

REGISTERED NUMBER: 02366942 (England and Wales)

**GROUP STRATEGIC REPORT, REPORT OF THE DIRECTORS AND
CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017**

**FOR
NORTHERN ELECTRIC PLC**

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FOR THE YEAR ENDED 31 DECEMBER 2017**

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NORTHERN ELECTRIC PLC GROUP

**COMPANY INFORMATION
FOR THE YEAR ENDED 31 DECEMBER 2017**

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**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

The directors present the annual reports and financial statements for the year ended 31 December 2017 of Northern Electric plc (the "Company") which have been drawn up and are presented in accordance with the Companies Act 2006.

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 ("NPg Metering"), collectively, (the "Group"). Northern Powergrid is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. As a distribution network operator ("DNO"), Northern Powergrid 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 NPg Metering rents meters to energy suppliers.


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

Core Principle	Strategic objective	Key Performance Indicators ("KPI")
 Financial strength	Strong finances that enable improvement and growth.	<ul style="list-style-type: none"> Profitability Maintenance of investment grade credit ratings Cash flow
 Customer service	Delivering exceptional customer service.	<ul style="list-style-type: none"> Broad measure of customer satisfaction Stakeholder Engagement and Customer Vulnerability rank
 Operational excellence	High-quality, efficient operators running a smart reliable energy system.	<ul style="list-style-type: none"> Customer Minutes Lost Customer Interruptions Network investment High voltage restoration time Customers with Power Cuts over 12 hours
 Employee commitment	High-performing people doing rewarding jobs in a safe and secure workplace.	<ul style="list-style-type: none"> Occupational Safety and Health Administration Rate Preventable Vehicle Accidents Lost time accidents Restricted duty accidents Medical treatment accidents Operational incidents Absence rate
 Environmental respect	Leaders in environmental respect and low carbon technologies.	<ul style="list-style-type: none"> Total Oil/Fluid Lost SF6 Gas discharges Environmental Incidents Carbon Footprint
 Regulatory integrity	Trustworthy, fair and balanced, creating win-win outcomes.	<ul style="list-style-type: none"> Quarterly certification process

Each of the core principles defined above has a strategic objective which is achieved through the delivery of a strategic focus, as set out in the Strategic Report. The level of success in achieving the strategic focus and therefore the delivery of each strategic objective is measured using KPI's.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR

	FINANCIAL STRENGTH		
Strategic objective	KPI	2016/17	2015/16
Strong finances that enable improvement and growth	Operating Profit	£180.2 million	£181.2 million
	Credit Rating (Standard & Poor's)	A	A
	Cash Flow	Operating activities	£159.6 million
		Investing activities	£168.9 million
		£(279.9) million	£(214.8) million

Strategic focus: To provide the financial resources to support long-term corporate stability.

Performance during the year: The Group continued to maintain good control in respect of both its capital and operating costs by effectively managing the financial risks that could have had an adverse impact on its business.

Revenue: The Group's revenue at £403.4 million was £18.5 million higher than the prior year due to higher smart meter rental income and engineering contracting revenue.

Operating profit and position at the year-end: The Group's operating profit of £180.2 million was £1.0 million lower than the previous year, primarily reflecting higher depreciation charges, increased business rates and pension costs, partially offset by higher metering profits. The statement of financial position on page 27 and 28 shows that, as at 31 December 2017, the Group had total equity of £1,111.8 million. The directors consider the Group to have a strong financial position which, when coupled with the preference of its parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy"), for operating with lower levels of debt than equivalent companies in the sector, creates a stable base for continued strong performance during the ED1 period.

Finance costs and investments: Finance costs net of investment income at £40.3 million were £1.2 million higher than the prior year due to the impact of a full year of 2016 financing and lower investment income.

Taxation: The effective tax rate in the year was 20.5%. Corporation tax of £21.3 million was paid in the year which was higher than the prior year of £8.6 million due to the conclusion of a tax claim with HM Revenue & Customs in 2016. Details of the income tax expense are provided in Note 7 to the financial statements.

Share capital: There were no changes to the Company's share capital during the year.

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 £159.6 million was £9.3 million lower than the previous year, mainly due to higher tax paid partially offset by higher operating profit before depreciation.
- Investing activities: Net cash used in investing activities at £279.9 million was £65.1 million higher than the prior year reflecting higher purchase of property, plant and equipment partly offset by higher customer contributions.
- Financing activities: The net cash from in financing activities at £136.4 million was £98.8 million higher than prior year reflecting smart meter financing in 2017 partially offset by a larger dividend payment in 2016 than in 2017.


**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR – continued

FINANCIAL STRENGTH - continued

Pensions: The Company is the principal employer of the Northern Powergrid Group of the Electricity Supply Pension Scheme (the "DB Scheme"), a defined benefit scheme. Full details of the Company's commitments to the DB Scheme and the associated deficit repair payments are provided in Note 27 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 employees, 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 are extremely important, given the contribution they make to the elimination or reduction of exposure to such risks.

	CUSTOMER SERVICE		
Strategic objective	KPI	2017	2016
Delivering exceptional customer service..	BMCS	87.2%	86.3%
	BMCS Rank	9	8
	BMCS Power Cuts	88.2%	87.5%
	BMCS General Enquiries	90.7%	90.1%
	BMCS Connections	85.1%	84.1%
	SECV rank (combined with Northern Powergrid (Yorkshire) plc)	3	5

Strategic focus: To improve the service delivered to customers.

Performance during the year: Under the broad measure of customer satisfaction ("BMCS"), an independent market research company carried out telephone surveys with Northern Powergrid's customers to find out how satisfied they were with services related to unplanned or planned power cuts, quotations and subsequent connections, and general enquiries. Northern Powergrid recorded an overall satisfaction score of 87.2%, which was comparable to the prior year (86.3%). The BMCS rank in 2017 of 9 showed a decline in comparison to the prior year (2016: 8). The change was attributed to a reduction in BMCS Connections performance which contributed towards half of the overall score. To further enhance the service provided to customers, a number of initiatives from the Northern Powergrid's customer experience improvement plan were implemented during the year. This included the continued development of the customer relationship management system and enhancing the self-service offerings available to customers.

Throughout the year, further improvements were made to the way in which the Contact Centre operates. The Quality Management Framework that was launched in 2016 to define the standards required of Contact Centre colleagues to deliver exceptional customer service was extended to incorporate the connections business. In addition, the Contact Centre was restructured to introduce a metering defect customer support team, designed to effectively support customers during the government's smart meter roll-out programme.

In May 2017, Northern Powergrid, together with its affiliate Northern Powergrid (Yorkshire) plc, put forward its SECV submission to the Office for Gas and Electricity Markets ("Ofgem") in respect of its work during the year. The submission provided an overview of initiatives including an increased focus on data quality which had resulted in cleansing Northern Powergrid's Priority Services Register ("PSR") and strengthening relationships with partners who deliver key services to customers. Following the submission to Ofgem's panel, the position of Northern Powergrid in the context of the wider DNO group increased from fifth place to third. The improvement demonstrated the effectiveness of the revised stakeholder engagement strategy launched in 2016.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

CUSTOMER SERVICE - continued

Connections to the network

Strategic focus: To further implement customer service improvements in support of the commitment to reduce routine, small works end-to-end connections lead times by 30% during the ED1 period, actively facilitate the development of competition from independent connections providers ("ICPs") and deliver the major works service improvement plan as part of the Ofgem Incentive on Connections Engagement ("ICE").

Performance during the year: Within connections services, work continued on the transformation of the small works connections business to improve customer service. A new process was implemented during January 2017 which introduced a single point of customer contact for the delivery of small works connections. In parallel the online service alterations process was overhauled to offer customers more choice in the way they receive a quotation.

Northern Powergrid continued to comply with the processes introduced by the Competition in Connections Code of Practice. This included 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.

During the year, Northern Powergrid began the delivery of 22 actions included in the major works service improvement plan as part of the ICE. Working proactively with customers and obtaining their feedback, Northern Powergrid formally increased the number of improvement actions to 31 during the mid-year return to Ofgem. All actions were completed and Ofgem determined that Northern Powergrid had met the assessment criteria for developing and delivering the ICE service improvement plan.

Corporate responsibility

Strategic focus: To build effective relationships with customers and other stakeholders whilst maximising the value of contact with customers, especially those who are vulnerable and hard to reach.

Performance during the year: Northern Powergrid worked closely with key partners such as the Environment Agency, local authorities and local resilience forums, particularly during periods of severe weather. Collaboration with stakeholders in the wider energy industry included the continued promotion of the national '105' number and preparation for the January 2018 overhead line safety campaign, an Energy Networks Association initiative, supported by DNOs.


With the assistance of the Social Issues Expert Group (which includes external experts and advisers) Northern Powergrid further developed the services provided to vulnerable customers including those on the PSR. To improve the accessibility and knowledge of the services available to vulnerable customers, a network of partners was established with community and third sector organisations.

Safety remains the Northern Powergrid Group's first priority and underpins all operations. Accordingly, the Northern Powergrid Group has maintained its support to charitable organisations and continued to sponsor the "Safety Champions" initiative, which is aimed at enhancing safety performance. Throughout the year, the Northern Powergrid Group engaged with thousands of school children through its series of safety events, and in addition, became the sponsor of the Cub Home Safety Activity Badge which has been designed to teach Cub Scouts about safety in and around the home.

Supporting customers through the use of tailored education programmes continued throughout 2017. Activity included Make the Grade in Energy, an education, skills and employability programme, Energy Heroes, targeted at primary school pupils to promote awareness of energy costs and ways of saving energy, and attendance at The Big Bang Fair which encourages young people to pursue science, technology, engineering and maths subjects.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

	OPERATIONAL EXCELLENCE				
Strategic objective	KPI	2016/17		2015/16	
		Actual	Target	Actual	Target
High-quality, efficient operators running a smart reliable energy system.	Customer Minutes Lost	45.0	<64.1	50.1	<65.9
	Customer Interruptions	53.3	<62.7	58.3	<63.8
	KPI	2017		2016	
		Actual		Actual	
	Network investment	£186.4 million		£181.3 million	
	High voltage restoration time	55.8 minutes		60.0 minutes	

Strategic focus: To provide, maintain and invest in an efficient distribution network that delivers electricity effectively. Enhancing the reliability of the network in support of the commitment to achieve 8% fewer unplanned power cuts and reduce the average length of unplanned power cuts by 20% during the ED1 period.

