

REGISTERED NUMBER: 02366942 (England and Wales)

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

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FOR THE YEAR ENDED 31 DECEMBER 2016**

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NORTHERN ELECTRIC PLC

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

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

The directors present the annual reports and accounts of Northern Electric plc (the "Company") and its subsidiary companies (together the "Group") for the year ended 31 December 2016, which includes the Strategic Report, the Report of the Directors and the audited financial statements for that year. Pages 2 to 20 inclusive comprise the Strategic Report and pages 21 to 27 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 Group 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") and acts as a holding company of Northern Powergrid (Northeast) Limited ("Northern Powergrid"), Integrated Utility Services Limited ("IUS") and Northern Powergrid Metering Limited ("Northern Powergrid Metering"). Northern Powergrid is a distribution network operator ("DNO"), which distributes electricity, at voltages of up to 132 kilovolts (kV), to approximately 1.6 million customers connected to its electricity distribution network within its distribution services area in the northeast of England. IUS provides engineering contracting services and Northern Powergrid Metering rents meters to energy suppliers.

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

Principle	Strategy	Indicator
Financial strength	Effective stewardship of the Group's financial resources, investing in assets and focusing on long-term opportunities, which contribute to the Group'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 Group's operations, system investment and maintenance.	Effective asset management, managing commercial risk and improving network resilience and performance.

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

BUSINESS MODEL - continued

Principle	Strategy	Indicator
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 Group'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 Group's strategic objectives are based on the Core Principles and accordingly remain consistent and are 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 Group 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 environment.

REVIEW OF THE YEAR

The Group delivered a satisfactory financial performance for the year, benefitting from a further change to the rate of taxation, settlement of a prior year tax claim, and continued effective cost control, with revenue at £385 million being broadly in line with the previous year.

Throughout 2016, Northern Powergrid continued its policy of enhancing the efficiency of its electricity distribution network by investing £181.3 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. Northern Powergrid'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 Northern Powergrid'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.

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

REVIEW OF THE YEAR - continued

Northern Powergrid remained focussed on the affordability, availability and reliability of the service it provides. Accordingly, the way in which Northern Powergrid 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 remained in place 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 Northern Powergrid. Due to the initiatives in place, with Northern Powergrid 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 Northern Powergrid'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 Northern Powergrid's assets and SF6 gas discharges from electrical plant, were all significantly better than target. Given the impact on the environment of such events, Northern Powergrid 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 Group'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 Group's employees and stakeholders, including delivering regional school safety presentations, running operational seminars for the Group's engineers and circulating regular safety newsflashes to all staff. The Group 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 Group'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.

IUS' external revenue in 2016, at £27.7 million was £3.2 million lower than 2015 mainly due reduction in revenues from Rail contracts partially offset by an increase in other contracts.

Northern Powergrid Metering's performance was encouraging, with it delivering the contracts secured with energy suppliers for the provision of smart meters in the United Kingdom and Ireland, and continuing to pursue business development opportunities with other energy suppliers in advance of the full smart meter roll-out programme.

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

CORE PRINCIPLES

Financial strength

During the year, the Group 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 Group 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 Northern Powergrid is required to deliver and, in that respect, Northern Powergrid 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 2016 year were as follows:

Revenue

The Group's revenue at £384.9 million was £1.5m lower than the prior year as lower distribution use of system and contracting revenues were partially offset by increased smart meter rental volumes. The distribution use of system revenue reduction was due to tariffs introduced with effect from the start of the ED1 period.

Operating profit and position at the year end

The Group's operating profit at £181.2 million was £15.0 million lower than the prior year mainly due to reduction in revenues and higher depreciation and amortisation charges.

The consolidated statement of financial position on pages 31 and 32 shows that, as at 31 December 2016, the Group had total equity of £974.8 million. The directors consider the Group 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 into ED1 by Northern Powergrid.

Finance costs and investments

Finance costs net of investment income at £37.8 million were £3.2m higher than the prior year reflecting higher borrowings.

Taxation

The effective tax rate in the year was 5.0%. The effective tax rate before adjusting for the impact of the changes in tax rates by the Finance Act 2016 and agreement 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 Group made a profit after tax for the year of £136.7 million (2015: £144.8 million). An interim dividend of £100 million was paid during the year (2015: £20.6 million). The directors recommended that no final dividend be paid in respect of the year to 31 December 2016. Other comprehensive income for the year net of income tax, was a loss of £70.5m (2015: £2.5m loss).

Share capital and debt structure

There were no changes to the Company's share capital or debt structure during the 0year.

Cash flow

The Group 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 Group.

Movements in cash flows were as follows:

Operating activities: Cash flow from operating activities at £168.9 million was £42.4 million higher than the previous year, mainly as a result of higher cash profits, favourable movements in working capital and lower tax paid.

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

Financial strength - continued

Investing activities: Net cash used in investing activities at £214.8 million was £9.6 million lower than the previous year, reflecting lower capital expenditure partially offset by lower receipt of customer contributions.

Financing activities: The net cash used in financing activities at £37.5 million was £16.3 million higher than £21.2 million inflow in the previous year, reflecting net movements in borrowings required to fund business operations.

Liquidity risk

As at 31 December 2016, Northern Powergrid 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. Northern Powergrid expects to raise further facilities, as required, at that time.

In addition, Northern Powergrid 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 Group'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 Group 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 Group's long-term borrowings were at fixed rates and the average maturity for these borrowings was 12 years.

Currency risk

No material currency risks are faced by the Group.

Pensions

The Company is the principal employer of the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "Scheme"), a defined benefit scheme. Full details of the Company's commitments to the Scheme and the associated deficit repair payments are provided in Note 24 to the accounts.

Companies in the Group also participate 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.

Customer service

During the year, Northern Powergrid 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. Northern Powergrid 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 Northern Powergrid, which, in recent years had been consistently ranking in the lower half of Ofgem's customer service league tables. Northern Powergrid 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.

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

Customer service - continued

Customer satisfaction with Northern Powergrid'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 Northern Powergrid 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.

Northern Powergrid 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 Northern Powergrid and its contractors. This technology will enable customers to communicate with Northern Powergrid in a range of accessible and easy ways across several channels.

During the year Northern Powergrid has continued 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 Northern Powergrid's plans, monitoring its performance and helping to deliver innovative initiatives and services. Guided by these panels, Northern Powergrid 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 Northern Powergrid to further develop its customer experience improvement and social obligations programme.

Northern Powergrid 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 Northern Powergrid's Freephone contact numbers.

In May 2016, Northern Powergrid 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 Northern Powergrid'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 Northern Powergrid's Priority Services Register. Following the submission to Ofgem's panel, the position of Northern Powergrid 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 Northern Powergrid'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 Northern Powergrid 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. Northern Powergrid recorded an overall satisfaction score of 86.4% for the financial year and expects that the customer experience improvement plan, including the range of initiatives noted on pages 6 and 7, will improve the services provided to customers and so increase the satisfaction ratings year-on-year.

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

Customer service - continued

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

Connections to the Network

During the year, Northern Powergrid 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"). Northern Powergrid 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 Northern Powergrid'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.

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

Northern Powergrid 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, Northern Powergrid 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. Northern Powergrid worked throughout the year to deliver those actions and continued to engage actively with customers through both informal and formal stakeholder events.

Corporate responsibility

The Group as a whole places significant value on the relationships that it has with its customers and other stakeholders and relating to Northern Powergrid in particular, also understands the importance of ensuring a secure and safe power supply for its customers and their local communities. To further embed these values, Northern Powergrid 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 Northern Powergrid in the Stakeholder Engagement and Consumer Vulnerability review directed at a cohesive approach to customer experience; consumer vulnerability and stakeholder engagement. Northern Powergrid 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 Northern Powergrid's agenda and have the opportunity to help shape and prioritise plans according to customer preference.

Northern Powergrid 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. Northern Powergrid has well-established emergency procedures that are implemented when customers are without power for some time and, as such, Northern Powergrid responded well to the significant weather-related incidents, which affected the distribution network during the year.

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

Customer service - continued

To address customer concerns and resolve any complaints, Northern Powergrid utilises its customer ambassadors and customer liaison officers, who are allocated to each of its operating zones. Dedicated Priority Service 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.

Northern Powergrid 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 Northern Powergrid'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. Northern Powergrid 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. Northern Powergrid 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 Group's community investment programme.

Safety remains the Group's first priority and underpins all operations. During the year, Northern Powergrid continued to deliver initiatives that reached thousands of school children including its regular series of school safety presentations. Northern Powergrid 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.

Operational excellence

Northern Powergrid's core service continues to be providing and maintaining an efficient distribution network that delivers electricity effectively. During the year, £181.3 million was invested in the improvement of the distribution network. Northern Powergrid'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 Northern Powergrid 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 Northern Powergrid's continued and substantial investment in its distribution network, reliability has increased over a sustained period and Northern Powergrid 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 Northern Powergrid 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.

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

Operational excellence - continued

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. Northern Powergrid's currently reported performance for the Regulatory Year is as follows:

	Year to 31 March 2016		Year to 31 March 2015	
	Actual	Target	Actual;	Target
CML	50.1	<65.9	56.1	<70.6
CI	58.3	<63.8	65.3	<68.1

Consequently, performance in the Regulatory Year was better than Ofgem's target for both CML and CI and contributed to Northern Powergrid's improved customer service performance.

Operational activity

During 2016, Northern Powergrid 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. Northern Powergrid 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.

Northern Powergrid'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 conurbation of Tyne and Wear, the industrialised area around the Tees and the rural areas of Northumberland, Durham and North Yorkshire, including the Dales, the Vale of York and the North Yorkshire Moors. The guaranteed standard for the restoration of supply within 12 hours of a power cut occurring came into effect from 1 April 2015 and Northern Powergrid's operational structure provides a localised focus to optimise response times in the event of a power cut.

During the year, Northern Powergrid 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. Northern Powergrid 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 responded well to the major weather events that impacted its network during the year including as a result of three significant events which resulted in Northern Powergrid invoking its full major incident management plan on each occasion.

Storm Gertrude brought 70 to 80mph winds widely across the whole licence area on the 29 January 2016, causing almost 100 separate incidents, of which 50 were on the high-voltage network. Approximately 25,000 customers experienced power cuts mainly in Northumberland, County Durham and Tyne and Wear with 98% restored within 12 hours. Over 300 field staff were deployed in response with helicopter patrols assisting with fault location when the weather allowed.

An intense lightning storm crossed Northumberland and Tyne & Wear during the early hours of 16 September 2016. Due to the high overnight temperatures and atmospheric conditions, the localised lightning was very damaging and gave rise to over 86 faults on the high-voltage network affecting supplies to some 42,000 customers. 99% of affected customers' supplies were restored in 12 hours with only 17 customers being off supply for more than 24 hours.

Following a particularly dry month, heavy rain caused accelerated low-voltage cable failures across Northumberland, Durham, Tyne and Wear and Teesside on 22 November 2016. Due to the localised nature of each incident, overall numbers of customers affected were small, but the nature of repairs required meant that over 584 customers were off supply for more than 12 hours.

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

Operational excellence - continued

Northern Powergrid's priorities during the year included delivering a significant level of capital expenditure on the network as in the previous year, 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 60.0 minutes (2015: 55.6 minutes), after allowing for severe weather incidents and other exemptions.

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

- Completion of the work to reinforce the network around Potterhouse substation and replacement of one 66kV circuit breaker at Peterlee Industrial substation;
- Refurbishment of eight EHV transformers, including four at 66kV and four at 33kV;
- Cable replacement work on the Coalburns - Prudhoe 66kV underground cable circuit with 1.8km of oil filled cable decommissioned and on the Bowesfield - Urray Nook 1 33kV circuit 1km of solid cable was replaced. Work also commenced on the second phase of the Sunderland - West Boldon scheme which will result in the eventual decommissioning of 16km of 66kV oil-filled underground cable assets;
- Commissioning of 20km of 66kV underground cable on the 66kV circuit route which runs between Malton, Thornton Dale and Whitby in order to facilitate the decommissioning of the overhead towers from the North Yorkshire Moors in 2017;
- Refurbishment of twelve 132kV overhead line towers and 286 EHV overhead line towers and the replacement of two EHV poles based on their condition;
- 96km of high-voltage overhead line and 78km of low-voltage overhead line were rebuilt and/or refurbished;
- 14 units of high-voltage outdoor switchgear, 36 high-voltage distribution substations and 190 units of high-voltage indoor switchgear were replaced; and
- 360 additional remote control points were installed and commissioned.

