

**REGISTERED NUMBER: 04112320 (England and Wales)**

**STRATEGIC REPORT, REPORT OF THE DIRECTORS AND  
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016  
FOR  
NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

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**NORTHERN POWERGRID (YORKSHIRE) PLC**

**COMPANY INFORMATION  
FOR THE YEAR ENDED 31 DECEMBER 2016**

**DIRECTORS:**

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T E Fielden  
J M France  
T H France  
N M Gill  
P A Jones  
A J Maclellan  
A R Marshall  
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**COMPANY SECRETARY:**

J C Riley

**REGISTERED OFFICE:**

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78 Grey Street  
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NE1 6AF

**REGISTERED NUMBER:**

04112320 (England and Wales)

**AUDITOR:**

Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Newcastle upon Tyne  
United Kingdom

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

The directors present the annual reports and accounts for the year ended 31 December 2016 of Northern Powergrid (Yorkshire) plc (the "Company"), which include the Strategic Report, the Report of the Directors and the audited financial statements for that year. Pages 2 to 21 inclusive comprise the Strategic Report and pages 22 to 31 comprise the Report of the Directors, which have been drawn up and are presented in accordance with the Companies Act 2006.

#### **CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS**

These annual reports and accounts have been prepared for the members of the Company only. The Company, its directors, employees or agents do not accept or assume responsibility to any other person in connection with this document and any such responsibility or liability is expressly disclaimed. These annual reports and accounts contain certain forward-looking statements, which can be identified by the fact that they do not relate only to historical or current facts. In particular, all statements that express forecasts, expectations and projections with respect to future matters, including trends in results of operations, business prospects, the availability of financing to the Company and anticipated cost savings are forward-looking statements.

By their nature, forward-looking statements and forecasts involve risk and uncertainty because they relate to events and depend on circumstances that may or may not occur in the future. There are a number of factors that could cause actual results or developments to differ materially from those expressed or implied by these forward-looking statements and forecasts. The forward-looking statements reflect the knowledge and information available at the date of preparation of these annual reports and accounts and will not be updated during the year. Nothing in these annual reports and accounts should be construed as a profit forecast.

#### **BUSINESS MODEL**

The Company is part of the Northern Powergrid Holdings Company group of companies, (the "Northern Powergrid Group"), which is ultimately owned by Berkshire Hathaway Inc. The Company is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. As a distribution network operator ("DNO"), the Company distributes electricity to approximately 2.3 million customers connected to its electricity distribution network within its distribution services area, which encompasses the counties of West Yorkshire, East Yorkshire and almost all of South Yorkshire, together with parts of North Yorkshire, Derbyshire, Nottinghamshire, Lincolnshire and Lancashire. Some 21,628 gigawatt-hours (GWh) of electricity were distributed to those customers during the year. The Company's distribution network includes over 53,000 kilometres (km) of overhead and underground cables and over 35,000 substations. Electricity is received from the National Grid's transmission system and from generators connected directly to the network and then distributed at voltages of up to 132 kilovolts (kV).

In common with the Northern Powergrid Group, the Company operates a business model and strategy based on its six core principles (the "Core Principles"), which are:

| <b>Principle</b>       | <b>Strategy</b>                                                                                                                                                             | <b>Indicator</b>                                                                                                                    |
|------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------|
| Financial strength     | Effective stewardship of the Company's financial resources, investing in assets and focusing on long-term opportunities, which contribute to the Company's future strength. | Profitability, cash flow and maintenance of investment grade credit ratings.                                                        |
| Customer service       | Delivering reliability, dependability, fair prices and exceptional service.                                                                                                 | Improving network resilience and performance, measured by: customer minutes lost, customer interruptions and customer satisfaction. |
| Operational excellence | Setting high standards for the Company's operations, system investment and maintenance.                                                                                     | Effective asset management, managing commercial risk and improving network resilience and performance.                              |

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **BUSINESS MODEL - continued**

|                       |                                                                                                                                    |                                                                                    |
|-----------------------|------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------|
| Employee commitment   | Equipping employees with the resources and support they need to operate successfully and in a safe and rewarding work environment. | Leading safety performance, engaging employees and effective leadership.           |
| Environmental respect | Using natural resources wisely and protecting the environment, where it is impacted by the Company's operations.                   | Reducing environmental impact and promoting and pursuing long-term sustainability. |
| Regulatory integrity  | Adhering to a policy of strict compliance with applicable laws, regulations, standards and policies.                               | Strong internal controls, regulatory engagement and industry influence.            |

#### **STRATEGIC OBJECTIVES**

The Company's strategic objectives are based on the Core Principles and accordingly remain consistent to build a business, which:

- continues to generate value over the long-term;
- invests in and manages its electricity distribution network in an efficient and effective manner;
- provides its customers with an excellent standard of service;
- engages with its employees so that they feel rewarded and recognised as part of a team that sets and achieves increasingly high standards of performance; and
- is viewed as being a leader in shaping the future direction of the electricity distribution sector in the United Kingdom.

As part of its strategy, the Company continues to be committed to putting safety first, respecting its customers, their time and property, doing a quality job, responding effectively to major incidents on the network in times of severe weather and caring for its local community and environment.

#### **REVIEW OF THE YEAR**

The Company delivered a satisfactory financial performance for the year, benefitting from a further change to the rate of taxation, the settlement of a prior year tax claim, and continued effective cost control, with revenue at £415.1 million being £5.1 million less than 2015. The decrease in revenue was mainly due to the reduction in tariffs introduced with effect from the start of the current regulatory period, which runs from 1 April 2015 to 31 March 2023 (the "ED1 Period").

Throughout 2016, the Company continued its policy of enhancing the efficiency of its electricity distribution network by investing £225.1 million in order to deliver the improvements required to maintain an effective supply of electricity to customers. As was the case in 2015, the resilience of the network was tested during the year by several major weather events, including intense lightning storms, periods of very heavy rain and high winds. The Company's major incident management processes were implemented in these instances to ensure that interruptions to customers were minimised. The on-going investments in the network, including those to assist with the management of environmental incidents, and the responses put in place to mitigate the effects of such events, supported the Company's achievements made against the incentive scheme operated by the Office of Gas and Electricity Markets (Ofgem) for quality of service targets with the number of customer minutes lost and customer interruptions both below the target levels.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **REVIEW OF THE YEAR - continued**

The Company remained focussed on the affordability, availability and reliability of the service it provides. Accordingly, the way in which the Company interacted with and supported its stakeholders continued to be important. The results of Ofgem's stakeholder engagement and customer vulnerability submission were disappointing. When compared against the other five DNOs, the Northern Powergrid Group ranked in fifth place (a decline from its previous position of second). In response, the opportunity was taken to further engage with vulnerable customers, those who struggle with fuel poverty, customers who require priority services and those whose welfare could be affected in the event of an interruption to supply. Collaboration with partners including the Children's Society, the British Red Cross and Citizens Advice was undertaken to deliver enhanced support to those groups with a greater need for assistance.

Customer satisfaction continued to be a management priority and therefore multi-year programmes continued throughout the year to embed improvements into the overall customer experience. To further develop the quality of customer conversations, defined performance standards were implemented, supported by a pilot recognition and reward scheme for employees. The Customer Relationship Management ("CRM") IT system was further deployed allowing faster responses with a greater degree of accuracy for the management of customer complaints, general enquiries services and service alterations. The use of technology (including the CRM system) was further embedded to enhance the ways in which customers can make contact with the Company. Due to the initiatives in place, with the Company writing, emailing and sending text messages to remind customers 72 hours and then 24 hours ahead of any planned power cuts taking place, further progress was made during the year to improve the level of customer satisfaction relating to planned power cuts.

The effect of the Company's operations on the local landscape, and upon wildlife and birds remained important and, accordingly, progress continued in the implementation of measures designed to protect the environment. Incidents reportable to the Environment Agency, including oil spills and leaks from the Company's assets and SF<sub>6</sub> gas discharges from electrical plant, were all significantly better than target. Given the impact on the environment of such events, the Company remains committed to reducing losses from fluid-filled cables and, during the ED1 period, plans to replace a significant number of those assets on a phased and prioritised basis.

The health and safety of the Company's employees, its contractors and customers continued to be a key priority in 2016, with the focus on delivering a safety and health improvement plan designed to accomplish a world class safety performance. Education concerning the dangers of coming into contact with the network's assets and how people can identify these dangers remained a firm commitment. A number of approaches were therefore deployed during the year to communicate health and safety messages to the Company's employees and stakeholders, including delivering regional school safety presentations, running operational seminars for the Company's engineers and circulating regular safety newsflashes to all staff. The Company also placed emphasis on the identification of significant health and safety risks and allocating the necessary resource to put actions in place to mitigate those risks. Driving the Company's vehicles has been identified as one such risk, and therefore a robust road risk management plan was expanded throughout 2016. This included the completion of the programme to install a telematics system in all fleet vehicles to increase driver and vehicle safety and to assist with vehicle safety checks.

In terms of health and safety performance, the Company made a strong contribution to the health and safety performance of the Northern Powergrid Group and the long-term overall trend continued to compare well with that of the industry. In recognition of the on-going health and safety initiatives in place, the Company was awarded a President's Award from the Royal Society for the Prevention of Accidents.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES**

##### **Financial strength**

During the year, the Company continued to maintain good control in respect of both its capital and operating costs by effectively managing the various financial risks that could have had an adverse impact on its business.

The ED1 price control provides the Company with some stability in terms of its income until 31 March 2023. The ED1 price control has been set for eight years with provision for a mid-period review of the outputs that the Company is required to deliver and, in that respect, the Company recognises that it needs to continue to show that it is delivering reliable services to its customers, while operating in an efficient and effective manner.

Key aspects of financial performance for the year were as follows:

##### **Revenue**

The Company's revenue at £415.1 million was £5.1 million lower than the prior year mainly due to the reduction in tariffs introduced with effect from the start of the ED1 period.

##### **Operating profit and position at the year end**

The Company's operating profit of £199.4 million was £5.5 million less than the previous year, primarily reflecting decreased revenues and higher depreciation charges. The statement of financial position on page 36 shows that, as at 31 December 2016, the Company had total equity of 1,238.9 million. The directors consider the Company to have a strong statement of financial position which, when coupled with the preference of its parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy"), for operating with lower levels of debt than equivalent companies in the sector, creates a stable base for continued strong performance during the ED1 period.

##### **Finance costs and investments**

Finance costs net of investment income at £46.4 million were £3.7 million higher than the prior year due to the bond issuance on 1 April 2015 and a new credit facility with the European Investment Bank (the "EIB") from 16 December 2015 (see debt structure below).

##### **Taxation**

The effective tax rate in the year was 3.5%. The effective tax rate before adjusting for the impact of the changes in tax rates by the Finance Act 2016 and the settlement of a prior year tax claim would be 19.9%. Details of the income tax expense are provided in Note 7 to the accounts.

##### **Results and dividends**

The Company made a profit after tax for the year of £148.1 million (2015: £146.7 million). An interim dividend of £28.7 million was paid during the year (2015: £27.6 million) and the directors recommended that no final dividend be paid in respect of the year to 31 December 2016.

##### **Share capital and debt structure**

There were no changes to the Company's share capital during the year. On 1 March 2016, the Company entered into a Deed of Amendment and Consent which increased the facility provided by the European Investment Bank under the agreement entered into on 2 December 2015 from £130 million to £180 million. On 1 December 2016, the Company drew on this additional £50 million credit facility in its entirety at a fixed rate of 2.073% for a period of 9 years.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Financial strength - continued**

###### **Cash flow**

The Company aims to collect from customers and pay suppliers within contracted terms. Any surplus cash held is remitted to Yorkshire Electricity Group plc ("YEG"), a company in the Northern Powergrid Group, and invested accordingly, generating a market rate of return for the Company.

Movements in cash flows were as follows:

**Operating activities:** Cash flow from operating activities at £215.7 million was £18.9 million higher than the previous year, mainly due to lower tax paid offset by adverse working capital movements and higher finance costs paid.

**Investing activities:** Net cash used in investing activities at £183.3 million was £24.9 million lower than the previous year, reflecting lower capital expenditure partly offset by lower customer contributions.

**Financing activities:** The net cash from financing activities at £21.3 million was £135.8 million lower than prior year reflecting net movements in borrowing to fund business operations.

###### **Liquidity risk**

As at 31 December 2016, the Company had access to £75 million under a five-year committed revolving credit facility provided by Lloyds Bank plc, The Royal Bank of Scotland plc and Abbey National Treasury Services plc. This expires on 30 April 2020. The Company expects to raise further facilities, as required, at that time.

In addition, the Company has access to further short-term borrowing facilities provided by YEG and to a £19 million overdraft facility provided by Lloyds Bank plc, which is reviewed annually.

The directors do not consider there to be any doubt over the Company's ability to raise appropriate levels of finance in the future, given its investment grade issuer credit rating and the fundamental financial strength and nature of its business.

###### **Interest rate risk**

The Company is financed by long-term borrowings at fixed rates and has access to short-term borrowing facilities at floating rates of interest. As at 31 December 2016, 100% of the Company's long-term borrowings were at fixed rates and the average maturity for these borrowings was 10 years.

###### **Currency risk**

No material currency risks are faced by the Company.

###### **Pensions**

The Company is a participating employer in the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Scheme"), a defined benefit scheme. Further details of the Company's commitments to the Scheme and the associated deficit repair payments are provided in Note 22 to the financial statements.

The Company also participates in the Northern Powergrid Pension Scheme, which is a defined contribution scheme.

###### **Insurance**

As part of its insurance and risk strategy, the Northern Powergrid Group has in place insurance policies, which cover risks associated with employers, third party motor and public liability. The Northern Powergrid Group carries appropriate excesses on those policies and is effectively self-insured up to the level of those excesses. Consequently, the risk management and health and safety programmes in place are viewed as extremely important elements of the business, given the contribution they make to the elimination or reduction of exposure to such risks.



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Customer service**

During the year, the Company distributed electricity to customers in its distribution services area and continued to improve the overall performance of the distribution network through an investment strategy targeted at delivering improvements in an efficient and cost-effective manner. The Company remains focused on delivering a safe, reliable and dependable supply of electricity, together with a high standard of service to its customers.

Customer service improvements are a priority for the Company, which, in recent years had been consistently ranking in the lower half of Ofgem's customer service league tables. The Company has a long-term goal to improve this position and has a multi-year programme of actions in place to support improvements to the overall customer experience.

Customer satisfaction with the Company's response to unplanned power cuts showed gradual improvement in the year and the focus remains on improving restoration times and proactively communicating more timely and accurate information to customers. Continuous improvements were made to the interactive voice response telephony system throughout the year to make it easier for customers to talk to a customer service advisor and to route their calls appropriately. Customer satisfaction with planned power cuts also showed some improvement with the Company continually enhancing the content of written customer communications and continuing to provide a text and email service to remind customers 72 hours and then 24 hours ahead of the planned power cut taking place.

A framework was introduced during 2016 to define the high standards required of our staff when interacting with our customers, supported by a pilot recognition and reward scheme as well as a performance management structure.

The Company has continued to invest in improving the reliability of under-performing parts of the distribution network by identifying "hot spots" of substandard network performance and taking specific action to address the issues in those areas. In the customer service support areas, further investment has been directed towards information technology with the continued deployment of the new CRM system for customer complaints, additional general enquiries services and service alterations, to both improve the self-service offering and provide quicker and more accurate information to customers with workflows automatically routed within both the Company and its contractors. This technology will enable customers to communicate with the Company in a range of accessible and easy ways across several channels.

During the year focus there was a focus to build on the industry-leading communications and engagement approaches used to support its business plan and maintains a number of engagement channels. Independently chaired expert panels continue to play a key role in challenging the Company's plans, monitoring its performance and helping to deliver innovative initiatives and services. Guided by these panels, the Company has been able to direct effort towards public meetings in the operating zones, community energy workshops aimed at enhancing the take-up of low-carbon technologies and wider collaborations such as with other utilities via Infrastructure North. The feedback received as part of the stakeholder engagement process helped the Company to further develop its customer experience improvement and social obligations programme.

The Company recognised that the evolving nature of the environment and the level of customer service provided in respect of new connections to the network required additional significant focus and, as such, initiated a fundamental business process re-engineering review of this area of the business. Further details regarding the connections activity in the year are provided under "Connections to the network" below.

The single emergency number, 105, went live in September 2016, providing customers with a free national easy to remember phone number. During the winter period of 2016, approximately 28% of all inbound calls relating to power cuts were received via the 105 number, calls that previously would all have been made to the Company's Freephone contact numbers.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT**

**FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Customer service - continued**

In May 2016, the Company put forward its stakeholder engagement and customer vulnerability submission to Ofgem in respect of its work during the year. This included initiatives such as expanding the role of digital solutions in providing customer services and the enhancement of the Company's relationship with some voluntary sector organisations, with which it works closely in developing and delivering certain services particularly in respect of those customers on the Company's Priority Services Register. Following the submission to Ofgem's panel, the position of the Company in the context of the wider DNO group dropped from second place to fifth. The outcome was disappointing and in response to Ofgem's feedback some changes were initiated.

Under the Broad Measure of Customer Satisfaction, an independent market research company carried out telephone surveys with the Company's customers to find out how satisfied they were with the services provided. During the year, surveys were carried out with a number of customers who had contacted the Company regarding an unplanned or a planned power cut, had requested a price quotation and a subsequent connection, or had a general enquiry where a service had been provided or a job completed. The Company recorded an overall satisfaction score of 85.9% for the financial year and expects that the customer experience improvement plan, including the range of initiatives noted on pages 7 and 8, will improve the services provided to customers and so increase the satisfaction ratings year-on-year.

While recognising that its customer service performance can continually be improved, the Company made significant progress during the year ameliorating its overall customer satisfaction scores.

##### **Connections to the network**

During the year, the Company continued to deliver its action plans to improve the connections services provided to its customers, whilst also actively facilitating the development of competition from independent connections providers ("ICPs"). The Company continued to engage regularly with its connections customers both in groups and individually, by holding monthly customer surgeries, twice yearly customer stakeholder events and contributing to national stakeholder forums and events.

There were three main areas of development in the Company's connections business during the year: the introduction of the new Competition in Connections Code of Practice, compliance with which became a licence condition with effect from the end of October 2015, the introduction of the full Incentive on Connections Engagement ("ICE") regime in April 2015 and the introduction of a customer service improvement programme to deliver improvements in customer satisfaction for connections customers.

Delivery of the customer satisfaction improvement programme continued to evolve during 2016, with its focus being actions derived from customers' feedback obtained from weekly Ofgem telephone surveys. The programme is designed to support the Company's goal to be the leading provider of customer service within the electricity distribution sector.

The Company participated with other DNOs in the development of the new Competition in Connections code of practice and implemented the required new processes, including the provision of dual quotations, enabling ICPs to self-determine and approve points of connection to the network, and simplifying the authorisation process for ICPs' operational staff.

The start of the ED1 period saw the introduction of ICE in respect of customers requiring larger connections to the network, so that the needs of those customers can be met more effectively. Under ICE, the Company is required to submit a customer service improvement work plan for the forthcoming regulatory year at the end of April, followed by a comprehensive "looking back and forward" report commenting on the actions delivered in the previous year and future actions proposed in the service improvement plan. The Company worked throughout the year to deliver those actions and continued to engage actively with customers through both informal and formal stakeholder events.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Customer service - continued**

###### **Corporate responsibility**

The Company places significant value on the relationships that it has with its customers and other stakeholders and also understands the importance of ensuring a secure and safe power supply for its customers and their local communities. To further embed these values, the Company has developed a vision to maximise the value of contact with customers, especially those who are vulnerable and hard to reach, while ensuring that all stakeholders have the opportunity to influence the local and national energy agenda through effective engagement. This vision applies Ofgem's feedback to the Company in the Stakeholder Engagement and Consumer Vulnerability review directed at a cohesive approach to customer experience; consumer vulnerability and stakeholder engagement. The Company has made a commitment to tailor and enhance the support provided for more vulnerable and hard to reach customers and to ensure an optimum overall customer experience. In addition, through effective engagement, stakeholders can shape and influence the Company's agenda and have the opportunity to help shape and prioritise plans according to customer preference.