Performance during the year: Customer minutes lost ("CML") and customer interruptions ("CI") are the key performance indicators set by Ofgem and used by Northern Powergrid to measure the quality of supply and system performance. Both CML and CI are measured on a regulatory year basis which commences on 1 April of any given year and concludes on 31 March of the subsequent year. CML measures the average number of supply minutes lost for every connected customer due to both planned and unplanned power cuts that last for three minutes or longer. CI measures the average number of supply interruptions per every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer. In respect of these key customer service performance indicators, the goal is to achieve performance that is below Ofgem's target number. Northern Powergrid's performance during the most recent regulatory year was better than Ofgem's target for both CML and CI.


Northern Powergrid invested £186.4 million during the year through its approved network investment strategy (2016: £181.3 million), which has been designed to deliver improvements and increase the network's resilience. Various major projects were undertaken to reinforce the primary network, replace plant, refurbish transformers, rebuild overhead lines, remove and replace oil-filled cables, change deteriorated poles, replace switchgear and install and commission new remote control points.

Enhancements to the network continued through investment into the use of technology including the expansion of the automated power restoration system ("APRS"). 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's high-voltage restoration performance during the calendar year 2017 averaged some 55.8 minutes (2016: 60.0 minutes), after allowing for severe weather incidents and other exemptions.

Northern Powergrid aims to respond effectively to the needs of customers and local communities and to achieve the guaranteed standard for the restoration of supply: restoration within 12 hours of a power cut occurring under normal weather conditions. Northern Powergrid's major incident management procedure is utilised during severe weather events that affect the network. In the year, one such event occurred in January 2017, where high winds interrupted supplies to 42,000 customers across Northern Powergrid's network, 95% of whom had power restored within 12 hours.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

	EMPLOYEE COMMITMENT				
Strategic objective	KPI	2017		2016	
		Actual	Target	Actual	Target
High-performing people doing rewarding jobs in a safe and secure workplace.	Occupational Safety and Health Administration Rate Northern Powergrid Group	0.44	0.26	0.30	0.30
	Preventable Vehicle Accidents	12	13	11	10
	Lost time accidents	2	1	1	1
	Restricted duty accidents	1	0	0	1
	Medical treatment accidents	0	1	1	1
	Operational incidents	2	5	3	5
	Absence rate (Northern Powergrid Group)	2.9%		2.9%	

Health and Safety

Strategic focus: To deliver a comprehensive safety and health improvement plan ("SHIP") resulting in world class safety performance and achieve Northern Powergrid's commitment of halving its accident rate during the ED1 period.

Performance during the year: In common with the Berkshire Hathaway Energy group, the Northern Powergrid Group measures its safety performance in terms of the Occupational Safety and Health Administration ("OSHA") rate, which is a measure used in the United States to capture safety incidents down to minor levels of medical treatment. The Northern Powergrid Group missed its target OSHA rate of 0.26 (the equivalent of six recordable incidents) having reported ten recordable incidents. Whilst performance against the target was disappointing, Northern Powergrid's long term safety record suggests that it is one of the safest in its sector. This has been recognised in the form of a Gold President's Award from the Royal Society for the Prevention of Accidents for the achievement of 13 consecutive Gold Awards.

Improving safety performance remains a priority and the way in which this is achieved is set out in Northern Powergrid's SHIP. The SHIP focuses on leadership engagement, improving two-way communication on safety issues, supervisory oversight, ensuring managers and supervisors fulfil their safety inspection programmes and provide regular coaching and instruction to work teams, and workplace risk management, to develop competence in identification and risk mitigation methods.. These three areas are supported by driver training, operational safety seminars, stand-down briefings and regular safety reports and newsflashes.

Northern Powergrid's OHSAS 18001 health and safety management systems successfully retained certification.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

EMPLOYEE COMMITMENT - continued

Employees


Strategic focus: To effectively manage headcount whilst emphasising the importance of leadership and high standards of performance by engaging with employees and their trade union representatives.

Performance during the year: The Northern Powergrid Group 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. In support of this, a "speaking up" process is in place enabling all staff to raise concerns of unethical acts, malpractice or impropriety (including bribery or corruption), and an anonymous help line operated by an independent company is also available.

In order to support the well-being of its employees, the Northern Powergrid Group provides an independent employee assistance service to all staff. 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. Working with its occupational health provider, the Northern Powergrid Group is delivering a long-term programme aimed at improving the health of its staff.

During the year, 68 new recruits joined the Northern Powergrid Group workforce renewal programme, including for the first time, two Cyber Apprentices. In addition, 19 trainees graduated from their training programmes.

At 31 December 2017, the Group employed 1,112 staff (2016: 1,066).

	ENVIRONMENTAL RESPECT				
Strategic objective	KPI	2017		2016	
		Actual	Target	Actual	Target
Leaders in environmental respect and low carbon technologies.	Total Oil/Fluid Lost (litres)	14,066	<12,600	17,044	<17,142
	SF6 Gas discharges (kg)	33.33	34.00	14.17	28.00
	Environmental Incidents	1	<5	5	<7
	Carbon Footprint (tonnes)	33,007		33,552	

Strategic focus: Deliver Environmental "RESPECT" (Responsibility, Efficiency, Stewardship, Performance, Evaluation, Communication and Training) and in doing so achieve our commitment to reduce oil and fluid loss by 15% and reduce our business carbon footprint by 10% during the ED1 period.

Performance during the year: Northern Powergrid has operated a United Kingdom Accreditation Service scheme for environmental management since the late 1990s and is certified to the environmental management systems standard ISO 14001: 2015. The ISO 14001 standard is designed to enhance environmental performance, fulfil compliance obligations and achieve environmental objectives, all of which contribute to the achievement of the Group's KPIs. A full recertification assessment was carried out in March 2017 and a surveillance audit conducted in September 2017. Continued certification was confirmed following each audit.

Northern Powergrid's carbon footprint reporting framework is certified under the Certified Emissions Measurement and Reduction Scheme for compliance with ISO 14064-1:2006. The last full audit was undertaken in October 2017 where continued certification was confirmed. Initiatives including the implementation of telematics in fleet vehicles facilitated a further improvement in reducing Northern Powergrid's carbon footprint during the year to 33,007 tonnes (2016: 33,552 tonnes). In support of the target to further reduce oil and fluid loss, the 2017 annual environmental improvement plan included replacing fluid-filled cables and locating cable fluid leaks more quickly which resulted in a total fluid loss of 14,066 litres (2016: 17,044).

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

ENVIRONMENTAL RESPECT - continued

Northern Powergrid missed the total oil fluid loss target by approximately 12% due to a number of leaks from underground cables. Northern Powergrid continues to take steps and implement innovation solutions to minimise oil and fluid loss across the network. Additional activity to minimise the Northern Powergrid's impact on the environment included placing overhead lines underground in National Parks and Areas of Outstanding Natural Beauty and protecting wildlife and habitat.

Sustainability


Strategic focus: To help facilitate the United Kingdom's transition to a low-carbon economy in Northern Powergrid's capacity as a major participant in the United Kingdom energy industry and in terms of its own carbon footprint.

Performance during the year: As the country takes action to make significant reductions in its carbon emissions, the way in which electricity is produced and used is expected to have a substantial impact on the electricity network over time. This has already been seen through the number of low-carbon technology installations such as photovoltaic solar panels, electric vehicles and heat pumps. The volume and total capacity of decentralised energy generation has also been growing steadily and, given the greater range of load and generation technologies now 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.

From an innovation perspective, Northern Powergrid is running a portfolio of projects in the priority areas of smart grids, smart meters, digital-enabled customer service and affordability.

A partnership with Nissan is supporting new electric vehicle projects for the trialling of 'vehicle to grid' technology to enable car users to supply power to the electricity network. In addition, a new project was launched in the year to develop hybrid battery technology to expedite the restoration of the electricity supply following a power cut. Collaboration with Northern Gas Networks at the Integral demonstrator site continues to assess the potential future benefits of integrating both gas and electricity energy systems. Northern Powergrid is also scoping the role of distribution system operator ("DSO") with a new project to explore the value of the transition for customers and to understand the business changes that are required to realise those benefits.

The Northern Powergrid Group climate change adaptation strategy recognises the impact that climate change is anticipated to have on the business, the risks this poses and the proposed actions to mitigate these risks including vegetation management, network specifications for changing temperatures and improved weather prediction. The installation of flood defences is one such key activity that is already underway and the delivery of the committed programme in the ED1 period remains on track.

	REGULATORY INTEGRITY
Strategic objective	KPI
Trustworthy, fair and balanced, creating win-win outcomes.	Completion of a quarterly regulatory compliance affirmation process which comprises compliance with 1,950 regulatory obligations.

Strategic focus: To manage the Group's business to the highest behavioural standards and adhere to a policy of strict compliance with all relevant standards, legislation and regulatory conditions.

Performance during the year: Under the RHO (revenue = incentives + innovation + outputs) model for regulation, price controls are set for eight years with provision for a mid-period review if there are changes to 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. Northern Powergrid's base allowed revenue (excluding the effects of incentive schemes and any deferred revenues from the prior price control) before inflation reduced by 1.0% for the regulatory year ended 31 March 2017, relative to the previous regulatory year. Base allowed revenues before inflation remain constant for each subsequent regulatory year through to the 31 March 2023. Nominal base allowed revenues will increase in line with inflation (as measured by the United Kingdom's Retail Prices Index).

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

REVIEW OF THE YEAR - continued

REGULATORY INTEGRITY - continued

In order to assure compliance with licence and other regulatory obligations, Northern Powergrid operates a regulatory compliance affirmation process, under which ownership of approximately 1,950 regulatory obligations are assigned to around 80 responsible managers. Those responsible managers are required to review compliance with the relevant obligations on a quarterly basis and report on any identified non-compliances or perceived risks which are then addressed by members of the executive team. To minimise the risk of Northern Powergrid breaching its licence conditions and other statutory requirements (which could lead to financial penalties), the board of directors review the outcome of each quarter's exercise.