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

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 Group's fundamental objective that every employee and contractor should go home uninjured and in good health after a productive day's work. The Northern Powergrid Group 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 Group'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 Group 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.

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

Employee commitment - continued

The Northern Powergrid Group 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 three switching-related incidents experienced on the high-voltage network against a target of five and compared with eight events recorded in 2015. As one of the key deliverables in the Northern Powergrid Group's safety and health improvement plan is to raise awareness and improve the concentration skills of its operational engineers and other employees, Northern Powergrid continued its operational audit programme of senior authorised persons such that the operational practices of 81% of senior authorised persons were verified during the year. The Northern Powergrid Group also delivered operational seminars, stand-down briefings, and regular safety newsflashes 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	1	1	1	2
Restricted duty accidents	1	0	1	0
Medical treatment accidents	1	1	1	0
Operational incidents	6	4	5	8
Preventable vehicle accidents	11	13	10	9

The Group experienced one lost time accident in 2016 as opposed to two in 2015. In addition the Group incurred one accident that required medical treatment (none during 2015). Performance in respect of preventable vehicle accidents was above the target for the year. The Group contributed to the strong safety performance of the Northern Powergrid Group and the long-term overall trend continued to compare well with that of the industry. None of those incidents reported gave rise to any significant safety-related risks.

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 Group'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 also contributed to the Northern Powergrid Group achieving an OSHA rate of 0.30 against a target of 0.30, which equated to seven recordable incidents; this was one more than performance recorded in 2015. The Group recorded an OSHA rate for 2016 of 0.20 (2015: 0.20) against a target of 0.32.

As part of the safety and health improvement plan and in order to reinforce the operational safety values, Northern Powergrid 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 Group 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.

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

Employee commitment - continued

During the year, Northern Powergrid received an Order of Distinction Award from the Royal Society for the Prevention of Accidents for achieving 15 consecutive Gold Awards in recognition of achievements in 2015 and for continued or improving standards of health and safety over a sustained period. The Group'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 Northern Powergrid and that of its affiliate, Northern Powergrid (Yorkshire) plc ("NPg Yorkshire"), 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 Group 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 Group 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 Group 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 ED1 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.

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 Group 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 Group continued to set and uphold the promotion of high standards of probity among staff. In addition, the Group'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 Group employed 1,238 staff (2015: 1,297)

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

Environmental respect

The Group'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 Group's staff and contractors.

The Group 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 Group 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.

Improvements in support of Northern Powergrid'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 Group also provided environmental awareness training for staff via an online system to avoid the need for travelling to central training locations. These improvements support Northern Powergrid in delivering sustained environmental performance, which it measures on a calendar year basis, and, in the year ended 31 December 2016, only five incidents were reportable to the Environment Agency, which was significantly better than the target of seven. Oil spills and leaks from Northern Powergrid's assets were under the target of 17,142 litres by 1% with a loss of 17,044 litres and SF6 gas discharges from electrical plant were also under the target of 28 kilogrammes by 49% with a loss of 14 kilogrammes.

During the year, work continued with many of the Group's key stakeholders, including the Environment Agency, to enhance the advanced environmental management processes already in place and, in 2017, the Group 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. Northern Powergrid'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 Group'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, Northern Powergrid 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. Northern Powergrid continues to work with local social enterprises that rescue waste timber in order to provide affordable reclaimed timber products to the local community.

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

Environmental respect - continued

Sustainability

The Northern Powergrid Group'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 significant 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, Northern Powergrid is taking action to develop innovative solutions that will reduce the need for traditional and potentially expensive reinforcement of the network.

The Northern Powergrid Group'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, Northern Powergrid 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.

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 Northern Powergrid's carbon footprint being lower than targeted. Northern Powergrid's policy of installing over-sized cables continues to save network losses, which contributed to further carbon emission reductions.

Regulatory integrity

The 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 Group.

As has been the case for some years, 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, Northern Powergrid 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.

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

Regulatory integrity - continued

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, Northern Powergrid's base allowed revenue before inflation reduced by 1.0% 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;
- 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 adjustment to 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.

Northern Powergrid submits a number of information returns to Ofgem and is required, under the terms of the Northern Powergrid's licences, 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.

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

PRINCIPAL RISKS AND UNCERTAINTIES

There are a number of potential risks and uncertainties, which could have an impact on the Group, 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, Northern Powergrid 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 ("RPI"), as well as factors such as performance against certain regulatory incentives. Where Northern Powergrid 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 now 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 Northern Powergrid's allowed income in respect of each regulatory year. Consequently, one of the risks faced by the Group is that its costs may increase by more than RPI. Any changes in costs incurred will have a direct impact on Northern Powergrid's financial results, as will changes in performance under incentive schemes, such as in customer service, which can lead to adjustments to allowed revenues.

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 ED1 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 Group are outlined on page 6 of this Strategic Report.

Operational risk

There are a number of risks to Northern Powergrid'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, Northern Powergrid 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.

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

PRINCIPAL RISKS AND UNCERTAINTIES - continued

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 Northern Powergrid and strict policies and procedures are in place both to ensure the safety of the employees and customers.

Cyber security is an increasing risk. The Northern Powergrid Group 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.

Northern Powergrid 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 Northern Powergrid's distribution services area, which is expected to result in a requirement to address a proportionate number of reported defects. Northern Powergrid 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 Group remained focused on ensuring that its policies for credit checking, payment terms, payment performance tracking and debt management were strictly adhered to.

Northern Powergrid'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 Northern Powergrid's network are RWE Npower, British Gas, EDF Energy, E.ON, Scottish and Southern Energy and Scottish Power.

Northern Powergrid 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. Northern Powergrid 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 2 and 3 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.

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

PRINCIPAL RISKS AND UNCERTAINTIES - continued

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.

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 Northern Powergrid Group 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 Group 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 Northern Powergrid 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.

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

PRINCIPAL RISKS AND UNCERTAINTIES - continued

Northern Powergrid 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 Group for the purposes of making the statement below and do so on an ongoing basis as part of the preparation and approval of the Group'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 to the Group's new assets, the enduring nature of the Group's business and the fact that the notice period for revocation of Northern Powergrid's electricity distribution licence is 25 years. Northern Powergrid'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 Northern Powergrid for certain specified reasons. Consequently and given the general stability associated with the regulatory environment in which Northern Powergrid operates, the directors have been able to prepare sufficiently robust forecasts as part of the Group's annual business planning process, taking account of the principal risks and uncertainties which might have an impact on those forecasts. The Group's forecasts look forward for a 10-year period and anticipate the Group's continued stable operations beyond the ED1 price control.

Details of the principal risks and uncertainties, which could have an impact on the Group, are provided on pages 17 to 20 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.

The directors' ongoing assessment of the principal risks and uncertainties facing the Group also includes meeting the obligations in Northern Powergrid's Licence to provide Ofgem with annual certificates, approved by the board, confirming that the directors have a reasonable expectation that the Group will have sufficient financial resources, financial facilities and operational resources available to it so that Northern Powergrid 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 Northern Powergrid'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 Group of suitably qualified and experienced staff. Given the regulatory environment in which the Northern Powergrid operates, it is currently considered unlikely that there will be material variances to the assumptions used in providing those certificates during ED1.

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

ON BEHALF OF THE BOARD:



J M France
Director

26 April 2017

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

REPORT OF THE DIRECTORS FOR THE YEAR ENDED 31 DECEMBER 2016

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

DIVIDENDS

During the year, an interim dividend of £100.0 million (78p per ordinary share) was paid (2015: £20.6 million). The directors recommend that no final dividend be paid in respect of the year.

RESEARCH AND DEVELOPMENT

The Group 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 Group invested £0.8 million (2015: £2.1 million) (Note 6 to the accounts) in its research and development activities.

FUTURE DEVELOPMENTS

The financial position of the Group, as at 31 December 2016, is shown in the statement of financial position on pages 32 and 33.

There have been no significant events since the year end and the directors intend that:

Northern Powergrid 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.

The objective for IUS will remain the development of its business in a manner that concentrates on its core skills of engineering contracting by delivering a high standard of service to its existing clients and pursuing opportunities to increase its portfolio of clients across all regions of the United Kingdom in the sectors within which it operates.

Northern Powergrid Metering will retain its focus on pursuing opportunities in the market for meter asset provision as the smart meter roll-out programme develops.

DIRECTORS

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

G E Abel	Chairman (stood down from the board on 15 December 2016)
R Dixon	Non-executive Director
T E Fielden	Finance Director
J M France	Regulation Director
P J Goodman	Executive Vice-President and Chief Financial Officer, Berkshire Hathaway Energy
P A Jones	President and Chief Executive Officer

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

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.

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

FINANCIAL RISK MANAGEMENT

The Group'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 under review, the Group'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 Group's policy not to hold any derivative financial instruments.

Further details of the financial risks facing the Group are provided in the Financial strength and Principal Risks and Uncertainties sections on pages 5 and 17 to 20 respectively of the Strategic Report.

POLITICAL DONATIONS

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

EMPLOYEES

Employee consultation

The Group has a constitutional framework in place for employee consultation and has agreed that framework with trade union representatives. In addition, the Group 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 Group 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 briefs on current issues, meetings with staff and their representatives, and utilising the 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 the Northern Powergrid Group's intranet on key elements of performance during the preceding week.

Disabled employees

The Group 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 Group would work to make reasonable adjustments, wherever possible.

VOTE HOLDER AND ISSUER NOTIFICATION

There have been no disclosures to the Company under Disclosure and Transparency Rule 5 (Vote Holder and Issuer Notification Rules).

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

DIRECTORS' BIOGRAPHIES

RONALD DIXON

Appointed in October 1997, Mr Dixon, 79, worked for North Eastern Electricity Board and Northern Electric plc throughout his career, being appointed Secretary in 1987. He was appointed Managing Director of the Power Division in 1990, responsible for electricity supply and distribution, and Commercial Director in 1991. He retired from the board on 31 July 1997 and was re-appointed in the capacity of a non-executive director on 22 October 1997. Mr Dixon is also a non-executive director of Northern Powergrid Holdings Company, Northern Powergrid (Northeast) Limited and Northern Powergrid (Yorkshire) plc.

THOMAS E FIELDEN

Appointed in October 2009, Mr Fielden, 46, joined the Northern Powergrid Group in July 2009 and became Finance Director on 12 October 2009. Mr Fielden is a chartered accountant, having started his career at Coopers & Lybrand and has held a variety of finance appointments in BT, working in BT Group and BT Global Services, before joining Great North East Railway (GNER) as Financial Controller in 2005. He became Finance Director of GNER in 2006, transferring to National Express East Coast in 2007.

JOHN M FRANCE

Appointed in January 2000, Dr France, 59, is Regulation Director for the Northern Powergrid Group. After leaving university he joined the British Gas Corporation where he held a number of posts before becoming a member of the team that handled the privatisation of British Gas in 1986. He joined Northern Electric plc as its Regulation Manager in 1989 and has been involved with all the distribution (and supply) price control reviews that have affected the Northern Powergrid Group since privatisation. He was a member of the team that negotiated the acquisition of the distribution business of Yorkshire Electricity Group plc and the sale of the Northern Electric plc supply businesses in 2001.