During the year, the Company continued to work closely with key partners such as the Environment Agency, the local authorities and the local resilience forums so that it can respond quickly to significant faults on, or threats to, the network. An example of this collaboration in the year included the cascade of the new national '105' number, designed to make it easier for partners and customers to quickly get in touch to report a problem. The Company has well-established emergency procedures that are implemented when customers are without power for some time and, as such, the Company responded well to the significant weather-related incidents, which affected the distribution network during the year.

To address customers' concerns and resolve any complaints, the Company utilises its customer ambassadors and customer liaison officers, who are allocated to each of its operating zones. Dedicated Priority Services Register co-ordinators contact our vulnerable customers to offer support during and after a power cut. Support may include liaising with staff from the British Red Cross who check on the welfare of the customer.

The Company has developed its support for vulnerable customers based on market research which defined where and what assistance was most needed. This work has been supported by the Company's Social Issues Expert Group which comprises external experts and advises on service improvements. Membership of the internal Social Responsibility Management Group has been widened to include more business representatives to help develop this programme. The Company continued to campaign to promote the Priority Services Register to eligible customers and now has a clear view of service need profiles for each customer to inform the appropriate priority service response. The Company has undertaken a comprehensive data cleanse process for the Register and developed a proactive contact programme to routinely renew records and ensure that the quality of the information held on the register and the services offered to priority services customers continue to improve.

The Northern Powergrid Group has maintained its support to charitable organisations through sponsorship and the "Safety Champions" initiative, which is aimed at enhancing safety performance in the operational zones. Furthermore, a volunteering policy was implemented permitting employees to volunteer on schemes specifically designed to support the five priority areas within the Company's community investment programme.

Safety remains the Company's first priority and underpins all operations. During the year, the Company continued to deliver initiatives that reached thousands of school children including its regular series of school safety presentations. The Company participated in 'Crucial Crew', which is a schools-based safety initiative that teaches children to recognise and avoid situations that put them in danger.

Other programmes expanded during the year included Make the Grade in Energy, an education, skills and employability programme, Energy Heroes, a new educational programme, which uses the maths curriculum at primary school level to promote awareness of energy costs and ways of saving energy, and Green Doctors, a multi-partner project which helped to install energy saving measures and give advice to fuel poor households. New projects undertaken in the year included a partnership with the Children's Society, which aims to support young people and families through specialist support services, including work sessions and group activities, and the creation of an outreach worker in Citizens Advice to train volunteers to help more vulnerable people, particularly those with fuel debt.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

#### CORE PRINCIPLES - continued

##### Operational excellence

The Company's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the year, £225.1 million was invested in the improvement of the distribution network. The Company's inspection and maintenance regimes have ensured that the underlying health of the network assets has been sustained and none of the leading indicators used by the Company suggest any diminishing performance in this respect in the future.

Ofgem's incentive scheme for quality of service provides a measure of the level of customer service. As a result of the Company's continued and substantial investment in its distribution network, reliability has increased over a sustained period and the Company has generally outperformed in relation to the customer service targets set by Ofgem in respect of customer interruptions ("CI") and customer minutes lost ("CML").

CML and CI are the key performance indicators used by the Company to measure the quality of supply and system performance. Both indicators are measured on a Regulatory Year basis, which runs annually to 31 March, (being 31 March 2016 for the period covered by this report). CML measures the average number of supply minutes lost for every connected customer due to both planned and unplanned power cuts that last for three minutes or longer. CI measures the average number of supply interruptions per every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer.

In respect of these key customer service performance indicators, the goal is to achieve performance that is below Ofgem's target number in respect of CML and CI. The Company's reported performance for the year was as follows:

|     | Year to 31 March 2016 |        | Year to 31 March 2015 |        |
|-----|-----------------------|--------|-----------------------|--------|
|     | Actual                | Target | Actual                | Target |
| CML | 41.8                  | <63.1  | 50.4                  | <76.0  |
| CI  | 52.5                  | <68.5  | 60.9                  | <75.3  |

Consequently, performance in the regulatory year was better than Ofgem's target for both CML and CI and contributed to the Company's improved customer service performance.

##### Operational activity

During 2016, the Company continued to implement its approved network investment strategy, which is designed to deliver improvements in an efficient and cost-effective manner in order to improve the network's resilience. The Company is committed to enhancing the reliability of the network such that fewer power cuts affect customers and, when power cuts do happen, they are shorter in duration.

The Company's Operations structure is designed to respond effectively to the needs of customers and local communities by delivering improved performance standards in the restoration of power following power cuts and in new connection activities for small works. That structure is organised into operating zones around the main conurbations of West Yorkshire and South Yorkshire, the industrialised area around the Humber and the rural areas of the Yorkshire Dales, the east coast of Yorkshire and North Lincolnshire. The guaranteed standard for the restoration of supply within 12 hours of a power cut occurring came into effect from 1 April 2015 and the Company's operational structure provides a localised focus to optimise response times in the event of a power cut.

During the year, the Company continued to invest in technology to support its drive to improve response times, including the expansion of the automated power restoration system ("APRS") which operates within the existing network management system. In the event of a high-voltage fault, APRS analyses the information presented by intelligent assets installed on the network and, from that information, determines where the fault is located and executes switching to restore power to the 'healthy' network in a safe manner in under three minutes.

It is planned to enable APRS at 306 primary substations across the Northern Powergrid Group by the end of the ED1 period. The Company expects, therefore, that APRS will significantly improve the service to customers due to the speed with which it can understand the information presented and then complete the switching required to restore power.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Operational excellence - continued**

The Company responded well to the major weather events that impacted its network during the year. There were three events - Storm Gertrude brought strong winds in January, an intense lightning storm in September and heavy rains following a prolonged dry spell in November - which resulted in the Company invoking its full major incident management plan.

The Company's priorities during the year included delivering a significant level of capital expenditure on the network, a further reduction in the average level of fault repair work in progress and continued focus on the restoration times associated with both high-voltage and low-voltage power cuts, with high-voltage restoration performance averaging some 52.8 minutes (2015: 55.5 minutes), after allowing for severe weather incidents and other exemptions.

The Company undertook various major projects during the year in support of those targets and as part of the investment strategy, including:

- Continuation of reinforcement of the primary network in the Doncaster area with excavation and duct installation for the 132kV cables to connect West Melton to the new 132/33kV Mallard Way substation at Potteric Carr;
- Completion of the work to replace the 6kV network in the King George Docks area of Hull and replacement of the 11kV switchboard at West End Lane;
- Refurbishment of two 132kV transformers and plant replacement at Horbury substation;
- Replacement of 19km of 132kV oil-filled cable from Creyke Beck to Hull South;
- Replacement of 4km of 132kV oil-filled cable from Beeston Royds to Kirkstall;
- Extensive on-going works in the Sheffield area including the replacement of 15km of 33kV gas insulated cable and 3km of 33kV oil-filled cable;
- Extensive ongoing works in the Huddersfield area including the replacement of 14km of 33kV solid cable and 1km of 33kV gas insulated cable;
- Sections of nine extra-high-voltage overhead line circuits were rebuilt with the replacement of 27km of conductor, 44 decayed wood poles and the removal of 165 Woodhouse Mast overhead line structures;
- 35km of high-voltage overhead line and 22km of low-voltage overhead line were refurbished or rebuilt;
- 78 units of high-voltage outdoor switchgear, 60 high-voltage distribution substations and 258 units of high-voltage indoor switchgear were replaced; and
- 190 new remote control points were installed and commissioned.

In order to deliver its investment strategy, the Company undertook its activities using a mix of its own staff and contractors, including affiliated companies in the Northern Powergrid Group.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

#### CORE PRINCIPLES - continued

##### Employee commitment

###### **Health and safety**

The focus on health and safety continued to be of paramount importance for the directors, as it is for all employees. There is a continuous drive for improvement in safety performance through the setting of challenging goals and the pursuit of a comprehensive safety and health improvement plan, which reflects the Company's fundamental objective that every employee and contractor should go home uninjured and in good health after a productive day's work. The Company makes no compromise in respect of its health and safety obligations and centres its safety plans and systems on the principles found in companies with world class safety performance.

The Company's safety record over a number of years suggests that it is one of the safest in the sector in which it operates. There is an intention to improve performance still further and, in doing so, maintain its position over the coming years. Having identified issues that may pose an increased safety risk, such as metal theft and the roll-out of smart meters, the Company is implementing measures through its safety and health improvement plan that will build incrementally on the existing strong safety record and ensure that safety considerations are always part of the investment decision-making and appraisal process.

The Company measures its health and safety performance in calendar years and operational incident performance for the year ended 31 December 2016 had significantly improved, with only four switching-related incidents experienced on the high-voltage network against a target of six and compared with eight events recorded in 2015. As one of the key deliverables in the Company's safety and health improvement plan is to raise awareness and improve the concentration skills of its operational engineers and other employees, the Company continued its operational audit programme of senior authorised persons such that the operational practices of 86% of senior authorised persons were verified during the year. The Company also delivered operational seminars, stand-down briefings, and regular safety newswashes to staff in order to cascade information on safety trends, issues and incidents.

Several key performance indicators are used to monitor safety performance, with the goal of achieving performance that is below the target number. The main key performance indicators are as follows:

|                               | 2016   |        | 2015   |        |
|-------------------------------|--------|--------|--------|--------|
|                               | Target | Actual | Target | Actual |
| Lost time accidents           | 2      | 4      | 1      | 2      |
| Restricted duty accidents     | 1      | 0      | 1      | 0      |
| Medical treatment accidents   | 1      | 1      | 2      | 1      |
| Operational incidents         | 6      | 4      | 6      | 8      |
| Preventable vehicle accidents | 13     | 12     | 13     | 15     |

The Company experienced four lost time accidents in 2016 (as opposed to two in 2015) and recorded one medical treatment (equalling 2015). In addition, performance in respect of preventable vehicle accidents was one accident below the target for the year and performance improved with three fewer accidents compared with 2015.

In common with the Berkshire Hathaway Energy Group, the Northern Powergrid Group measures its safety performance in terms of the OSHA rate, which is a measure used in the United States to capture safety incidents down to minor levels of medical treatment, such as a stitch or the use of prescription pain killers. As part of its plan to reduce the OSHA rate across the group, Berkshire Hathaway Energy issues daily e-mail updates in respect of performance against its overall OSHA rate and preventable vehicle accident targets, which include information on incidents that have occurred. The Company's Director of Safety, Health and Environment also delivered updates using conference call facilities, which were available to the entire workforce, regarding performance and other safety-related issues.

Delivery of the various initiatives in the safety and health improvement plan contributed to the Northern Powergrid Group achieving an OSHA rate of 0.30 against a target of 0.30, which equated to only seven recordable incidents; one more than the performance recorded in 2015. The Company recorded an OSHA rate for 2016 of 0.44 (2015: 0.26) against a target of 0.35.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Employee commitment - continued**

As part of the safety and health improvement plan and in order to reinforce the operational safety values, the Company continued to implement its cross-business operational assurance audit programme and its senior management field engagement programme in order to improve two-way communication on safety and other key business issues. During the year, a robust road risk management plan was effective which involved electronic driving licence checking, delivering road risk awareness workshops to new employees and using risk reduction tools such as online driver assessment and training followed by an on-road refresher training session if required. The driver training programme provides practical driving training to a targeted population of drivers and is the primary route to improving driver skills in the longer term. Recognising that driving is one of most hazardous activities undertaken on a daily basis, the programme has continued to expand further throughout 2016 via an interactive, web-based system designed to assess skills and then provide individual training plans to improve hazard perception and reinforce specific aspects of driving-related skills. The Company also completed a programme to install a telematics system in all of its fleet vehicles in order to support driver and vehicle safety by encouraging responsible and safe driving styles, assist with the completion and management of vehicle safety checks, and expedite investigation of vehicle accidents and incidents.

During the year, the Company was awarded a President's Award from the Royal Society for the Prevention of Accidents for achieving 12 consecutive Gold Awards in recognition of achievements in 2015 and for continued or improving standards of health and safety over a sustained period. The Company's OHSAS 18001 health and safety management systems successfully retained certification having been subject to a ten-day recertification audit by an external auditor.

The sickness absence rate across the Northern Powergrid Group for 2016 was 2.96% (2015: 2.71%).

##### **Management structure**

Operational management of the Company and that of its affiliate, Northern Powergrid (Northeast) Limited ("NPg Northeast"), is undertaken by a single senior management team with specific functional responsibilities. Those functional responsibilities are in respect of operations, safety, health and environment, asset management (including procurement), customer service, business development (including new connections to the network), policy and markets (including trading and innovation), regulation, human resources, organisation development, legal and finance (including property management, stakeholder engagement and information technology). Some of those functions also provide services across the Northern Powergrid Group.

##### **Employees**

The Company continued to apply appropriate control to its headcount policy and to place significant emphasis on the importance and application of high standards of management and performance in support of the Core Principles. The Company ensures that a level of consistency is adopted in so doing and, in respect of employee relations, continued to build constructive and partnered relationships with the trades unions. In that respect, the Company has secured multi-year pay agreements with the various employment groups such that the relevant terms and conditions are fair and appropriate across the Northern Powergrid Group.

The Northern Powergrid Group will continue to recruit trainees under its workforce renewal programme during the ED1 period taking account of the rate at which existing employees either leave or retire from the Northern Powergrid Group. A total of 71 new recruits joined the workforce renewal programmes during 2016. In addition, 73 trainees who were part of the workforce renewal programme in previous years graduated from their training programmes. In total, the Northern Powergrid Group recruited 95 new employees from the external market.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Employee commitment - continued**

As a member of the Berkshire Hathaway Inc. group of companies, Berkshire Hathaway Energy sets high expectations for honesty and integrity in the conduct of all business activity. Consequently, the Company is committed to proper business conduct and has adopted the Berkshire Hathaway Energy code of business conduct, which details the commitment to ethics and compliance with the law, provides reporting mechanisms for known or suspected ethical or legal violations, and establishes minimum standards of behaviour expected of all employees. All employees must complete annual training on the code of business conduct. A "speaking up" policy is also in place so that members of staff are able to raise any instances of unethical acts, malpractice or impropriety. An additional process is also available to all staff via an international, anonymous help line operated by an independent company.

In order to support the welfare of its employees, the Northern Powergrid Group provides an employee assistance service to its staff via an independent company that supports over 350 organisations in the United Kingdom. The programme is a confidential, self-referral counselling and information service to assist with personal or work-related problems that may be affecting health, wellbeing or performance and is available 24 hours a day, 365 days a year. The services available include health, wellbeing and family-care information, financial information and debt counselling, and legal guidance. Working in partnership with its occupational health provider, the Northern Powergrid Group is delivering a long-term strategic programme aimed at improving the health of its staff.

Progress continued to be made during the year on the key priorities in the human resources and organisational development functions, including recruitment, employee engagement, and performance management and development. Throughout the year, the Company continued to set and uphold the promotion of high standards of probity among staff. In addition, the Company's organisational structure has been developed to control business units and to delegate authority and accountability, having regard to acceptable levels of risk.

As at 31 December 2016, the Company employed 1,184 staff (2015: 1,213).

##### **Environmental respect**

The Company's approach to environmental compliance is governed by an environmental policy and, in addition, the policy of Environmental RESPECT (Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training) implemented by Berkshire Hathaway Energy. These policies and their subordinate operational control procedures and systems address compliance with legal and other key environmental requirements, pollution prevention and continual improvement, and also promote environmental awareness and best practice amongst the Company's staff and contractors.

The Company has operated a United Kingdom Accreditation Service scheme for environmental management since the late 1990s, certified to the environmental management systems standard ISO 14001: 2004. It is subject to regular six-monthly assessment visits and a three-yearly certificate renewal assessment by an accredited external certification body in order to retain that status.

The most recent visit was a surveillance assessment carried out by Lloyd's Register Quality Assurance in October 2016. The assessment reported the continued improvement made to the environmental management system over the past three years. There were no non-conformances noted and, after a rigorous three-day surveillance audit, continued certification was recommended and subsequently confirmed.

Procedures and processes were reviewed and developed in the year to improve the effectiveness of the environmental management system. Operational controls at depots have also significantly improved, which has supported the reduced number of minor non-conformances raised at recent surveillance visits, with zero minor non-conformances reported in 2016. In the event that fluid leakages do occur, the Company has in place an emergency incident response support contract with a specialist service provider, under which 24-hour environmental incident assistance is provided, including contamination mitigation, remediation and incident-validation reporting.



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Environmental respect - continued**

Improvements in support of the Company's environmental policy objectives continued to focus on replacing selected fluid-filled cable sections with non-fluid polymeric equivalents, replacing oil-filled circuit breakers with vacuum and sulphur hexafluoride gas-filled units at outdoor substations to reduce the potential for oil leakage and using gas tracer technology to locate cable fluid leaks quicker, where it was practicable to do so. The Company also provided environmental awareness training for staff via an online system to avoid the need for travelling to central training locations. These improvements support the Company in delivering sustained environmental performance, which it measures on a calendar year basis, and, in the year ended 31 December 2016, only three incidents were reportable to the Environment Agency, which was significantly better than the target of seven. Oil spills and leaks from the Company's assets were under the target of 25,714 litres by 39% with a loss of 15,722 litres and SF6 gas discharges from electrical plant exceeded the target of 84 kilogrammes by 19% with a loss of 100 kilogrammes.

During the year, work continued with many of the Company's key stakeholders, including the Environment Agency, to enhance the advanced environmental management processes already in place and, in 2017, the Company plans to maintain this progress so that the impact on the environment in which it works is reduced and the most effective ways of doing so are utilised. The Company's business plan contains a commitment to reduce its business carbon footprint by 10% by the end of ED1 and performance remains on course to achieve that target.

The Company's commitment to the Environmental RESPECT policy and its improved overall performance contributes towards minimising its impact on the environment. As part of its annual environmental improvement plan, the Company has mobilised significant programmes to replace fluid-filled cables and place overhead lines underground in National Parks and Areas of Outstanding Natural Beauty, reduce electrical losses and implement further improvements to the network that take account of protected structures, features, areas, wildlife and habitat. Birdlife is being protected by placing bird-diverters on power lines where they are in proximity to nature reserves, wetlands, flight paths or in locations where rare species of bird are known to live or breed and also in response to information obtained from incident trends. The Company continues to work with local social enterprises that rescue waste timber in order to provide affordable reclaimed timber products to the local community.

##### **Sustainability**

The Company's activities have an important part to play in the United Kingdom's transition to a low-carbon economy, both in its capacity as a major participant in the United Kingdom energy industry and in terms of its own carbon footprint.

As the country takes action to make significant reductions in its carbon emissions, the way in which electricity is produced and used is expected to have a substantial impact on the electricity network over time. Evidence of this has already been seen through the number of installations made by customers of low-carbon technologies such as photovoltaic solar panels, electric vehicles and heat pumps which continued to increase during the year and are reported via the regulatory reporting process. The volume and total capacity of decentralised energy generation has also been growing steadily for the last few years and, given the greater range of load and generation technologies now being connected to the network, the Company is taking action to develop innovative solutions that will reduce the need for traditional and potentially expensive reinforcement of the network.