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

PRINCIPAL RISKS AND UNCERTAINTIES

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 support of its financial reporting practices. A robust system is in place to facilitate the identification of new risks, including those associated with the achievement of the Northern Powergrid Group's strategic objectives and Core Principles. Once identified, key risks and their respective controls and mitigation plans are continually assessed and formally reviewed by the Governance and Risk Management Group, which reports to the Audit Committee.

Supported by the internal audit function, the risk management programme includes regular reviews of the crisis management, disaster recovery and major incident plans. To determine the level of disaster preparedness and responsiveness against threats to business continuity, risk management plans and processes are periodically tested. This self-evaluation approach is reinforced by that of the Berkshire Hathaway Energy group, which continue to benchmark risk management activities across its business units and share significant lessons learned.

Category	Risk / Uncertainty	Mitigation
Financial	The Gas and Electricity Markets Authority ("GEMA") resetting the price control formula (which determines the maximum permitted revenue for each Regulatory Year) set out in the electricity distribution licence without the consent of the electricity distribution licence holder.	Appeal to the Competition and Markets Authority against a decision by GEMA to proceed with such a modification.
Financial	The Company's costs increase or change by more than RPI having a direct impact on the Company's financial results. The rate of inflation as measured by RPI is taken into account in setting the Company's allowed income in respect of each regulatory year.	The Company monitors performance against regulatory allowances including forecasts for the remainder of the price period and takes appropriate corrective action to ensure it lives within regulatory allowances.
Financial	Changes in performance under incentive schemes, such as those caused as a result of a decline in customer service performance, may lead to adjustments to allowed revenues.	Performance against incentives is routinely measured and management action taken to address any performance issues.
Financial	Interest rate risk – the exposure to uncertain future interest rates.	The Group is financed by long-term borrowings at fixed and floating rates and has access to short-term borrowing facilities at floating rates of interest. As at 31 December 2017, 99% of the Group's long-term borrowings were at fixed rates and the average maturity for these borrowings was 8 years. The Group uses interest rate swaps to mitigate exposure to uncertain future interest rates.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

PRINCIPAL RISKS AND UNCERTAINTIES - continued

Category	Risk / Uncertainty	Mitigation
Financial	Cost of the defined benefit pension schemes and the possible effect on the current deficit position.	The cost of the defined benefit pension scheme, including deficit repair payments, is managed in triennial cycles by negotiation with the trustees of the scheme. On-going and repair costs form part of the assessment of cost made by Ofgem in each price control, and if judged efficient, these costs are permitted to be recovered through revenues at a stable level to provide certainty for customers. The Company works with scheme trustees to ensure that scheme judgements reflect this indirect obligation to customers.
Financial	The existing Data Protection policies and procedures are not sufficient to comply with the additional requirements of the incoming General Data Protection Regulation ("GDPR") resulting in financial penalties and reputational damage.	A programme to identify the impact of GDPR and the actions required ahead of the regulation becoming effective is well underway and under regular review.
Financial	Trading risk - investments fail to deliver anticipated outcome.	The Company's policy is that no trading in financial instruments should be undertaken.
Financial / Operational	Major Incidents (including weather and terrorism attacks) causing network disruption resulting in customer service penalties and a reduction in the number of units delivered on which income is charged.	A number of major incident and crisis management policies, plans and governance arrangements are in place to react to and deal with such situations. In addition, an industry mutual aid agreement is in place.
Operational	Health and Safety incident - The electricity distribution business is inherently hazardous. Employees work at height, in closed spaces, alone and with live electricity, increasing the risk of potential safety incidents.	Health and Safety is given the highest priority within the Northern Powergrid Group and clear policies and procedures are in place both to ensure the safety of the employees and customers but also ensure compliance with relevant legislation. Health and safety training is provided to employees on a continuous basis through formal programmes, regular briefings and the sharing of best practice and lessons learnt between DNOs.
Operational	Cyber-attack or cyber-security breach affecting hardware, systems, customer data or intellectual property.	A robust cyber security risk mitigation programme is in place including accreditation under the ISO 27001 Information Security (process security) standard for certain discrete business areas and compliance with the Centre for Internet Security Critical Security Controls. Further advances are being continuously implemented and managed.
Operational	The take-up of low-carbon technologies and the resulting effect on the networks capacity.	In addition to smart grid deployment activity, Northern Powergrid has a range of innovation projects to develop and demonstrate future technologies and commercial practices. Northern Powergrid is considering how the transition to a DSO role could assist customers to connect more low carbon technologies.

**GROUP STRATEGIC REPORT
FOR THE YEAR ENDED 31 DECEMBER 2017**

PRINCIPAL RISKS AND UNCERTAINTIES - continued

Category	Risk / Uncertainty	Mitigation
Commercial	The emergence of increased competition in the electricity distribution market including the emerging role of DSO.	Northern Powergrid is setting out the policy position supporting the expanded role of DSO which is underpinned by electricity distributors being ideally placed to deliver benefits to customers from a DSO role and to maintain overall accountability for the stability of local networks.
Commercial	Credit control – protecting the Company from incurring bad debt and maintaining strong cash flow.	The Northern Powergrid Group requires strict adherence to credit checking, payment terms, payment performance tracking and debt management policies
Commercial	Credit-cover arrangements with electricity suppliers.	The relationship with energy suppliers, including credit-cover arrangements, is governed by a distribution connection and use of system agreement which sets out how creditworthiness will be determined and, as a result, whether the supplier needs to provide collateral.
Commercial	Availability of resource to deliver work programmes.	Northern Powergrid uses a mix of direct labour and contracted resource to facilitate the delivery of work programmes (including the capital expenditure programme).

Internal Control

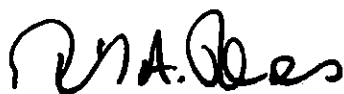
A rigorous internal control environment exists within the Northern Powergrid Group to support the financial reporting process, the key features of which include regular reporting, a series of operational and financial policy statements, investigations undertaken by internal audit and a stringent process for ensuring the implementation of internal audit recommendations. In addition, the Northern Powergrid Group utilises comprehensive business planning procedures, regularly reviews key performance indicators to assess progress towards its goals, and has a strong internal audit function to provide independent scrutiny. Financial controls include a centralised treasury operations and established procedures for the planning, approving and monitoring of major capital expenditure.

In accordance with Berkshire Hathaway Energy's requirements to comply with the United States Sarbanes-Oxley Act, the Northern Powergrid Group undertakes a quarterly risk control assessment 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.

The Northern Powergrid Group does not have a specific human rights policy. However, in accordance with the Core Principles, it remains fully committed to operating ethically and responsibly and with fairness and integrity. This is implemented through the policies and procedures it has in place which are applicable to all stakeholder groups and encompasses employees' health, safety and welfare, dealings with customers, particularly those who are vulnerable, the impact of the Northern Powergrid Group on the environment and the contribution to sustainability.

The Northern Powergrid Group is committed to maintaining the highest ethical standards in the conduct of its business and, implements Berkshire Hathaway Energy's code of business conduct, details of which can be found on page 8. The Northern Powergrid Group has robust procedures in place to meet the requirements of the Bribery Act 2010.

ON BEHALF OF THE BOARD:



P A Jones
Director

24 April 2018

**REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2017**

The directors present their report together with the strategic report, audited financial statements and the auditor's report of the Group for the year ended 31 December 2017.

DIVIDENDS

During the year, an interim dividend of £22.7 million was paid (2016: £100.0 million). The directors recommend that no final dividend be paid in respect of the year.

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

RESEARCH AND DEVELOPMENT AND FUTURE OUTLOOK

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. New activities initiated in the year included projects regarding the use of bi-directional power flow to electric vehicles, an improved methodology to determine the overall societal impact of network investment and operations, a project to understand and test cross-vector energy systems in collaboration with the regional gas distribution network operator and a project to explore and understand the technical and economic opportunities and implications of the DSO role.

During the year, the Group invested £1.3 million (2016: £0.8 million) (Note 6 to the accounts) in its research and development activities.

FUTURE DEVELOPMENTS

The financial position of the Group, as at 31 December 2017, is shown in the statement of financial position on pages 27 and 28.

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

- Northern Powergrid will continue to implement well-justified business plan and will develop its business by efficiently investing in the network and improving the quality of supply and service provided to customers.
- IUS will develop its business and in doing so concentrate on its core skills of engineering contracting by delivering a high standard of service to its existing and new clients.
- NPG Metering will retain its focus on pursuing opportunities in the market for meter asset provision as the smart meter roll-out programme develops.

There are no plans to change the existing business model of the Company, or any of the companies within the Group.

DIRECTORS

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

R Dixon	Non-executive Director (retired 26 October 2017)
T E Fielden	Finance Director
J M France	Regulation Director (resigned 5 April 2018)
T H France	General Counsel (appointed 28 March 2018)
P J Goodman	Executive Vice-President and Chief Financial Officer, Berkshire Hathaway Energy
P A Jones	President and Chief Executive Officer
J N Reynolds	Non-executive Director (appointed 26 October 2017)

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 2017**

FINANCIAL RISK MANAGEMENT

Details of financial risks are included in the Principal Risks and Uncertainties on pages 10, 11 and 12 of the Strategic Report and note 21 to the financial statements.

FINANCIAL DERIVATIVES

As at 31 December 2017, the Group held one derivative financial instrument (2016: nil) to mitigate the interest rate risk on a floating interest rate loan. More details on derivative instruments are available in Note 21 to the financial statements.

POLITICAL DONATIONS

No contributions were made to political organisations during the year (2016: £nil).

EMPLOYEES

Employee consultation

A constitutional framework agreed with trade union representatives exists in respect of employee consultation. The management team keep employees and trade union representatives informed of and involved as appropriate in developments that may impact them now or in the future.

Employee engagement continues to show improvement with local action plans augmented by routine communication channels including regular staff briefings, meetings with staff and their representatives, and utilising the Northern Powergrid Group's intranet.

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 regular electronic briefings.

Disabled employees

The Northern Powergrid 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 Northern Powergrid Group will make reasonable adjustments, wherever possible.

In accordance with Section 414c of the Companies Act 2006 disclosures concerning relations with employees and greenhouse gas emissions can be found on page 8 of the Strategic Report.

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).

DIRECTORS' BIOGRAPHIES

THOMAS E FIELDEN

Appointed in October 2009, Mr Fielden, 47, 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.