PATRICK J GOODMAN

Mr Goodman, 49, is executive vice president and chief financial officer of Berkshire Hathaway Energy. Mr Goodman is responsible for managing all aspects of Berkshire Hathaway Energy's financial operations. Mr Goodman serves as a director of PacifiCorp, Northern Powergrid, Kern River Gas Transmission Company and Northern Natural Gas Company. Mr Goodman supports the evaluation, negotiation and closing of Berkshire Hathaway Energy's domestic and international financings, acquisitions and project developments. Additionally, he manages all accounting, financial reporting, tax, budgeting, long-range financial planning and internal audit functions for Berkshire Hathaway Energy. Mr Goodman has been the chief financial officer since 1999 and has served in various financial positions, including chief accounting officer since joining the Company in 1995. Mr Goodman has more than 20 years of experience in public accounting and management and is a certified public accountant. He received his accounting degree from the University of Nebraska at Omaha.

PHILIP A JONES

Appointed in April 2007, Dr Jones, 48, is President and Chief Executive Officer of the Northern Powergrid Group, the UK platform in the global portfolio of Berkshire Hathaway Energy. Prior to his appointment as President and Chief Executive Officer, he was Strategy and Investment Director and, as such, was responsible for technical, economic and regulatory strategy within the organisation. Dr Jones is a chartered electrical engineer and has been working in the UK power distribution sector since completing his PhD in Electronic and Electrical Engineering in 1993. He has held a range of technical and managerial roles, mostly in the engineering field. He is also actively involved in a range of other industry bodies. He has been a director of the Institute of Asset Management and of the Energy Networks Association, the trade association that represents the power transmission and distribution companies.

**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

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

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The directors are responsible for preparing the Group 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 Group and the Company and of the profit or loss of the Group and 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 IFRS are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Company's and the Group's financial position and financial performance; and
- Make an assessment of the Company's and the Group'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 Group's and the Company's transactions and disclose with reasonable accuracy at any time the financial position of the Group and 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 Group and 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 and the Group, 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.

DIRECTORS' RESPONSIBILITY STATEMENT PURSUANT TO DTR 4

Each of the directors as at the date of the Annual Reports and Accounts, whose names and functions are set out on page 21 in the Report of the Directors confirms that, to the best of their knowledge

a) the Company's accounts, prepared in accordance with applicable UK law and in conformity with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of the Company; and

b) the Management Report (which is comprised of the Strategic Report and the Report of the Directors) includes a fair review of the development and performance of the business and the position of the Company, together with a description of the principal risks and uncertainties it faces.

GOING CONCERN

A review of the Group'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:

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

GOING CONCERN – continued

- The Group's main subsidiary, Northern Powergrid, 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 Group is profitable with strong underlying cash flows; and
- The Group is financed by long-term borrowings with an average maturity of 12 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 and the Group have 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:

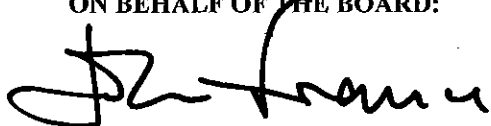
- a) so far as he is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- b) he has taken all the steps he ought to have taken as a director in order to make himself aware of any relevant audit information and to establish that the auditor is aware of that information.

This confirmation is given and should be interpreted in accordance with the provisions of section 418 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:



J M France
Director

26 April 2017

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

We have audited the financial statements of Northern Electric plc Group ("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 29. 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 pages 25 and 26, 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 circumstances of the Company and the Group 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 and the Group's affairs as at 31 December 2016 and of the Group's profit for the year then ended;
- have been properly prepared in accordance with the requirements of the Companies Act 2006 and in accordance with IFRSs as adopted by the European Union;
- in respect of the Company, have been properly prepared in accordance with IFRS as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- in respect of the Group, have been properly prepared in accordance with Article 4 of the IAS Regulations.

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 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 by the Company, or
- returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements of the Company or the Group 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

26 April 2017

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

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

	Notes	2016 £'000	2015 £'000
CONTINUING OPERATIONS			
Revenue	3	384,867	386,388
Cost of sales		<u>(43,336)</u>	<u>(42,552)</u>
GROSS PROFIT		341,531	343,836
Operating expenses		<u>(160,350)</u>	<u>(147,675)</u>
OPERATING PROFIT		181,181	196,161
Other gains		522	474
Finance costs	5	(39,139)	(36,198)
Finance income	5	<u>1,354</u>	<u>1,619</u>
PROFIT BEFORE INCOME TAX	6	143,918	162,056
Income tax	7	<u>(7,210)</u>	<u>(17,282)</u>
PROFIT FOR THE YEAR		<u>136,708</u>	<u>144,774</u>
Profit attributable to: Owners of the parent		<u>136,708</u>	<u>144,774</u>

The notes on pages 38 to 85 form part of these financial statements

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

	2016 £'000	2015 £'000
PROFIT FOR THE YEAR	136,708	144,774
OTHER COMPREHENSIVE INCOME		
Item that will not be reclassified to profit or loss:		
Re-measurement of net pension obligation	(84,700)	(400)
Income tax relating to item of other comprehensive income	<u>14,197</u>	<u>(2,099)</u>
OTHER COMPREHENSIVE INCOME FOR THE YEAR, NET OF INCOME TAX	<u>(70,503)</u>	<u>(2,499)</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u><u>66,205</u></u>	<u><u>142,275</u></u>
Total comprehensive income attributable to: Owners of the parent	<u><u>66,205</u></u>	<u><u>142,275</u></u>

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

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

	Notes	2016 £'000	2015 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	11	40,857	31,623
Property, plant and equipment	12	2,322,900	2,130,082
Investments	13	3,319	3,556
Pension asset	24	31,500	88,100
Trade and other receivables	15	8,406	8,769
		<u>2,406,982</u>	<u>2,262,130</u>
CURRENT ASSETS			
Inventories	14	12,836	13,452
Trade and other receivables	15	83,640	73,879
Cash and cash equivalents	16	515	8,824
		<u>96,991</u>	<u>96,155</u>
TOTAL ASSETS		<u>2,503,973</u>	<u>2,358,285</u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	17	72,173	72,173
Share premium	18	158,748	158,748
Other reserves	18	6,185	6,185
Retained earnings	18	737,668	771,463
TOTAL EQUITY		<u>974,774</u>	<u>1,008,569</u>

The notes on pages 38 to 85 form part of these financial statements

CONSOLIDATED STATEMENT OF FINANCIAL POSITION - continued
31 DECEMBER 2016

	Notes	2016 £'000	2015 £'000
LIABILITIES			
NON-CURRENT LIABILITIES			
Trade and other payables	19	562,308	526,800
Borrowings			
Interest bearing loans and borrowings	20	587,414	587,175
Deferred tax	23	89,462	104,859
Provisions	22	1,803	1,984
		<u>1,240,987</u>	<u>1,220,818</u>
CURRENT LIABILITIES			
Trade and other payables	19	129,882	110,011
Borrowings			
Interest bearing loans and borrowings	20	153,844	13,917
Tax payable		3,764	3,962
Provisions	22	722	1,008
		<u>288,212</u>	<u>128,898</u>
TOTAL LIABILITIES		<u>1,529,199</u>	<u>1,349,716</u>
TOTAL EQUITY AND LIABILITIES		<u>2,503,973</u>	<u>2,358,285</u>

The financial statements were approved by the Board of Directors on 26 April 2017 and were signed on its behalf by:

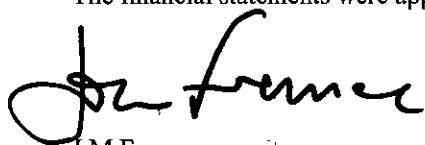


J M France
 Director

COMPANY STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2016

	Notes	2016 £'000	2015 £'000
ASSETS			
NON-CURRENT ASSETS			
Property, plant and equipment	12	1,634	1,680
Investments	13	<u>328,070</u>	<u>328,070</u>
		<u>329,704</u>	<u>329,750</u>
CURRENT ASSETS			
Trade and other receivables	15	317	427
Tax receivable		6,047	2,694
Cash and cash equivalents	16	-	<u>24,322</u>
		<u>6,364</u>	<u>27,443</u>
TOTAL ASSETS		<u>336,068</u>	<u>357,193</u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	17	72,173	72,173
Share premium	18	158,748	158,748
Other reserves	18	6,185	6,185
Retained earnings	18	<u>23,391</u>	<u>107,480</u>
TOTAL EQUITY		<u>260,497</u>	<u>344,586</u>
LIABILITIES			
NON-CURRENT LIABILITIES			
Borrowings			
Interest bearing loans and borrowings	20	1,117	1,117
Deferred tax	23	2,758	4,809
Provisions	22	<u>1,705</u>	<u>1,652</u>
		<u>5,580</u>	<u>7,578</u>
CURRENT LIABILITIES			
Trade and other payables	19	3,177	2,748
Borrowings			
Interest bearing loans and borrowings	20	66,806	2,272
Provisions	22	<u>8</u>	<u>9</u>
		<u>69,991</u>	<u>5,029</u>
TOTAL LIABILITIES		<u>75,571</u>	<u>12,607</u>
TOTAL EQUITY AND LIABILITIES		<u>336,068</u>	<u>357,193</u>

The financial statements were approved by the Board of Directors on 26 April 2017 and were signed on its behalf by:



J M France
Director

The notes on pages 38 to 85 form part of these financial statements

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

	Called up share capital £'000	Retained earnings £'000	Share premium £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2015	72,173	649,788	158,748	6,185	886,894
Changes in equity					
Dividends	-	(20,600)	-	-	(20,600)
Total comprehensive income	-	142,275	-	-	142,275
Balance at 31 December 2015	<u>72,173</u>	<u>771,463</u>	<u>158,748</u>	<u>6,185</u>	<u>1,008,569</u>
Changes in equity					
Dividends	-	(100,000)	-	-	(100,000)
Total comprehensive income	-	66,205	-	-	66,205
Balance at 31 December 2016	<u>72,173</u>	<u>737,668</u>	<u>158,748</u>	<u>6,185</u>	<u>974,774</u>

The notes on pages 38 to 85 form part of these financial statements

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

	Called up share capital £'000	Retained earnings £'000	Share premium £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2015	72,173	113,523	158,748	6,185	350,629
Changes in equity					
Dividends	-	(20,600)	-	-	(20,600)
Total comprehensive income	-	14,557	-	-	14,557
Balance at 31 December 2015	<u>72,173</u>	<u>107,480</u>	<u>158,748</u>	<u>6,185</u>	<u>344,586</u>
Changes in equity					
Dividends	-	(100,000)	-	-	(100,000)
Total comprehensive income	-	15,911	-	-	15,911
Balance at 31 December 2016	<u>72,173</u>	<u>23,391</u>	<u>158,748</u>	<u>6,185</u>	<u>260,497</u>

The notes on pages 38 to 85 form part of these financial statements

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

	Notes	2016 £'000	2015 £'000
Cash flows from operating activities			
Cash generated from operations	28	217,880	189,124
Finance costs paid		(41,413)	(38,809)
Interest received		1,065	956
Tax paid		<u>(8,608)</u>	<u>(24,805)</u>
Net cash from operating activities		<u>168,924</u>	<u>126,466</u>
Cash flows used in investing activities			
Purchase of intangible fixed assets		(12,963)	(10,476)
Purchase of tangible fixed assets		(247,702)	(271,339)
Sale of tangible fixed assets		487	467
Customer contributions		44,896	56,357
Dividends received		<u>491</u>	<u>548</u>
Net cash used in investing activities		<u>(214,791)</u>	<u>(224,443)</u>
Cash flows from financing activities			
Movement in external loans		-	50,365
Movement in loans from Group		137,558	(8,550)
Equity dividends paid		<u>(100,000)</u>	<u>(20,600)</u>
Net cash from financing activities		<u>37,558</u>	<u>21,215</u>
Decrease in cash and cash equivalents		(8,309)	(76,762)
Cash and cash equivalents at beginning of year		<u>8,824</u>	<u>85,586</u>
Cash and cash equivalents at end of year		<u><u>515</u></u>	<u><u>8,824</u></u>

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

	Notes	2016 £'000	2015 £'000
Cash flows from operating activities			
Cash generated from operations	28	778	1,384
Finance costs paid		(9,096)	(9,028)
Interest received		56	195
Dividends received		22,291	21,113
Tax (paid)/received		(2,885)	1,452
Net cash from operating activities		11,144	15,116
Cash flows from financing activities			
Movement in borrowings		2,395	-
Movement in loans from Group		62,139	-
Equity dividends paid		(100,000)	(20,600)
Net cash from financing activities		(35,466)	(20,600)
Decrease in cash and cash equivalents		(24,322)	(5,484)
Cash and cash equivalents at beginning of year		24,322	29,806
Cash and cash equivalents at end of year		-	24,322

The notes on pages 38 to 85 form part of these financial statements

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

1. GENERAL INFORMATION

Northern Electric 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 Group'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 IFRS 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 Company's financial statements have also been prepared in accordance with IFRS, as applied in accordance with the provisions of the Act. The directors have taken advantage of the exemption offered by Section 408 of the Act not to present a separate statement of profit or loss for the Company.