The Company's innovation projects have continued this year from the platform established by the ground-breaking Customer-Led Network Revolution ("CLNR") programme of work that concluded in 2015. The four priorities of smart grids, smart meters, digital-enabled services and issues of affordability continue to be highly relevant to our stakeholders. In the smart grid area, the transition to distribution system operator is taking increased prominence in the innovation portfolio. During the year, the Company completed work to better understand how local energy markets may develop, the potential impact of future market models and the role of new players such as local authorities. Deployment of innovation in the year has delivered £7.5 million of value, with around half of that centred on releasing capacity and providing flexible connections for immediate customer benefit.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Environmental respect - continued**

The Northern Powergrid Group climate change adaptation strategy outlines the impact that climate change is anticipated to have on the business, the risks that this poses and the proposals recommended to mitigate these risks. The proposals include flood defences, vegetation management, network specifications for changing temperatures, improved weather prediction, and adequate staff availability. The planned number of flood defences to be installed during the year was not achieved. This was primarily due to the re-tendering of the delivery contract. Under the re-phased programme, the delivery of the overall commitment to install further flood defences during the ED1 period remains on-track.

Environmental performance was strong with incidents reportable to the Environment Agency, fluid loss and the Company's carbon footprint being lower than targeted. The Company policy of installing over-sized cables continues to save network losses, which contributed to further carbon emission reductions.

##### **Regulatory integrity**

The Company manages its business to the highest behavioural standards and adheres to a policy of strict compliance with all relevant standards, legislation and regulatory conditions. The Governance and Risk Management Group ("GRMG") is the principal risk management forum in the Northern Powergrid Group, and monitors and manages performance in risk-related and compliance areas. The GRMG met on three occasions during the year in order to review the mechanisms for meeting external obligations, to strengthen the business-control-improvement environment, and to consider and advise on key strategic risks facing the Company.

Breaches by a DNO of its licence conditions and certain other statutory requirements could lead to financial penalties, which Ofgem has stated "will have a proportionate impact on shareholder returns". In order to assure compliance with licence and other regulatory obligations, the Company operates a regulatory compliance affirmation process, under which ownership of approximately 1,780 regulatory obligations contained within the compliance database is currently assigned to around 75 responsible managers. Those responsible managers are required, on a quarterly basis, to review compliance with the relevant obligations that have been assigned to them for certification and report on any identified non-compliances or perceived risks to the compliance process, which are then addressed. The Head of Regulatory Compliance reports to the board of directors on the outcome of each quarter's exercise.

Under the RIIO (revenue = incentives + innovation + outputs) model for regulation, price controls are set for eight years (rather than five as has previously been the case), with provision for a mid-period review of the outputs that network companies are required to deliver. The ED1 price control became effective on 1 April 2015 and is due to end on 31 March 2023.

Under the ED1 price control, excluding the effects of incentive schemes and any deferred revenues from the prior price control, the Company's base allowed revenue before inflation reduced by 0.5% for the regulatory year ended 31 March 2017, relative to the previous year. Base allowed revenues before inflation will then be constant for each subsequent regulatory year through to the regulatory year ended 31 March 2023. Nominal base allowed revenues will therefore increase in line with inflation (as measured by the United Kingdom's Retail Prices Index).

The ED1 price control is the first to be set for electricity distribution in Great Britain since Ofgem completed its review of network regulation (known as the RPI-X @ 20 project). The key changes to the price control calculations, compared to those used in previous price controls are that:

- the period over which new regulatory assets are depreciated is being gradually lengthened, from 20 years to 45 years, with the change being phased over eight years;
- allowed revenues will be adjusted during the price control period, rather than at the next price control review, to partially reflect cost variances relative to cost allowances;

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORE PRINCIPLES - continued**

##### **Regulatory integrity - continued**

- the allowed cost of debt will be updated within the price control period by reference to a long-run trailing average based on external benchmarks of public debt costs;
- allowed revenues will be adjusted in relation to some new service standard incentives, principally relating to speed and service standards for new connections to the network; and
- there is scope for a mid-period review and adjust revenues in the latter half of the period for any changes in the outputs required of licensees for certain specified reasons.

Many other aspects of the previous price control remain in place (either in their previous or similar form), including adjustments to revenues in relation to the number and duration of service interruptions and customer service standards. In addition, network tariffs, from which actual revenues are derived, are now set further in advance than was previously the case.

With the start of the new price control, changes were also made to the legislation that prescribes the standards of service to be provided by the DNOs in specified circumstances and payments to be made to end-customers for failure to meet those standards. The most significant of these changes reduced from 18 to 12 hours the time that is allowed for restoration of supplies following an unplanned power cut in normal weather conditions.

The Company submits a number of information returns to Ofgem and is required, under the terms of the Company's licence, to assure the accuracy of those returns. These arrangements involve the preparation and submission to Ofgem, by the end of February in each year, of a risk-based data-assurance plan for the regulatory year ahead, together with a report detailing the assurance work actually carried out in the regulatory year just ended and the findings of that work.

#### **PRINCIPAL RISKS AND UNCERTAINTIES**

There are a number of potential risks and uncertainties, which could have an impact on the Company, its financial position and its operations and may cause actual results to vary materially from those expected or historically experienced. The principal risks are outlined as follows:

##### **Financial risk**

As a holder of an electricity distribution licence, the Company is subject to regulation by the Gas and Electricity Markets Authority (GEMA), which acts through Ofgem. Most of the revenue of the electricity distribution licence holders is controlled by the distribution price control formula set out in the electricity distribution licence.

The price control formula does not constrain profits from year to year but sets the maximum permitted revenue for each regulatory year, taking into account base allowed revenues and movements in Retail Prices Index, as well as factors such as performance against certain regulatory incentives. Where the Company recovers more, or less, than this maximum the difference is carried forward, with interest. For amounts relating to the regulatory year ended 31 March 2016, the carry forward will be into the entitlement for the regulatory year ended 31 March 2018.

The price control for ED1 has been set for the eight-year period commencing on 1 April 2015, although the price control formula may be reviewed at other times at the discretion of Ofgem, and it is Ofgem's intention to use eight-year price control periods in the future. A resetting of the formula is made by GEMA without the consent of the electricity distribution licence holder, but a licensee can appeal to the CMA against a decision by GEMA to proceed with such a modification. Certain other interested parties have the same right.

During the term of the price control, the rate of inflation as measured by RPI is taken into account in setting the Company's allowed income in respect of each regulatory year. Consequently, one of the risks faced by the Company is that its costs may increase by more than RPI. Any changes in costs incurred will have a direct impact on the Company's financial results, as will changes in performance under incentive schemes, such as in customer service, which can lead to adjustments to allowed revenues.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **PRINCIPAL RISKS AND UNCERTAINTIES - continued**

Ofgem recognises that defined benefit pension schemes and, particularly, the current deficit positions of various schemes, represent a significant cost to the DNOs and, in its final proposals in respect of the previous price control period ("DPCR5"), Ofgem confirmed that DNOs would be allowed to recover the actuarial value of the deficits attributable to a licensee's distribution business in existence as at 31 March 2010 via its regulated revenues (after an adjustment to reflect the residual of unfunded early retirement deficiency costs as at 31 March 2010). Ofgem re-affirmed these principles in its EDI final determination.

However, given the stable and regulated nature of the DNOs' businesses, Ofgem took the view that a notional repair period of 15 years from 1 April 2010 was appropriate for the purpose of assessing the DNOs' allowed revenues in respect of pension costs. Moreover, Ofgem reviews the reasonableness of the triennial actuarial valuations of DNOs' pension schemes and calculates new deficit funding allowances, including any adjustments that may be necessary to account for differences between allowances received and payments actually made to the relevant pension scheme.

The other financial risks facing the Company are outlined on page 6 of this Strategic Report.

#### **Operational risk**

There are a number of risks to the Company's operational performance in respect of which mitigating actions have been taken. Appropriate credit cover arrangements are in place with the electricity suppliers, which would allow recovery of defaulted payments through the price control mechanism and a robust major incident management plan is implemented whenever severe weather impacts on the distribution network's performance. Given the regular instances of metal theft experienced in previous years, the Company maintained its programme of risk-assessed and enhanced security measures at its sites and pursued awareness raising activity at a national and local level, including commencing a social media campaign in early 2016 in partnership with Crimestoppers.

The electricity distribution business has an inherently increased health and safety risk due to the network operating at up to 132kV. Employees work at height, in closed spaces and with live electricity, increasing the risk of potential safety matters. Health and safety is given the highest priority within the Company and strict policies and procedures are in place to ensure the safety of both employees and customers.

Cyber security is an increasing risk. The Company has a robust cyber security risk mitigation programme in place including gaining accreditation under of ISO 27001 Information Security (process security) standard for certain discrete business areas, plus compliance with the Centre for Internet Security Critical Security Controls. Further advances to this are being continuously implemented and managed.

The Company recognises that there are uncertainties around the future take-up of low-carbon technologies and the resulting capacity requirements for the network, and from the fitting of smart meters throughout the Company's distribution services area, which is expected to result in a requirement to address a proportionate number of reported defects. The Company believes that it can effectively manage these issues through its usual risk management practices.

#### **Commercial risk**

Managing commercial risk continued to be of key importance and the Company remained focused on ensuring that its policies for credit checking, payment terms, payment performance tracking and debt management were strictly adhered to.

The Company's relationship with its main customers is governed by a distribution connection and use of system agreement ("DCUSA"), which is in place with each of those customers. Those customers are the electricity suppliers who, under the terms of the DCUSA, pay charges for the use of the distribution network, in respect of which it is necessary to ensure that credit cover arrangements in line with Ofgem's guidance remain in place. The principal electricity suppliers that use the Company's network are RWE Npower, British Gas, EDF Energy, E.ON, SSE and Scottish Power.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **PRINCIPAL RISKS AND UNCERTAINTIES – continued**

The Company operates utilising a mix of direct labour and contracted resource and has a range of contracts in place with various service providers for delivery of its work programmes, which are subject to regular market testing and tendering exercises. Those services include vegetation management, overhead line inspection and construction, substation construction and maintenance, underground cable laying services, vehicle leasing and servicing, tower refurbishment and information technology services. The Company also has an extensive suite of contracts in place for the procurement of all of the goods and equipment it requires to deliver its capital expenditure programme and to run its business, including for varying types of transformers, switchgear and cables.

#### **Risk Management**

The Northern Powergrid Group operates a structured and disciplined approach to the management of risk as part of its overall risk management policy and, in DPCR5 and previous price control periods, accepted and successfully managed substantial cost and delivery risks by developing a culture of cost and risk management over that period of time. Risks are divided into a number of risk sectors which, in turn, align to the Northern Powergrid Group's Core Principles, as detailed on pages 5 to 17 of this Strategic Report. A report regarding the effectiveness of each risk sector in terms of risk management, control activity, key success factors and supporting measures is presented at meetings of the GRMG. The risk environment is reviewed continually in order that new or emerging potential risks are identified.

The Northern Powergrid Group identifies and assesses risks associated with the achievement of its strategic objectives so that any actions needed to further enhance the control environment are identified, along with the person responsible for the management of the specific risk. A regular review of the key risks, controls and action plans is undertaken. The risk management programme includes regular review of the crisis management, disaster recovery and major incident plans, which are periodically tested, the sharing of best practice on disaster preparedness and response, disaster recovery tests of IT servers and priority processes, penetration tests against firewall systems, and a peer review of the Northern Powergrid Group's risk management systems by Berkshire Hathaway Energy.

Risk management continues to be a central theme of senior management priority setting, as well as an explicit business process that helps to identify lower probability, high consequence threats to business success or continuity. This approach is reinforced by that of the Berkshire Hathaway Energy group, whose activities have continued to include benchmarking of risk management activities across its business units, including the sharing of significant lessons learned associated with risk management.

A key element and requirement of the risk management process is that a written certificate is provided by the President and Chief Executive Officer of the Northern Powergrid Group confirming that the effectiveness of the system of internal controls has been reviewed during the year. A self-certification process is in place, in support of this review, whereby certain senior managers are required to confirm that the system of internal control in their area of the business is operating effectively. Consequently, the directors believe that a robust system of risk assessment and management is in place.

#### **Internal Control**

A rigorous internal control environment exists within the Northern Powergrid Group based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. Berkshire Hathaway Energy requires a quarterly risk control assessment to be undertaken by certain senior managers as part of its programme for compliance with the requirements of the United States Sarbanes-Oxley Act and, while no significant areas of weakness have been identified, any recommended improvements are implemented.

In addition, the Northern Powergrid Group employs comprehensive business planning and financial reporting procedures, regularly reviews key performance indicators to assess progress towards its goals and has a strong internal audit function to provide independent scrutiny of its internal control systems. The Northern Powergrid Group has risk management procedures in place, including the standards required by the United States Sarbanes-Oxley Act, and has centralised treasury operations and established procedures for the planning, approving and monitoring of major capital expenditure.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **PRINCIPAL RISKS AND UNCERTAINTIES - continued**

The Northern Powergrid Group is committed to maintaining the highest ethical standards in the conduct of its business and, in that respect, implements Berkshire Hathaway Energy's code of business conduct for employees. The code of conduct sets out and emphasises the required standards and commitment to ethical behaviour, provides reporting mechanisms for known or suspected ethical issues, helps prevent wrongdoing, and creates and sustains an ethical work environment across the Northern Powergrid Group. All employees are required to complete annual training on the code of business conduct and then confirm that they understand the requirements outlined in the code. The training is available online and employees who do not have access to the online system attend a briefing with their line manager.

The Company does not have a specific human rights policy but, as noted in this Strategic Report, it bases its operations on the Core Principles in order to deliver its long-term objectives. Accordingly, the Company remains fully committed to operating ethically and responsibly and with fairness and integrity through the policies and procedures it has in place which set the approach to its employees, their health, safety and welfare, its dealings with customers, particularly those who are vulnerable and on the Priority Services Register, its impact on the environment and its contribution to the sustainability agenda within the energy industry. The Core Principles are a key factor in the responsible way in which the Company operates its electricity distribution business, examples of which are described throughout this Strategic Report.

The Northern Powergrid Group is also committed to preventing corruption in all its forms and continues to have a zero-tolerance approach to corruption in its business or by those with whom it does business. The board of Northern Powergrid Holdings Company has addressed the risks introduced by the Bribery Act 2010 through a compliance policy, changes to contractual terms, training and other staff awareness measures. The introduction of annual risk assessments and enhanced due diligence in respect of new business transactions has further assisted in ensuring compliance.

The Northern Powergrid Group requires staff, suppliers of services and business partners to comply with the Bribery Act. Its policies encourage an employee who has any suspicion of bribery or other form of corruption within or related to the Northern Powergrid Group to report the suspicion to a manager or via the international, anonymous help line mentioned in the Employee commitment section.

The Company has appropriate controls in place directed at ensuring compliance with the conditions in its licence requiring any payments made to, or received from, affiliates or related undertakings in respect of goods and services provided or supplied to be on an arm's length basis and on normal commercial terms.

In preparing these accounts, the directors have assessed the viability of the Company for the purposes of making the statement below and do so on an ongoing basis as part of the preparation and approval of the Company's ten-year business plan.

The directors have chosen the eight-year period from 1 April 2015 for the purposes of making this statement because it equates to the ED1 regulatory period, though longer periods may be appropriate given the 45-year life ascribed by Ofgem to the Company's new assets, the enduring nature of the Company's business and the fact that the notice period for revocation of the Company's electricity distribution licence is 25 years. The Company's income has been set for the ED1 regulatory period, although there is scope for a mid-period review and Ofgem may adjust revenues in the latter half of the period for any changes in the outputs required of the Company for certain specified reasons. Consequently and given the general stability associated with the regulatory environment in which the Company operates, the directors have been able to prepare sufficiently robust forecasts as part of the Company's annual business planning process, taking account of the principal risks and uncertainties which might have an impact on those forecasts. The Company's forecasts look forward for a 10-year period and anticipate the Company's continued stable operations beyond the ED1 price control period.

Details of the principal risks and uncertainties, which could have an impact on the Company, are provided on pages 17 to 19 of the Strategic Report and details of how those principal risks are assessed and managed are provided in the Risk Management section of the Strategic Report.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **PRINCIPAL RISKS AND UNCERTAINTIES - continued**

The directors' ongoing assessment of the principal risks and uncertainties facing the Company also includes meeting the obligations in the Company's licence to provide Ofgem with annual certificates, approved by the board, confirming that the directors have a reasonable expectation that the Company will have sufficient financial resources, financial facilities and operational resources available to it so that the Company is able to carry on its Distribution Business for a period of 12 months from the dates of those certificates. Assumptions taken into account when approving those certificates include (i) the potential for significant adverse financial impact from the various incentive schemes that can lead to variations in the Company's allowed income under its price control arrangements; (ii) the occurrence of catastrophic natural or other events, which could have a significant impact on the operating performance of the distribution network or involve significant expenditure; (iii) whether significant customer payment defaults may be experienced; and (iv) the continued availability to the Company of suitably qualified and experienced staff. Given the regulatory environment in which the Company operates, it is currently considered unlikely that there will be material variances to the assumptions used in providing those certificates during the ED1 period.

The stable nature of the Company's business is evidenced by the fact that the commitments made by the Company in its well-justified business plan, which was originally submitted to Ofgem as part of the ED1 price control review process, have not changed materially. Consequently, assuming that the principal risks and uncertainties facing the Company continue to be managed effectively, the directors have a reasonable expectation that the Company will be able to continue in operation and meet its liabilities as they fall due over the ED1 period.

#### **ON BEHALF OF THE BOARD:**



P A Jones  
Director  
24 March 2017

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

The directors present their report with the audited financial statements of the company for the year ended 31 December 2016.

#### **DIVIDENDS**

During the year, an interim dividend of £28.7 million (9.9p per ordinary share) was paid (2015: £27.6 million, 9.5p per ordinary share). The directors recommended that no final dividend be paid in respect of the statutory accounting year ended 31 December 2016. No interim dividend was paid during the period from 1 January 2017 to 24 March 2017.

The Company's dividend policy is that dividends will be paid only after having due regard to available distributable reserves, available liquid funds and the financial resources and facilities needed to enable the Company to carry on its business for at least the next year. In addition, the level of dividends is set to maintain sufficient equity in the Company so as not to jeopardise its investment grade issuer credit rating.

#### **RESEARCH AND DEVELOPMENT**

The Company supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. Projects to investigate enhanced load reduction opportunities from customer participation, the accessing of disbursed domestic demand-side response and, alongside other utilities, to determine optimum energy system technology approaches appropriate to local socio-economic factors have continued. New activities initiated in the year included projects regarding the use of domestic electricity storage in conjunction with small-scale photovoltaic solar generation, an improved methodology to determine network load growth and a project to improve circuit reliability and reduce restoration times through fault monitoring and anticipation on the low-voltage network. In addition, a wood replacement technology for overhead line support was evaluated and an investigations into environmentally acceptable alternative systems for wood preservation, was undertaken.

During the year, the Company invested £1.6 million (2015: £2.7 million) (Note 6 to the accounts) in its research and development activities.

#### **FUTURE DEVELOPMENTS**

The financial position of the Company, as at 31 December 2016, is shown in the statement of financial position on page 36.

There have been no significant events since the year end and the directors intend that the Company will continue to implement its well-justified business plan that was revised as part of the ED1 price control review process and will develop its business by operating with the goal of efficiently investing in the network and improving the quality of supply and service provided to customers.

#### **DIRECTORS**

The directors who held office during the year under review and to the date of signing were:

|               |                                              |
|---------------|----------------------------------------------|
| R Dixon       | Non-executive Director                       |
| T E Fielden   | Finance Director                             |
| J M Francé    | Regulation Director                          |
| T H France    | General Counsel (appointed 15 December 2016) |
| N M Gill      | Field Operations Director                    |
| P A Jones     | President and Chief Executive Officer        |
| A J Maclellan | Business Development Director                |
| A R Marshall  | Non-executive Director                       |
| P C Taylor    | Non-executive Director                       |

During the year, no director was interested in any contract which was significant in relation to the business of the Company.

During the year and up to the date of approval of the Directors' Report, an indemnity contained in the Company's Articles of Association was in force for the benefit of the directors of the Company and as directors of associated companies, which was a qualifying third party indemnity provision for the purposes of the Companies Act 2006.