THOMAS H FRANCE

Appointed in March 2018, Mr France 33, joined the Northern Powergrid Group in November 2013 and he became General Counsel in July 2015. He is a solicitor, having qualified with Herbert Smith in their corporate energy and infrastructure team.

**REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2017**

DIRECTORS' BIOGRAPHIES

PATRICK J GOODMAN

Mr Goodman, 50, 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, 49, 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 is a director of the Energy Networks Association, the trade association that represents the power transmission and distribution companies.

JOHN N REYNOLDS

Appointed in October 2017, Mr Reynolds OBE, 51, is the Chief Executive Officer of Castle Water. Mr Reynolds became a director of Northern Powergrid Holding Company in January 2011 and was further appointed to Chairman of the audit committee in October 2017. He chairs the Market Operator Services Limited audit committee, is a Fellow of the Institution of Engineering & Technology and was a former commission member of the Water Industry Commission for Scotland. Mr Reynolds chaired the Church of England Ethical Investment Advisory Group and is the author of a number of books and articles on business ethics.

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.

DIVERSITY POLICY

The Northern Powergrid Group has adopted a number of policies (including the policy on diversity at work and code of business conduct) that collectively comprise the policy on diversity. Diversity is actively supported.

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 carries out the functions required by DTR 7.1.3 R.

Committee members:

J Reynolds	Non-Executive Director (appointed as Chairman on 26 October 2017)
R Dixon	Non-Executive Director (retired 26 October 2017)
T E Fielden	Finance Director

**REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2017**

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union. Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, International Accounting Standard 1 requires that directors:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Group 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 Company and Group, 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 the corporate and financial information included on the Company'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 13 in the Report of the Directors confirms that, to the best of their knowledge.

- a) the financial statements, 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 of the Company and the undertakings included in the consolidation taken as a whole; 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 and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties it faces.

NON FINANCIAL INFORMATION STATEMENT

In accordance with Section 414CB(7) of the Companies Act 2006, the directors have elected to set out the information required by Section 414CB (1) to (6) 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.

**REPORT OF THE DIRECTORS
FOR THE YEAR ENDED 31 DECEMBER 2017**

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:

- 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 9 years and has access to short-term committed borrowing facilities of £137m.

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

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



P A Jones
Director

24 April 2018

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

REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion on financial statements

In our opinion the financial statements:

- the financial statements give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2017 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union and IFRSs as issued by the International Accounting Standards Board (IASB);
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements of Northern Electric plc (the 'parent company') and its subsidiaries (the 'group') which comprise:

- the consolidated statement of profit or loss;
- the consolidated statement of profit or loss and other comprehensive income;
- the consolidated and company statements of financial position;
- the consolidated and company statements of changes in equity;
- the consolidated and company statements of cash flows; and
- the related notes to the financial statements 1 to 33

The financial reporting framework that has been applied in their preparation is applicable law and IFRSs as adopted by the European Union and, as regards the parent company financial statements, as applied in accordance with the provisions of the Companies Act 2006.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) (ISAs (UK)) and applicable law. Our responsibilities under those standards are further described in the auditor's responsibilities for the audit of the financial statements section of our report.

We are independent of the group and the parent company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the FRC's Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We confirm that the non-audit services prohibited by the FRC's Ethical Standard were not provided to the group or the parent company.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHERN ELECTRIC PLC - continued

Summary of audit approach

- Key audit matter The key audit matters that we identified in the current year was percentage allocation of overheads capitalised
- Materiality The materiality that we used in the current year was £7.0m which was determined on the basis of 5% of profit before tax for the year.
- Scoping The focus of our audit work was on the main regulated business, Northern Powergrid (Northeast) Ltd and the significant sub-consolidations in the group.

Conclusions relating to going concern

We are required by ISAs (UK) to report in respect of the following matters where:

- the directors' use of the going concern basis of accounting in preparation of the financial statements is not appropriate; or
- the directors have not disclosed in the financial statements any identified material uncertainties that may cast significant doubt about the company's ability to continue to adopt the going concern basis of accounting for a period of at least twelve months from the date when the financial statements are authorised for issue.

We have nothing to report in respect of these matters.

Key audit matters

Key audit matters are those matters that, in our professional judgement, were of most significance in our audit of the financial statements of the current period and include the most significant assessed risks of material misstatement (whether or not due to fraud) that we identified. These matters included those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team.

These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Overhead allocation

Key audit matter description	Total additions in the year across Northern Powergrid (Northeast) were £192m, which includes replacement of failed assets and overheads. Due to the potential for bias to be involved in making these estimates, the nature of expenditure capitalised by the distribution business is a key audit matter. A portion of overheads are capitalised to the extent they are considered to relate to capital additions that have taken place during the year.
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The calculation of capitalised overheads remains an area at risk of potential bias due to the level of subjectivity in the percentages of overheads capitalised. The key risk here being management's judgement in the percentage amounts capitalised are not reflective of the capital spend.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF NORTHERN ELECTRIC PLC - continued

Overhead allocation - continued

How the scope of the audit responded to the key audit matter

We have reviewed the capital spend in the year, the current policies in place and assessed their suitability in line with IAS 16, along with reviewing of the approach management takes towards assessing capitalised overheads and any changes introduced in the current year.

We have obtained relevant industry benchmarks for the proportions to capitalised, using these benchmarks to challenge management as to the appropriateness of their judgement.

We have evaluated the design and implementation of controls surrounding accounting for capital spend.

We have reviewed the overhead allocation model, including testing the underlying overhead expenditure being apportioned.

We have performed a substantive analytical review to consider whether the apportionment between entities is consistent with the prior year.

We have performed detailed testing of the total overheads included within the allocation model which are subsequently capitalised based on management's assessment of percentage allocation.

Key observations

No material differences were identified based upon the procedures above. We have therefore concluded management's overhead capitalisation judgement is reasonable, with policies applied being appropriate and consistent with prior year and IFRS requirements.

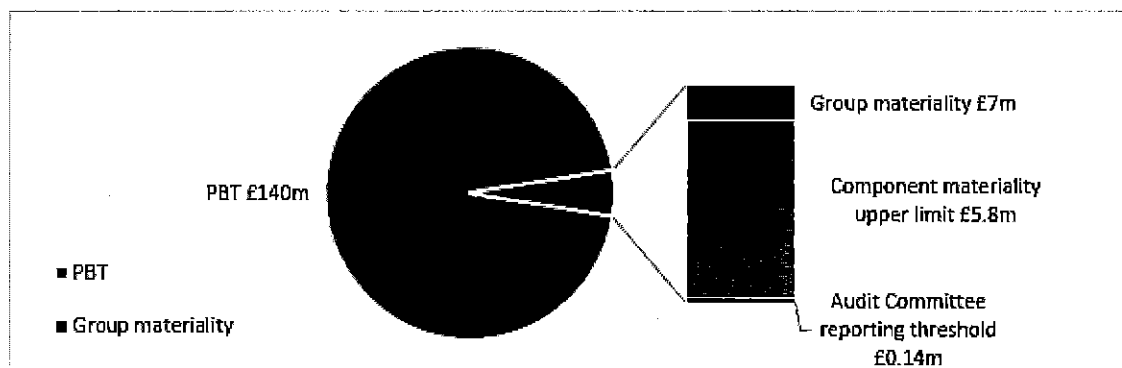
Our application of materiality

We define materiality as the magnitude of misstatement in the financial statements that makes it probable that the economic decisions of a reasonably knowledgeable person would be changed or influenced. We use materiality both in planning the scope of our audit work and in evaluating the results of our work

Based on our professional judgement, we determined materiality for the financial statements as a whole as follows:

Materiality	£7.0m
Basis for determining materiality	5% of profit before tax during the current year.
Rationale for the benchmark applied	The company's primary activity is to borrow funds to lend to other group companies. Therefore the interest income balance is considered to be a key driver of company activity.

Our application of materiality - continued



We agreed with the Board of Directors that we would report to the Board all audit differences in excess of £0.25m (2016: £0.30m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Board of Directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

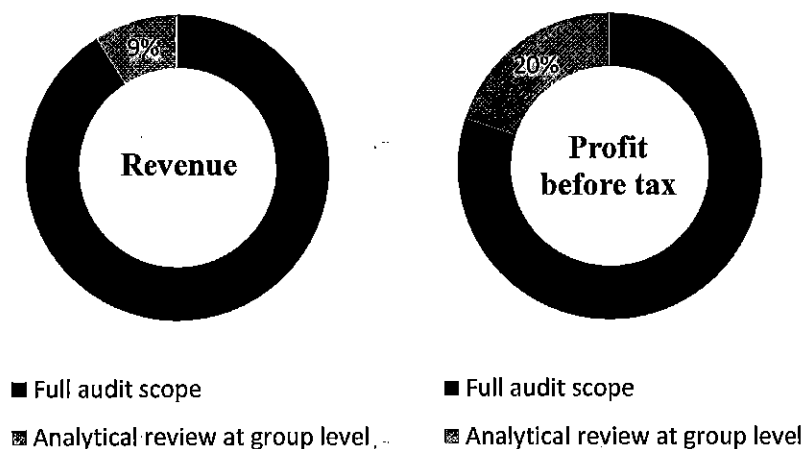
Our group audit was scoped by obtaining an understanding of the Group and its environment, including internal controls, and assessing the risks of material misstatement at the Group level. The operations of the group are mainly focused in the United Kingdom in the electricity distribution business, with some overseas assets in the oil and gas industry.

The focus of our audit work was on the main regulated business, Northern Powergrid (Northeast) Ltd, with work performed at a combination of the group's offices in the North East and Yorkshire regions, and we have audited the significant subconsolidations in the group. Other sizeable companies within the group include Integrated Utility Services Ltd, which provides contracting and maintenance services to the electricity, rail and water industries, and Northern Powergrid Metering Ltd which leases smart meters to energy providers.

At the Group level we have tested the consolidation process and carried out analytical procedures to confirm our conclusion that there were no significant risks of material misstatement of the aggregated financial information of the remaining components not subject to audit or audit of specified account balances.

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

An overview of the scope of our audit – continued



The majority of profit before tax not accounted for by our full scope audit procedures relates to consolidation adjustments which are tested in full as part of our audit procedures

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated.

