

REGISTERED NUMBER: 03070482 (England and Wales)

**STRATEGIC REPORT, REPORT OF THE DIRECTORS AND
FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2016
FOR
NORTHERN ELECTRIC FINANCE PLC**

NORTHERN ELECTRIC FINANCE PLC

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NORTHERN ELECTRIC FINANCE PLC

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

DIRECTORS: T E Fielden
T H France
P A Jones
S J Lockwood

COMPANY SECRETARY: J C Riley

REGISTERED OFFICE: Lloyds Court
78 Grey Street
Newcastle upon Tyne
NE1 6AF

REGISTERED NUMBER: 03070482 (England and Wales)

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

NORTHERN ELECTRIC FINANCE PLC

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

The directors present the annual reports and accounts of Northern Electric Finance plc (the "Company") for the year ended 31 December 2016, which includes the Strategic Report, the Report of the Directors, Statement of Directors' Responsibilities and the audited financial statements for that year. Pages 2 to 4 of this annual report comprise the Strategic Report and pages 5 to 9 comprise the Report of the Directors, which have been drawn up and presented in accordance with the Companies Act 2006.

Cautionary statement regarding forward-looking statements

This annual report has 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. This annual report contains 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, these 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 this annual report and will not be updated during the year. Nothing in this annual report should be construed as a profit forecast.

REVIEW OF BUSINESS BUSINESS MODEL

The Company is a wholly-owned subsidiary of Northern Powergrid (Northeast) Limited ("Northern Powergrid"), which is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group"). During the year, the Company continued to be the issuer of long-term bonds.

The Northern Powergrid Group operates a business model and strategy based on its six core principles (the "Core Principles"), which are financial strength, customer service, operational excellence, employee commitment, environmental respect and regulatory integrity. The core principles of the Northern Powergrid Group that are applicable to the Company are as follows:

Principle	Strategy	Indicator
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.
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 objective is to ensure that it has sufficient funds to cover the interest charges that arise from the finance raised on behalf of Northern Powergrid as they fall due.

NORTHERN ELECTRIC FINANCE PLC

STRATEGIC REPORT FOR THE YEAR ENDED 31 DECEMBER 2016

REVIEW OF BUSINESS - continued

REVIEW OF THE YEAR

The Company's sole activity during the year was to meet its obligations to make the interest payments required by the 2020 8.875% bonds and the 2035 5.125% bonds. Those payments were made on 17 October 2016 and 4 May 2016 respectively. The nature of the business of the Company is not sufficiently large or complex for analysis of key performance indicators to be required for an understanding of the development, performance or position of that business.

Details of the operations and activities of and the key performance indicators used in the Northern Powergrid Group can be found in the Strategic Report in the Northern Powergrid Holdings Company annual reports and accounts. The Company undertakes its activities through employees of other companies in the Northern Powergrid Group and has no employees of its own.

CORE PRINCIPLES

Financial strength

Results, dividends and position at the year end

The Company made a loss after tax for the year of £123,000 (2015: loss £107,000) mainly due to interest expenses exceeding interest income. No dividends were paid during the year and the directors recommend that no final dividend be paid in respect of the year. The statement of financial position on page 14 shows that, as at 31 December 2016, the Company had total equity and liabilities of £253.0 million. Given that it is part of the Northern Powergrid Group, the directors have a reasonable expectation that the Company has adequate resources to continue in operational existence for the foreseeable future. Further details of the other factors taken into account by the directors when forming that view are included in the Going Concern statement on pages 8 and 9 in the Report of the Directors.

Share capital and debt structure

There were no changes to the Company's share capital or debt structure during the year.

Taxation

Full details of the Company's taxation credit are provided in Note 6 to the accounts.

Net cash outflow from operating activities

The net cash outflow from operating activities was £15,000 (2015: £24,000).

Regulatory integrity

The Northern Powergrid Group 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 Northern Powergrid Group. Further details regarding the activities of the GRMG and the main features of the Northern Powergrid Group's internal control and risk management systems are included in the Corporate Governance Statement in the Report of the Directors.

NORTHERN ELECTRIC FINANCE PLC

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

REVIEW OF BUSINESS - continued

PRINCIPAL RISKS AND UNCERTAINTIES

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.