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **FINANCIAL RISK MANAGEMENT**

The Company's short-term financial objective is to ensure that it has access to sufficient liquidity to enable it to meet its obligations as they fall due and to provide adequately for contingencies. The long-term objective is to provide a stable and low cost of financing over time whilst observing approved risk parameters. The main risks are liquidity and interest rate risk.

##### **Trading risk**

Throughout the year, the Company's policy was that no trading in financial instruments should be undertaken.

##### **Financial derivatives**

As at 31 December 2016 and during the year it was the Company's policy not to hold any derivative financial instruments.

Further details of the financial risks facing the Company are provided in the Financial strength section on pages 5 and 6, and Principal Risks and Uncertainties section on pages 17 to 19 of the Strategic Report.

#### **POLITICAL DONATIONS**

No contributions were made to political organisations during the year (2015: £nil).

#### **EMPLOYEES**

##### **Employee consultation**

The Company has a constitutional framework in place for employee consultation and has agreed that framework with trade union representatives. In addition, the Company communicates directly and through the management structure with non-collectively bargained staff, who are primarily of management grade, and keeps them informed of and involved as appropriate in developments that may impact on them now or in the future.

The Company is committed to maintaining and improving effective engagement and communication with employees. Following the employee engagement survey in 2016, the results continue to show improvement and work has been undertaken to analyse the feedback and develop local action plans. This approach is augmented by routine communication channels including regular staff briefings on current issues, meetings with staff and their representatives, and utilising Northern Powergrid Group's intranet to communicate and engage with employees.

During the year, the President and Chief Executive Officer of the Northern Powergrid Group continued to provide employees with updates on the Northern Powergrid Group's financial, organisational, safety and customer service performance through postings and weekly blogs on Northern Powergrid Group's intranet on key elements of performance during the preceding week.

##### **Disabled employees**

The Company is committed to equality at work and, as such, its policy is to provide all protected groups, including disabled people, with equality at work in respect of employment, training, career development and promotion, having regard to their aptitudes and abilities. Should any member of staff become disabled during their employment, the Company would work to make reasonable adjustments, wherever possible.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT**

The Company has sought to apply a number of provisions in the UK Corporate Governance Code 2014 (the "Code") in so far as it considers them to be appropriate.

The Company has not complied with certain of the main principles of the Code, including main principles A2, A3, B2, B6, B7, D1, D2 and E2.

The directors confirm that the governance framework in place is appropriate to the circumstances of the Company and where possible, the spirit of the Code has been applied. The framework is agreed with Berkshire Hathaway Energy and includes regular reporting to and meetings with the Chairman and senior management of Berkshire Hathaway Energy. Sufficiently independent, non-executive directors are present at board meetings of the Company and in addition there is a strong internal control environment designed to meet the standards required by the United States Sarbanes-Oxley Act.

#### **Section A: Leadership**

##### **Main Principle A1: The Role of the Board**

The board meets on a quarterly basis to review business performance, strategic initiatives and operational and risk-related issues. Additional board meetings are held as required.

Attendance at meetings by board members during the year was as follows:

|               |                                                 |                                |
|---------------|-------------------------------------------------|--------------------------------|
| R Dixon       | Non-executive Director                          | 5                              |
| T E Fielden   | Finance Director                                | 6                              |
| J M France    | Regulation Director                             | 5                              |
| T H France    | General Counsel                                 | 0 (of 0 following appointment) |
| N M Gill      | Operations Director                             | 6                              |
| P A Jones     | President and Chief Executive Officer           | 5                              |
| A J Maclellan | Business Development Director                   | 6                              |
| A R Marshall  | Sufficiently independent non-executive Director | 6                              |
| P C Taylor    | Sufficiently independent non-executive Director | 5                              |

The directors have overall responsibility for the internal control environment, which, within the Northern Powergrid Group, is based on regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of any recommendations. In addition, Berkshire Hathaway Energy requires a quarterly risk control assessment to be undertaken by certain senior managers as part of its programme for compliance with the requirements of the United States Sarbanes-Oxley Act. The assessments undertaken during the year did not identify any significant weaknesses in the process but resulted in the implementation of recommended improvements. The key features of the Company's internal control system and the issues addressed by the Company during the year can be found in the Strategic Report.

A schedule of key delegations of authority has been approved by the board which enables senior and other managers to make decisions in respect of issues such as capital expenditure, procurement, contractual arrangements, human resource matters, payment processes and for the conduct of claims and litigation. That schedule reserves decision-making to the directors above certain financial limits. Matters reserved for board approval includes but are not limited to, the declaration of dividends, the approval of the annual statutory and regulatory accounts and changes to capital structure.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

Operational management of the Company's business (and that of its affiliate, Northern Powergrid (Northeast) Limited) is delegated to a single senior management team, with specific functional responsibilities. That senior management team meets on a monthly basis with the senior management of the Northern Powergrid Group to monitor performance and address issues of policy across all areas of the business. In addition, weekly conference calls are held to report on and consider performance-related issues. Further details of the management structure of the Northern Powergrid Group are provided in the Strategic Report.

#### **Board and Management Committees**

During the year, there were a number of committees in operation, acting under delegated terms of reference, which oversee the Northern Powergrid Group and, therefore, Company policy. As part of their approved terms of reference, certain of those committees report regularly to the board on their activities.

#### **Health and Safety Management Committee**

The board of Northern Powergrid Holdings Company has established the Northern Powergrid Group Health and Safety Management Committee with delegated powers to manage the health and safety policy and performance of the Northern Powergrid Group. The committee meets on a regular basis in order to:

- oversee implementation of health and safety policy;
- review and agree strategy for the management of health and safety issues;
- monitor health and safety performance across the Northern Powergrid Group;
- review the effectiveness of the health and safety policies and the health and safety management system; and consider recommendations for changes in policy due to changes in appropriate legislation, codes of practice or guidance or due to recommendations arising from investigations into significant incidents.

#### **Committee members:**

|               |                                            |
|---------------|--------------------------------------------|
| G M Earl      | Director of Health, Safety and Environment |
| T E Fielden   | Finance Director                           |
| J M France    | Regulation Director                        |
| T H France    | General Counsel                            |
| N M Gill      | Operations Director                        |
| P A Jones     | President and Chief Executive Officer      |
| A J MacLennan | Business Development Director              |

#### **Treasury Committee**

The Treasury Committee oversees and implements the treasury policies, which are outlined in the Strategic Report and the Directors' Report.

#### **Committee members:**

|              |                                                                                 |
|--------------|---------------------------------------------------------------------------------|
| G E Abel     | Chairman, Berkshire Hathaway Energy                                             |
| L Bennett    | Treasurer and Investor Reporting Manager                                        |
| D Brady      | Treasury and Reporting Manager                                                  |
| T E Fielden  | Finance Director                                                                |
| P J Goodman  | Executive Vice President and Chief Financial Officer, Berkshire Hathaway Energy |
| S Gormally   | Accounting Assistant and Secretary to the Committee                             |
| P A Jones    | President and Chief Executive Officer                                           |
| S J Lockwood | Group Financial Controller                                                      |

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

##### **Pensions Committee**

The Pensions Committee oversees the Northern Powergrid Group's approach to the pension schemes to which it contributes.

##### **Committee members:**

|               |                                                    |
|---------------|----------------------------------------------------|
| N Dawson      | Senior Pensions Advisor (retired 24 February 2017) |
| T E Fielden   | Finance Director                                   |
| J M France    | Regulation Director                                |
| S J Lockwood  | Group Financial Controller                         |
| K Mawson      | Head of Regulatory Finance and Systems             |
| L Tweedie     | Head of Field Change                               |
| K Weatherburn | Director of Human Resources                        |

##### **Governance and Risk Management Group (GRMG)**

Details can be found on pages 27 and 28 below.

##### **Audit Committee**

Details can be found on page 29 below.

##### **Main Principle A2: Division of Responsibility**

Mr G E Abel, the Chairman of Berkshire Hathaway Energy, is also the Chairman of Northern Powergrid Holdings Company. As President and Chief Executive Officer, Dr P A Jones is responsible for the operational management of both the Company and the Northern Powergrid Group. Dr P A Jones reports directly to Mr G E Abel.

##### **Main Principle A3: The Chairman**

The board does not have a formally appointed Chairman. Dr P A Jones chairs board meetings and is responsible for the operational management of both the Company and the Northern Powergrid Group. Dr P A Jones divides his time accordingly between his various commitments within the Northern Powergrid Group.

##### **Main Principle A4: Non-Executive Directors**

Three non-executive directors served on the board during the year, each of whom acts under the terms of their individual service contracts or terms of reference. Mrs A R Marshall and Professor P C Taylor were appointed to the board as sufficiently independent non-executive directors in accordance with the requirement in condition 43A of the Company's electricity distribution licence.

#### **Section B: Effectiveness**

##### **Main Principle B1: The composition of the board**

The board comprises six executive directors and three non-executive directors. Although the board does not include a balanced number of executive and non-executive directors, the board believes that it possesses the requisite skills and experience necessary to provide effective leadership, stewardship and control of the Company, a position supported by the presence of the sufficiently independent directors required by the Company's licence.

##### **Main Principle B2: Appointments to the board**

The Company does not have a nomination committee. The Chairman of Berkshire Hathaway Energy, in conjunction with the President and Chief Executive Officer make appointments to the board with due regard to the board's overall composition including the balance of skills and experience.

##### **Main Principle B3: Commitment**

The Company's non-executive directors commit sufficient time to preparation for and attendance at board meetings. Service contracts or terms of reference do not specify a time commitment.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

##### **Main Principle B4: Development**

The directors continually update their knowledge of and familiarity with the operations of the Company due to the robust reporting arrangements in place and have on-going access to the Company's operations and its staff.

##### **Main Principle B5: Information and support**

The board is provided with timely information during the course of the regular board meeting cycle and via interim briefings in order that it can discharge its duties effectively. The directors are able to utilise the advice and services of the Company Secretary, in respect of their duties and responsibilities and any new legislation that may affect those duties and responsibilities. Upon request, the directors have access to independent professional advice.

##### **Main Principle B6: Evaluation**

As part of their approved terms of reference, certain committees report regularly on their activities, enabling the board to perform an evaluation of their effectiveness. The board itself does not have a process of evaluation of its own performance or of the performance of individual directors in their capacity as directors. The performance of the executive directors and senior managers is reviewed formally on an annual basis as part of Berkshire Hathaway Energy's performance appraisal and development scheme. Performance is measured against individual and Berkshire Hathaway Energy goals.

##### **Main Principle B7: Re-election**

The Company's articles of association do not require the periodic retirement and re-election of directors.

#### **Section C: Accountability**

##### **Main Principle C1: Financial and business reporting**

The board considers that the annual reports and accounts, which include the Strategic Report and the Report of the Directors, taken as a whole is fair, balanced and understandable and provides the information necessary for shareholders to assess the Company's performance, position, business model and strategy.

The directors explain, at pages 2 to 3, the Core Principles behind the Company's strategy and, at page 30, their responsibility for preparing the Strategic Report, the Report of the Directors and the annual accounts. They have reported, at page 31 in the Report of the Directors that the Company is a going concern and have included the Report of the Independent Auditor to the Company at pages 32 and 33 of these annual reports and accounts.

##### **Main Principle C2: Risk management and internal control**

Details of the principal risks and uncertainties facing the Company and its internal control system, together with details of the issues addressed by the Company during the year, can be found at pages 17 to 21 of the Strategic Report. Also included at page 20 of the Strategic Report is an explanation of how the prospects of the Company have been assessed, the period to which that assessment relates and the reasons as to why that period is considered to be appropriate.

The Governance and Risk Management Group ("GRMG") is the principal management forum in the Northern Powergrid Group with regard to corporate governance and the management of risk. Its purpose is to ensure that companies in the Northern Powergrid Group apply and maintain appropriate arrangements to deliver sound corporate governance and comply with the overall strategy, framework and supporting policies. The GRMG monitors and reviews the strategic risk environment, ensuring the continued suitability, adequacy and effectiveness of risk management arrangements and reports to the Northern Powergrid Group's Audit Committee.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

##### **Committee members:**

|               |                                            |
|---------------|--------------------------------------------|
| N Applebee    | Head of Shared Services                    |
| J Cardwell    | Head of Trading and Innovation             |
| R Dixon       | Non-executive Director                     |
| M Drye        | Director of Asset Management               |
| G Earl        | Director of Safety, Health and Environment |
| T E Fielden   | Finance Director                           |
| J M France    | Regulation Director                        |
| T H France    | General Counsel                            |
| N M Gill      | Operations Director                        |
| A Jones       | Head of Strategic Planning and Delivery    |
| L Mackay      | Head of Internal Audit                     |
| A J MacLennan | Business Development Director              |
| A Patterson   | Director of Organisation Development       |
| K Weatherburn | Director of Human Resources                |

During the year, the GRMG monitored the risk management framework regularly to ensure that all key risks were being addressed and further enhanced the development of the risk assessment process seeing guidance and training provided to employees to support them in identifying and reporting on key risks. In addition, risk management policies and procedures were reviewed and updated to ensure a robust and clear approach was maintained. Mr R Dixon, one of the Company's non-executive directors, attended meetings of the GRMG to provide an independent view in respect of the matters discussed.

The Company has a strong focus on the management of its assets and as a consequence, the Asset Risk Management Executive Review Group had comprehensive plans in place to manage risks affecting all critical property assets and to strengthen the arrangements for crisis management and business continuity planning. In that respect, the Emergency Planning and Co-ordination Group ("EPCG") has a remit to develop and maintain the Northern Powergrid Group's approach to emergency planning and to provide strategic leadership and guidance in respect of such matters.

The EPCG also ensures appropriate coordination between the various emergency planning disciplines, which include operational management of network incidents, property and the physical environment, non-operational management and resources and the support areas of human resources, information technology, health and safety, communications and legal services.

Further details of the Northern Powergrid Group's approach to corporate governance and the management of internal controls can be found in the Strategic Report. Additional key features of the internal control system include:

- Comprehensive business planning and financial reporting procedures, including the annual preparation of detailed operational budgets for the year ahead and projections for subsequent years;
- Regular review of key performance indicators to assess progress towards objectives;
- A range of policies, codes of practice and more detailed instructions that define the processes to be followed;
- A strong internal audit function, which provides independent scrutiny of internal control systems and risk management procedures, including the standards required by the United States Sarbanes-Oxley Act;
- On-going health and safety performance reviews carried out by in-house safety professionals in addition to the regime of routine health and safety risk assessment and management processes carried out within each of the operating units;

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

- Processes and procedures to operate under OHSAS 18001, which is subject to external certification and regular assessment;
- An external obligations register, which assists with compliance with financial, legal and regulatory obligations;
- Centralised treasury operations that operate within defined limits and are subject to regular reporting requirements and audit reviews; and
- Established procedures for planning, approving and monitoring major capital expenditure, major projects and the development of new business which includes short and long-term budgets, risk evaluation, detailed appraisal and review procedures, defined authority levels and post-investment performance reviews.

#### **Main Principle C3: Audit committee and auditor**

The board of Northern Powergrid Holdings Company has established an audit committee for the Northern Powergrid Group under delegated terms of reference which include monitoring the financial reporting process, the effectiveness of internal controls, internal audit and risk management systems, the statutory audit of the accounts, and the independence of and the provision of non-audit services by the auditor.

The audit committee comprises three members, two of whom are considered as independent and one who has competence in accounting. At its meetings, the committee receives reports from the GRMG and from the Northern Powergrid Group's Head of Internal Audit on the internal audits undertaken during the year and the audit plan for the following year.

#### **Committee members:**

|             |                                                    |
|-------------|----------------------------------------------------|
| R Dixon     | Non-Executive Director (Chairman)                  |
| J Reynolds  | Non-Executive Director (appointed 20 January 2016) |
| T E Fielden | Finance Director                                   |

Details of the fees paid by the Company to Deloitte LLP in relation to non-audit services during the year are provided in Note 6 to the accounts.

The Company has a process in place by which staff can confidentially raise any concerns that they may have. Details of the Company's "speaking up" policy can be found in the employee section on page 14 of the Strategic Report.

#### **Section D: Remuneration**

#### **Main Principle D1: The level and components of remuneration**

Remuneration of the directors is designed to promote the long-term success of the Company with clear performance accountabilities defined either in personal goals, or in the individual's terms of reference or service contract. As the Company has no equity securities listed on the London Stock Exchange, it is not required to make directors' remuneration disclosures, other than those required for private companies. The Company does not have a remuneration committee.

#### **Main Principle D2: Procedure**

As noted under main principle D1, the Company does not have a remuneration committee. Annual remuneration awards for the senior management of the Northern Powergrid Group are subject to the performance appraisal and development scheme process and consideration by the Chairman of Berkshire Hathaway Energy and the President and Chief Executive Officer. No director is involved in deciding his own remuneration.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **CORPORATE GOVERNANCE STATEMENT - continued**

##### **Section E: Relations with shareholders**

###### **Main Principle E1: Dialogue with Shareholders**

As a wholly-owned subsidiary of a privately held group of companies, the board is in continuing dialogue with Berkshire Hathaway Energy.

The President and Chief Executive Officer participates in weekly performance review meetings with the Chairman of Berkshire Hathaway Energy and other senior managers of the Berkshire Hathaway Energy group, including the Executive Vice President and Chief Financial Officer. At those weekly meetings, the key current issues facing the Northern Powergrid Group are discussed. The review meetings are supported by regular reports detailing the Northern Powergrid Group's performance.

Weekly review meetings are also held in respect of Berkshire Hathaway Energy's financial and legal functions, at which the Northern Powergrid Group's Finance Director and General Counsel present their respective updates.

###### **Main Principle E2: Constructive use of General Meetings**

This section of the Code is not applicable as the Company is privately owned and not traded.

#### **STATEMENT OF DIRECTORS' RESPONSIBILITIES**

The directors are responsible for preparing the Strategic Report, the Report of the Directors 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 International Financial Reporting Standards ("IFRS") as adopted by the European Union. 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, International Accounting Standard 1 requires the directors to:

- Properly select and apply accounting policies;
- Present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Provide additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's financial position and financial performance; and
- Make an assessment of the Company's ability to continue as a going concern.

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions, 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. The directors are responsible for the maintenance and integrity of any corporate and financial information relating to the Company, which is included on the Northern Powergrid Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **GOING CONCERN**

A review of the Company's business activities during the year, together with details regarding its future development, performance and position, its objectives, policies and processes for managing its capital, its financial risk management objectives and details of its exposures to trading risk, credit risk and liquidity risk are set out in the Strategic Report, the Report of the Directors and the appropriate notes to the accounts.

When considering continuing to adopt the going concern basis in preparing the annual reports and accounts, the directors have taken into account a number of factors, including the following:

- The Company is a stable electricity distribution business operating an essential public service and is regulated by GEMA. In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Company is profitable with strong underlying cash flows and holds investment grade credit ratings; and
- The Company is financed by long-term borrowings with an average maturity of 10 years and has access to borrowing facilities provided by Lloyds Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc.

Consequently, after making enquiries, the directors 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 reports and accounts.

#### **STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITOR**

Each of the directors, who is a director of the Company as at the date of this report, confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of S418 of the Companies Act 2006.

#### **AUDITOR**

Deloitte LLP will continue in office in accordance with the provisions in section 487 of the Companies Act 2006 and has indicated its willingness to do so.