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

Responsibilities of directors

As explained more fully in the directors' responsibilities statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the directors are responsible for assessing the group's and the parent company's ability to continue as a going concern, disclosing as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the group or the parent company or to cease operations, or have no realistic alternative but to do so.

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

REPORT ON OTHER LEGAL AND REGULATORY REQUIREMENTS

Auditor's responsibilities for the audit of the financial statements

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

A further description of our responsibilities for the audit of the financial statements is located on the Financial Reporting Council's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Use of our report

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

Opinions on other matters prescribed by the Companies Act 2006

In our opinion, based on the work undertaken in the course of the audit:

- the information given in the strategic report and the directors' report for the financial year for which the financial statements are prepared is consistent with the financial statements; and
- the strategic report and the directors' report have been prepared in accordance with applicable legal requirements.

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

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records	Under the Companies Act 2006 we are required to report to you if, in our opinion: <ul style="list-style-type: none">- we have not received all the information and explanations we require for our audit; or- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or- the financial statements are not in agreement with the accounting records and returns.	We have nothing to report in respect of these matters.
Directors' remuneration	Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.	We have nothing to report in respect of these matters.

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

Other Matters

Auditor tenure

Following the recommendation of the audit committee, we were appointed by the board of Northern Powergrid Holdings Company in 1998 to audit the financial statements for the year ending 31 December 1998 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 19 years, covering the years ending 31 December 1998 to 31 December 2017.

Consistency of the audit report with the additional report to the Board of Directors
Our audit opinion is consistent with the additional report to the Board of Directors we are required to provide in accordance with ISAs (UK).



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

25 April 2018

**CONSOLIDATED STATEMENT OF PROFIT OR LOSS
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
CONTINUING OPERATIONS			
Revenue	3	403,441	384,867
Cost of sales		<u>(41,615)</u>	<u>(43,336)</u>
GROSS PROFIT		361,826	341,531
Operating expenses	9	<u>(181,610)</u>	<u>(160,350)</u>
OPERATING PROFIT		180,216	181,181
Other gains		331	522
Finance costs	5	<u>(41,404)</u>	<u>(39,139)</u>
Finance income	5	<u>1,100</u>	<u>1,354</u>
PROFIT BEFORE INCOME TAX	6	140,243	143,918
Income tax	7	<u>(28,805)</u>	<u>(7,210)</u>
PROFIT FOR THE YEAR		<u>111,438</u>	<u>136,708</u>
Profit attributable to: Owners of the parent		<u>111,438</u>	<u>136,708</u>

The notes on pages 34 to 87 form part of these financial statements

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

**CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME
FOR THE YEAR ENDED 31 DECEMBER 2017**

	2017 £'000	2016 £'000
PROFIT FOR THE YEAR	111,438	136,708
OTHER COMPREHENSIVE INCOME		
Item that will not be reclassified to profit or loss:		
Re-measurement of net pension obligation	57,800	(84,700)
Income tax relating to item of other comprehensive income	<u>(9,262)</u>	<u>14,197</u>
	48,538	(70,503)
Item that may be reclassified subsequently to profit or loss:		
Cash flow hedge	(346)	-
Income tax relating to item of other comprehensive income	<u>59</u>	<u>-</u>
	(287)	-
OTHER COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR, NET OF INCOME TAX	<u>48,251</u>	<u>(70,503)</u>
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	<u>159,689</u>	<u>66,205</u>
 Total comprehensive income attributable to: Owners of the parent	 <u>159,689</u>	 <u>66,205</u>

The notes on pages 34 to 87 form part of these financial statements

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

**CONSOLIDATED STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	10	47,568	40,857
Property, plant and equipment	11	2,551,472	2,322,900
Investments	12	3,428	3,319
Pension asset	24	116,900	31,500
Trade and other receivables	15	6,358	8,406
		<u>2,725,726</u>	<u>2,406,982</u>
CURRENT ASSETS			
Inventories	13	13,382	12,836
Trade and other receivables	14	94,321	83,640
Cash and cash equivalents	15	16,612	515
Restricted cash	16	2,182	-
		<u>126,497</u>	<u>96,991</u>
TOTAL ASSETS		<u>2,852,223</u>	<u>2,503,973</u>
EQUITY			
SHAREHOLDERS' EQUITY			
Called up share capital	17	72,173	72,173
Share premium	18	158,748	158,748
Hedging reserves	18	(287)	-
Other reserves	18	6,185	6,185
Retained earnings	18	874,944	737,668
TOTAL EQUITY		<u>1,111,763</u>	<u>974,774</u>

The notes on pages 34 to 87 form part of these financial statements

CONSOLIDATED STATEMENT OF FINANCIAL POSITION - continued
31 DECEMBER 2017

	Notes	2017 £'000	2016 £'000
LIABILITIES			
NON-CURRENT LIABILITIES			
Trade and other payables	19	584,348	562,308
Borrowings	20	694,092	587,414
Derivative liability	21	327	-
Deferred tax	23	102,552	89,462
Provisions	22	1,690	1,803
		<u>1,383,009</u>	<u>1,240,987</u>
CURRENT LIABILITIES			
Trade and other payables	19	144,828	129,882
Borrowings	20	203,972	153,844
Derivative liability	21	19	-
Tax payable		7,421	3,764
Provisions	22	1,211	722
		<u>357,451</u>	<u>288,212</u>
TOTAL LIABILITIES		<u>1,740,460</u>	<u>1,529,199</u>
TOTAL EQUITY AND LIABILITIES		<u>2,852,223</u>	<u>2,503,973</u>

The financial statements were approved by the Board of Directors on 24 April 2018 and were signed on its behalf by:



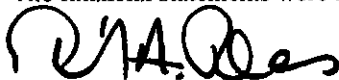
P A Jones
Director

COMPANY STATEMENT OF FINANCIAL POSITION
31 DECEMBER 2017

	Notes	2017 £'000	2016 £'000
ASSETS			
NON-CURRENT ASSETS			
Intangible assets	10	-	-
Property, plant and equipment	11	1,587	1,634
Investments	12	328,070	328,070
Deferred tax	23	137	-
		<u>329,794</u>	<u>329,704</u>
CURRENT ASSETS			
Trade and other receivables	14	3,762	317
Tax receivable		1,684	6,047
		<u>5,446</u>	<u>6,364</u>
TOTAL ASSETS		<u>335,240</u>	<u>336,068</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	14,797	23,391
TOTAL EQUITY		<u>251,903</u>	<u>260,497</u>
LIABILITIES			
NON-CURRENT LIABILITIES			
Borrowings	20	1,117	1,117
Deferred tax	23	-	2,758
		<u>1,117</u>	<u>3,875</u>
CURRENT LIABILITIES			
Trade and other payables	19	6,073	3,177
Borrowings	20	74,537	66,806
Provisions	22	1,610	1,713
		<u>82,220</u>	<u>71,696</u>
TOTAL LIABILITIES		<u>83,337</u>	<u>75,571</u>
TOTAL EQUITY AND LIABILITIES		<u>335,240</u>	<u>336,068</u>

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 £14.1 million (2016: £14.4 million).

The financial statements were approved by the Board of Directors on 24 April 2018 and were signed on its behalf by:



P A Jones
Director

The notes on pages 34 to 87 form part of these financial statements

**CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Called up share capital £'000	Retained earnings £'000	Share premium £'000	Hedging reserve £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2016	72,173	771,463	158,748	-	6,185	1,008,569
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>-</u>	<u>6,185</u>	<u>974,774</u>
Changes in equity						
Dividends	-	(22,700)	-	-	-	(22,700)
Total comprehensive income	-	159,976	-	(287)	-	159,689
Balance at 31 December 2017	<u>72,173</u>	<u>874,944</u>	<u>158,748</u>	<u>(287)</u>	<u>6,185</u>	<u>1,111,763</u>

The notes on pages 34 to 87 form part of these financial statements

**COMPANY STATEMENT OF CHANGES IN EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Called up share capital £'000	Retained earnings £'000	Share premium £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2016	72,173	107,480	158,748	6,185	344,586
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>
Changes in equity					
Dividends	-	(22,700)	-	-	(22,700)
Total comprehensive income	-	14,106	-	-	14,106
Balance at 31 December 2017	<u>72,173</u>	<u>14,797</u>	<u>158,748</u>	<u>6,185</u>	<u>251,903</u>

The notes on pages 34 to 87 form part of these financial statements

**CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
Cash flows from operating activities			
Cash generated from operations	31	225,498	217,880
Finance costs paid		(45,048)	(41,413)
Interest received		435	1,065
Tax paid		<u>(21,261)</u>	<u>(8,608)</u>
Net cash from operating activities		<u>159,624</u>	<u>168,924</u>
Cash flows used in investing activities			
Purchase of intangible fixed assets		(11,417)	(12,963)
Purchase of property, plant and equipment		(321,520)	(247,702)
Sale of property, plant and equipment		396	487
Customer contributions		52,141	44,896
Dividends received		<u>509</u>	<u>491</u>
Net cash used in investing activities		<u>(279,891)</u>	<u>(214,791)</u>
Cash flows from financing activities			
New loans in year		155,011	-
Movement in loans from Group		6,235	137,558
Movement in restricted cash		(2,182)	-
Equity dividends paid		<u>(22,700)</u>	<u>(100,000)</u>
Net cash from financing activities		<u>136,364</u>	<u>37,558</u>
Increase/(decrease) in cash and cash equivalents		16,097	(8,309)
Cash and cash equivalents at beginning of year		<u>515</u>	<u>8,824</u>
Cash and cash equivalents at end of year		<u><u>16,612</u></u>	<u><u>515</u></u>

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

**COMPANY STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2017**

	Notes	2017 £'000	2016 £'000
Cash flows from operating activities			
Cash generated from operations	31	1,091	778
Finance costs paid		(9,428)	(9,096)
Interest received		-	56
Dividends received		23,209	22,291
Tax received/(paid)		97	(2,885)
Net cash from operating activities		14,969	11,144
Cash flows used in financing activities			
Movement in borrowings in year		-	2,395
Movements in loans from Group		7,731	62,139
Equity dividends paid		(22,700)	(100,000)
Net cash used in financing activities		(14,969)	(35,466)
Decrease in cash and cash equivalents		-	(24,322)
Cash and cash equivalents at beginning of year		-	24,322
Cash and cash equivalents at end of year		-	-

The notes on pages 34 to 87 form part of these financial statements

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
FOR THE YEAR ENDED 31 DECEMBER 2017**

1. GENERAL INFORMATION

Northern Electric plc (the "Company") is a private company limited by shares 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.