Liquidity risk

The principal risk facing the Company is not having sufficient liquidity to enable the Company to meet its liabilities as they fall due. In this respect, borrowing facilities are made available to the Company by other companies in the Northern Powergrid Group, if required. The Company continues to maintain its investment grade issuer credit rating.

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 borrowings were at fixed rates and the average maturity of these borrowings was 14 years.

Foreign currency risk

No material currency risks are faced by the Company.

Details of the other financial risks faced by the Company can be found on page 5 in the Report of the Directors.

ON BEHALF OF THE BOARD:



P A Jones
Director
24 March 2017

NORTHERN ELECTRIC FINANCE PLC

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

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

DIVIDENDS

No dividends were paid during the year (2015: £nil) and the directors recommend that no final dividend be paid in respect of the year (2015: £nil). 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

Given that the sole purpose of the Company is to raise finance on behalf of Northern Powergrid, the Company does not undertake research and development.

FUTURE DEVELOPMENTS

The financial position of the Company, as at the year end, is shown in the statement of financial position on page 14. There have been no significant events since the year end and it is the intention of the directors that the Company will continue to meet its obligations as they fall due and to raise finance on behalf of Northern Powergrid, if required, in the future.

DIRECTORS

Directors who held office during the year and to the date of signing the accounts were:

G E Abel	Chairman (stood down from the board on 15 December 2016)
T E Fielden	Finance Director, Northern Powergrid
T H France	General Counsel (appointed 15 December 2016)
P A Jones	President and Chief Executive Officer
S J Lockwood	Group Financial Controller

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.

FINANCIAL RISK MANAGEMENT

The main risks are liquidity and interest rate risk, further details of which can be found on page 4 in the Strategic Report. Other financial risks are:

Trading risk

Throughout the year under review, 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 (2015: £nil).

POLITICAL DONATIONS

During the year, no contributions were made to political organisations (2015: £nil).

NORTHERN ELECTRIC FINANCE PLC

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

CORPORATE GOVERNANCE STATEMENT

In accordance with Disclosure and Transparency Rule (DTR) 7.2.9, the directors have elected to set out the information required by DTR 7.2.1 to DTR 7.2.7 R in the Group annual report and audited consolidated financial statements of Northern Powergrid Holdings Company, a copy of which can be found on Northern Powergrid's corporate website. 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.

Audit committee

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

NORTHERN ELECTRIC FINANCE PLC

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

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.

GOING CONCERN

The Company's business activities, together with details regarding its future development, performance and position are set out in the Strategic Report and in the Report of the Directors. In addition, the Company's objectives, policies and processes for managing its capital, its financial risk management objectives, details of its financial instruments and its exposures to credit risk and liquidity risk are included in the Principal Risks and Uncertainties section of 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 report and accounts, the directors have taken account of a number of factors that arise due to the Company being a wholly-owned subsidiary of Northern Powergrid, including the following:

- a) Northern Powergrid is a stable electricity distribution business operating an essential public service and is regulated by the Gas and Electricity Markets Authority ("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 their 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;
- b) Northern Powergrid is profitable with strong underlying cash flows resulting in low gearing and holds investment grade credit ratings; and

NORTHERN ELECTRIC FINANCE PLC

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

GOING CONCERN – continued

- c) Northern Powergrid has access to considerable financial resources, in the form of short-term borrowings made available by Yorkshire Electricity Group plc, a fellow company in the Northern Powergrid Group, and an overdraft facility provided by Lloyds Bank plc which is reviewed annually. In addition, Northern Powergrid has committed revolving credit facilities in place from Lloyds Bank plc, Royal Bank of Scotland plc and Abbey National Treasury Services plc until 30 April 2020.

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 report and accounts.

STATEMENT AS TO DISCLOSURE OF INFORMATION TO AUDITORS

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

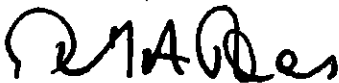
- a) so far as he is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- b) he has taken all the steps he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

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

AUDITOR

A resolution to re-appoint Deloitte LLP as the Company's auditor and authorise the directors to determine their remuneration will be proposed at the Annual General Meeting.