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 Group 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 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.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company and its subsidiaries made up to 31 December each year. Control is achieved where the Company has power over the investee, is exposed, or has rights, to variable returns from its involvement with the investee, and has the ability to use its power to affect its returns.

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

2. ACCOUNTING POLICIES - continued

Investments in associates and joint ventures

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have the rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The results and assets and liabilities of associates or joint ventures are incorporated in these consolidated financial statements using the equity method of accounting except when classified as held for sale. Investments in associates or joint venture entities are initially recognised at cost and adjusted thereafter to recognise the Group's share of profit or loss and other comprehensive income of the associate or joint venture. When the Group's share of losses of an associate or a joint venture exceeds the Group's interest in that associate or joint venture, the Group discontinues recognising its share of future losses.

An investment in an associate or a joint venture is accounted for using the equity method from the date on which the investee becomes an associate or a joint venture. On acquisition of the investment in an associate or a joint venture, any excess of the cost of the investment over the Group's share of the net fair value of the identifiable assets and liabilities of the investee is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets and liabilities over the cost of the investment, after reassessment, is recognised immediately in profit or loss in the period in which the investment is acquired.

A joint operation is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the assets, and obligations for the liabilities, relating to the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

Fixed asset investments are stated at cost less provision or amounts written off for impairment in value.

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

2. ACCOUNTING POLICIES - continued

Application of new and revised IFRS

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.

**NOTES TO THE CONSOLIDATED 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 £23.2 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.

**NOTES TO THE CONSOLIDATED 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 Group's accounting policies and that have the most significant effect on amounts recognised in the consolidated financial statements:

- Revenue recognition, the methodology for which is disclosed below;
- Useful economic lives for property, plant and equipment, details of which can be found on page 43; and
- The split of operating and capital expenditure and the allocation of overheads to property, plant and equipment. The allocation of overheads to capital is derived from a detailed analysis of indirect cost centres and their usage which is reviewed on a regular basis.

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:

- Assumptions used when evaluating long-term pension plans, these assumptions and their possible impacts are disclosed in note 24.

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 Group'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 Group'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 Group'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.

Income from credit sale charges is apportioned in the statement of profit or loss over the period of the sales agreements.

Interest income from a financial asset is recognised when it is probable that the economic benefits will flow to the Group 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.

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

2. ACCOUNTING POLICIES - continued

Construction contracts

Where the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, based on the proportion of contract costs incurred for work performed to date relative to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.

Where the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of the costs incurred where it is probable they will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

When contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is shown as amounts due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is shown as the amounts due to customers for contract work. Amounts received before the related work is performed are included in the consolidated statement of financial position, as a liability, as advances received. Amounts billed for work performed but not yet paid by the customer are included in the consolidated statement of financial position under trade and other receivables.

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 and depreciation

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

Freehold land is not depreciated.

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

2. ACCOUNTING POLICIES - continued

Property, plant and equipment and depreciation - continued

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 estimate accounted for on a prospective basis. Due to the significance of the Group'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 Group's accounting policy. Such assets are classified to the appropriate categories of property, plant and equipment when incurred 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 Group 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

Inventories are stated at the lower of cost and net realisable value. Net realisable value represents the estimated selling price for inventories less all estimated costs of completion and costs necessary to make the sale. Raw materials and goods for resale are valued at purchase cost on an average price basis. 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.

Assets held for sale comprise of vehicles which have been sold to the Group at the end of the lease agreement and are stated at the lower of the value attributed to the vehicle under the terms of the agreement or net realisable value. Net realisable value is based on estimated selling price less further costs expected to be incurred to completion and disposal. Within the statement of profit or loss, any profits or losses arising from the sale of assets held for sale are recognised in costs of sales.

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 consolidated 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 Group's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax is recognised on temporary differences between the carrying amounts of assets and liabilities in the consolidated 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.

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

2. ACCOUNTING POLICIES - continued

Taxation - continued

Deferred tax liabilities are 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.

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.

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 the software development licenses, the Group and the Company do 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 charged to the statement of profit or loss or in property, plant and equipment on a straight-line basis over the lease term.

Provisions

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group 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.

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

2. ACCOUNTING POLICIES - continued

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 Group'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.

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.

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

2. ACCOUNTING POLICIES - continued

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 Group'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 and the Group have 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. SEGMENTAL REPORTING

The tables below represent the internal information provided to the President and Chief Executive Officer of the Northern Powergrid Group for the purposes of resource allocation and segmental performance appraisal.

The Group operates in three principal areas of activity, those of the distribution of electricity, engineering contracting and smart meter rental in the United Kingdom.

Group revenue, Group profit before tax and Group net assets are analysed below:

	Distribution 2016 £m	Contracting 2016 £m	Other 2016 £m	Consolidation adjustments 2016 £m	Total 2016 £m
REVENUE					
External sales	332.5	27.7	24.7	-	384.9
Inter-segment sales	0.5	2.0	3.6	(6.1)	-
Total revenue	333.0	29.7	28.3	(6.1)	384.9
SEGMENT RESULTS					
Operating profit/(loss)	153.5	(3.9)	7.7	23.9	181.2
Other gains					0.5
Finance costs					(39.1)
Finance income					1.3
Profit before tax					143.9
OTHER INFORMATION					
Capital additions	199.7	-	90.1	(0.1)	289.7
Depreciation and amortisation	77.9	-	11.2	(1.7)	87.4
Amortisation of deferred revenue	(19.3)	-	-	-	(19.3)

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

3. SEGMENTAL REPORTING – continued

	Distribution 2016 £m	Contracting 2016 £m	Other 2016 £m	Consolidation adjustments 2016 £m	Total 2016 £m
STATEMENT OF FINANCIAL POSITION					
Segment assets	<u>2,340.6</u>	<u>17.5</u>	<u>174.0</u>	<u>(32.0)</u>	2,500.1
Unallocated corporate assets					<u>3.8</u>
Total assets					<u>2,503.9</u>
Segment liabilities	<u>(666.6)</u>	<u>(9.8)</u>	<u>(20.0)</u>	<u>1.7</u>	(694.7)
Unallocated corporate liabilities					<u>(834.4)</u>
Total liabilities					<u>(1,529.1)</u>
Net assets by segment	<u>1,674.0</u>	<u>7.7</u>	<u>154.0</u>	<u>(30.3)</u>	1,805.4
Unallocated net corporate liabilities					<u>(830.6)</u>
Total net assets					<u>974.8</u>
	Distribution 2015 £m	Contracting 2015 £m	Other 2015 £m	Consolidation adjustments 2015 £m	Total 2015 £m
REVENUE					
External sales	342.2	30.9	13.3	-	386.4
Inter-segment sales	<u>0.5</u>	<u>2.0</u>	<u>4.0</u>	<u>(6.5)</u>	-
Total revenue	<u>342.7</u>	<u>32.9</u>	<u>17.3</u>	<u>(6.5)</u>	<u>386.4</u>
SEGMENT RESULTS					
Operating profit	<u>163.6</u>	<u>(0.5)</u>	<u>5.1</u>	<u>28.0</u>	196.2
Other gains					0.5
Finance costs					(36.2)
Finance income					<u>1.6</u>
Profit before tax					<u>162.1</u>
OTHER INFORMATION					
Capital additions	219.7	-	52.8	(5.4)	267.1
Depreciation and amortisation	73.8	0.1	3.9	(1.8)	76.0
Amortisation of deferred revenue	<u>(22.2)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(22.2)</u>

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

3. SEGMENTAL REPORTING – continued

	Distribution 2015 £m	Contracting 2015 £m	Other 2015 £m	Consolidation adjustments 2015 £m	Total 2015 £m
STATEMENT OF FINANCIAL POSITION					
Segment assets	<u>2,219.2</u>	<u>18.2</u>	<u>89.2</u>	<u>19.3</u>	2,345.9
Unallocated corporate assets					<u>12.4</u>
Total assets					<u>2,358.3</u>
Segment liabilities	<u>(643.1)</u>	<u>(6.8)</u>	<u>(15.1)</u>	<u>25.1</u>	(639.9)
Unallocated corporate liabilities					<u>(709.9)</u>
Total liabilities					<u>(1,349.8)</u>
Net assets/(liabilities) by segment	<u>1,576.1</u>	<u>11.4</u>	<u>74.1</u>	<u>44.4</u>	1,706.0
Unallocated net corporate liabilities					<u>(697.5)</u>
Total net assets					<u>1,008.5</u>

“Other” comprises smart meter rental and business support units.

Unallocated corporate assets and liabilities include cash and cash equivalents (2016: £0.5 million, 2015: £8.8 million), borrowings (2016: £741.2 million, 2015: £601.1 million) and taxation (2016: £93.0 million, 2015: £108.8 million).

External sales to RWE Npower plc in 2016 of £76.3 million (2015: £86.1 million) are included within the Distribution segment. External sales to British Gas plc in 2016 of £53.0 million (2015: £59.7 million) are included within the Distribution segment.

Sales and purchases between the different segments are made at commercial prices.

Consolidation Adjustments include the recognition of the £31.5m retirement benefit asset (2015: £88.1 million).

4. EMPLOYEES AND DIRECTORS

	2016 £'000	2015 £'000
Salaries	63,030	61,472
Social security costs	7,004	6,392
Defined benefit pension costs	(2,458)	(384)
Defined contribution pension costs	<u>1,893</u>	<u>1,648</u>
	69,469	69,128
Less charged as capital expenditure	<u>(42,129)</u>	<u>(41,591)</u>
	<u>27,340</u>	<u>27,537</u>

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

4. EMPLOYEES AND DIRECTORS - continued

The majority of the Group's employees are members of the Northern Powergrid Group of the ESPS, details of which are given in the Employee Benefit Obligations note.

The average monthly number of employees during the year was:

	2016 No.	2015 No.
Distribution	1,066	1,074
Engineering Contracting	160	166
Other	44	41
	<u>1,270</u>	<u>1,281</u>

DIRECTORS' REMUNERATION

	2016 £'000	2015 £'000
Highest Paid:		
Short-term employee benefits	342	266
Post-employment benefits	11	21
Other long-term benefits	396	335
	<u>749</u>	<u>622</u>
Total:		
Short-term employee benefits	551	462
Post-employment benefits	23	38
Other long-term benefits	562	523
	<u>1,135</u>	<u>1,023</u>
Directors who are a member of the defined benefit scheme	<u>2</u>	<u>3</u>
Accrued pension benefit relating to highest paid director	<u>-</u>	<u>-</u>

OTHER KEY PERSONNEL REMUNERATION

	2016 £'000	2015 £'000
Total:		
Short-term employee benefits	520	423
Post-employment benefits	111	115
Other long-term benefits	316	209
	<u>948</u>	<u>747</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 and the Group.

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 Group.