Entities not controlled by the Company and its subsidiaries are recognised at their fair value through profit or loss.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

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.

Application of new and revised IFRS

In the current year, the Company has a number of amendments to IFRS issued by the International Accounting Standards Board ("IASB") that are mandatorily effective for an accounting period that begins on or after 1 January 2017:

Amendments to IAS 1

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.

In addition the amendments clarify that an entity's share of its other comprehensive income of associates and joint ventures accounted for using the equity method should be presented separately from those arising from the Group.

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

Amendments to IAS 7

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 has had no material impact on the Company's financial statements.

Amendments to IAS 12

The amendments to IAS 12 Income Taxes clarify when a deferred tax asset should be recognised for unrealised losses. The application of the amendments has not resulted in any impact on the financial performance or financial position of the Company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Amendments to IAS 16 and IAS 38

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. As the Group already uses the straight-line method for depreciation and amortisation for its property, plant and equipment and intangible assets, respectively, the adoption of these amendments has had no impact on the Group's consolidated financial statements.

Amendments to IAS 27

The amendments focus on separate financial statements and allow the use of the equity method in such statements. Specifically amendments allow an entity to account for investments in subsidiaries, associates and joint ventures in its separate financial statements. Additionally the amendments also clarify that when a parent ceases to be an investment entity, or becomes an investment entity, it should account for the change from the date when the change in status occurs. The adoption of the amendments has had no impact on the Company's separate financial statements as the Company accounts for investments in subsidiaries and associates at cost.

Annual Improvements to IFRSs 2014-2016 Cycle

The annual improvements to IFRSs 2014-2016 Cycle include a number of amendments to IFRSs. The application of these amendments has had no effect on the Company's financial statement.

New and revised standards in issue but not yet effective

The Company has not applied the following new and revised IFRS that have been issued but are not yet effective for the year ended 31 December 2017:

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 a material impact on amounts reported in respect of the Company's financial assets and financial liabilities.

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. On the whole the directors anticipate that the application of IFRS 15 will not have a material impact on the Company's financial statements, however there is ongoing discussion in the industry and amongst the accounting professions to consider the appropriate accounting treatment for customer contributions towards distribution system assets. We continue to engage in these conversations and will evaluate and conclude prior to the application of the standard.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES - continued

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 2017, the Company has non-cancellable operating lease commitments of £24.0 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. The directors of the Company anticipate that the application of IFRS 16 is unlikely to have a material impact on amounts reported in the statement of profit or loss.

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:

- 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 the costs and their cost drivers which is reviewed on annual basis. The percentage allocation of overheads across the workstream categories are obtained from section managers who are asked to provide reasoning and supporting evidence for the allocation. Finance then undertake a financial impact assessment review and the rationale to ensure it complies with IFRS:

The amount of overheads capitalised in the year was £40.0m (2016: £38.3m)

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 evaluation long-term pension plans, these assumptions and their possible impacts are disclosed in note 24.

Operating profit

Operating profit is stated after charging restructuring costs and after the share of results of associates but before investment income and finance costs.

Investments in subsidiaries

Investments in subsidiaries are account for at cost less impairment.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES - continued

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, 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.

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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Software development costs

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

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use are added to the cost of those assets, until such time as the assets are substantially ready for their intended use.

All other borrowing costs are recognised in profit or loss in the period which they are incurred.

Property, plant and equipment

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

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

Distribution system:

Distribution system assets	45 years
Distributed generation assets	15 years
Information technology equipment included in distribution system assets	up to 10 years

Metering equipment up to 10 years

Non-operational land & buildings:

Buildings - freehold	up to 60 years
Buildings - leasehold	lower of lease period or 60 years

Fixtures and equipment: up to 10 years

Freehold land is not depreciated.

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

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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

2. ACCOUNTING POLICIES - continued

Internally-generated intangible assets

An internally generated intangible asset arising from development is recognised if the conditions set out in IAS 38 relating to the recognition of intangible assets are met. The amount initially recognised for internally-generated intangible asset is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria. Amortisation is recognised on a straight-line basis over their estimated useful lives.

Impairment of tangible and intangible assets

At the balance sheet date, the Company reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated to determine the extent of the impairment loss (if any). Where the asset does not generate cash flows that are independent from other assets, the group estimates the recoverable amount of the cash-generating unit to which the asset belongs.

An intangible asset with an indefinite useful life is tested for impairment at least annually and whenever there is an indication that the asset may be impaired.

Where the recoverable amount is estimated to be less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. An impairment loss is recognised immediately in profit or loss.

Financial instruments

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

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

Financial liabilities are either recognised as financial liabilities at fair value through profit or loss, or as other liabilities. A financial liability is classified at FVTPL when the financial liability is either held for trading or it is designated at FVTPL. An asset is designated at FVTPL if such designation eliminates or substantially reduces a measurement or recognition inconsistency that would otherwise arise.

Other financial liabilities, including borrowings, are initially recognised at fair value, net of transaction costs and subsequently measured at amortised cost using the effective interest method, with interest expense recognised on an effective yield basis.

Derivative Financial Instruments

Derivative financial instruments are initially recognised at fair value and subsequently remeasured at fair value at each reporting date. Changes in fair values are recorded in the period they arise, in either the income statement or other comprehensive income depending on the applicable accounting standards. Where the fair value of a derivative is positive it is carried as a derivative asset, and where negative as a derivative liability. The fair value of the financial derivatives is calculated by discounting all future cash flows using the market yield curve at the reporting date. The market yield curve for each currency is obtained from external sources. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives.

The Group designates certain hedging instruments as cash flow hedges. At inception of the hedge and on an ongoing basis the group documents whether the hedging instrument is highly effective in offsetting changes in cash flows of the hedged item. The effective portion of changes in fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is immediately recognised in profit or loss. Amounts previously recognised in other comprehensive income and accumulated in equity are reclassified to profit or loss in the periods when the hedged item is recognised in profit or loss. Hedge accounting is discontinued when the Group revokes the hedging relationship, the hedging instrument expires or no longer qualifies for hedge accounting. Any gain or loss recognised in other comprehensive income at that time is accumulated in equity and is recognised when the forecast transaction is ultimately recognised in profit or loss.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES - continued

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 leased vehicles which have been returned 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 statement of profit or loss because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Company's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

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

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

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.

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.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES - continued

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.

Pensions

The Group contributes to the DB Scheme a defined benefit scheme.

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

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

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

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

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

2. ACCOUNTING POLICIES - continued

Financial assets

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

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

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

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

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

For certain categories of financial assets, such as trade receivables, assets are assessed for impairment on a collective basis even if they were assessed not to be impaired individually. Objective evidence of impairment for a portfolio of receivables could include the 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

Reportable segments are those that meet two or more of the following criteria under IFRS 8:

- Its reported revenue is 10% or more of the combined revenue of all segments;
- The absolute measure of its profit or loss is 10% or more of the combined reported profit; and
- Its assets are 10% or more of the combined assets of all segments.

"Other" comprises business support units.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

3. SEGMENTAL REPORTING – continued

	Distribution	Contacting	Metering	Other	Consolidation adjustments	Total
	2017 £m	2017 £m	2017 £m	2017 £m	2017 £m	2017 £m
Revenue						
External Sales	328.0	33.0	37.5	4.9	-	403.4
Inter-segment sales	0.3	3.7	-	3.4	(7.4)	-
Total Revenue	<u>328.3</u>	<u>36.7</u>	<u>37.5</u>	<u>8.3</u>	<u>(7.4)</u>	<u>403.4</u>
Segment results						
Operating profit/(loss)	<u>137.1</u>	<u>3.1</u>	<u>14.2</u>	<u>2.4</u>	<u>23.4</u>	180.2
Other gains						0.3
Finance costs						(41.4)
Finance income						<u>1.1</u>
Profit before tax						<u>140.2</u>
Other information						
Capital additions	203.0	-	137.3	-	(2.5)	337.8
Depreciation and amortisation	82.0	-	22.2	-	(1.6)	102.6
Amortisation of revenue	<u>(21.2)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(21.2)</u>
Statement of financial position						
Segment assets	<u>2,462.4</u>	<u>16.2</u>	<u>278.2</u>	<u>15.4</u>	<u>57.8</u>	2,830.0
Unallocated assets						<u>22.2</u>
Total assets						<u>2,852.2</u>
Segment liabilities	<u>(694.3)</u>	<u>(8.3)</u>	<u>(22.7)</u>	<u>(4.6)</u>	<u>(2.6)</u>	(732.5)
Unallocated liabilities						<u>(1,007.9)</u>
Total liabilities						<u>(1,740.4)</u>
Net assets by segment	<u>1,768.1</u>	<u>7.9</u>	<u>255.5</u>	<u>11.0</u>	<u>55.2</u>	2,097.5
Unallocated net liabilities						<u>(985.7)</u>
Total net assets						<u>1,111.8</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

3. SEGMENTAL REPORTING – continued

	Distribution	Contacting	Metering	Other	Consolidation adjustments	Total
	2016 £m	2016 £m	2016 £m	2016 £m	2016 £m	2016 £m
Revenue						
External Sales	332.5	27.7	19.2	5.5	-	384.9
Inter-segment sales	0.5	2.0	-	3.6	(6.1)	-
Total Revenue	333.0	29.7	19.2	9.1	(6.1)	384.9
Segment results						
Operating profit/(loss)	153.5	(3.9)	7.4	0.3	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 revenue	(19.3)	-	-	-	-	(19.3)
Statement of financial position						
Segment assets	2,340.6	17.5	156.5	17.5	(32.0)	2,500.1
Unallocated assets						3.8
Total assets						2,503.9
Segment liabilities	(666.6)	(9.8)	(14.2)	(5.8)	1.7	(694.7)
Unallocated liabilities						(834.4)
Total liabilities						(1,529.1)
Net assets by segment	1,674.0	7.7	142.3	11.7	(30.3)	1,805.4
Unallocated net liabilities						(830.6)
Total net assets						974.8

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

3. SEGMENTAL REPORTING – continued

	2017 £'000	2016 £'000.
Distribution revenue	327,959	332,480
Engineering contracting	33,036	27,737
Meter asset rental	37,482	19,183
Other	4,964	5,467
	<u>403,441</u>	<u>384,867</u>

Unallocated corporate assets and liabilities include cash and cash equivalents (2017: £16.6 million, 2016: £0.5 million), borrowings (2017: £742.8 million, 2016: £741.2 million) and taxation (2017: £110.0 million, 2016: £93.0 million).