#### **ON BEHALF OF THE BOARD:**



P A Jones  
Director  
24 March 2017

## **REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF NORTHERN POWERGRID (YORKSHIRE) PLC**

We have audited the financial statements of Northern Powergrid (Yorkshire) plc ("the Company") for the year ended 31 December 2016, which comprise the Statement of Profit or Loss, the Statement of Profit or Loss and Other Comprehensive Income, the Statement of Financial Position, the Statement of Changes in Equity, the Statement of Cash Flows and related notes 1 to 25. The financial reporting framework that has been applied in their preparation is applicable law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

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 a Report of the Auditor 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 Statement of Directors' Responsibilities set out on page 30, 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 financial statements**

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 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 financial statements**

In our opinion the financial statements:

- give a true and fair view of the state of the Company's affairs as at 31 December 2016 and of its profit for the year then ended;
- have been properly prepared in accordance with IFRSs as adopted by the European Union; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

### **Opinion on other matter 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 Report of the Directors for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the Strategic Report and the Report of the Directors 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 Report of the Directors.

## **REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF NORTHERN POWERGRID (YORKSHIRE) PLC**

### **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 financial statements 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.



David M Johnson FCA (Senior Statutory Auditor)  
for and on behalf of Deloitte LLP  
Chartered Accountants and Statutory Auditor  
Newcastle upon Tyne  
United Kingdom

24 March 2017

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**STATEMENT OF PROFIT OR LOSS  
FOR THE YEAR ENDED 31 DECEMBER 2016**

|                                 | Notes | 2016<br>£'000         | 2015<br>£'000         |
|---------------------------------|-------|-----------------------|-----------------------|
| <b>CONTINUING OPERATIONS</b>    |       |                       |                       |
| Revenue                         | 3     | 415,126               | 420,220               |
| Cost of sales                   |       | <u>(16,799)</u>       | <u>(16,834)</u>       |
| <b>GROSS PROFIT</b>             |       | <b>398,327</b>        | <b>403,386</b>        |
| Operating expenses              | 9     | <u>(198,959)</u>      | <u>(198,455)</u>      |
| <b>OPERATING PROFIT</b>         |       | <b>199,368</b>        | <b>204,931</b>        |
| Other gains                     |       | 483                   | 264                   |
| Finance costs                   | 5     | (47,522)              | (43,574)              |
| Finance income                  | 5     | <u>1,116</u>          | <u>890</u>            |
| <b>PROFIT BEFORE INCOME TAX</b> | 6     | <b>153,445</b>        | <b>162,511</b>        |
| Income tax                      | 7     | <u>(5,316)</u>        | <u>(15,852)</u>       |
| <b>PROFIT FOR THE YEAR</b>      |       | <b><u>148,129</u></b> | <b><u>146,659</u></b> |

The notes on pages 39 to 71 form part of these financial statements

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME  
FOR THE YEAR ENDED 31 DECEMBER 2016**

|                                                    | <b>2016</b>           | <b>2015</b>           |
|----------------------------------------------------|-----------------------|-----------------------|
|                                                    | <b>£'000</b>          | <b>£'000</b>          |
| <b>PROFIT FOR THE YEAR</b>                         | <b>148,129</b>        | <b>146,659</b>        |
| <b>OTHER COMPREHENSIVE INCOME</b>                  | <b>—</b>              | <b>—</b>              |
| <b>TOTAL COMPREHENSIVE INCOME<br/>FOR THE YEAR</b> | <b><u>148,129</u></b> | <b><u>146,659</u></b> |

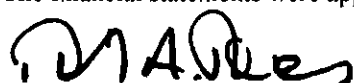
The notes on pages 39 to 71 form part of these financial statements

**NORTHERN POWERGRID (YORKSHIRE) PLC (REGISTERED NUMBER: 04112320)**

**STATEMENT OF FINANCIAL POSITION**  
**31 DECEMBER 2016**

|                                       | Notes | 2016<br>£'000           | 2015<br>£'000           |
|---------------------------------------|-------|-------------------------|-------------------------|
| <b>ASSETS</b>                         |       |                         |                         |
| <b>NON-CURRENT ASSETS</b>             |       |                         |                         |
| Intangible assets                     | 10    | -                       | -                       |
| Property, plant and equipment         | 11    | <u>3,054,645</u>        | <u>2,921,050</u>        |
|                                       |       | <u>3,054,645</u>        | <u>2,921,050</u>        |
| <b>CURRENT ASSETS</b>                 |       |                         |                         |
| Inventories                           | 12    | 265                     | 465                     |
| Trade and other receivables           | 13    | 68,499                  | 63,820                  |
| Cash and cash equivalents             | 14    | <u>199,298</u>          | <u>145,668</u>          |
|                                       |       | <u>268,062</u>          | <u>209,953</u>          |
| <b>TOTAL ASSETS</b>                   |       | <u><u>3,322,707</u></u> | <u><u>3,131,003</u></u> |
| <b>EQUITY</b>                         |       |                         |                         |
| <b>SHAREHOLDERS' EQUITY</b>           |       |                         |                         |
| Called up share capital               | 15    | 290,000                 | 290,000                 |
| Retained earnings                     | 16    | <u>948,896</u>          | <u>829,467</u>          |
| <b>TOTAL EQUITY</b>                   |       | <u><u>1,238,896</u></u> | <u><u>1,119,467</u></u> |
| <b>LIABILITIES</b>                    |       |                         |                         |
| <b>NON-CURRENT LIABILITIES</b>        |       |                         |                         |
| Trade and other payables              | 17    | 762,475                 | 728,901                 |
| Borrowings                            |       |                         |                         |
| Interest bearing loans and borrowings | 18    | 1,022,804               | 972,174                 |
| Deferred tax                          | 21    | 127,673                 | 134,193                 |
| Provisions                            | 20    | <u>1,170</u>            | <u>886</u>              |
|                                       |       | <u>1,914,122</u>        | <u>1,836,154</u>        |
| <b>CURRENT LIABILITIES</b>            |       |                         |                         |
| Trade and other payables              | 17    | 115,229                 | 129,760                 |
| Borrowings                            |       |                         |                         |
| Interest bearing loans and borrowings | 18    | 33,340                  | 33,294                  |
| Tax payable                           |       | 20,087                  | 11,215                  |
| Provisions                            | 20    | <u>1,033</u>            | <u>1,113</u>            |
|                                       |       | <u>169,689</u>          | <u>175,382</u>          |
| <b>TOTAL LIABILITIES</b>              |       | <u><u>2,083,811</u></u> | <u><u>2,011,536</u></u> |
| <b>TOTAL EQUITY AND LIABILITIES</b>   |       | <u><u>3,322,707</u></u> | <u><u>3,131,003</u></u> |

The financial statements were approved by the Board of Directors on 24 March 2017 and were signed on its behalf by:



P A Jones  
Director

The notes on pages 39 to 71 form part of these financial statements

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**STATEMENT OF CHANGES IN EQUITY  
FOR THE YEAR ENDED 31 DECEMBER 2016**

|                                    | <b>Called up<br/>share<br/>capital<br/>£'000</b> | <b>Retained<br/>earnings<br/>£'000</b> | <b>Total<br/>equity<br/>£'000</b> |
|------------------------------------|--------------------------------------------------|----------------------------------------|-----------------------------------|
| <b>Balance at 1 January 2015</b>   | 290,000                                          | 710,408                                | 1,000,408                         |
| <b>Changes in equity</b>           |                                                  |                                        |                                   |
| Dividends                          | -                                                | (27,600)                               | (27,600)                          |
| Total comprehensive income         | -                                                | 146,659                                | 146,659                           |
| <b>Balance at 31 December 2015</b> | <u>290,000</u>                                   | <u>829,467</u>                         | <u>1,119,467</u>                  |
| <b>Changes in equity</b>           |                                                  |                                        |                                   |
| Dividends                          | -                                                | (28,700)                               | (28,700)                          |
| Total comprehensive income         | -                                                | 148,129                                | 148,129                           |
| <b>Balance at 31 December 2016</b> | <u>290,000</u>                                   | <u>948,896</u>                         | <u>1,238,896</u>                  |

The notes on pages 39 to 71 form part of these financial statements

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**STATEMENT OF CASH FLOWS  
FOR THE YEAR ENDED 31 DECEMBER 2016**

|                                                       | Notes | 2016<br>£'000         | 2015<br>£'000         |
|-------------------------------------------------------|-------|-----------------------|-----------------------|
| <b>Cash flows from operating activities</b>           |       |                       |                       |
| Cash generated from operations                        | 24    | 266,810               | 275,312               |
| Finance costs paid                                    |       | (49,301)              | (43,453)              |
| Dividends received                                    |       | 43                    | 41                    |
| Interest received                                     |       | 1,128                 | 849                   |
| Tax paid                                              |       | (2,964)               | (35,947)              |
| Net cash from operating activities                    |       | <u>215,661</u>        | <u>196,802</u>        |
| <b>Cash flows used in investing activities</b>        |       |                       |                       |
| Purchase of tangible fixed assets                     |       | (234,831)             | (279,004)             |
| Sale of tangible fixed assets                         |       | 494                   | 336                   |
| Receipt of customer contributions                     |       | <u>51,006</u>         | <u>70,419</u>         |
| Net cash used in investing activities                 |       | <u>(183,331)</u>      | <u>(208,249)</u>      |
| <b>Cash flows from financing activities</b>           |       |                       |                       |
| Movements in borrowings in the year                   |       | 50,000                | 208,114               |
| Movement in loans from group undertaking              |       | -                     | (23,399)              |
| Equity dividends paid                                 |       | (28,700)              | (27,600)              |
| Net cash from financing activities                    |       | <u>21,300</u>         | <u>157,115</u>        |
| <b>Increase in cash and cash equivalents</b>          |       | <b>53,630</b>         | <b>145,668</b>        |
| <b>Cash and cash equivalents at beginning of year</b> |       | <u><b>145,668</b></u> | <u>-</u>              |
| <b>Cash and cash equivalents at end of year</b>       |       | <u><b>199,298</b></u> | <u><b>145,668</b></u> |

The notes on pages 39 to 71 form part of these financial statements



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **1. GENERAL INFORMATION**

Northern Powergrid (Yorkshire) plc (the "Company") is a company incorporated in England and Wales and is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group"). The address of the registered office is Lloyds Court, 78 Grey Street, Newcastle-upon-Tyne, NE1 6AF.

The nature of the Company's business model, strategic objectives, operations and activities are set out in the Strategic Report.

#### **2. ACCOUNTING POLICIES**

##### **Accounting convention and basis of preparation**

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS"). These financial statements have also been prepared in accordance with IFRSs as adopted by the European Union and with those parts of the Companies Act 2006 (the "Act") that are applicable to companies reporting under IFRS.

The financial statements have been prepared under the historical cost convention. Historical cost is generally based on the fair value of the consideration given in exchange for goods and services.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date, regardless of whether that price is directly observable or estimated using another valuation technique. In estimating the fair value of an asset or a liability, the Company takes into account the characteristics of the asset or liability if market participants would take those characteristics into account when pricing the asset or liability at the measurement date. Fair value for measurement and/or disclosure purposes in these financial statements is determined on such a basis, except for leasing transactions which are within the scope of IAS 17, and measurements that have some similarities to fair value but are not fair value, such as net realisable value in IAS 2 or value in use in IAS 36.

In addition, for financial reporting purposes, fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety, which are described as follows:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company can access at the measurement date;
- Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; and
- Level 3 inputs are unobservable inputs for the asset or liability.

The principal accounting policies are set out below.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

#### 2. ACCOUNTING POLICIES- continued

##### Application of new and revised IFRSs

In the current year, the Company has a number of amendments to IFRSs issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for an accounting period that begins on or after 1 January 2016:

- Amendments to IAS 1 Disclosure Initiative The amendments clarify that an entity need not provide specific disclosure required by an IFRS if the information resulting from that disclosure is not material, and give guidance on the bases of aggregating and disaggregating information for disclosure purposes. However, the amendments reiterate that an entity should consider providing additional disclosures when compliance with the specific requirements of IFRS is insufficient to enable users of financial statements to understand the impact of particular transactions, events and conditions on the entity's financial position and financial performance.

The application of these amendments has not resulted in any impact on the financial performance or financial position of the Company.

- IAS 16 and IAS 38 Clarification of Acceptable Methods of Depreciation and Amortisation The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortisation of an intangible asset. This presumption can only be rebutted in the following two limited circumstances:-when the intangible asset is expressed as a measure of revenue; or-when it can be demonstrated that revenue and consumption of the economic benefits or the intangible asset are highly correlated.

As the group already uses the straight line method for depreciation for its property, plant and equipment, and intangible assets respectively, the application of these amendments has had no impact on the Company's financial position.

- Annual Improvements to IFRSs 2012-2014 Cycle The Annual Improvements to IFRSs 2012-2014 Cycle include a number of amendments to various IFRSs. The application of these amendments has had no effect on the Company's financial statements.

##### New and revised standards in issue but not yet effective

The Company has not applied the following new and revised IFRSs that have been issued but are not yet effective for the year ended 31 December 2016:

- IFRS 9 - Financial Instruments (1 January 2018). A revised version of IFRS 9, Financial Instruments, was issued in July 2014 mainly to include: a) impairment requirements for financial assets; and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' ("FVTOCI") measurement category for certain simple debt instruments. The directors of the Company anticipate that the application of IFRS 9 in the future is unlikely to have an impact on amounts reported in respect of the Company's financial assets and financial liabilities.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

#### 2. ACCOUNTING POLICIES- continued

- IFRS 15 - Revenue from Contracts with Customers (1 January 2018).

In May 2014, IFRS 15, Revenue from Contracts with Customers, was issued which establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 11 Construction Contracts, IAS 18 Revenue and the related Interpretations.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

The directors anticipate that the application of IFRS 15 will not have a material impact on the Company's financial statements.

- IFRS 16 - Leases (1 January 2019)

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective.

IFRS 16 distinguishes between leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions between operating leases and finance leases are removed for lessee accounting, and is replaced by a model where right-of-use asset and a corresponding liability have to be recognised for all leases by lessees except for short term leases and leases of low-value assets.

As of 31 December 2016, the Company has non-cancellable operating lease commitments of £8.6 million, IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases.

A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Company will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16.

- Amendments to IAS 7 (1 January 2017)

The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities. The directors of the Company do not anticipate the application of these amendments will have a material impact on the Company's financial statements.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. ACCOUNTING POLICIES- continued**

##### **Critical judgements in applying accounting policies**

The following are the critical judgements, apart from those involving estimations, that the directors have made in the process of applying the Company's accounting policies and that have the most significant effect on amounts recognised in the financial statements:

- Revenue recognition.

##### **Key sources of estimation uncertainty**

The following are the key assumptions concerning the future and other key sources of estimation uncertainty at the end of the reporting period that may have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year:

- Useful economic lives for property, plant and equipment;
- The split of operating and capital expenditure and the allocation of overheads to capital;
- Impairment reviews carried out to evaluate the carrying value of assets held at the end of the reporting period; and
- Fair valuation measurements and valuation processes.

##### **Revenue**

Revenue is only recognised when the risks and rewards of ownership have been transferred to a third party. No revenue is recognised where there are significant uncertainties regarding the consideration to be received or the costs associated with the transaction.

Revenue is measured at the fair value of consideration received or receivable.

Revenue represents charges for the use of the Company's distribution network, rental of meters, amortisation of customer contributions, recharge of costs incurred on behalf of related parties and the invoiced value of other goods sold and services provided, exclusive of value added tax.

Revenues from charges to end customers for the use of the Company's distribution network include estimates of the units distributed. The estimated usage is based on historic data, judgement and assumptions. Revenues are gradually adjusted to reflect actual usage in the period during which actual meter readings are obtained.

Any under or over-recovery of allowed distribution network revenues as prescribed by Ofgem is not provided for in the financial statements and will be recovered/repaid through future tariffs.

Customer contributions towards distribution system assets are included in deferred revenue. The Company's policy is to credit the customer contribution to revenue on a straight-line basis, in line with the useful life of the distribution system assets.

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Company and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Dividend income from investments is recognised when the shareholders' rights to receive payment have been established.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

#### 2. ACCOUNTING POLICIES - continued

##### Software development costs

Costs in respect of major developments are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognised on a straight-line basis over the estimated useful life of the software of up to 10 years. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

##### Property, plant and equipment

Property, plant and equipment is stated at cost less accumulated depreciation and accumulated impairment losses. Cost includes the purchase price of the asset and any costs, including internal employee and other costs, directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

Depreciation is recognised so as to write off the cost of assets less their residual values over their useful lives, using the straight-line method:

|                                                                         |                                   |
|-------------------------------------------------------------------------|-----------------------------------|
| Distribution system assets                                              | 45 years                          |
| Distributed generation assets                                           | up to 15 years                    |
| Metering equipment included in distribution system assets               | up to 5 years                     |
| Information technology equipment included in distribution system assets | up to 10 years                    |
| Non-operational assets:                                                 |                                   |
| Buildings - freehold                                                    | up to 60 years                    |
| Buildings - leasehold                                                   | lower of lease period or 60 years |
| Fixtures and equipment                                                  | up to 10 years                    |
| Software development costs                                              | up to 10 years                    |

Freehold land is not depreciated.

The estimated useful lives, residual values and depreciation method are reviewed at the end of each reporting period, with the effect of any material changes in those estimates accounted for on a prospective basis. Due to the significance of the Company's investment in property, plant and equipment, variations in estimates could impact operating results both positively and negatively although, historically, few changes have been required.

Assets in the course of construction are carried at cost, less any recognised impairment loss. Costs include professional fees, and, for qualifying assets, borrowing costs capitalised in accordance with the Company's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when completed and ready for intended use. Depreciation on these assets, on the same basis as other assets, commences when the assets are commissioned.

##### Financial instruments

Financial assets and financial liabilities are recognised on the statement of financial position when the Company becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition.

##### Inventories

Work in progress is valued at the cost of direct materials and labour plus attributable overheads based on the normal level of activity less progress payments.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. ACCOUNTING POLICIES - continued**

##### **Taxation**

The income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year. Taxable profit differs from 'profit before tax' as reported in the statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Current and deferred tax are recognised in profit or loss, except when they relate to items that are recognised in other comprehensive income or directly in equity, in which case the current and deferred tax are also recognised in other comprehensive income or directly in equity respectively.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognised for all taxable temporary differences. Deferred tax assets are generally recognised for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognised if the temporary difference arises from the initial recognition of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. In addition, deferred tax liabilities are not recognised if the temporary difference arises from the initial recognition of goodwill.

Deferred tax liabilities recognised for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Company is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognised to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at each reporting period and reduced to the extent that that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

##### **Research costs**

Expenditure on research activities is written off to the statement of profit or loss in the year in which it is incurred.

Other than software development, the Company does not carry out any other development activity that would give rise to an intangible asset.

##### **Foreign currencies**

Transactions in foreign currencies are recognised at the rate of exchange prevailing at the date of the transaction. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at that date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

##### **Leases**

Leases are classified as finance leases wherever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Operating lease rentals are recognised in the statement of profit or loss on a straight-line basis over the lease term.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. ACCOUNTING POLICIES - continued**

##### **Provisions**

Provisions are recognised when the Company has a present obligation (legal or constructive) as a result of a past event, it is probable that the Company will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognised as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

##### **Pensions**

The Group contributes to the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Northern Powergrid Group of the ESPS"), a defined benefit scheme.

The cost of providing benefits is determined using the projected unit credit method, with actuarial valuations being carried out at the end of each annual reporting period. Re-measurement, comprising actuarial gains and losses, the effect of the changes to the asset ceiling and the return on plan assets (excluding interest) are reflected immediately in the statement of financial position with a charge or credit recognised in other comprehensive income in the period in which they occur. Re-measurement recognised in other comprehensive income is reflected immediately in retained earnings and will not be reclassified to profit or loss. Past service cost is recognised in profit or loss in the period of a plan amendment. Net interest is calculated by applying a discount rate at the beginning of the period to the net defined liability or asset. Defined benefit costs are categorised as service cost, net interest expense or income and re-measurement.

The retirement benefit obligation recognised in the statement of financial position represents the actual deficit or surplus in the Company's defined benefit plan. Any surplus resulting from this calculation is limited to the present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan.