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

5. NET FINANCE COSTS

	2016 £'000	2015 £'000
Finance income:		
Interest in joint venture	254	628
Dividends received	37	35
Interest on tax refund	388	-
Deposit account interest	58	91
Interest receivable on loans to Group undertakings	617	865
	<u>1,354</u>	<u>1,619</u>
	2016 £'000	2015 £'000
Finance costs:		
Bank interest	113	918
Interest payable on other loans	25,612	22,618
Interest payable on loans from Group undertakings	7,073	6,910
Capitalised interest	(2,660)	(3,249)
Preference dividends payable	9,001	9,001
	<u>39,139</u>	<u>36,198</u>
Net finance costs	<u>37,785</u>	<u>34,579</u>

6. PROFIT BEFORE INCOME TAX

The profit before income tax is stated after charging/(crediting):

	2016 £'000	2015 £'000
Depreciation - owned assets	83,737	73,419
Software development costs amortisation	3,730	2,674
Foreign exchange differences	(40)	23
Research costs	830	2,052
Amortisation of deferred revenue	(19,342)	(22,203)
Impairment of trade and other receivables	440	191
Profit on disposal of fixed assets	(522)	(474)

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	26	33
Fees payable to the Company's auditor for the audit of the Company's subsidiaries pursuant to legislation	<u>208</u>	<u>140</u>
Total audit fees	<u>234</u>	<u>177</u>
Other services	<u>45</u>	<u>50</u>
Total auditor's remuneration	<u>279</u>	<u>227</u>

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

6. PROFIT BEFORE INCOME TAX - continued

	2016 £'000	2015 £'000
Fees payable to the Company's auditor and its associates in respect of the audit of associated pension schemes	<u>7</u>	<u>7</u>

7. INCOME TAX

Analysis of tax expense

	2016 £'000	2015 £'000
Current tax	14,030	29,661
Deferred tax	<u>(6,820)</u>	<u>(12,379)</u>
Total tax expense in consolidated statement of profit or loss	<u>7,210</u>	<u>17,282</u>

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
Tax expense comprises:	<u>143,918</u>	<u>162,056</u>
Profit multiplied by the standard rate of corporation tax in the UK of 20.00% (2015 - 20.25%)	28,784	32,816
Effects of:		
Dividends on non-equity preference shares	1,800	1,823
Tax effect of result of joint venture	(51)	(127)
Agreement of prior year tax claim	(13,817)	(2,845)
Other over provision for prior years	(2,520)	(441)
Changes in legislation	(7,651)	(13,942)
Pension contributions recognised in Other Comprehensive Income ("OCI")	789	801
Other	<u>(124)</u>	<u>(803)</u>
Tax expense	<u>7,210</u>	<u>17,282</u>

The prior year tax claim refers to a capital allowances claim for earlier years agreed with HMRC in the year ended 31 December 2016.

	2016 £'000	2015 £'000
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	28,907	32,947
Over provision for prior years	<u>(14,877)</u>	<u>(3,286)</u>
Total current tax charge	<u>14,030</u>	<u>29,661</u>

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

7. INCOME TAX – continued

	2016 £'000	2015 £'000
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	831	1,562
Effect of changes in tax rates	<u>(7,651)</u>	<u>(13,942)</u>
Total deferred tax charge	<u>(6,820)</u>	<u>(12,379)</u>
Tax on profit before tax	<u>7,210</u>	<u>17,282</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. PROFIT OF PARENT COMPANY

As permitted by Section 408 of the Companies Act 2006, the statement of profit or loss of the Company is not presented as part of these financial statements. The Company's profit for the financial year was £15.9 million (2015: 14.6 million).

9. DIVIDENDS

	2016 £'000	2015 £'000
Interim dividend at 78p per share (2015: 16p)	<u>100,000</u>	<u>20,600</u>

10. OPERATING EXPENSES

Operating expenses comprise:

	2016 £'000	2015 £'000
Distribution costs	101,879	99,607
Administrative expenses	<u>58,471</u>	<u>50,068</u>
	<u>160,350</u>	<u>149,675</u>

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

11. INTANGIBLE ASSETS

Group

	Software development costs £'000
COST	
At 1 January 2016	65,503
Additions	<u>12,964</u>
At 31 December 2016	<u>78,467</u>
AMORTISATION	
At 1 January 2016	33,880
Amortisation for year	<u>3,730</u>
At 31 December 2016	<u>37,610</u>
NET BOOK VALUE	
At 31 December 2016	<u>40,857</u>

	Software development costs £'000
COST	
At 1 January 2015	55,027
Additions	<u>10,476</u>
At 31 December 2015	<u>65,503</u>
AMORTISATION	
At 1 January 2015	31,206
Amortisation for year	<u>2,674</u>
At 31 December 2015	<u>33,880</u>
NET BOOK VALUE	
At 31 December 2015	<u>31,623</u>

The Company had no intangible assets at 31 December 2016 (2015: £nil).

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

12. PROPERTY, PLANT AND EQUIPMENT

Group	Non-operational land and buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Metering equipment £'000	Totals £'000
COST					
At 1 January 2016	6,534	2,872,430	67,721	133,218	3,079,903
Additions	-	181,349	5,236	90,093	276,678
Disposals	-	(10,526)	(217)	(398)	(11,141)
At 31 December 2016	<u>6,534</u>	<u>3,043,253</u>	<u>72,740</u>	<u>222,913</u>	<u>3,345,440</u>
DEPRECIATION					
At 1 January 2016	5,973	823,154	56,712	63,982	949,821
Charge for year	105	67,461	3,508	12,663	83,737
Eliminated on disposal	-	(10,403)	(217)	(398)	(11,018)
At 31 December 2016	<u>6,078</u>	<u>880,212</u>	<u>60,003</u>	<u>76,247</u>	<u>1,022,540</u>
NET BOOK VALUE					
At 31 December 2016	<u>456</u>	<u>2,163,041</u>	<u>12,737</u>	<u>146,666</u>	<u>2,322,900</u>

	Non-operational land and buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Metering equipment £'000	Totals £'000
COST					
At 1 January 2015	6,534	2,686,350	60,380	80,224	2,833,488
Additions	-	195,828	7,781	53,021	256,630
Disposals	-	(9,748)	(440)	(27)	(10,215)
At 31 December 2015	<u>6,534</u>	<u>2,872,430</u>	<u>67,721</u>	<u>133,218</u>	<u>3,079,903</u>
DEPRECIATION					
At 1 January 2015	5,857	767,439	54,638	58,683	886,617
Charge for year	116	65,463	2,514	5,326	73,419
Eliminated on disposal	-	(9,748)	(440)	(27)	(10,215)
At 31 December 2015	<u>5,973</u>	<u>823,154</u>	<u>56,712</u>	<u>63,982</u>	<u>949,821</u>
NET BOOK VALUE					
At 31 December 2015	<u>561</u>	<u>2,049,276</u>	<u>11,009</u>	<u>69,236</u>	<u>2,130,082</u>

Assets in the course of construction included above:

	Distribution system £'000	Fixtures and fittings £'000	Total £'000
At 1 January 2016	162,715	-	162,715
Additions	181,503	5,236	186,739
Available for use	<u>(173,551)</u>	<u>(5,236)</u>	<u>(178,787)</u>
At 31 December 2016	<u>170,667</u>	<u>-</u>	<u>170,667</u>

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

12. PROPERTY, PLANT AND EQUIPMENT - continued

The Group has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £32.8 million (2015: £25.5 million).

The net book value of the Group's non-operational land and buildings comprises:

	2016 £'000	2015 £'000
Freehold	-	162
Long leasehold	363	306
Short leasehold	93	93
	<u>456</u>	<u>561</u>

Company

	Non operational land and buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2016 and 31 December 2016	<u>280</u>	<u>1,259</u>	<u>3,634</u>	<u>5,173</u>
DEPRECIATION				
At 1 January 2016	29	-	3,464	3,493
Charge for year	<u>6</u>	<u>-</u>	<u>40</u>	<u>46</u>
At 31 December 2016	<u>35</u>	<u>-</u>	<u>3,504</u>	<u>3,539</u>
NET BOOK VALUE				
At 31 December 2016	<u>245</u>	<u>1,259</u>	<u>130</u>	<u>1,634</u>

	Non operational land and buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2015 and 31 December 2015	<u>280</u>	<u>1,259</u>	<u>3,634</u>	<u>5,173</u>
DEPRECIATION				
At 1 January 2015	22	-	3,423	3,445
Charge for year	<u>7</u>	<u>-</u>	<u>41</u>	<u>48</u>
At 31 December 2015	<u>29</u>	<u>-</u>	<u>3,464</u>	<u>3,493</u>
NET BOOK VALUE				
At 31 December 2015	<u>251</u>	<u>1,259</u>	<u>170</u>	<u>1,680</u>

The Company has no assets in the course of construction as at 31 December 2016.

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

13. INVESTMENTS

	Share of joint venture's net assets	Group Shares in other undertakings	Total
	£'000	£'000	£'000
At 31 December 2015	3,535	21	3,556
Movement	(237)	-	(237)
At 31 December 2016	<u>3,297</u>	<u>21</u>	<u>3,318</u>

	Subsidiary undertakings	Company Shares in other undertakings	Total
	£'000	£'000	£'000
At 31 December 2015	327,099	971	328,070
Movement	-	-	-
At 31 December 2016	<u>327,099</u>	<u>971</u>	<u>328,070</u>

Details of the investments of the Group at 31 December 2016 are listed below:

Name of company	Holding of shares	Proportion of voting rights and shares held	Nature of business
Subsidiary undertakings			
Held by Company:			
CE Electric Services Limited	1 at £1	100%	Dormant
Central PowerGrid Limited	1 at £1	100%	Dormant
East PowerGrid Limited	1 at £1	100%	Dormant
Eastern PowerGrid Limited	1 at £1	100%	Dormant
Infrastructure North Limited	1 at £1	100%	Dormant
Integrated Utility Services Limited	3,103,000 at £1	100%	Engineering contracting services
IUS Limited	100 at £1	100%	Dormant
Midlands PowerGrid Limited	1 at £1	100%	Dormant
NEDL Limited	2 at £1	100%	Dormant
North East PowerGrid Limited	1 at £1	100%	Dormant
North Eastern PowerGrid Limited	1 at £1	100%	Dormant
North PowerGrid Limited	1 at £1	100%	Dormant
North West PowerGrid Limited	1 at £1	100%	Dormant
North Western PowerGrid Limited	1 at £1	100%	Dormant
Northern Electric & Gas Limited	84,785,000 at £1	100%	Non-trading company
Northern Electric Distribution Limited	1 at £1	100%	Dormant
Northern Electric Properties Limited	32,207,100 at £1	100%	Property holding & management company
Northern Electric Share Scheme Trustee Limited	2 at £1	100%	Dormant
Northern Electricity (North East) Limited	1 at £1	100%	Dormant