External sales to RWE Npower plc in 2017 of £69.3 million (2016: £76.3 million) and British Gas plc in 2017 of £48.3 million (2016: £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 £116.9m retirement benefit asset (2016: £31.5 million liability).

4. EMPLOYEES AND DIRECTORS

	2017 £'000	2016 £'000
Salaries	63,699	63,030
Social security costs	7,049	7,004
Defined benefit pension costs	(869)	(2,458)
Defined contribution pension costs	2,312	1,893
	<u>72,191</u>	<u>69,469</u>
Less charged to property, plant and equipment	<u>(41,372)</u>	<u>(42,129)</u>
	<u>28,495</u>	<u>27,340</u>

A large number of the Group's employees are members of the DB Scheme, details of which are given in the Employee Benefit Obligations note 27.

The average monthly number of employees during the year was:

	2017 No.	2016 No.
Distribution	1,072	1,066
Engineering Contracting	159	160
Other	29	44
	<u>1,260</u>	<u>1,270</u>

The company had an average of 29 employees during the year (2016: 44).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

4. EMPLOYEES AND DIRECTORS - continued

DIRECTORS' REMUNERATION

	2017 £'000	2016 £'000
Highest Paid:		
Short-term employee benefits	402	342
Post-employment benefits	-	11
Other long-term benefits	466	396
	<u>868</u>	<u>749</u>
Total:		
Short-term employee benefits	628	551
Post-employment benefits	3	23
Other long-term benefits	587	562
	<u>1,218</u>	<u>1,136</u>
Directors who are a member of the defined benefit scheme	-	2
Directors who are a member of the defined contribution scheme	1	1
	<u>-</u>	<u>-</u>
Accrued pension benefit relating to highest paid director	-	-

OTHER KEY PERSONNEL REMUNERATION

	2017 £'000	2016 £'000
Total:		
Short-term employee benefits	528	520
Post-employment benefits	124	111
Other long-term benefits	314	316
	<u>966</u>	<u>947</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.

5. NET FINANCE COSTS

	2017 £'000	2016 £'000
Finance income:		
Interest in joint venture	619	254
Dividends received	46	37
Interest on tax refund	-	388
Deposit account interest	52	58
Interest receivable on loans to Group undertakings	383	617
	<u>1,100</u>	<u>1,354</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

5. NET FINANCE COSTS - continued

	2017 £'000	2016 £'000
Finance costs:		
Bank interest	326	113
Interest payable on other loans	27,627	25,612
Interest payable on loans from Group undertakings	7,238	7,073
Preference dividends payable	9,001	9,001
Capitalised interest	<u>(2,788)</u>	<u>(2,660)</u>
	<u>41,404</u>	<u>39,139</u>
Net finance costs	<u>40,304</u>	<u>37,785</u>

6. PROFIT BEFORE INCOME TAX

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

	2017 £'000	2016 £'000
Depreciation - owned assets	97,845	83,737
Software development costs amortisation	4,706	3,730
Foreign exchange differences	(9)	(40)
Research costs	1,479	830
Amortisation of deferred revenue	(21,210)	(19,342)
Impairment of trade and other receivables	361	440
Profit on disposal of property, plant and equipment	<u>(331)</u>	<u>(522)</u>

Analysis of auditor's remuneration is as follows:

	2017 £'000	2016 £'000
Fees payable to the Company's auditor for the audit of the Company's annual accounts	26	26
Fees payable to the Company's auditor for the audit of the Company's subsidiaries pursuant to legislation	<u>205</u>	<u>208</u>
Total audit fees	<u>231</u>	<u>234</u>
Audit of regulatory reporting	45	45
Other services	<u>22</u>	<u>-</u>
Total auditor's remuneration	<u>298</u>	<u>279</u>

	2017 £'000	2016 £'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>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

7. INCOME TAX

Analysis of tax expense

	2017 £'000	2016 £'000
Current tax	30,174	14,030
Deferred tax	<u>(1,369)</u>	<u>(6,820)</u>
Total tax expense in consolidated statement of profit or loss	<u>28,805</u>	<u>7,210</u>

Factors affecting the tax expense

The tax assessed for the year is higher (2016 - lower) than the standard rate of corporation tax in the UK. The difference is explained below:

	2017 £'000	2016 £'000
Profit before income tax	<u>140,243</u>	<u>143,918</u>
Profit multiplied by the standard rate of corporation tax in the UK of 19.25% (2016 - 20.00%)	26,997	28,784
Effects of:		
Permanent items/non-taxable income	(149)	(130)
Tax effect of result of joint venture	(119)	(51)
Under/(over) provision	2,385	(2,520)
Agreement of prior year tax claim	-	(13,817)
Release of deferred tax in respect of prior year holdover relief claims due to asset reinvestment	(1,369)	-
Effect of difference between corporation and deferred tax rate	(1,269)	-
Effect of changes in tax rates	-	(7,651)
Pension contributions recognised in Other Comprehensive Income ("OCI")	588	789
Non-deductible interest expense	1,733	1800
Other	<u>8</u>	<u>6</u>
Tax expense	<u>28,805</u>	<u>7,210</u>

Included within the prior year under-provision of £2.4m is a net current and deferred tax amount of £2.5m in relation to an initial assessment which the company has undertaken on the availability of business asset replacement relief to shelter historic chargeable gains. This under provision may reduce in future periods following the completion of the assessment by the company.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

7. INCOME TAX - continued

	2017 £'000	2016 £'000
Tax expense comprises:		
Current tax expense:		
Corporation tax charge for the year	26,477	28,907
Under/(over) provision for prior years	<u>3,697</u>	<u>(14,877)</u>
Total current tax charge	30,174	14,030
Deferred tax:		
Deferred tax expenses relating to the origination and reversal of temporary differences	(1,369)	831
Effect of changes in tax rates	<u>-</u>	<u>(7,651)</u>
Total deferred tax credit	<u>(1,369)</u>	<u>(6,820)</u>
Tax on profit before tax	<u><u>28,805</u></u>	<u><u>7,210</u></u>

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

8. DIVIDENDS

	2017 £'000	2016 £'000
Interim dividend paid at 18p per share (2016: 78p)	<u>22,700</u>	<u>100,000</u>

9. OPERATING EXPENSES

Operating expenses comprise:

	2017 £'000	2016 £'000
Distribution costs	107,931	101,879
Administrative expenses	<u>73,679</u>	<u>58,471</u>
	<u><u>181,610</u></u>	<u><u>160,350</u></u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

10. INTANGIBLE ASSETS

Group

	Software development costs £'000
COST	
At 1 January 2017	78,467
Additions	<u>11,417</u>
At 31 December 2017	<u>89,884</u>
AMORTISATION	
At 1 January 2017	37,610
Amortisation for year	<u>4,706</u>
At 31 December 2017	<u>42,316</u>
NET BOOK VALUE	
At 31 December 2017	<u>47,568</u>

	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>

The Company had no intangible assets at 31 December 2017 (2016: £nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

11. 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 2017	6,534	3,043,253	72,740	222,913	3,345,440
Additions	-	186,418	2,700	137,299	326,417
Disposals	-	(7,024)	(423)	-	(7,447)
At 31 December 2017	<u>6,534</u>	<u>3,222,647</u>	<u>75,017</u>	<u>360,212</u>	<u>3,664,410</u>
DEPRECIATION					
At 1 January 2017	6,078	880,212	60,003	76,247	1,022,540
Charge for year	103	70,094	4,007	23,641	97,845
Eliminated on disposal	-	(7,024)	(423)	-	(7,447)
At 31 December 2017	<u>6,181</u>	<u>943,282</u>	<u>63,587</u>	<u>99,888</u>	<u>1,112,938</u>
NET BOOK VALUE					
At 31 December 2017	<u>353</u>	<u>2,279,365</u>	<u>11,430</u>	<u>260,324</u>	<u>2,551,472</u>

	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>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

11. PROPERTY, PLANT AND EQUIPMENT - continued

Group

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>
Additions	188,871	2,694	191,565
Available for use	<u>(148,049)</u>	<u>(2,694)</u>	<u>(150,743)</u>
At 31 December 2017	<u>211,489</u>	<u>-</u>	<u>211,489</u>

The Group has entered into contractual commitments in relation to the future acquisition of property, plant and equipment of £19.6 million (2016: £32.8 million).

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

	2017 £'000	2016 £'000
Long leasehold	264	363
Short leasehold	<u>89</u>	<u>93</u>
	<u>353</u>	<u>456</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

11. PROPERTY, PLANT AND EQUIPMENT - continued

Company

	Non operational land and buildings £'000	Distribution system £'000	Fixtures and fittings £'000	Totals £'000
COST				
At 1 January 2017 and 31 December 2017	<u>280</u>	<u>1,259</u>	<u>3,634</u>	<u>5,173</u>
DEPRECIATION				
At 1 January 2017	35	-	3,504	3,539
Charge for year	<u>7</u>	<u>-</u>	<u>40</u>	<u>47</u>
At 31 December 2017	<u>42</u>	<u>-</u>	<u>3,544</u>	<u>3,586</u>
NET BOOK VALUE				
At 31 December 2017	<u>238</u>	<u>1,259</u>	<u>90</u>	<u>1,587</u>
	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>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

12. INVESTMENTS

Group	Share of joint venture's net assets £'000	Shares in other undertakings £'000	Total £'000
At 31 December 2016	3,297	21	3,318
Profit attributable to the Group	619	-	619
Dividends	(509)	-	(509)
At 31 December 2017	<u>3,407</u>	<u>21</u>	<u>3,428</u>

Company	Subsidiary undertakings £'000	Shares in other undertakings £'000	Total £'000
At 31 December 2016	327,099	971	328,070
Movement	-	-	-
At 31 December 2017	<u>327,099</u>	<u>971</u>	<u>328,070</u>

Details of the investments of the Group at 31 December 2017 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 PLC (REGISTERED NUMBER: 02366942)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

12. INVESTMENTS – continued

Name of company	Holding of shares	Proportion of voting rights and shares held	Nature of business
Northern Electric Share Scheme Trustee Limited	2 at £1	100%	Dormant
Northern Electricity (North East) Limited	1 at £1	100%	Dormant
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
Northern Powergrid (Northeast) Limited	200,000,100 at £1	100%	Distribution of 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

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

12. INVESTMENTS – continued

Name of company	Holding of shares	Proportion of voting rights and shares held	Nature of business
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

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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All subsidiaries are registered in England and Wales, and except where indicated, the registered office address of the above companies is Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF. Except where stated share holdings are ordinary shares.