ON BEHALF OF THE BOARD:



P A Jones
Director
24 March 2017

REPORT OF THE INDEPENDENT AUDITOR TO THE MEMBERS OF NORTHERN ELECTRIC FINANCE PLC

We have audited the financial statements of Northern Electric Finance 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 15. 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, 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 in the Strategic Report and the Report of the Directors 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 loss 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 ELECTRIC FINANCE 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 ELECTRIC FINANCE PLC

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

	Notes	2016 £'000	2015 £'000
CONTINUING OPERATIONS			
Revenue		-	-
Administrative expenses		<u>(8)</u>	<u>(7)</u>
OPERATING LOSS		(8)	(7)
Finance costs	4	(17,182)	(17,173)
Finance income	4	<u>17,030</u>	<u>17,026</u>
LOSS BEFORE INCOME TAX	5	(160)	(154)
Income tax	6	<u>37</u>	<u>47</u>
LOSS FOR THE YEAR		<u>(123)</u>	<u>(107)</u>

The notes on pages 16 to 24 form part of these financial statements

NORTHERN ELECTRIC FINANCE PLC

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

	2016 £'000	2015 £'000
LOSS FOR THE YEAR	(123)	(107)
OTHER COMPREHENSIVE INCOME	—	—
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>(123)</u>	<u>(107)</u>

The notes on pages 16 to 24 form part of these financial statements

NORTHERN ELECTRIC FINANCE PLC (REGISTERED NUMBER: 03070482)

**STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2016**

	Notes	2016 £'000	2015 £'000
ASSETS			
NON-CURRENT ASSETS			
Trade and other receivables	7	<u>248,024</u>	<u>247,951</u>
CURRENT ASSETS			
Trade and other receivables	7	3,419	3,419
Tax receivable		34	33
Cash and cash equivalents	8	<u>1,521</u>	<u>1,536</u>
		<u>4,974</u>	<u>4,988</u>
TOTAL ASSETS		<u>252,998</u>	<u>252,939</u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	9	50	50
Retained earnings	10	<u>(1,315)</u>	<u>(1,192)</u>
TOTAL EQUITY		<u>(1,265)</u>	<u>(1,142)</u>
LIABILITIES			
NON-CURRENT LIABILITIES			
Borrowings			
Interest-bearing loans and borrowings	11	247,372	247,158
Deferred tax	12	<u>112</u>	<u>144</u>
		<u>247,484</u>	<u>247,302</u>
CURRENT LIABILITIES			
Borrowings			
Interest-bearing loans and borrowings	11	<u>6,779</u>	<u>6,779</u>
TOTAL LIABILITIES		<u>254,263</u>	<u>254,081</u>
TOTAL EQUITY AND LIABILITIES		<u>252,998</u>	<u>252,939</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 16 to 24 form part of these financial statements

NORTHERN ELECTRIC FINANCE PLC

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

	Called up share capital £'000	Retained earnings £'000	Total equity £'000
Balance at 1 January 2015	50	(1,085)	(1,035)
Changes in equity			
Total comprehensive income	-	(107)	(107)
Balance at 31 December 2015	50	(1,192)	(1,142)
Changes in equity			
Total comprehensive income	-	(123)	(123)
Balance at 31 December 2016	50	(1,315)	(1,265)

The notes on pages 16 to 24 form part of these financial statements

NORTHERN ELECTRIC FINANCE PLC

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

		2016	2015
		£'000	£'000
Cash flows used in operating activities			
Cash used in operations	14	(81)	(78)
Interest paid		(16,968)	(16,972)
Interest received		17,030	17,026
Tax paid		<u>4</u>	<u>-</u>
Net cash used in operating activities		<u>(15)</u>	<u>(24)</u>
Decrease in cash and cash equivalents		(15)	(24)
Cash and cash equivalents at beginning of year		<u>1,536</u>	<u>1,560</u>
Cash and cash equivalents at end of year		<u><u>1,521</u></u>	<u><u>1,536</u></u>

The notes on pages 16 to 24 form part of these financial statements

NORTHERN ELECTRIC FINANCE PLC

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

1. GENERAL INFORMATION

Northern Electric Finance 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 consolidated financial statements is determined on such a basis, except for leasing transactions which are in 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 entity 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 ELECTRIC FINANCE PLC

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

2. ACCOUNTING POLICIES- continued

Adoption of new or revised standards

Amendments to IFRSs made by the International Accounting Standards Board ("IASB") that are effective mandatorily for an accounting period that begins on or after 1 January 2016:

- 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 material impact on the Company's financial statements.