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

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

13. INVESTMENTS – continued

Northern Electricity (Yorkshire) Limited	1 at £1	100%	Dormant
Northern Electricity Limited	1 at £1	100%	Dormant
Northern Electricity Networks Company (North East) Limited	1 at £1	100%	Dormant
Northern Electricity Networks Company (Yorkshire) Limited	1 at £1	100%	Dormant
Northern Electricity Networks Company Limited	1 at £1	100%	Dormant
Northern Electrics Limited	2 at £1	100%	Dormant
Northern Energy Funding Company Limited	1 at £1	100%	Dormant
Northern Metering Services Limited	100 at £1	100%	Dormant
Northern Powergrid Metering Limited	1 at £1	100%	Meter asset provider
			Distribution of
Northern Powergrid (Northeast) Limited	200,000,100 at £1	100%	electricity
Northern PowerGrid (North West) Limited	1 at £1	100%	Dormant
Northern Power Networks Company (North East) Limited	1 at £1	100%	Dormant
Northern Power Networks Company (Yorkshire) Limited	1 at £1	100%	Dormant
Northern Power Networks Company Limited	1 at £1	100%	Dormant
Northern Transport Finance Limited	7,000,000 at £1	100%	Car finance company
Northern Utility Services Limited	100 at £1	100%	Dormant
PowerGrid (Central) Limited	1 at £1	100%	Dormant
PowerGrid (East) Limited	1 at £1	100%	Dormant
PowerGrid (Eastern) Limited	1 at £1	100%	Dormant
PowerGrid (Midlands) Limited	1 at £1	100%	Dormant
PowerGrid (North East) Limited	1 at £1	100%	Dormant
PowerGrid (North Eastern) Limited	1 at £1	100%	Dormant
PowerGrid (North West) Limited	1 at £1	100%	Dormant
PowerGrid (North Western) Limited	1 at £1	100%	Dormant
PowerGrid (North) Limited	1 at £1	100%	Dormant
PowerGrid (Northern) Limited	1 at £1	100%	Dormant
PowerGrid (South East) Limited	1 at £1	100%	Dormant
PowerGrid (South Eastern) Limited	1 at £1	100%	Dormant
PowerGrid (South West) Limited	1 at £1	100%	Dormant
PowerGrid (South Western) Limited	1 at £1	100%	Dormant
PowerGrid (South) Limited	1 at £1	100%	Dormant
PowerGrid (Southern) Limited	1 at £1	100%	Dormant
PowerGrid (West) Limited	1 at £1	100%	Dormant
PowerGrid (Western) Limited	1 at £1	100%	Dormant
PowerGrid (Yorkshire) Limited	1 at £1	100%	Dormant
South East PowerGrid Limited	1 at £1	100%	Dormant
South Eastern PowerGrid Limited	1 at £1	100%	Dormant
South PowerGrid Limited	1 at £1	100%	Dormant
South West PowerGrid Limited	1 at £1	100%	Dormant
South Western PowerGrid Limited	1 at £1	100%	Dormant
Southern PowerGrid Limited	1 at £1	100%	Dormant
West PowerGrid Limited	1 at £1	100%	Dormant
Western PowerGrid Limited	1 at £1	100%	Dormant
YEDL Limited	1 at £1	100%	Dormant
Yorkshire Electricity Distribution Limited	1 at £1	100%	Dormant
Yorkshire PowerGrid Limited	1 at £1	100%	Dormant

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

13. INVESTMENTS – continued

Held by the Company's subsidiaries:

Northern Electric Finance plc	50,000 at £1	100%	Finance company
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Joint Venture Entity Held by the Company:

Vehicle Lease and Service Limited(registered office - Centre for Advanced Industry, 3rd Floor, Coble Dene, North Shields, NE29 6DE)	950,000 at £1	50%	Transport services
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Held by Joint Venture Entity Held by the Company:

VLS Limited (registered office - Centre for Advanced Industry, 3rd Floor, Coble Dene, North Shields, NE29 6DE)	50% of 1 at £1	50%	Dormant
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Except where indicated, the registered office address of the above companies is Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

Interest in Joint venture

Summarised financial information in respect of the Group's joint venture is set out below:

	2016	2015
	£'000	£'000
Long-term assets	16,192	16,849
Current assets	15,706	16,283
Long-term liabilities	(14,962)	(14,436)
Current liabilities	(10,340)	(11,626)
Net assets	<u>6,596</u>	<u>7,070</u>
Group's share of joint venture's net assets	<u>3,298</u>	<u>3,535</u>
Revenue	<u>18,417</u>	<u>17,515</u>
Profit for the year	<u>508</u>	<u>1,256</u>
Group's share of joint venture's profit for the year	<u>254</u>	<u>628</u>

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

14. INVENTORIES

	Group	
	2016	2015
	£'000	£'000
Stocks	11,853	12,541
Work-in-progress	232	265
Assets held for sale	751	646
	<u>12,836</u>	<u>13,452</u>

The Company had no inventories at 31 December 2016 (2015 - £nil).

15. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Current:				
Distribution use of system receivables	50,280	39,854	-	-
Construction contract customers	1,974	3,901	-	-
Amounts due from customers for contract work	12,542	11,082	-	-
Amounts receivable in respect of finance leases	8,047	5,342	-	-
Amounts receivable for sale of goods and services	8,011	9,675	65	176
Prepayments and accrued income	2,786	4,025	252	251
	<u>83,640</u>	<u>73,879</u>	<u>317</u>	<u>427</u>
Non-current:				
Amounts receivable in respect of finance leases	8,406	8,769	-	-
	<u>92,046</u>	<u>82,648</u>	<u>317</u>	<u>427</u>

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

15. TRADE AND OTHER RECEIVABLES - continued

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 end of the reporting period. The fair valuation of the assets is based on Level 1 inputs. The maximum exposure of risk to the Group is the book value of these receivables less any provisions for impairment.

Distribution use of system receivables

The customers served by the Group's distribution network are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 22% of distribution revenues in 2016 (2015: 24%) and British Gas plc accounting for approximately 15% of distribution revenues in 2016 (2015: 16%). 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 Northern Powergrid (Northeast) Limited 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 Group's use of system ("UoS") receivables are debtors with a carrying value of £0.2 million, which have been placed into administration and have therefore been provided in full at the year-end (2015: £nil).

Construction contract customers

The average credit period on construction contracts is 30 days. Interest is not generally charged on construction contracts paid after the due date. The Group has provided fully for all receivables over one year for UK Contracting debts and all receivables over six months for Multi-Utility debts. Trade receivables between 30 days and these pre-determined provision dates are provided for based on estimated irrecoverable amounts, determined by reference to past default experience.

Included in the Group's construction contracts balance are debtors with a carrying amount of £3.3 million (2015: £2.5 million), which are past due at the reporting date for which the Group has provided for an irrecoverable amount of £0.3 million (2015: £0.2 million) based on experience. The Group does not hold collateral over these balances. The average age of these receivables is 91 days (2015: 55 days).

Included in the Group's construction contracts balance are debtors with a carrying amount of £nil (2015: £nil) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in credit quality and the amounts are still considered recoverable. The Group does not hold any collateral over these balances.

Amounts due from customers for contract work

Contracts in progress at the reporting date:

	2016 £'000	2015 £'000
Contract costs incurred plus recognised profits less recognised losses to date	70,382	60,125
Less: progress billings	(57,840)	(49,043)
Amount due from customers	<u>12,542</u>	<u>11,082</u>

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

15. TRADE AND OTHER RECEIVABLES - continued

At 31 December 2016, retentions held by customers for contract work amounted to £0.3 million (2015: £0.4 million).

Advances received from customers for contract work amounted to £nil (2015: £nil).

The Company had no construction contracts at 31 December 2016 (2015: £nil).

Finance lease receivables

	Minimum lease payments		Present value	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Amounts receivable under finance leases:				
Within one year	5,650	5,508	5,189	5,342
In the second to fifth years inclusive	12,913	10,384	10,522	8,769
More than five years	4,962	-	742	-
	<u>23,525</u>	<u>15,892</u>	<u>16,453</u>	<u>14,111</u>
Less: unearned finance income	<u>(7,072)</u>	<u>(1,781)</u>	<u>-</u>	<u>-</u>
	<u><u>16,453</u></u>	<u><u>14,111</u></u>	<u><u>16,453</u></u>	<u><u>14,111</u></u>

Northern Transport Finance Limited ("NTFL"), a wholly-owned subsidiary, enters into credit finance arrangements for motor vehicles with employees in the Northern Powergrid Group. All agreements are denominated in sterling. The term of the finance agreements is predominantly three years.

The interest rate inherent in the agreements is fixed at the contract date for all of the term of the agreement. The average effective interest rate contracted is approximately 6.5% (2015: 6.5%) per annum. None of these debts are past due and there are no indicators of impairment.

Northern Powergrid Metering Limited, a wholly-owned subsidiary, enters into credit finance arrangements for smart meters with energy supply companies. All agreements are denominated in sterling. The term of the finance agreements is predominantly ten years.

The interest rate inherent in the agreements is fixed at the contract date for all of the term of the agreement. None of these debts are past due and there are no indicators of impairment.

The directors consider the carrying value of finance lease receivables approximates their fair value. The maximum risk exposure is the book value of these receivables, less the residual value of the leased assets.

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 meter rentals, service alterations, 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. 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.

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

15. TRADE AND OTHER RECEIVABLES - continued

Included in the Group's amounts receivable for goods and services balance are debtors with a carrying amount of £1.1 million (2015: £0.8 million) which are past due at the reporting date and for which the Group has provided an irrecoverable amount of £0.2 million (2015: £0.2 million) based on past experience. The Group does not hold any collateral over these balances. The average age of these receivables is 223 days (2015: 207 days).

Included in the Group's amounts receivable for goods and services balance are debtors with a carrying amount of £0.2 million (2015: £0.2 million). These amounts are past due at the reporting date and the Group 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 Group does not hold any collateral over these balances. The average age of these receivables is 78 days (2015: 66 days).

Ageing of past due but not impaired receivables:

	2016 £'000	2015 £'000
30-60 days	116	133
60-120 days	66	49
120-210 days	7	12
Total	<u>189</u>	<u>194</u>

Movement in the allowance for doubtful debts

	2016 £'000	2015 £'000
At 1 January	400	501
Amounts utilised/written off in the year	(262)	(292)
Amounts recognised in statement of profit or loss	<u>620</u>	<u>191</u>
At 31 December	<u>758</u>	<u>400</u>

In determining the recoverability of the trade and other receivables, the Group 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 £0.1 million (2015: £0.2 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.

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

15. TRADE AND OTHER RECEIVABLES – continued

Categories of financial assets

	2016	2015
	£'000	£'000
Group:		
Cash and bank balances	515	8,824
Loans and receivables at amortised cost	<u>89,260</u>	<u>78,623</u>
Total financial assets	<u>89,775</u>	<u>87,447</u>
Non-current assets	2,367,076	2,165,261
Inventories	12,836	13,452
Prepayments and accrued income	2,786	4,025
Pension asset	<u>31,500</u>	<u>88,100</u>
Total non-financial assets	<u>2,414,198</u>	<u>2,270,838</u>
Total assets	<u>2,503,973</u>	<u>2,358,285</u>
	2016	2015
	£'000	£'000
Company:		
Cash and bank balances	-	29,806
Loans and receivables at amortised cost	<u>65</u>	<u>81</u>
Total financial assets	<u>65</u>	<u>24,498</u>
Non-current assets	329,704	329,750
Prepayments and accrued income	252	251
Income tax receivables	<u>6,047</u>	<u>2,694</u>
Total non-financial assets	<u>336,003</u>	<u>332,695</u>
Total assets	<u>336,068</u>	<u>357,193</u>

16. CASH AND CASH EQUIVALENTS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Amounts owed by Group undertakings	<u>515</u>	<u>8,824</u>	<u>-</u>	<u>24,322</u>
	<u>515</u>	<u>8,824</u>	<u>-</u>	<u>24,322</u>

Cash and cash equivalents have a maturity of less than three months, are readily convertible to cash and are subject to an insignificant risk of changes in value. The carrying amount of these assets approximates their fair value.

Amounts owed by Group undertakings represent surplus cash remitted to Yorkshire Electricity Group plc ("YEG"), a fellow company in the Northern Powergrid Group, and invested to generate a market rate of return for the Group. This is repayable on demand by YEG.

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

17. CALLED UP SHARE CAPITAL

Allotted, issued and fully paid:

Number:	Class:	Nominal value:	2016 £'000	2015 £'000
127,689,809	Ordinary share capital	56 12/13p	<u>72,173</u>	<u>72,173</u>

The Company has one class of ordinary shares which carries no right to fixed income.

Details of the cumulative non-equity preference shares are contained in the borrowings note.

