing defined benefit obligation	<u>517,084</u>	<u>427,139</u>

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

	2017 £'000	2016 £'000
Opening fair value of plan assets	418,967	420,745
Expected return	14,841	13,870
Actuarial gains	55,561	(14,856)
Employer contributions	33,040	18,490
Member contributions	670	465
Benefits paid	(28,055)	(19,730)
Expenses paid	-	(17)
	<u>495,024</u>	<u>418,967</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:

	2017 %	2016 %
Equity securities	13.5	18.1
Bond securities	63.7	63.8
Property	8.1	9.3
Other	14.7	8.8

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:

	2017 £'000	2016 £'000
Actual return on plan assets	<u>70,403</u>	<u>(986)</u>

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

	2017	2016
Discount rate	2.6%	3.6%
Future salary increases	3.7%	3.5%
Future pension increases	3.2%	3.0%
Inflation	3.2%	3.0%
Life expectancy - member aged 65 (retiring today)	22.1 years	22.2 years
- member aged 45 (retiring in 20 years)	24.2 years	24.4 years

The company also operates defined contribution schemes for which the pension charge for the period amounted to £2,416,000 (2016 - £474,000). At 31 March 2017 unpaid contributions amounted to £nil (2016 - £4,000).

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 wholly owned 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%)