The Group also participates in a defined contribution scheme. Contributions payable to the defined contribution scheme are charged to the statement of profit or loss in the year or capitalised as appropriate when employees have rendered service entitling them to the contributions.

A liability is recognised for benefits accruing to employees in respect of wages and salaries, annual leave and sick leave in the period in which the related service is rendered at the undiscounted amount of the benefits expected to be paid in exchange for that service. Liabilities recognised in respect of short-term employee benefits are measured at the undiscounted amount of the benefits expected to be paid in exchange for the related service. Liabilities recognised in respect of other long-term employee benefits are measured at the present value of the estimated future cash outflows expected to be made by the Company in respect of services provided by employees up to the reporting date.

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **2. ACCOUNTING POLICIES - continued**

##### **Financial assets**

Financial assets, including trade and other receivables and cash and cash equivalents, are classified as loans and receivables. Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables are measured at amortised cost using the effective interest method, less any impairment.

The effective interest method is a method of calculating the amortised cost of an instrument and of allocating income over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts through the expected life of the instrument to the net carrying amount on initial recognition.

Interest income is recognised by applying the effective interest rate, except for short-term receivables when the effect of discounting is immaterial.

Cash and cash equivalents (which are presented as a single class of assets on the face of the statement of financial position) comprise cash at bank and other short-term highly liquid investments with a maturity of three months or less, which are subject to an insignificant risk of changes in value.

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired where there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For certain categories of financial assets, such as trade receivables, assets are assessed for impairment on a collective basis even if they were assessed not to be impaired individually. Objective evidence of impairment for a portfolio of receivables could include the Company's past experience of collecting payments, an increase in the number of delayed payments in the portfolio past the average credit period of 30 days, as well as observable changes in national or local economic conditions that correlate with default on receivables.

The carrying amount of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of an allowance account. When a trade receivable is considered uncollectible, it is written off against the allowance account. Subsequent recoveries of amounts previously written off are credited against the allowance account. Changes in the carrying amount of the allowance account are recognised in the statement of profit or loss.

##### **Going concern**

The directors have, at the time of approving the financial statements, 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 financial statements. Further detail is contained within the Going Concern Statement in the Report of the Directors.



## NORTHERN POWERGRID (YORKSHIRE) PLC

### NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

#### 3. SEGMENTAL REPORTING

IFRS 8 requires operating segments to be identified on the basis of internal reports about components of the Company that are regularly reviewed by the President and Chief Executive Officer of the Northern Powergrid Group in order to allocate resources to these segments and to assess their performance.

In practice, the President and Chief Executive Officer allocates resources and assesses performance based upon the aggregate results of the Company and Northern Powergrid (Northeast) Limited, another distribution network operator in the Northern Powergrid Group, suggesting that no segmental reporting is required.

Revenue, profit before tax and net assets are attributable to electricity distribution. Revenue is all in respect of sales to United Kingdom customers.

Revenue represents charges made to customers for use of the distribution system, rental of meters, amortisation of customer contributions, the recharge of costs incurred on behalf of related parties and other services and is included net of value added tax.

#### 4. EMPLOYEES AND DIRECTORS

|                                               | 2016            | 2015            |
|-----------------------------------------------|-----------------|-----------------|
|                                               | £'000           | £'000           |
| Salaries                                      | 58,487          | 57,233          |
| Social security costs                         | 6,501           | 5,860           |
| Defined benefit pension costs                 | 15,009          | 17,866          |
| Defined contribution pension costs            | <u>2,351</u>    | <u>2,039</u>    |
|                                               | 82,348          | 82,998          |
| Less charged to property, plant and equipment | <u>(50,318)</u> | <u>(49,562)</u> |
|                                               | <u>32,030</u>   | <u>33,436</u>   |

The majority of the Company's employees are members of the Northern Powergrid Group of the ESPS, most of the remaining employees are members of the Northern Powergrid Pension Scheme, details of both are given in the employee benefits note (note 22).

The average monthly number of employees during the year was:

|                | 2016         | 2015         |
|----------------|--------------|--------------|
|                | No.          | No.          |
| Technical      | 377          | 370          |
| Industrial     | 589          | 591          |
| Administration | 98           | 99           |
| Other          | <u>123</u>   | <u>120</u>   |
|                | <u>1,187</u> | <u>1,180</u> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **4. EMPLOYEES AND DIRECTORS - continued**

#### **DIRECTORS' REMUNERATION**

|                                                          | <b>2016<br/>£'000</b> | <b>2015<br/>£'000</b> |
|----------------------------------------------------------|-----------------------|-----------------------|
| Highest Paid:                                            |                       |                       |
| Short-term employee benefits                             | <b>319</b>            | 255                   |
| Post-employment benefits                                 | <b>10</b>             | 20                    |
| Other long-term benefits                                 | <b>370</b>            | 322                   |
|                                                          | <u><b>699</b></u>     | <u><b>597</b></u>     |
|                                                          |                       |                       |
|                                                          | <b>2016<br/>£'000</b> | <b>2015<br/>£'000</b> |
| Total:                                                   |                       |                       |
| Short-term employee benefits                             | <b>667</b>            | 627                   |
| Post-employment benefits                                 | <b>52</b>             | 82                    |
| Other long-term benefits                                 | <b>612</b>            | 496                   |
|                                                          | <u><b>1,331</b></u>   | <u><b>1,205</b></u>   |
|                                                          |                       |                       |
| Directors who are a member of the defined benefit scheme | <u><b>3</b></u>       | <u><b>3</b></u>       |

#### **OTHER KEY PERSONNEL REMUNERATION**

|                              | <b>2016<br/>£'000</b> | <b>2015<br/>£'000</b> |
|------------------------------|-----------------------|-----------------------|
| Total:                       |                       |                       |
| Short-term employee benefits | <b>424</b>            | 306                   |
| Post-employment benefits     | <b>81</b>             | 74                    |
| Other long-term benefits     | <b>250</b>            | 227                   |
|                              | <u><b>755</b></u>     | <u><b>607</b></u>     |

Other key personnel includes a number of senior functional managers who, whilst not board directors, have authority and responsibility for planning, directing and controlling the activities of the Company.

The directors and key personnel are remunerated for their services to the Northern Powergrid Group, of which the Company is a subsidiary. The figures above represent the share of the costs borne by the Company.

Other long-term benefits relate to deferred bonus plan accrued over the period of the plan.

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **5. NET FINANCE COSTS**

|                                                   | <b>2016</b>          | 2015                 |
|---------------------------------------------------|----------------------|----------------------|
|                                                   | <b>£'000</b>         | £'000                |
| Finance income:                                   |                      |                      |
| Dividends received                                | 43                   | 41                   |
| Interest on tax refund                            | 537                  | -                    |
| Deposit account interest                          | 2                    | 2                    |
| Interest receivable on loans to Group undertaking | <u>534</u>           | <u>847</u>           |
|                                                   | <u><b>1,116</b></u>  | <u><b>890</b></u>    |
| Finance costs:                                    |                      |                      |
| Bank interest                                     | 105                  | 1,000                |
| Interest payable on other loans                   | 50,073               | 45,900               |
| Borrowing costs capitalised                       | <u>(2,656)</u>       | <u>(3,326)</u>       |
|                                                   | <u><b>47,522</b></u> | <u><b>43,574</b></u> |
| Net finance costs                                 | <u><b>46,406</b></u> | <u><b>42,684</b></u> |

### **6. PROFIT BEFORE INCOME TAX**

The profit before income tax is stated after charging:

|                                           | <b>2016</b>  | 2015         |
|-------------------------------------------|--------------|--------------|
|                                           | <b>£'000</b> | £'000        |
| Depreciation - owned assets               | 95,569       | 89,262       |
| Research and development costs            | 1,562        | 2,727        |
| Amortisation of deferred revenue          | (24,864)     | (23,044)     |
| Impairment of trade and other receivables | 841          | 390          |
| Profit on disposal of fixed assets        | <u>(482)</u> | <u>(264)</u> |

Analysis of auditor's remuneration is as follows:

|                                                                                      | <b>2016</b>       | 2015              |
|--------------------------------------------------------------------------------------|-------------------|-------------------|
|                                                                                      | <b>£'000</b>      | £'000             |
| Fees payable to the Company's auditor for the audit of the Company's annual accounts | 130               | 122               |
| Other assurance services                                                             | <u>45</u>         | <u>48</u>         |
| Total fees payable to the Company's auditor                                          | <u><b>175</b></u> | <u><b>170</b></u> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **7. INCOME TAX**

#### **Analysis of tax expense**

|                                                  | <b>2016</b>           | <b>2015</b>            |
|--------------------------------------------------|-----------------------|------------------------|
|                                                  | <b>£'000</b>          | <b>£'000</b>           |
| Current tax                                      | <b>11,836</b>         | <b>29,219</b>          |
| Deferred tax                                     | <b><u>(6,520)</u></b> | <b><u>(13,367)</u></b> |
| Total tax expense in statement of profit or loss | <b><u>5,316</u></b>   | <b><u>15,852</u></b>   |

#### **Factors affecting the tax expense**

The tax assessed for the year is lower than the standard rate of corporation tax in the UK. The difference is explained below:

|                                                                                                | <b>2016</b>           | <b>2015</b>           |
|------------------------------------------------------------------------------------------------|-----------------------|-----------------------|
|                                                                                                | <b>£'000</b>          | <b>£'000</b>          |
| Profit before income tax                                                                       | <b><u>153,445</u></b> | <b><u>162,511</u></b> |
| Profit multiplied by the standard rate of corporation tax in the UK of 20%<br>(2015 - 20.250%) | <b>30,689</b>         | <b>32,908</b>         |
| Effects of:                                                                                    |                       |                       |
| - Changes in legislation                                                                       | <b>(7,329)</b>        | <b>(13,871)</b>       |
| Over provision for prior years                                                                 | <b>(18,276)</b>       | <b>(3,329)</b>        |
| Tax free income and disallowable costs                                                         | <b>(70)</b>           | <b>39</b>             |
| Prior deferred tax                                                                             | <b>380</b>            | <b>124</b>            |
| Tax free capital receipt                                                                       | <b>-</b>              | <b>(194)</b>          |
| Other                                                                                          | <b><u>(78)</u></b>    | <b><u>175</u></b>     |
| Tax expense                                                                                    | <b><u>5,316</u></b>   | <b><u>15,852</u></b>  |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **7. INCOME TAX - continued**

|                                                                                         | 2016<br>£'000       | 2015<br>£'000        |
|-----------------------------------------------------------------------------------------|---------------------|----------------------|
| Tax expense comprises:                                                                  |                     |                      |
| Current tax expense:                                                                    |                     |                      |
| Corporation tax charge for the year                                                     | 30,112              | 32,548               |
| Over provision for prior years                                                          | <u>(18,276)</u>     | <u>(3,329)</u>       |
| Total current tax charge                                                                | 11,836              | 29,219               |
| Deferred tax:                                                                           |                     |                      |
| Deferred tax expenses relating to the origination and reversal of temporary differences | 809                 | 504                  |
| Effect of changes in legislation                                                        | <u>(7,329)</u>      | <u>(13,871)</u>      |
| Total deferred tax charge                                                               | <u>(6,520)</u>      | <u>(13,367)</u>      |
| Tax on profit before tax                                                                | <u><u>5,316</u></u> | <u><u>15,852</u></u> |

The Finance No2 Act 2015 reduced the rate of corporation tax to 19% effective from 1 April 2017 and to 18% effective from 1 April 2020. The Finance Act 2016, which was substantively enacted on 6 September, 2016 further reduced the rate of corporation tax effective from 1 April 2020 to 17%. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

### **8. DIVIDENDS**

|                                                 | 2016<br>£'000 | 2015<br>£'000 |
|-------------------------------------------------|---------------|---------------|
| Interim dividend at 9.9p per share (2015: 9.5p) | <u>28,700</u> | <u>27,600</u> |

### **9. OPERATING EXPENSES**

|                             | 2016<br>£'000         | 2015<br>£'000         |
|-----------------------------|-----------------------|-----------------------|
| Operating expenses comprise |                       |                       |
| Distribution costs          | 142,139               | 137,482               |
| Administrative expenses     | <u>56,820</u>         | <u>60,973</u>         |
|                             | <u><u>198,959</u></u> | <u><u>198,455</u></u> |

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**NOTES TO THE FINANCIAL STATEMENTS - continued  
FOR THE YEAR ENDED 31 DECEMBER 2016**

**10. INTANGIBLE ASSETS**

|                       | Software<br>development<br>costs<br>£'000 |
|-----------------------|-------------------------------------------|
| <b>COST</b>           |                                           |
| At 1 January 2016     |                                           |
| and 31 December 2016  | <u>29,497</u>                             |
| <b>AMORTISATION</b>   |                                           |
| At 1 January 2016     |                                           |
| and 31 December 2016  | <u>29,497</u>                             |
| <b>NET BOOK VALUE</b> |                                           |
| At 31 December 2016   | <u><u>-</u></u>                           |

|                       | Software<br>development<br>costs<br>£'000 |
|-----------------------|-------------------------------------------|
| <b>COST</b>           |                                           |
| At 1 January 2015     |                                           |
| and 31 December 2015  | <u>29,497</u>                             |
| <b>AMORTISATION</b>   |                                           |
| At 1 January 2015     |                                           |
| and 31 December 2015  | <u>29,497</u>                             |
| <b>NET BOOK VALUE</b> |                                           |
| At 31 December 2015   | <u><u>-</u></u>                           |

**11. PROPERTY, PLANT AND EQUIPMENT**

|                        | Non<br>operational<br>land &<br>buildings<br>£'000 | Distribution<br>system<br>£'000 | Fixtures<br>and<br>fittings<br>£'000 | Totals<br>£'000         |
|------------------------|----------------------------------------------------|---------------------------------|--------------------------------------|-------------------------|
| <b>COST</b>            |                                                    |                                 |                                      |                         |
| At 1 January 2016      | 4,505                                              | 3,665,873                       | 30,701                               | 3,701,079               |
| Additions              | -                                                  | 225,065                         | 4,099                                | 229,164                 |
| Disposals              | <u>-</u>                                           | <u>(8,938)</u>                  | <u>(304)</u>                         | <u>(9,242)</u>          |
| At 31 December 2016    | <u>4,505</u>                                       | <u>3,882,000</u>                | <u>34,496</u>                        | <u>3,921,001</u>        |
| <b>DEPRECIATION</b>    |                                                    |                                 |                                      |                         |
| At 1 January 2016      | 2,237                                              | 756,598                         | 21,194                               | 780,029                 |
| Charge for year        | 178                                                | 92,177                          | 3,214                                | 95,569                  |
| Eliminated on disposal | <u>-</u>                                           | <u>(8,938)</u>                  | <u>(304)</u>                         | <u>(9,242)</u>          |
| At 31 December 2016    | <u>2,415</u>                                       | <u>839,837</u>                  | <u>24,104</u>                        | <u>866,356</u>          |
| <b>NET BOOK VALUE</b>  |                                                    |                                 |                                      |                         |
| At 31 December 2016    | <u><u>2,090</u></u>                                | <u><u>3,042,163</u></u>         | <u><u>10,392</u></u>                 | <u><u>3,054,645</u></u> |

**NORTHERN POWERGRID (YORKSHIRE) PLC**

**NOTES TO THE FINANCIAL STATEMENTS - continued  
FOR THE YEAR ENDED 31 DECEMBER 2016**

**11. PROPERTY, PLANT AND EQUIPMENT - continued**

|                        | Non<br>operational<br>land &<br>buildings<br>£'000 | Distribution<br>system<br>£'000 | Fixtures<br>and<br>fittings<br>£'000 | Totals<br>£'000  |
|------------------------|----------------------------------------------------|---------------------------------|--------------------------------------|------------------|
| <b>COST</b>            |                                                    |                                 |                                      |                  |
| At 1 January 2015      | 4,505                                              | 3,395,089                       | 25,531                               | 3,425,125        |
| Additions              | -                                                  | 281,523                         | 5,583                                | 287,106          |
| Disposals              | -                                                  | (10,739)                        | (413)                                | (11,152)         |
| At 31 December 2015    | <u>4,505</u>                                       | <u>3,665,873</u>                | <u>30,701</u>                        | <u>3,701,079</u> |
| <b>DEPRECIATION</b>    |                                                    |                                 |                                      |                  |
| At 1 January 2015      | 2,059                                              | 680,827                         | 18,953                               | 701,839          |
| Charge for year        | 178                                                | 86,430                          | 2,654                                | 89,262           |
| Eliminated on disposal | -                                                  | (10,659)                        | (413)                                | (11,072)         |
| At 31 December 2015    | <u>2,237</u>                                       | <u>756,598</u>                  | <u>21,194</u>                        | <u>780,029</u>   |
| <b>NET BOOK VALUE</b>  |                                                    |                                 |                                      |                  |
| At 31 December 2015    | <u>2,268</u>                                       | <u>2,909,275</u>                | <u>9,507</u>                         | <u>2,921,050</u> |

Assets in the course of construction included above:

|                     | Distribution<br>system<br>£'000 | Fixtures and<br>fittings<br>£'000 | Totals<br>£'000  |
|---------------------|---------------------------------|-----------------------------------|------------------|
| At 1 January 2016   | 192,567                         | -                                 | 192,567          |
| Additions           | 225,065                         | 4,099                             | 229,164          |
| Available for use   | <u>(228,863)</u>                | <u>(4,099)</u>                    | <u>(232,962)</u> |
| At 31 December 2016 | <u>188,769</u>                  | <u>-</u>                          | <u>188,769</u>   |

The Company has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £20.0m (2015: £32.6m).

The net book value of non-operating land and buildings comprise:

|                 | 2016<br>£'000 | 2015<br>£'000 |
|-----------------|---------------|---------------|
| Freehold        | 1,225         | 1,346         |
| Long leasehold  | 739           | 772           |
| Short leasehold | <u>126</u>    | <u>150</u>    |
|                 | <u>2,090</u>  | <u>2,268</u>  |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **12. INVENTORIES**

|                  | 2016       | 2015       |
|------------------|------------|------------|
|                  | £'000      | £'000      |
| Work-in-progress | <u>265</u> | <u>465</u> |

### **13. TRADE AND OTHER RECEIVABLES**

|                                                    | 2016          | 2015          |
|----------------------------------------------------|---------------|---------------|
|                                                    | £'000         | £'000         |
| Current:                                           |               |               |
| Distribution use of system receivables             | 61,406        | 57,282        |
| Amounts receivable from sale of goods and services | 2,341         | 4,166         |
| Prepayments and accrued income                     | <u>4,752</u>  | <u>2,372</u>  |
|                                                    | <u>68,499</u> | <u>63,820</u> |

The directors consider that the carrying amount of trade and other receivables approximates their fair value calculated by discounting the future cash flows at the market rate at the end of the reporting period. The maximum exposure to risk to the Company is the book value of these receivables less any provisions for impairment.

#### **Distribution use of system receivables**

The customers served by the Company's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 23% of distribution revenues in 2016 (2015: 24%) and British Gas plc accounting for approximately 17% of distribution revenues in 2016 (2015: 18%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account. Included within other payables are customer deposits of £0.4 million as at 31 December 2016 (2015: £0.4 million).

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any bad debt losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material. Included in the Company's use of system ("UoS") receivables are debtors with a carrying value of £0.3 million, which have been placed into administration and have therefore been provided in full at the year-end (2015: £nil).

#### **Amounts receivable from sale of goods and services**

Sales of goods and services comprise all income streams which are not classified as UoS income. Examples of non-UoS income streams would be customer contributions in relation to distribution system assets and recovery of amounts for damage caused by third parties to the distribution system.

The average credit period on sales of goods and services is 30 days (2015: 30 days). Interest is not generally charged on the trade receivables paid after the due date. An allowance for doubtful debts is made for debts past their due date based on estimated irrecoverable amounts from the sale of goods and services, determined by reference to past default experience.



# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **13. TRADE AND OTHER RECEIVABLES - continued**

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £2.2 million (2015: £2.2 million) which are past due at the reporting date and for which the Company has provided an irrecoverable amount of £1.5 million (2015: £0.7 million) based on past experience. The Company does not hold any collateral over these balances. The average age of these receivables is 300 days (2015: 297 days).

Included in the Company's amounts receivable for goods and services balance are debtors with a carrying amount of £0.3 million (2015: £0.4 million). These amounts are past due at the reporting date and the Company has not provided for any amounts as not being recoverable, because there has not been a significant change in credit quality and the amounts are still considered recoverable. The Company does not hold any collateral over these balances. The average age of these receivables is 72 days (2015: 96 days).

Ageing of past due but not impaired receivables

|              | 2016<br>£'000     | 2015<br>£'000     |
|--------------|-------------------|-------------------|
| 30-60 days   | 189               | 167               |
| 60-120 days  | 59                | 82                |
| 120-210 days | <u>45</u>         | <u>129</u>        |
| Total        | <u><u>293</u></u> | <u><u>378</u></u> |

#### **Movement in the allowance for doubtful debts**

|                                                   | 2016<br>£'000       | 2015<br>£'000     |
|---------------------------------------------------|---------------------|-------------------|
| At 1 January                                      | 721                 | 618               |
| Amounts utilised/written off in the year          | (97)                | (287)             |
| Amounts recognised in statement of profit or loss | <u>841</u>          | <u>390</u>        |
| At 31 December                                    | <u><u>1,465</u></u> | <u><u>721</u></u> |

In determining the recoverability of the trade and other receivables, the Company considers any change in the credit quality of the trade and other receivable from the date credit was initially granted up to the reporting date. The concentration of credit risk, other than in relation to UoS receivables, is limited due to the customer base being large and unrelated. Accordingly, the directors believe that there is no further credit provision required in excess of the allowance for doubtful debts.

Included in the allowance for doubtful debts are specific trade receivables, with a balance of £1.0 million (2015: £0.4 million) which have been placed in administration. The impairment represents the difference between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **13. TRADE AND OTHER RECEIVABLES - continued**

#### **Categories of financial assets**

|                                         | 2016<br>£'000    | 2015<br>£'000    |
|-----------------------------------------|------------------|------------------|
| Cash and bank balances                  | 199,298          | 145,668          |
| Loans and receivables at amortised cost | <u>63,747</u>    | <u>61,448</u>    |
| Total financial assets                  | <u>263,045</u>   | <u>207,116</u>   |
| Non-current assets                      | 3,054,645        | 2,921,050        |
| Inventories                             | 265              | 465              |
| Prepayments and accrued income          | <u>4,752</u>     | <u>2,372</u>     |
| Total non-financial assets              | <u>3,059,662</u> | <u>2,923,887</u> |
| Total assets                            | <u>3,322,707</u> | <u>3,131,003</u> |

### **14. CASH AND CASH EQUIVALENTS**

|              | 2016<br>£'000  | 2015<br>£'000  |
|--------------|----------------|----------------|
| Cash in hand | <u>199,298</u> | <u>145,668</u> |

Cash and cash equivalents represent amounts owed by companies within the Northern Powergrid Group (see related party disclosures note), which have a maturity date of less than three months and which are subject to an insignificant risk of changes in value. The fair value of cash and cash equivalents is equal to their book value.

### **15. CALLED UP SHARE CAPITAL**

Allotted, issued and fully paid:

| Number:     | Class:                 | Nominal<br>value: | 2016<br>£'000  | 2015<br>£'000  |
|-------------|------------------------|-------------------|----------------|----------------|
| 290,000,000 | Ordinary share capital | £1                | <u>290,000</u> | <u>290,000</u> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **16. RESERVES**

|                     | <b>Retained<br/>earnings<br/>£'000</b> |
|---------------------|----------------------------------------|
| At 1 January 2016   | 829,467                                |
| Profit for the year | 148,129                                |
| Dividends           | <u>(28,700)</u>                        |
| At 31 December 2016 | <u><b>948,896</b></u>                  |
|                     | <b>Retained<br/>earnings<br/>£'000</b> |
| At 1 January 2015   | 710,408                                |
| Profit for the year | 146,659                                |
| Dividends           | <u>(27,600)</u>                        |
| At 31 December 2015 | <u><b>829,467</b></u>                  |

### **17. TRADE AND OTHER PAYABLES**

|                                    | <b>2016<br/>£'000</b> | <b>2015<br/>£'000</b> |
|------------------------------------|-----------------------|-----------------------|
| Current:                           |                       |                       |
| Payments on account                | 40,354                | 49,465                |
| Trade creditors                    | 5,283                 | 6,023                 |
| Amounts owed to Group undertakings | 429                   | 440                   |
| Social security and other taxes    | 8,959                 | 11,085                |
| Other creditors                    | 5,968                 | 5,944                 |
| Deferred revenue                   | 26,743                | 24,836                |
| Accrued expenses                   | <u>27,493</u>         | <u>31,967</u>         |
|                                    | <u><b>115,229</b></u> | <u><b>129,760</b></u> |
| Non-current:                       |                       |                       |
| Deferred revenue                   | <u><b>762,475</b></u> | <u><b>728,901</b></u> |
| Aggregate amounts                  | <u><b>877,704</b></u> | <u><b>858,661</b></u> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued** **FOR THE YEAR ENDED 31 DECEMBER 2016**

### **17. TRADE AND OTHER PAYABLES - continued**

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the end of the reporting period. The valuation of liabilities set out above is based on Level 1 inputs. Trade creditors and accruals principally comprise amounts outstanding for trade purchases and ongoing costs. Invoices are paid at the end of the month following the date of the invoice. The Company has financial risk management policies in place to ensure that all payables are paid within the credit timeframe.

The following tables detail the remaining contractual maturities for the non-derivative financial liabilities. The tables have been drawn up based on the discounted cash flows of financial liabilities based on the earliest possible date on which the Company can be required to pay. The tables include both interest and principal cash flows.

|                                     | Less than 3<br>months<br>£'000 | 3 months to 1<br>year<br>£'000 | 1 to 5 years<br>£'000 | 5+ years<br>£'000 | Total<br>£'000   |
|-------------------------------------|--------------------------------|--------------------------------|-----------------------|-------------------|------------------|
| 2016:                               |                                |                                |                       |                   |                  |
| Non-interest bearing                | 48,132                         | -                              | -                     | -                 | 48,132           |
| Variable interest rate<br>liability | 12                             | -                              | -                     | -                 | 12               |
| Fixed interest rate liability       | 18,500                         | 31,173                         | 380,192               | 1,092,074         | 1,521,939        |
|                                     | <u>66,644</u>                  | <u>31,173</u>                  | <u>380,192</u>        | <u>1,092,074</u>  | <u>1,570,083</u> |
| 2015:                               |                                |                                |                       |                   |                  |
| Non-interest bearing                | 55,459                         | -                              | -                     | -                 | 55,459           |
| Variable interest rate<br>liability | 53                             | -                              | -                     | -                 | 53               |
| Fixed interest rate liability       | 18,500                         | 30,137                         | 394,546               | 1,068,064         | 1,511,247        |
|                                     | <u>74,012</u>                  | <u>30,137</u>                  | <u>394,546</u>        | <u>1,068,064</u>  | <u>1,566,759</u> |

### **Categories of financial liabilities**

|                                      | 2016<br>£'000    | 2015<br>£'000    |
|--------------------------------------|------------------|------------------|
| Loans and payables at amortised cost | 1,067,824        | 1,017,875        |
| Total financial liabilities          | <u>1,067,824</u> | <u>1,017,875</u> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **17. TRADE AND OTHER PAYABLES – continued**

|                                        | 2016<br>£'000    | 2015<br>£'000    |
|----------------------------------------|------------------|------------------|
| Payments received on account           | 40,354           | 49,465           |
| Income tax liabilities                 | 147,760          | 145,408          |
| Other taxes and social security        | 8,959            | 11,085           |
| Accruals                               | 27,493           | 31,967           |
| Deferred Revenue                       | 789,218          | 753,737          |
| Provisions                             | 2,203            | 1,999            |
| <b>Total non-financial liabilities</b> | <b>1,015,987</b> | <b>993,661</b>   |
| <b>Total liabilities</b>               | <b>2,083,811</b> | <b>2,011,536</b> |

#### **Deferred Revenue**

|                       | 2016<br>£'000  | 2015<br>£'000  |
|-----------------------|----------------|----------------|
| At 1 January          | 753,737        | 721,860        |
| Additions             | 60,344         | 54,921         |
| Amortisation          | 24,864         | 23,044         |
| <b>At 31 December</b> | <b>789,217</b> | <b>753,737</b> |

Deferred revenue represents contributions from customers made in advance towards distribution system assets. This income is released to the statement of profit or loss over 45 years or 15 years on a straight line basis, in line with the useful economic life of the distribution system assets.

### **18. BORROWINGS**

The directors' consideration of liquidity, interest rate and foreign currency risk are described in the Strategic Report.

|                                          | <b>Book Value</b> |                  | <b>Fair Value</b> |                  |
|------------------------------------------|-------------------|------------------|-------------------|------------------|
|                                          | 2016<br>£'000     | 2015<br>£'000    | 2016<br>£'000     | 2015<br>£'000    |
| Loans                                    | 1,056,144         | 1,005,468        | 1,260,799         | 1,121,056        |
|                                          | <u>1,056,144</u>  | <u>1,005,468</u> | <u>1,260,799</u>  | <u>1,121,056</u> |
| The borrowings are repayable as follows: |                   |                  |                   |                  |
| On demand or within one year             | 33,340            | 33,294           | 33,340            | 33,294           |
| Between one and five years               | 199,549           | 199,401          | 248,750           | 252,086          |
| After five years                         | 823,255           | 772,773          | 878,709           | 835,676          |
|                                          | <u>1,056,144</u>  | <u>1,005,468</u> | <u>1,260,799</u>  | <u>1,121,056</u> |

# NORTHERN POWERGRID (YORKSHIRE) PLC

## NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

### 18. BORROWINGS - continued

Analysis of borrowings:

|                                        | Book Value       |                  | Fair Value       |                  |
|----------------------------------------|------------------|------------------|------------------|------------------|
|                                        | 2016<br>£'000    | 2015<br>£'000    | 2016<br>£'000    | 2015<br>£'000    |
| Short-term loan                        | 12               | 53               | 12               | 53               |
| 2020 - 9.25% bonds                     | 217,227          | 217,079          | 266,428          | 269,764          |
| 2035 - 5.125% bonds                    | 203,933          | 203,834          | 276,674          | 240,312          |
| 2032 - 4.375% bonds                    | 150,528          | 150,409          | 187,202          | 164,512          |
| 2022 - European Investment Bank 4.133% | 153,692          | 153,674          | 179,923          | 172,953          |
| 2025 - 2.5% bonds                      | 150,527          | 150,280          | 160,420          | 146,585          |
| 2022 - European Investment Bank 2.564% | 130,139          | 130,139          | 139,487          | 126,877          |
| 2022 - European Investment Bank 2.073% | 50,086           | -                | 50,653           | -                |
|                                        | <u>1,056,144</u> | <u>1,005,468</u> | <u>1,260,799</u> | <u>1,121,056</u> |

The fair value of the bonds is determined with reference to quoted market prices. The directors' estimates of the fair value of bank loans and internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments. The fair value of short-term borrowings is equal to their book value. All loans are non-secured and are denominated in sterling.

The valuation of liabilities set out above is based on Level 1 inputs.

Interest on short-term loans and inter-company short term loans is charged at a floating rate of LIBOR plus 0.35%, thus exposing the Company to cash flow interest rate risk. A 1% movement in interest rates would not subject the Company to any change in interest costs during the year. All other loans are at fixed interest rates and expose the Company to fair value interest rate risk.

The covenants associated with the 2035 bonds issued by the Company include restrictions on the issuance of new indebtedness and the making of distributions dependent on the scale of the ratio of Senior Total Net Debt to Regulatory Asset Value ("RAV").

The definition of Senior Total Net Debt excludes any subordinated debt and any debt incurred on a non-recourse basis. In addition, it excludes interest payable, any fair value adjustments and unamortised issue costs.

The Company's Senior Total Net Debt as at 31 December 2016 totalled £831.7 million. Using the RAV value as at March 2017, as outlined by Ofgem in its electricity distribution price control financial model published in November 2015, and adjusting for the effects of movements in the value of the Retail Prices Index ("RPI") gives an approximation for the RAV value as at December 2016 of £1,701.6 million. The Senior Total Net Debt to RAV ratio for the Company is therefore estimated at 48.9% (2015: 50.9%)

At 31 December 2016, the Company had available £94.0 million (2015: £94.0 million) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **19. LEASING AGREEMENTS**

Minimum lease payments under non-cancellable operating leases fall due as follows:

|                            | <b>2016</b>         | <b>2015</b>         |
|----------------------------|---------------------|---------------------|
|                            | <b>£'000</b>        | <b>£'000</b>        |
| Within one year            | <b>2,343</b>        | <b>2,590</b>        |
| Between one and five years | <b>4,866</b>        | <b>5,098</b>        |
| In more than five years    | <b><u>1,430</u></b> | <b><u>545</u></b>   |
|                            | <b><u>8,639</u></b> | <b><u>8,233</u></b> |

|                                                                      | <b>2016</b>         | <b>2015</b>         |
|----------------------------------------------------------------------|---------------------|---------------------|
|                                                                      | <b>£'000</b>        | <b>£'000</b>        |
| Minimum lease payments under operating leases recognised in the year | <b><u>4,587</u></b> | <b><u>4,514</u></b> |

Leases primarily relate to the hire of fleet vehicles with lease terms between 2 and 7 years. The Company does not have the option to purchase the vehicles at the end of the lease term.

### **20. PROVISIONS**

|                      | <b>2016</b>         | <b>2015</b>         |
|----------------------|---------------------|---------------------|
|                      | <b>£'000</b>        | <b>£'000</b>        |
| Provisions           | <b><u>2,203</u></b> | <b><u>1,999</u></b> |
| Analysed as follows: |                     |                     |
| Current              | <b>1,033</b>        | <b>1,113</b>        |
| Non-current          | <b><u>1,170</u></b> | <b><u>886</u></b>   |
|                      | <b><u>2,203</u></b> | <b><u>1,999</u></b> |

|                                        | <b>Claims</b>     | <b>Other</b>        | <b>Total</b>        |
|----------------------------------------|-------------------|---------------------|---------------------|
|                                        | <b>£'000</b>      | <b>£'000</b>        | <b>£'000</b>        |
| At 1 January 2016                      | <b>738</b>        | <b>1,261</b>        | <b>1,999</b>        |
| Utilised/paid in the year              | <b>(834)</b>      | <b>(414)</b>        | <b>(1,248)</b>      |
| Charged to statement of profit or loss | <b><u>795</u></b> | <b><u>657</u></b>   | <b><u>1,452</u></b> |
| At 31 December 2016                    | <b><u>699</u></b> | <b><u>1,504</u></b> | <b><u>2,203</u></b> |

Claims: Provision has been made to cover costs arising from actual claims, which are not externally insured. Settlement is expected substantially within 12 months.

Other: Primarily consists of a provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and for an amount to cover claims made under section 74 of the New Road and Street Works Act 1991. Costs are expected to be incurred over the next 15 years.

# NORTHERN POWERGRID (YORKSHIRE) PLC

## NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

### 21. DEFERRED TAX

|                                                | Accelerated<br>Tax<br>Depreciation<br>£'000 | Other<br>£'000 | Total<br>£'000 |
|------------------------------------------------|---------------------------------------------|----------------|----------------|
| At 1 January 2016                              | 134,423                                     | (230)          | 134,193        |
| (Credit)/charge to statement of profit or loss | <u>(6,533)</u>                              | <u>13</u>      | <u>(6,520)</u> |
| At 31 December 2016                            | <u>127,890</u>                              | <u>(217)</u>   | <u>127,673</u> |

|                                                | Accelerated Tax<br>Depreciation<br>£'000 | Other<br>£'000 | Total<br>£'000  |
|------------------------------------------------|------------------------------------------|----------------|-----------------|
| At 1 January 2015                              | 147,820                                  | (260)          | 147,560         |
| (Credit)/charge to statement of profit or loss | <u>(13,397)</u>                          | <u>30</u>      | <u>(13,367)</u> |
| At 31 December 2015                            | <u>134,423</u>                           | <u>(230)</u>   | <u>134,193</u>  |

Other comprises provisions and employee expenses deductible for tax on a paid basis and claims for hold over relief.

### 22. EMPLOYEE BENEFIT OBLIGATIONS

#### Introduction

The Company contributes to two pension schemes, which it operates on behalf of the participating companies within the Northern Powergrid Group. Those pension schemes are:

- The Northern Powergrid Group of the ESPS (the "DB Scheme"); and
- The Northern Powergrid Pension Scheme.

The Northern Powergrid Pension Scheme was introduced for new employees of the Northern Powergrid Group from July 1997 and is a money purchase arrangement accounted for as a defined contribution scheme.

The DB Scheme is a defined benefit scheme for directors and employees, which provides pension and other related retirement benefits based on final pensionable pay. The DB Scheme closed to staff commencing employment with the Northern Powergrid Group on or after 23 July 1997. Members who joined before this date, including some Protected Persons under The Electricity (Protected Persons) (England and Wales) Pension Regulations 1990, continue to build up future pension benefits.

Under the DB Scheme, employees are typically entitled to annual pensions on retirement at age 63 of one-eightieth of final pensionable salary for each year of service plus an additional tax-free cash lump sum at retirement of three times pension. Benefits are also payable on death and following other events such as withdrawing from active service.

No other post-retirement benefits are provided to members of the DB Scheme.



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **22. EMPLOYEE BENEFIT OBLIGATIONS - continued**

##### **Role of Trustees**

The DB Scheme is administered by a board of Trustees which is legally separate from the Company. The assets of the DB Scheme are held in a separate trustee-administered fund. The board of Trustees is made up of Trustees appointed by Northern Electric plc, as the Principal Employer of the DB Scheme, Trustees elected by the membership and an independent trustee. The Trustees are required by law to act in the interests of all relevant beneficiaries and are responsible in particular for the asset investment strategy plus the day-to-day administration of the benefits payable. They also are responsible for jointly agreeing with the Principal Employer the level of contributions due to the DB Scheme.

Unless otherwise stated, disclosures within this note are representative of the Northern Powergrid Group as a whole and not the Company on an individual basis as the Company accounts for the DB Scheme as if it were a defined contribution scheme.

##### **Funding requirements**

UK legislation requires that pension schemes are funded prudently (i.e. to a level in excess of the current expected cost of providing benefits). The last actuarial valuation of the DB scheme was carried out by the Trustees' actuarial advisors, Aon Hewitt, as at 31 March 2013. Such valuations are required by law to take place at intervals of no more than three years. Following each valuation, the Trustees and the Northern Powergrid Group must agree the contributions required (if any) to ensure the DB Scheme is fully funded over time on the basis of suitable, prudent assumptions. Contributions agreed in this manner constitute a minimum funding requirement.

Agreement was reached during October 2014 with the Trustees to repair the funding deficit of £286.4m as at 31 March 2014 over the 11 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2013 being borne out in practice. The agreement includes cash payments of £34.9m per annum over the period to 31 March 2015, made on a monthly basis, followed by an agreed profile of payments to be made over the remaining ten years of the recovery plan, as set out below:

|                               |             |
|-------------------------------|-------------|
| 1 April 2015 to 31 March 2016 | £28.6m p.a. |
| 1 April 2016 to 31 March 2025 | £18.4m p.a. |

All contributions set out above are in 2014/15 prices and will be increased each year in line with increases in RPI over the period until they fall due.