18. RESERVES

Group

	Retained earnings £'000	Share premium £'000	Other reserves £'000	Totals £'000
At 1 January 2016	771,463	158,748	6,185	936,396
Profit for the year	136,708	-	-	136,708
Dividends	(100,000)	-	-	(100,000)
Movements on pension reserve	<u>(70,503)</u>	<u>-</u>	<u>-</u>	<u>(70,503)</u>
At 31 December 2016	<u>737,668</u>	<u>158,748</u>	<u>6,185</u>	<u>902,601</u>
	Retained earnings £'000	Share premium £'000	Other reserves £'000	Totals £'000
At 1 January 2015	649,788	158,748	6,185	814,721
Profit for the year	144,774	-	-	144,774
Dividends	(20,600)	-	-	(20,600)
Movements on pension reserve	<u>(2,499)</u>	<u>-</u>	<u>-</u>	<u>(2,499)</u>
At 31 December 2015	<u>771,463</u>	<u>158,748</u>	<u>6,185</u>	<u>936,396</u>

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

18. RESERVES - continued

Company	Retained earnings £'000	Share premium £'000	Other reserves £'000	Totals £'000
At 1 January 2016	107,480	158,748	6,185	272,413
Profit for the year	15,911	-	-	15,911
Dividends	(100,000)	-	-	(100,000)
At 31 December 2016	<u>23,391</u>	<u>158,748</u>	<u>6,185</u>	<u>23,391</u>
	Retained earnings £'000	Share premium £'000	Other reserves £'000	Totals £'000
At 1 January 2015	113,523	158,748	6,185	278,456
Profit for the year	14,557	-	-	14,557
Dividends	(20,600)	-	-	(20,600)
At 31 December 2015	<u>107,480</u>	<u>158,748</u>	<u>6,185</u>	<u>272,413</u>

19. TRADE AND OTHER PAYABLES

	Group		Company	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
Current:				
Payments on account	37,438	49,345	-	-
Trade creditors	5,037	7,817	263	387
Amounts owed to related parties	583	499	-	-
Social security and other taxes	5,036	3,171	54	395
Other creditors	8,922	9,347	2,394	1,543
Deferred revenue	20,920	19,790	-	-
Accrued expenses	<u>51,946</u>	<u>20,042</u>	<u>466</u>	<u>423</u>
	<u>129,882</u>	<u>110,011</u>	<u>3,177</u>	<u>2,748</u>
Non-current:				
Deferred revenue	<u>562,308</u>	<u>526,800</u>	-	-
	<u>562,308</u>	<u>526,800</u>	-	-
Aggregate amounts	<u>692,190</u>	<u>636,811</u>	<u>3,177</u>	<u>2,748</u>

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

19. 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 Group 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 non-derivative financial liabilities. The tables have been drawn up based on the cash flows of financial liabilities based on the earliest possible date on which the Company or the Group can be required to pay. The tables include both interest and principal cash flows.

Group

	Less than 3 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2016:					
Non-interest bearing	71,524	-	-	-	71,524
Variable interest rate liability	2,925	-	-	-	2,925
Fixed interest rate liability	5,031	25,539	325,057	590,486	946,113
	<u>79,480</u>	<u>25,539</u>	<u>325,057</u>	<u>590,486</u>	<u>1,020,562</u>
2015:					
Non-interest bearing	40,876	-	-	-	40,876
Variable interest rate liability	275	-	-	-	275
Fixed interest rate liability	5,031	25,539	339,016	607,150	976,736
	<u>46,182</u>	<u>25,539</u>	<u>339,016</u>	<u>607,150</u>	<u>1,017,887</u>

Company

	Less than 3 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2016:					
Non-interest bearing	3,177	-	-	-	3,177
Variable interest rate liability	66,806	-	-	-	66,806
Fixed interest rate liability	-	9,000	36,000	115,532	160,532
	<u>69,983</u>	<u>9,000</u>	<u>36,000</u>	<u>115,532</u>	<u>230,515</u>
2015:					
Non-interest bearing	2,798	-	-	-	2,798
Fixed interest rate liability	-	9,000	36,000	115,532	160,532
	<u>2,798</u>	<u>9,000</u>	<u>36,000</u>	<u>115,532</u>	<u>163,330</u>

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

19. TRADE AND OTHER PAYABLES - continued

Categories of financial liabilities

	2016	2015
Group:	£'000	£'000
Loans and payables at amortised cost	<u>755,740</u>	<u>618,755</u>
Total financial liabilities	<u>755,740</u>	<u>618,755</u>
Payments received on account	37,438	49,345
Income tax liabilities	93,226	108,821
Other taxes and social security	5,036	3,171
Accruals	51,946	20,042
Deferred revenue	583,288	546,590
Provisions	<u>2,525</u>	<u>2,992</u>
Total non-financial liabilities	<u>773,459</u>	<u>730,961</u>
Total liabilities	<u>1,529,199</u>	<u>1,349,716</u>

	2016	2015
Company:	£'000	£'000
Loans and payables at amortised cost	<u>70,632</u>	<u>5,319</u>
Total financial liabilities	<u>70,632</u>	<u>5,319</u>
Income tax liabilities	2,758	4,809
Other taxes and social security	54	395
Accruals	466	423
Provisions	<u>1,661</u>	<u>1,661</u>
Total non-financial liabilities	<u>4,939</u>	<u>7,288</u>
Total liabilities	<u>75,571</u>	<u>12,607</u>

Deferred Revenue

	2016	2015
	£'000	£'000
At 1 January	546,590	522,532
Additions	55,980	46,261
Amortisation	<u>(19,342)</u>	<u>(22,203)</u>
At 31 December	<u>583,228</u>	<u>546,590</u>

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 on a straight line basis (except for distributed generation which is released over 15 years on a straight line basis), in line with the useful economic life of the distribution system assets.

The Company had no deferred revenue at 31 December 2016 (2015: £nil).

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

20. BORROWINGS

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

Group

	Book Value		Fair Value	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Loans	497,685	497,486	599,169	560,985
Cumulative preference shares	3,368	3,368	167,790	163,602
Amounts owed to Group undertakings	102,930	100,238	153,191	153,554
	<u>603,983</u>	<u>601,092</u>	<u>920,150</u>	<u>853,743</u>
The borrowings are repayable as follows:				
On demand or within one year	16,569	13,917	16,569	38,315
Between one and five years	218,268	218,103	256,576	257,034
After five years	369,146	369,072	647,005	582,792
	<u>603,983</u>	<u>601,092</u>	<u>920,150</u>	<u>853,743</u>
Analysis of borrowings:				
Short-term loan	11	53	11	53
Inter-company short-term loan	2,914	222	2,914	222
Bond 2020 - 8.875%	101,192	101,052	130,276	130,560
Bond 2035 - 5.125%	152,959	152,883	207,505	180,462
Cumulative preference shares	3,368	3,368	167,790	163,602
European Investment Bank 2018 - 4.065%*	41,419	41,410	42,974	43,632
European Investment Bank 2019 - 4.241%*	41,481	41,472	44,655	44,683
European Investment Bank 2020 - 4.386%*	40,495	40,488	44,990	44,478
European Investment Bank 2027 - 2.564%	120,128	120,128	128,758	117,117
Yorkshire Electricity Group plc 2037 - 5.9%	100,016	100,016	150,277	128,934
	<u>603,983</u>	<u>601,092</u>	<u>920,150</u>	<u>853,743</u>

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

20. BORROWINGS - continued

Company

	Book Value		Fair Value	
	2016 £'000	2015 £'000	2016 £'000	2015 £'000
The borrowings are repayable as follows:				
On demand or within one year	66,806	2,272	66,806	2,273
After one year	1,117	1,117	165,539	158,560
	<u>67,923</u>	<u>3,389</u>	<u>232,345</u>	<u>160,833</u>
Analysis of borrowings:				
Short term loans	2,395	-	2,395	-
Inter-company short-term loan	62,161	22	62,160	22
Cumulative preference shares	3,367	3,367	167,790	160,810
	<u>67,923</u>	<u>3,389</u>	<u>232,345</u>	<u>160,832</u>

Of the total financial liabilities, £500.9 million relates to external borrowings and preference shares whose fair value is determined with reference to quoted market prices. The directors' estimates of the fair value of 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 valuation of liabilities set out above is based on Level 1 inputs.

* The borrowings from the European Investment Bank were drawn down in twelve tranches, repayable in 2018, 2019 and 2020. The interest rates shown are average rates for those repayment dates. The spread of interest rates is as follows:

2018: 3.901% - 4.283%
 2019: 4.077% - 4.455%
 2020: 4.227% - 4.586%

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

The Company had authorised 115,000,000 non-equity cumulative preference shares of 1p each as at 31 December 2016 and 2015. As at 31 December 2016 and 2015 111,662,378 were allotted, called up and fully paid.

The terms of the cumulative preference shares:

- i) entitle holders, in priority to holders of all other classes of shares, to a fixed cumulative preferential dividend of 8.061p (net) per share per annum payable half-yearly in equal amounts on 31 March and 30 September;
- ii) on a return of capital on a winding up, or otherwise, will carry the right to repayment of capital together with a premium of 99p per share and a sum equal to any arrears or accruals of dividend. This right is in priority to the rights of ordinary shareholders;

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

20. BORROWINGS - continued

- iii) carry the right to attend a general meeting of the Company and vote if, at the date of the notice convening the meeting, payment of the dividend to which they are entitled is six months or more in arrears, or if a resolution is to be considered at the meeting for winding-up the Company or abrogating, varying or modifying any of the special rights attaching to them; and
- iv) are redeemable in the event of the revocation by the Secretary of State of the Company's Public Electricity Supply Licence at the value given in (ii) above.

During the year ended 31 December 2001, under the terms of the Company's transfer scheme, as approved by the Secretary of State in accordance with the provisions of the Utilities Act 2000, the Company's Public Electricity Supply Licence was converted into an Electricity Distribution Licence and an Electricity Supply Licence.

At 31 December 2016, the Group had available £97 million (2015: £97 million) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

No material market risks in relation to currency or interest rates are faced by the Group. As at 31 December 2016, 100% (2015: 100%) of the Group's long-term borrowings were at fixed rates and the average maturity for these borrowings was 12 years (2015: 14 years).

21. LEASING AGREEMENTS

Group

	2016	2015
	£'000	£'000
Within one year	5,772	6,182
Between one and five years	14,530	18,195
In more than five years	<u>2,921</u>	<u>8,689</u>
	<u>23,223</u>	<u>33,066</u>
Minimum lease payments under operating leases recognised in the year	<u>5,447</u>	<u>5,121</u>

Company

	2016	2015
	£'000	£'000
Within one year	172	172
Between one and five years	<u>88</u>	<u>218</u>
	<u>260</u>	<u>390</u>

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

22. PROVISIONS

	Group		Company	
	2016	2015	2016	2015
	£'000	£'000	£'000	£'000
Other provisions	<u>2,525</u>	<u>2,992</u>	<u>1,713</u>	<u>1,661</u>
Analysed as follows:				
Current	722	1,008	8	9
Non-current	<u>1,803</u>	<u>1,984</u>	<u>1,705</u>	<u>1,652</u>
	<u>2,525</u>	<u>2,992</u>	<u>1,713</u>	<u>1,661</u>
		Claims	Other	Total
		£'000	£'000	£'000
At 1 January 2016		534	2,458	2,992
Utilised/paid in the year		(874)	(577)	(1,451)
Charged to statement of profit or loss		<u>630</u>	<u>354</u>	<u>984</u>
At 31 December 2016		<u>290</u>	<u>2,235</u>	<u>2,525</u>

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.

Also included in 'other' is a provision to cover the actuarial assessment of the costs of unfunded pension arrangements in respect of former employees. Further details can be found in the Employee Benefit Obligations note.