The Company has not applied the new and revised IFRSs that have been issued but are not yet effective for the year ending 31 December 2016, the directors of the Company do not anticipate that the application of the new and revised IFRSs will have significant impact on the Company's financial statements.

Finance income Interest income is accrued on a time basis by reference to the principal outstanding and at the effective interest rate applicable.

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.

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 Group 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.

NORTHERN ELECTRIC FINANCE 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 loans advanced to the parent company, having a maturity of less than three months on the basis that they are readily convertible to known amounts of cash and are subject to 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.

3. EMPLOYEES AND DIRECTORS

No directors' or key personnel remuneration was charged for the year (2015: £nil). There are no directors' emoluments that are required to be disclosed under the Act (2015: £nil).

There were no employees of the Company during the year (2015: nil).

NORTHERN ELECTRIC FINANCE PLC

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

4. NET FINANCE COSTS

	2016 £'000	2015 £'000
Finance income:		
Interest receivable on loans to Group undertakings	<u>17,030</u>	<u>17,026</u>
Finance costs:		
Interest payable on other loans	17,167	17,152
Interest payable on loans from Group undertakings	<u>15</u>	<u>21</u>
	<u>17,182</u>	<u>17,173</u>
Net finance costs	<u>152</u>	<u>147</u>

5. LOSS BEFORE INCOME TAX

Analysis of auditor's remuneration is as follows:

	2016 £'000	2015 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	<u>7</u>	<u>7</u>
Total fees payable to the Company's auditor	<u>7</u>	<u>7</u>

6. INCOME TAX

Analysis of tax income

	2016 £'000	2015 £'000
Current tax:		
Tax	(5)	(5)
Deferred tax	<u>(32)</u>	<u>(42)</u>
Total tax income in statement of profit or loss	<u>(37)</u>	<u>(47)</u>

NORTHERN ELECTRIC FINANCE PLC

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

6. INCOME TAX - continued

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:

	2016 £'000	2015 £'000
Loss before income tax	<u>(160)</u>	<u>(154)</u>
Loss multiplied by the standard rate of corporation tax in the UK of 20% (2015 - 20.25%)	(32)	(31)
Effects of:		
Changes in legislation	(6)	(16)
Other	<u>1</u>	<u>-</u>
Tax income	<u>(37)</u>	<u>(47)</u>
	2016 £'000	2015 £'000
Tax expense comprises:		
Current tax expense:		
Corporation tax credit for the year	<u>(5)</u>	<u>(5)</u>
Total current tax charge	(5)	(5)
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	(26)	(26)
Effect of changes in legislation	<u>(6)</u>	<u>(16)</u>
Total deferred tax charge	<u>(32)</u>	<u>(42)</u>
Tax on profit before tax	<u>(37)</u>	<u>(47)</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.

7. TRADE AND OTHER RECEIVABLES

	2016 £'000	2015 £'000
Current:		
Prepayments and accrued income	<u>3,419</u>	<u>3,419</u>

NORTHERN ELECTRIC FINANCE PLC

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

7. TRADE AND OTHER RECEIVABLES - continued

	2016 £'000	2015 £'000
Non-current:		
Amounts due from group undertakings	<u>248,024</u>	<u>247,951</u>
Aggregate amounts	<u>251,443</u>	<u>251,370</u>

The fair value of the trade and other receivables as at 31 December 2016 is estimated to be £338 million (2015: £311 million), determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable market transactions or dealer quotes for similar instruments. The valuation is based on Level 1 inputs.

Amounts owed to group undertakings represent the value of loans made to Northern Powergrid (Northeast) Limited, the Company's immediate parent, and are at fixed rates of interest. Prepayments and accrued income represent the accrued interest due on these loans. The maximum exposure to risk to the Company is the book value of these loans.

8. CASH AND CASH EQUIVALENTS

	2016 £'000	2015 £'000
Cash in hand	<u>1,521</u>	<u>1,536</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.