The contributions payable by the Northern Powergrid Group to the DB Scheme in respect of future benefits, which are accruing, are 34.2% of pensionable pay. These contributions were determined as part of the 31 March 2013 actuarial valuation and are payable in addition to the deficit repair contributions mentioned above. These rates will remain in place until such a time as a new schedule of contributions is agreed between the Trustees and Northern Electric plc as part of the 31 March 2016 or earlier valuation. In addition, the Northern Powergrid Group pays 3.0% of pensionable pay to the DB Scheme to cover the expenses of running the DB Scheme.

The next funding valuation is on-going and expected to be concluded by the end of June 2017.

The Northern Powergrid Group's total contributions to the DB Scheme for the next financial year are expected to be £36.7 million.

Under the rules of the DB Scheme, any future surplus in the DB Scheme may, following consultation with the Group Trustees, be allocated for the benefit of the members of the DB Scheme and/or the Principal and Participating Employers.

## NORTHERN POWERGRID (YORKSHIRE) PLC

### NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

#### 22. EMPLOYEE BENEFIT OBLIGATIONS - continued

##### Pensions' Regulation

The UK pensions market is regulated by the Pensions Regulator whose key statutory objectives in relation to UK defined benefit plans are to:

- protect the benefits of members;
- promote and to improve understanding of good administration;
- reduce the risk of situations arising which may lead to compensation being payable from the Pension Protection Fund ("PPF"); and
- minimise any adverse impact on the sustainable growth of an employer.

The Pensions Regulator has various powers including the power to:

- wind up a scheme where winding up is necessary to protect members' interests;
- appoint or remove a trustee;
- impose a schedule of company contributions or the calculation of the technical provisions where trustees and company fail to agree on appropriate contributions; and
- impose contributions where there has been a detrimental action against the scheme.

##### Profile of the DB Scheme

The Defined Benefit Obligation ("DBO") includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 17 years based on the results of the 31 March 2013 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

Broadly, about 40% of the liabilities are attributable to current employees (duration about 23 years), 10% to former employees (duration about 24 years) and 50% to current pensioners (duration about 12 years).

##### Risks associated with the DB Scheme

The DB Scheme exposes the Northern Powergrid Group to a number of risks, the most significant of which are:

| Risk                   | Description                                                                                                                                                                                                                                                                                                                                                                                                            | Mitigation                                                                                                                                                                                                                                                                                                                                                                                                                                             |
|------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Volatile asset returns | The DBO is calculated using a discount rate set with reference to corporate bond yields. If assets underperform this discount rate, this will create an element of deficit. The DB Scheme aims to hold a significant proportion (48%) of its assets in return-seeking assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term. | The allocation to return-seeking assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from return-seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation. |

# NORTHERN POWERGRID (YORKSHIRE) PLC

## NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

### 22. EMPLOYEE BENEFIT OBLIGATIONS - continued

| Risk                   | Description                                                                                                                                                                                                 | Mitigation                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
|------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Changes in bond yields | A decrease in corporate bond yields will increase the value placed on the DBO for accounting purposes, although this will be partially offset by an increase in the value of the DB Scheme's bond holdings. | The DB Scheme also holds a substantial proportion of its assets (61%) as bonds, which provide a hedge against falling bond yields (falling yields which increase the DBO will also increase the value of the bond assets). There are some differences in the credit quality of bonds held by the DB Scheme and the bonds analysed to decide the DBO discount rate, such that there remains some risk should yields on different quality bond/swap assets diverge. |
| Inflation risk         | A significant proportion of the DBO is indexed in line with price inflation (specifically in line with RPI) and higher inflation will lead to higher liabilities                                            | The DB Scheme holds around 30% in UK government index-linked bonds which provide a hedge against higher than expected inflation increases of the DBO (rising inflation will increase both the DBO and the value of the index-linked bond portfolio).                                                                                                                                                                                                              |
| Currency risk          | To increase diversification, the DB Scheme invests in overseas assets. This leads to a risk that foreign currency movements negatively impact the value of assets in Sterling terms.                        | The DB Scheme hedges a proportion of the overseas investments currency risk for those overseas currencies that can be hedged efficiently. The DB Scheme's currency hedging ratio is currently 50% in respect of overseas developed market currencies.                                                                                                                                                                                                             |
| Life expectancy        | The majority of the DB Scheme's obligations are to provide benefits for the pensionable lifetime of the member, so increases in life expectancy will result in an increase in the liabilities.              | The DB Scheme regularly reviews actual experience of its membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption.                                                                                                                                                                                                               |

The Northern Powergrid Group and Trustees have agreed a long-term strategy for reducing investment risk as and when appropriate. This includes the use of Liability Driven Investment (LDI) from October 2016 to more closely match the nature and duration of the DB Scheme's liabilities through the use of derivatives such as swaps and repurchase agreements. The portfolio is designed to hedge a proportion of the interest rate and inflation risk inherent in the Scheme's liabilities. The target hedging level is currently 60% of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

The Trustees insure certain benefits payable on death before retirement.

#### Other risks

There are a number of other risks associated with the DB Scheme including operational risks (such as paying out the wrong benefits), legislative risks (such as the government increasing the burden on pension schemes through new legislation) and other demographic risks (such as a higher proportion members dying than assumed with a dependant eligible to receive a survivor's pension from the DB Scheme).

## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **22. EMPLOYEE BENEFIT OBLIGATIONS - continued**

A particular legislative risk exists in relation to the equalisation of the Guaranteed Minimum Pension ("GMP"), a quasi-state benefit accrued by many UK plans over the period 1978 to 1997 as a result of a UK government programme allowing pension plans to "contract out" of the State Second Pension. The UK Government has announced its intention to ensure that these benefits, which currently pay out at different levels for men and women, are gender-equalised in accordance with sex-discrimination legislation. This would increase the DBO but it is not possible to fully quantify the impact of this change at this stage. However, it could lead to an increase in the order of 2% to the DBO for a typical scheme.

#### **Reporting at 31 December 2016**

For the purposes of this disclosure, the current and future pension costs of the Northern Powergrid Group have been assessed by Aon Hewitt, a qualified independent actuary, using the assumptions set out below, which the actuary has confirmed represent a reasonable best estimate of those costs. This review has been based on the same membership and other data as at 31 March 2013. The board of Northern Powergrid Holdings Company has accepted the advice of the actuary and formally approved the use of these assumptions for the purpose of calculating the pension cost of the Northern Powergrid Group.

The results of the latest funding valuation at 31 March 2013 have been adjusted to 31 December 2016. Those adjustments take account of experience over the period since 31 March 2013, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the DBO and the related current service cost were measured using the Projected Unit Credit Method.

For schemes closed to new members, such as the DB Scheme, the current service cost calculated under the Projected Unit Credit Method is expected to increase as the members of the DB Scheme approach retirement.

The Company's total pension cost for the year ended 31 December 2016 was £17.4m (2015: £19.9m).

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

### **22. EMPLOYEE BENEFIT OBLIGATIONS - continued**

The principal assumptions used to calculate the liabilities under IAS 19 are set out below:

| <b>Main financial assumptions</b>      | <b>2016<br/>% p.a.</b> | <b>2015<br/>% p.a.</b> |
|----------------------------------------|------------------------|------------------------|
| RPI Inflation                          | <b>3.00</b>            | 2.90                   |
| Rate of long-term increase in salaries | <b>3.00</b>            | 2.90                   |
| Pension increases                      | <b>2.90</b>            | 2.80                   |
| Discount rate for scheme liabilities   | <b>2.70</b>            | 3.70                   |

The financial assumptions reflect the nature and term of the DB Scheme's liabilities.

| <b>Main demographic assumptions</b>                               | <b>2016</b> | <b>2015</b> |
|-------------------------------------------------------------------|-------------|-------------|
| Life expectancy for a male currently aged 60                      | <b>27.1</b> | 27.0        |
| Life expectancy for a female currently aged 60                    | <b>28.8</b> | 28.7        |
| Life expectancy at 60 for a male currently aged 45                | <b>28.6</b> | 28.5        |
| Life expectancy at 60 for a female currently aged 45              | <b>30.6</b> | 30.4        |
| Proportion of pension exchanged for additional cash at retirement | <b>10%</b>  | 10%         |

The mortality assumptions are based on recent actual mortality experience of DB Scheme members and allow for expected future improvements in mortality rates.

The DB Scheme's funds are invested in the following assets:

| <b>Asset allocation</b>          | <b>2016<br/>£m</b>    | <b>2015<br/>£m</b>   |
|----------------------------------|-----------------------|----------------------|
| Developed market equity          | <b>338.6</b>          | 331.0                |
| Emerging market equity           | <b>12.9</b>           | 11.2                 |
| Property                         | <b>91.4</b>           | 146.0                |
| Reinsurance                      | <b>71.3</b>           | 68.2                 |
| Listed infrastructure            | <b>99.2</b>           | 90.1                 |
| Investment grade corporate bonds | <b>366.9</b>          | 375.5                |
| Other debt                       | <b>30.3</b>           | 38.7                 |
| Fixed interest gilts             | <b>52.4</b>           | 24.9                 |
| Index-linked gilts               | <b>3.1</b>            | 453.7                |
| Liability driven investments     | <b>581.2</b>          | -                    |
| Cash                             | <b>107.1</b>          | 22.0                 |
| <b>Total</b>                     | <b><u>1,754.4</u></b> | <b><u>1541.3</u></b> |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued** **FOR THE YEAR ENDED 31 DECEMBER 2016**

### **22. EMPLOYEE BENEFIT OBLIGATIONS - continued**

The fair values of the above equity and debt instruments are determined based on quoted market prices in active markets whereas the fair values of properties are not based on quoted prices in active markets.

As at 31 December 2016, the fair value of the DB Scheme's assets, which related to self-investment, amounted to Nil% (2015: Nil%).

| <b>Changes to the present value of the DBO during the year</b>                                  | <b>2016</b>    | <b>2015</b>   |
|-------------------------------------------------------------------------------------------------|----------------|---------------|
|                                                                                                 | <b>£m</b>      | <b>£m</b>     |
| Opening DBO                                                                                     | 1453.2         | 1463.2        |
| Current service cost                                                                            | 14.9           | 15.9          |
| Interest expense on defined benefit obligation                                                  | 53.0           | 52.0          |
| Contributions by DB Scheme participants                                                         | 1.0            | 1.5           |
| Actuarial gains on DB Scheme liabilities arising from changes in demographic assumptions        | -              | (12.4)        |
| Actuarial losses/(gains) on DB Scheme liabilities arising from changes in financial assumptions | 311.5          | (1.9)         |
| Actuarial gains on DB Scheme liabilities arising from experience                                | (25.9)         | (5.6)         |
| Net benefits paid out                                                                           | (84.8)         | (59.5)        |
| Closing DBO                                                                                     | <u>1,722.9</u> | <u>1453.2</u> |

| <b>Changes in the fair value of DB Scheme assets during the year</b> | <b>2016</b>    | <b>2015</b>    |
|----------------------------------------------------------------------|----------------|----------------|
|                                                                      | <b>£m</b>      | <b>£m</b>      |
| Opening fair value of DB Scheme assets                               | 1541.3         | 1516.1         |
| Interest income on DB Scheme assets                                  | 56.7           | 54.5           |
| Re-measurement gains/(losses) on DB Scheme assets                    | 200.9          | (20.3)         |
| Contributions by the employer                                        | 40.5           | 50.2           |
| Contributions by DB Scheme participants                              | 1.0            | 1.5            |
| Net benefits paid out                                                | (84.8)         | (59.5)         |
| Administration costs incurred                                        | (1.2)          | (1.2)          |
| Closing fair value of DB Scheme assets                               | <u>1,754.4</u> | <u>1,541.3</u> |

| <b>Actual return on DB Scheme assets</b>       | <b>2016</b>  | <b>2015</b> |
|------------------------------------------------|--------------|-------------|
|                                                | <b>£m</b>    | <b>£m</b>   |
| Interest income on DB Scheme assets            | 56.7         | 54.5        |
| Re-measurement gain/(loss) on DB Scheme assets | 200.9        | (20.3)      |
| Actual return on DB Scheme assets              | <u>257.6</u> | <u>34.2</u> |

| <b>Analysis of amounts recognised in SoCI</b> | <b>2016</b> | <b>2015</b> |
|-----------------------------------------------|-------------|-------------|
|                                               | <b>£m</b>   | <b>£m</b>   |
| Total re-measurement gains                    | <u>84.7</u> | <u>0.4</u>  |

# NORTHERN POWERGRID (YORKSHIRE) PLC

## NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016

### 22. EMPLOYEE BENEFIT OBLIGATIONS - continued

#### Sensitivity to key assumptions

The key assumptions used for IAS 19 are discount rate, inflation and mortality. If different assumptions were used, it could have a material effect on the results of the Group. The sensitivity of the results to these assumptions is as follows.

|                                                         | Changes in<br>DBO<br>£m | Revised DBO<br>£m |
|---------------------------------------------------------|-------------------------|-------------------|
| Current Figures                                         | 1,722.9                 |                   |
| Following a 10 bps decrease in the discount rate        | 33.8                    | 1,756.7           |
| Following a 10 bps increase in the discount rate        | (33.2)                  | 1,689.7           |
| Following a 10 bps increase in the inflation assumption | 30.0                    | 1,752.9           |
| Following a 10 bps decrease in the inflation assumption | (29.6)                  | 1,693.3           |
| Following a 1 year increase in life expectancy          | 67.1                    | 1,790.0           |
| Following a 1 year decrease in life expectancy          | (67.0)                  | 1,655.9           |

The sensitivity information shown above has been prepared using the same method as adopted when adjusting the results of the latest funding valuation to the statement of financial position date. This is the same approach as has been adopted in previous periods.

### 23. RELATED PARTY DISCLOSURES

The Company entered into transactions, in the ordinary course of business, with affiliated companies. Transactions entered into and trading balances outstanding at the year-end were as follows:

|                                                             | Sales to<br>related<br>parties<br>£'000 | Purchases<br>from related<br>parties<br>£'000 | Amounts<br>owed to<br>related<br>parties<br>£'000 | Finance<br>costs/income<br>to related<br>parties<br>£'000 | Borrowings<br>to/(from<br>related<br>parties)<br>£'000 |
|-------------------------------------------------------------|-----------------------------------------|-----------------------------------------------|---------------------------------------------------|-----------------------------------------------------------|--------------------------------------------------------|
| <b>Related Party</b>                                        |                                         |                                               |                                                   |                                                           |                                                        |
| 2016                                                        |                                         |                                               |                                                   |                                                           |                                                        |
| Integrated Utility Services<br>Limited                      | 112                                     | 1,210                                         | -                                                 | -                                                         | -                                                      |
| Integrated Utility Services<br>Limited (registered in Eire) | -                                       | 236                                           | 14                                                | -                                                         | -                                                      |
| Northern Electric plc                                       | -                                       | 4,915                                         | -                                                 | -                                                         | -                                                      |
| Northern Powergrid Insurance<br>Services Limited            | -                                       | 633                                           | -                                                 | -                                                         | -                                                      |
| Northern Powergrid Metering<br>Limited                      | 355                                     | -                                             | -                                                 | -                                                         | -                                                      |
| Northern Powergrid<br>(Northeast) Limited                   | 10,841                                  | 17,348                                        | -                                                 | 55                                                        | -                                                      |
| Vehicle Lease and Service<br>Limited                        | 62                                      | 4,017                                         | 415                                               | -                                                         | -                                                      |
| Yorkshire Electricity Group<br>plc                          | -                                       | -                                             | -                                                 | (589)                                                     | 199,298                                                |
|                                                             | <u>11,371</u>                           | <u>28,359</u>                                 | <u>429</u>                                        | <u>(534)</u>                                              | <u>199,298</u>                                         |

# **NORTHERN POWERGRID (YORKSHIRE) PLC**

## **NOTES TO THE FINANCIAL STATEMENTS - continued** **FOR THE YEAR ENDED 31 DECEMBER 2016**

### **23. RELATED PARTY DISCLOSURES - continued**

| 2015                                                        | Sales to<br>related<br>parties<br>£'000 | Purchases<br>from related<br>parties<br>£'000 | Amounts<br>owed to<br>related<br>parties<br>£'000 | Finance<br>costs/(income)<br>to related<br>parties<br>£'000 | Borrowings<br>to/(from<br>related<br>parties)<br>£'000 |
|-------------------------------------------------------------|-----------------------------------------|-----------------------------------------------|---------------------------------------------------|-------------------------------------------------------------|--------------------------------------------------------|
| Integrated Utility Services<br>Limited                      | 112                                     | 1,370                                         | -                                                 | -                                                           | -                                                      |
| Integrated Utility Services<br>Limited (registered in Eire) | -                                       | 212                                           | 25                                                | -                                                           | -                                                      |
| Northern Electric plc                                       | -                                       | 3,962                                         | -                                                 | -                                                           | -                                                      |
| Northern Powergrid Insurance<br>Services Limited            | -                                       | 633                                           | -                                                 | -                                                           | -                                                      |
| Northern Powergrid Metering<br>Limited                      | 305                                     | -                                             | -                                                 | -                                                           | -                                                      |
| Northern Powergrid<br>(Northeast) Limited                   | 9,294                                   | 17,887                                        | -                                                 | -                                                           | -                                                      |
| Vehicle Lease and Service<br>Limited                        | 62                                      | 3,929                                         | 415                                               | -                                                           | -                                                      |
| Yorkshire Electricity Group<br>plc                          | -                                       | -                                             | -                                                 | (847)                                                       | 145,668                                                |
|                                                             | <u>9,773</u>                            | <u>27,993</u>                                 | <u>440</u>                                        | <u>(847)</u>                                                | <u>145,668</u>                                         |

Sales and purchases from related parties were made at commercial prices.

Interest on loans from Northern Powergrid Group companies is charged at a commercial rate.

The amounts outstanding are unsecured and will be settled in cash. No guarantees have been given or received. No provisions have been made for doubtful debts in respect of amounts owed by related parties.

### **24. RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS**

|                                                    | 2016<br>£'000         | 2015<br>£'000         |
|----------------------------------------------------|-----------------------|-----------------------|
| Profit before income tax                           | 153,445               | 162,511               |
| Depreciation charges                               | 95,569                | 89,262                |
| Profit on disposal of fixed assets                 | (482)                 | (264)                 |
| Amortisation of deferred revenue                   | (24,864)              | (23,044)              |
| Increase/(decrease) in provisions                  | 204                   | (199)                 |
| Finance costs                                      | 47,522                | 43,574                |
| Finance income                                     | (1,116)               | (890)                 |
|                                                    | <u>270,278</u>        | <u>270,950</u>        |
| Decrease/(increase) in inventories                 | 200                   | (184)                 |
| (Increase)/decrease in trade and other receivables | (2,777)               | 7,566                 |
| Decrease in trade and other payables               | (891)                 | (3,020)               |
| <b>Cash generated from operations</b>              | <u><b>266,810</b></u> | <u><b>275,312</b></u> |



## **NORTHERN POWERGRID (YORKSHIRE) PLC**

### **NOTES TO THE FINANCIAL STATEMENTS - continued FOR THE YEAR ENDED 31 DECEMBER 2016**

#### **25. ULTIMATE CONTROLLING PARTY**

The immediate parent undertaking of Northern Powergrid (Yorkshire) plc is Yorkshire Electricity Group plc. The ultimate controlling party and ultimate parent undertaking Yorkshire Electricity Group plc is Berkshire Hathaway, Inc., a company incorporated in the United States of America.

Copies of the group accounts of Berkshire Hathaway, Inc. (the parent undertaking of the largest group preparing group accounts) which include Northern Powergrid (Yorkshire) plc and the group accounts of Northern Powergrid Holdings Company, the smallest parent undertaking to prepare group accounts in the UK, can both be obtained from the Company Secretary, Northern Powergrid Holdings Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.