23. DEFERRED TAX

	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Other	Total
Group	£'000	£'000	£'000	£'000	£'000
At 1 January 2016	89,204	6,016	9,295	344	104,859
Credit to the statement of profit or loss	(2,046)	(2,141)	(1,932)	(701)	(6,820)
Credit to other comprehensive income	-	-	(8,577)	-	(8,577)
At 31 December 2016	<u>87,158</u>	<u>3,875</u>	<u>(1,214)</u>	<u>(357)</u>	<u>89,462</u>

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

23. DEFERRED TAX - continued

	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Other	Total
Group	£'000	£'000	£'000	£'000	£'000
At 1 January 2015	104,092	6,626	(2,516)	(272)	107,930
Charge/(credit) to the statement of profit or loss	(14,888)	(610)	2,503	616	(12,379)
Charge to other comprehensive income	-	-	9,308	-	9,308
At 31 December 2015	<u>89,204</u>	<u>6,016</u>	<u>9,295</u>	<u>344</u>	<u>104,859</u>

	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Total
Company	£'000	£'000	£'000	£'000
At 1 January 2016	(23)	5,129	(297)	4,809
Charge/(credit) to statement of profit or loss	<u>5</u>	<u>(2,063)</u>	<u>7</u>	<u>(2,051)</u>
At 31 December 2016	<u>(18)</u>	<u>3,066</u>	<u>(290)</u>	<u>2,758</u>

	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Total
	£'000	£'000	£'000	£'000
At 1 January 2015	(45)	5,594	(339)	5,210
Charge/(credit) to statement of profit or loss	<u>22</u>	<u>(465)</u>	<u>42</u>	<u>(401)</u>
At 31 December 2015	<u>(23)</u>	<u>5,129</u>	<u>(297)</u>	<u>4,809</u>

Other comprises provisions and employee expenses deductible for tax on a paid basis.

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

24. 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.

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 the Company, 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.

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. The next funding valuation is due no later than 31 March 2016 at which progress towards full-funding will be reviewed.

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.

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

24. EMPLOYEE BENEFIT OBLIGATIONS - continued

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 the Company as part of the 31 March 2016. 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 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.

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).

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

24. EMPLOYEE BENEFIT OBLIGATIONS – continued

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.
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 Company 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.

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

24. EMPLOYEE BENEFIT OBLIGATIONS - continued

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).

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

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

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

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

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

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

24. EMPLOYEE BENEFIT OBLIGATIONS - continued

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

Asset allocation	2016 £m	2015 £m
Developed market equity	338.6	311.0
Emerging market equity	12.9	11.2
Property	91.4	146.0
Reinsurance	71.3	68.2
Listed infrastructure	99.2	90.1
Investment grade corporate bonds	366.9	375.5
Other debt	30.3	38.7
Fixed interest gilts	52.4	24.9
Index-linked gilts	3.1	453.7
Liability driven investments	581.2	-
Cash	107.1	22.0
Total	<u>1,754.4</u>	<u>1,541.3</u>

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%).

Changes to the present value of the DBO during the year	2016 £m	2015 £m
Opening DBO	1,453.2	1,463.2
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)/losses on DB Scheme liabilities arising from experience	(25.9)	(5.6)
Net benefits paid out	<u>(84.8)</u>	<u>(59.5)</u>
Closing DBO	<u>1,722.9</u>	<u>1,453.2</u>

Changes in the fair value of DB Scheme assets during the year	2016 £m	2015 £m
Opening fair value of DB Scheme assets	1,541.3	1,516.1
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	<u>(1.2)</u>	<u>(1.2)</u>
Closing fair value of DB Scheme assets	<u>1,754.4</u>	<u>1,541.3</u>

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

24. EMPLOYEE BENEFIT OBLIGATIONS – continued

Actual return on DB Scheme assets	2016	2015
	£m	£m
Interest income on DB Scheme assets	56.7	54.5
Re-measurement (loss)/gain on DB Scheme assets	200.9	(20.3)
	<u>257.6</u>	<u>34.2</u>
Actual return on DB Scheme assets		
Re-measurement in OCI	2016	2015
	£m	£m
Return on plan assets (in excess)/below of that recognised in net interest	(200.9)	20.3
Actuarial (gains)/losses due to changes in financial assumptions	311.5	(1.9)
Actuarial gains due to changes in demographic assumptions	-	(12.4)
Actuarial (gains)/losses due to liability experience	(25.9)	(5.6)
	<u>84.7</u>	<u>0.4</u>
Total amount recognised in OCI		
Reconciliation of funded status to balance sheet	2016	2015
	£m	£m
Fair value of scheme assets	1,754.4	1,541.3
Present value of funded defined benefit obligations	(1,722.9)	(1,453.2)
	<u>31.5</u>	<u>88.1</u>
Asset/(liability) recognised on the balance sheet		

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 DBO	Revised DBO
	£m	£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.

25. DIRECTORS' ADVANCES, CREDITS AND GUARANTEES

During the year, 2 directors (2015: 2) and 5 key personnel (2015: 6) utilised the services provided by NTFI. The amounts included in finance lease receivables owed by these directors and key personnel total £43,000 (2015: £30,000) in respect of non-current and £80,000 (2015: £15,000) in respect of current receivables.

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

26. RELATED PARTY DISCLOSURES

Group

Details of transactions between the Group and other related parties are disclosed below.

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

	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income/ (costs) from/(to) £'000	Borrowings to/(from) £'000
Related Party					
2016					
Integrated Utility Services Limited (registered in Eire)	-	(1,022)	165	-	-
Northern Powergrid Gas Limited	53	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,222)	-
Northern Powergrid Insurance Services Limited	-	-	-	-	-
Northern Powergrid (Yorkshire) plc	17,739	(11,311)	-	-	-
Vehicle Lease and Service Limited	175	(4,398)	418	617	-
Yorkshire Electricity Group plc	-	-	-	(7,073)	(102,930)
	<u>17,967</u>	<u>(16,731)</u>	<u>583</u>	<u>(12,674)</u>	<u>(102,930)</u>

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

26. RELATED PARTY DISCLOSURES - continued

	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income/ (costs from/(to) £'000	Borrowings to/(from) £'000
Related Party					
2015					
Integrated Utility Services Limited (registered in Eire)	7	(2,785)	82	-	-
Northern Powergrid Gas Limited	88	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,222)	-
Northern Powergrid Insurance Services Limited	-	(356)	-	-	-
Northern Powergrid (Yorkshire) plc	25,717	(10,664)	-	-	-
Vehicle Lease and Service Limited	229	(3,718)	417	628	-
Yorkshire Electricity Group plc	-	-	-	(6,045)	(100,238)
	<u>26,041</u>	<u>(17,523)</u>	<u>499</u>	<u>(11,639)</u>	<u>(100,238)</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.

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

26. RELATED PARTY DISCLOSURES - continued

Company

Details of transactions between the Company and other related parties are disclosed below.

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

	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income/ (costs) from/(to) £'000	Borrowings to/(from) £'000
Related Party					
2016					
Integrated Utility Services Limited	57	(556)	-	-	-
Northern Powergrid Gas Limited	88	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,228)	-
Northern Powergrid (Northeast) Limited	5,658	(35)	-	21,800	-
Northern Powergrid (Yorkshire) plc	4,915	-	-	-	-
Northern Transport Finance Limited	19	-	-	-	-
Vehicle Lease and Service Limited	138	-	-	491	-
Yorkshire Electricity Group plc	-	-	-	33	(62,160)
	<u>10,875</u>	<u>(591)</u>	<u>-</u>	<u>16,036</u>	<u>(62,160)</u>

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

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

26. RELATED PARTY DISCLOSURES - continued

	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income/ (costs from/(to) £'000	Borrowings to/(from) £'000
Related Party					
2015					
Integrated Utility Services Limited	60	(564)	-	-	-
Northern Powergrid Gas Limited	88	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,222)	-
Northern Powergrid (Northeast) Limited	6,018	(52)	-	20,600	-
Northern Powergrid (Yorkshire) plc	3,962	-	-	-	-
Northern Transport Finance Limited	20	-	-	-	-
Vehicle Lease and Service Limited	192	-	-	513	-
Yorkshire Electricity Group plc	-	-	-	195	24,322
	<u>10,340</u>	<u>(616)</u>	<u>-</u>	<u>15,086</u>	<u>24,322</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.

27. ULTIMATE CONTROLLING PARTY

The immediate parent undertaking of Northern Electric plc Group is Northern Powergrid Limited. The ultimate controlling party and ultimate parent undertaking of Northern Powergrid 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 plc Group and the group accounts of Northern Powergrid Holdings Company, the smallest company into which the results of Northern Electric plc consolidate 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.

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

28. RECONCILIATION OF PROFIT BEFORE INCOME TAX TO CASH GENERATED FROM OPERATIONS

Group

	2016	2015
	£'000	£'000
Profit before income tax	143,918	162,056
Depreciation charges	87,421	76,093
Profit on disposal of fixed assets	(522)	(474)
Amortisation of deferred revenue	(19,342)	(22,203)
Retirement benefit obligations	(28,753)	(38,514)
Decrease in provisions	(468)	(607)
Finance costs	39,139	36,198
Finance income	<u>(1,354)</u>	<u>(1,619)</u>
	220,039	210,930
Decrease/(increase) in inventories	615	(1,148)
Increase in trade and other receivables	(10,367)	(949)
Increase/(decrease) in trade and other payables	<u>7,593</u>	<u>(19,709)</u>
Cash generated from operations	<u>217,880</u>	<u>189,124</u>

Company

	2016	2015
	£'000	£'000
Profit before income tax	13,392	13,773
Depreciation charges	47	48
Increase/(decrease) in provisions	52	(35)
Finance costs	9,096	9,028
Finance income	<u>(22,347)</u>	<u>(21,308)</u>
	240	1,506
Decrease/(increase) in trade and other receivables	110	(119)
Increase/(decrease) in trade and other payables	<u>428</u>	<u>(3)</u>
Cash generated from operations	<u>778</u>	<u>1,384</u>

29. OTHER RESERVES

At the Company's Annual General Meeting in August 1994, the shareholders gave approval to on-market purchases of up to 10% of its shares and this was given effect on 21 September 1994 when 12,370,400 shares were purchased. This transaction resulted in the creation of a capital redemption reserve of £6.2m. Under section 831(4) of the Companies Act 2006 this reserve is treated as an un-distributable reserve.

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

32. NOTICE OF ANNUAL GENERAL MEETING

Notice is hereby given that the Annual General Meeting of Northern Electric plc will be held at Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF on Wednesday 21 June 2017 at 11.00 am

The following resolutions will be proposed as ordinary resolutions:

Resolution 1: To receive and consider the strategic, directors' and auditor's reports and the Group accounts for the year ended 31 December 2016.

Resolution 2: To declare that no final dividend be paid for the year ended 31 December 2016.

Resolution 3: To re-elect Mr P J Goodman as a director.

Resolution 4: To re-elect Dr J M France as a director.

Resolution 5: To re-elect Mr R Dixon as a director.

Resolution 6: To re-appoint Deloitte LLP as auditor until the conclusion of the next general meeting at which accounts are laid and to authorise the directors to determine their remuneration.

By order of the board
Jennifer Riley
Secretary
21 April 2017

Registered office:
Lloyds Court, 78 Grey Street,
Newcastle upon Tyne, NE1 6AF
Registered in England No 2366942

Note:

1. All the issued ordinary shares in the Company are held by or on behalf of Northern Powergrid Limited.
2. Holders of preference shares have the right to receive notice of, attend and speak at the Annual General Meeting but are only entitled to vote if, at the date of the notice of the meeting, payment of the dividend to which they are entitled is six months or more in arrears, or if a resolution is to be considered at the meeting for the winding up of the Company or abrogating, varying or modifying any of the special rights attaching to the preference shares. As none of these circumstances apply to this Annual General Meeting, preference shareholders should note that they do not have the right to vote on any of the business to be considered.
3. Members are entitled to appoint a proxy to exercise all or any of their rights on their behalf at the meeting. A shareholder may appoint more than one proxy in relation to the Annual General Meeting provided that each proxy is appointed to exercise the rights attached to a different share or shares held by the shareholder. A proxy need not be a shareholder of the Company.
4. Any person to whom this notice is sent who is a person nominated under section 146 of the Companies Act 2006 to enjoy information rights (a "Nominated Person") may, under an agreement between him/her and the shareholder by whom he/she was nominated, have a right to be appointed (or to have someone else appointed) as a proxy for the Annual General Meeting. If a nominated person does not have such a right or does not wish to exercise it, he/she may have a right under such an agreement to give instructions to the member as to the exercise of voting rights.
5. Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that they do not do so in relation to the same shares.
6. The current price of the Company's preference shares can be obtained from the web site of the London Stock Exchange at www.londonstockexchange.com.