9. CALLED UP SHARE CAPITAL

Allotted, issued and fully paid:		Nominal value:	2016 £	2015 £
Number:	Class:			
50,000	Ordinary shares	£1	<u>50,000</u>	<u>50,000</u>

10. RESERVES

	Retained earnings £'000
At 1 January 2016	(1,192)
Deficit for the year	<u>(123)</u>
At 31 December 2016	<u>(1,315)</u>

NORTHERN ELECTRIC FINANCE PLC

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

10. RESERVES - continued

	Retained earnings £'000
At 1 January 2015	(1,085)
Deficit for the year	<u>(107)</u>
At 31 December 2015	<u>(1,192)</u>

11. BORROWINGS

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

	Book Value		Fair Value	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Loans	<u>254,151</u>	<u>253,937</u>	<u>337,781</u>	<u>311,022</u>
	<u>254,151</u>	<u>253,937</u>	<u>337,781</u>	<u>311,022</u>
The borrowings are repayable as follows:				
On demand or within one year	6,779	6,779	6,779	6,779
Between one and five years	99,343	99,203	128,427	128,711
After five years	<u>148,029</u>	<u>147,955</u>	<u>202,575</u>	<u>175,532</u>
	<u>254,151</u>	<u>253,937</u>	<u>337,781</u>	<u>311,022</u>
Analysis of borrowings:				
2020 - 8.875% bonds	101,192	101,052	130,276	130,560
2035 - 5.125% bonds	<u>152,959</u>	<u>152,885</u>	<u>207,505</u>	<u>180,462</u>
	<u>254,151</u>	<u>253,937</u>	<u>337,781</u>	<u>311,022</u>

The fair value of the external borrowings is determined with reference to quoted market prices.

The fair valuation of the borrowings is based on Level 1 inputs.

The Company's 8.875% 2020 bonds are guaranteed by Northern Powergrid (Northeast) Limited, its immediate parent company, and Northern Electric plc. The Company's 5.125% 2035 bonds are guaranteed by Northern Powergrid (Northeast) Limited and AMBAC Assurance UK Limited.

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") of Northern Powergrid (Northeast) Limited. 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.

NORTHERN ELECTRIC FINANCE PLC

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

11. BORROWINGS - continued

At 31 December 2016, the Company had no undrawn committed borrowing facilities.

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 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2016:					
Fixed interest rate liability	-	16,563	157,375	257,625	431,563
	-	16,563	157,375	257,625	431,563
2015:					
Fixed interest rate liability	-	16,563	166,250	265,312	448,125
	-	16,563	166,250	265,312	448,125

12. DEFERRED TAX

	Total £'000
At 1 January 2016	144
Credit to statement of profit or loss	(32)
At 31 December 2016	112
	Total £'000
At 1 January 2015	186
Credit to statement of profit or loss	(42)
At 31 December 2015	144

The balance represents deferred tax on unamortised loan issue costs.

NORTHERN ELECTRIC FINANCE PLC

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

13. RELATED PARTY DISCLOSURES

Transactions entered into and balances outstanding at the year-end were as follows:

Related Party	Interest received from related parties £'000	Interest paid to related parties £'000	Amounts owed (to/from related parties) £'000
2016:			
Northern Powergrid (Northeast) Limited	17,027	-	251,443
Yorkshire Electricity Group plc	<u>3</u>	<u>15</u>	<u>1,521</u>
	<u>17,030</u>	<u>15</u>	<u>252,964</u>
2015:			
Northern Powergrid (Northeast) Limited	17,023	-	251,370
Yorkshire Electricity Group plc	<u>3</u>	<u>21</u>	<u>1,536</u>
	<u>17,026</u>	<u>21</u>	<u>252,906</u>

14. RECONCILIATION OF LOSS BEFORE INCOME TAX TO CASH USED IN OPERATIONS

	2016 £'000	2015 £'000
Loss before income tax	(160)	(154)
Finance costs	17,182	17,173
Finance income	<u>(17,030)</u>	<u>(17,026)</u>
	(8)	(7)
Increase in trade and other receivables	<u>(73)</u>	<u>(71)</u>
Cash used in operations	<u>(81)</u>	<u>(78)</u>

15. ULTIMATE CONTROLLING PARTY

The immediate parent undertaking of Northern Electric Finance plc is Northern Powergrid (Northeast) Limited. The ultimate controlling party and ultimate parent undertaking of Northern Powergrid (Northeast) Limited 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 Electric Finance plc and the group accounts of Northern Electric plc, 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.