Interest in Joint venture

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

	2017 £'000	2016 £'000
Long-term assets	19,244	16,192
Current assets	12,322	15,706
Long-term liabilities	(13,424)	(14,962)
Current liabilities	(11,328)	(10,340)
Net assets	<u>6,814</u>	<u>6,596</u>
Group's share of joint venture's net assets	<u>3,407</u>	<u>3,298</u>
Revenue	<u>18,711</u>	<u>18,417</u>
Profit for the year	<u>1,238</u>	<u>508</u>
Group's share of joint venture's profit for the year	<u>619</u>	<u>254</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

13. INVENTORIES

	Group	
	2017	2016
	£'000	£'000
Inventory	12,284	11,853
Work-in-progress	799	232
Vehicle Inventory	299	751
	<u>13,382</u>	<u>12,836</u>

The Company had no inventories at 31 December 2017 (2016 - £nil).

14. TRADE AND OTHER RECEIVABLES

	Group		Company	
	2017	2016	2017	2016
	£'000	£'000	£'000	£'000
Current:				
Distribution use of system receivables	49,140	50,524	-	-
Construction contract customers	6,205	2,160	-	-
Amounts due from customers for contract work	9,721	12,542	-	-
Amounts receivable in respect of finance leases	8,041	8,047	-	-
Social security and other taxes	-	-	3,487	-
Other debtors	286	-	-	-
Amounts receivable for sale of goods and services	16,895	8,339	60	65
Prepayments and accrued income	4,888	2,786	215	252
Allowance for doubtful debts	(855)	(758)	-	-
	<u>94,321</u>	<u>83,640</u>	<u>3,762</u>	<u>317</u>
Non-current:				
Amounts receivable in respect of finance leases	<u>6,358</u>	<u>8,406</u>	<u>-</u>	<u>-</u>
Aggregate amounts	<u>100,679</u>	<u>92,046</u>	<u>3,762</u>	<u>317</u>

The directors consider that the carrying amount of trade and other receivables approximates their fair value calculated by discounting the future cash flows at the market rate at 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

14. TRADE AND OTHER RECEIVABLES - continued

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 21% of distribution revenues in 2017 (2016: 22%) and British Gas plc accounting for approximately 14% of distribution revenues in 2017 (2016: 15%). 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 £0.9 million as at 31 December 2017 (2016: £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 £0.4 million, which have been placed into administration and have therefore been provided in full at the year-end (2016: £0.2m).

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 (2016: £3.3 million), which are past due at the reporting date for which the Group has provided for an irrecoverable amount of £0.3 million (2016: £0.3 million) based on experience. The Group does not hold collateral over these balances. The average age of these receivables is 91 days (2016: 55 days).

Included in the Group's construction contracts balance are debtors with a carrying amount of £nil (2016: £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:

	2017 £'000	2016 £'000
Contract costs incurred plus recognised profits less recognised losses to date	48,851	70,382
Less: progress billings	(39,130)	(57,840)
Amount due from customers	<u>9,721</u>	<u>12,542</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

14. **TRADE AND OTHER RECEIVABLES - continued**

At 31 December 2017, retentions held by customers for contract work amounted to £0.3 million (2016: £0.3 million).

Advances received from customers for contract work amounted to £nil (2016: £nil).

The Company had no construction contracts at 31 December 2017 (2016: £nil).

Finance lease receivables

	Minimum lease payments		Present value	
	2017	2016	2017	2016
	£'000	£'000	£'000	£'000
Amounts receivable under finance leases:				
Within one year	5,932	5,650	5,420	5,189
In the second to fifth years inclusive	10,483	12,913	8,142	10,522
More than five years	3,820	4,962	837	742
	<u>20,235</u>	<u>23,525</u>	<u>14,399</u>	<u>16,453</u>
Less: unearned finance income	<u>(5,836)</u>	<u>(7,072)</u>	<u>-</u>	<u>-</u>
	<u>14,399</u>	<u>16,453</u>	<u>14,399</u>	<u>16,453</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% (2016: 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 other income streams, examples 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 2017

14. 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 (2016: £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 (2016: £0.2 million) based on past experience. The Group does not hold any collateral over these balances. The average age of these receivables is 207 days (2016: 207 days).

Included in the Group's amounts receivable for goods and services balance are debtors with a carrying amount of £0.2 million (2016: £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 66 days (2016: 66 days).

Ageing of past due but not impaired receivables:

	2017 £'000	2016 £'000
30-60 days	194	116
60-120 days	119	66
120-210 days	17	7
Total	<u>330</u>	<u>189</u>

Movement in the allowance for doubtful debts

	2017 £'000	2016 £'000
At 1 January	758	400
Amounts utilised/written off in the year	(153)	(262)
Amounts recognised in statement of profit or loss	<u>250</u>	<u>620</u>
At 31 December	<u>855</u>	<u>758</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 (2016: £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 2017

14. TRADE AND OTHER RECEIVABLES – continued

Categories of financial assets

	2017	2016
	£'000	£'000
Group:		
Cash and bank balances	16,612	515
Restricted cash	2,182	-
Loans and receivables at amortised cost	95,791	89,260
Total financial assets	114,585	89,775
Non-current assets	2,602,468	2,367,076
Inventories	13,382	12,836
Prepayments and accrued income	4,888	2,786
Pension asset	116,900	31,500
Total non-financial assets	2,737,638	2,414,198
Total assets	2,852,223	2,503,973
	2017	2016
	£'000	£'000
Company:		
Cash and bank balances	-	-
Loans and receivables at amortised cost	60	65
Total financial assets	60	65
Non-current assets	329,657	329,704
Prepayments and accrued income	215	252
Income tax receivables	1,821	6,047
Social security and other taxes	3,487	-
Total non-financial assets	335,180	336,003
Total assets	335,240	336,068

15. CASH AND CASH EQUIVALENTS

	Group	
	2017	2016
	£'000	£'000
Cash at bank and in hand	16,612	-
Amounts owed by Group undertakings	-	515
	16,612	515

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 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 2017

16. RESTRICTED CASH

	Group	
	2017 £'000	2016 £'000
Restricted cash in Northern Powergrid Metering Limited	<u>2,182</u>	-
	<u>2,182</u>	-

Restricted cash are cash and cash equivalents that are restricted as to withdrawal or use under the terms of certain contractual agreements.

17. CALLED UP SHARE CAPITAL

Allotted, issued and fully paid:			2017	2016
Number:	Class:	Nominal value:	£'000	£'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

	Retained earnings £'000	Share premium £'000	Hedging reserve £'000	Other reserves £'000	Total equity £'000
Balance at 1 January 2016	771,463	158,748	-	6,185	936,396
Changes in equity					
Dividends	(100,000)	-	-	-	(100,000)
Total comprehensive income	<u>66,205</u>	-	-	-	<u>66,205</u>
Balance at 31 December 2016	<u>737,668</u>	<u>158,748</u>	-	<u>6,185</u>	<u>902,601</u>
Changes in equity					
Dividends	(22,700)	-	-	-	(22,700)
Total comprehensive income	<u>159,976</u>	-	(287)	-	<u>159,689</u>
Balance at 31 December 2017	<u>874,944</u>	<u>158,748</u>	<u>(287)</u>	<u>6,185</u>	<u>1,039,590</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

18. RESERVES - continued

Company	Retained earnings £'000	Share premium £'000	Other reserves £'000	Totals £'000
At 1 January 2017	23,391	158,748	6,185	188,324
Profit for the year	14,106	-	-	14,106
Dividends	(22,700)	-	-	(22,700)
At 31 December 2017	<u>14,797</u>	<u>158,748</u>	<u>6,185</u>	<u>179,730</u>
	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>188,324</u>

19. TRADE AND OTHER PAYABLES

	Group		Company	
	2017 £'000	2016 £'000	2017 £'000	2016 £'000
Current:				
Payments on account	44,726	37,438	-	-
Trade creditors	20,289	5,037	3,243	263
Amounts owed to related parties	-	583	-	-
Social security and other taxes	2,906	5,036	49	54
Other creditors	10,355	8,922	2,257	2,394
Deferred revenue	22,450	20,920	-	-
Accrued expenses	44,102	51,946	524	466
	<u>144,828</u>	<u>129,882</u>	<u>6,073</u>	<u>3,177</u>
Non-current:				
Deferred revenue	584,348	562,308	-	-
	<u>584,348</u>	<u>562,308</u>	<u>-</u>	<u>-</u>
Aggregate amounts	<u>729,176</u>	<u>692,190</u>	<u>6,073</u>	<u>3,177</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

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 standard payment terms for the Group is net monthly.

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
2017:					
Non-interest bearing	78,276	-	-	-	78,276
Variable interest rate liability	141,457	-	-	-	141,457
Fixed interest rate liability	45,031	38,341	389,307	659,910	1,132,589
	<u>264,764</u>	<u>38,341</u>	<u>389,307</u>	<u>659,910</u>	<u>1,132,589</u>
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>

Company

	Less than 3 months £'000	3 months to 1 year £'000	1 to 5 years £'000	5+ years £'000	Total £'000
2017:					
Non-interest bearing	6,073	-	-	-	6,073
Variable interest rate liability	72,286	-	-	-	72,286
Fixed interest rate liability	-	9,001	36,004	226,144	271,149
	<u>78,359</u>	<u>9,000</u>	<u>36,000</u>	<u>226,144</u>	<u>349,508</u>
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>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

19. TRADE AND OTHER PAYABLES - continued

Categories of financial liabilities

	2017	2016
	£'000	£'000
Group:		
Loans and payables at amortised cost	928,709	755,740
Derivative liability	345	-
Total financial liabilities	<u>929,054</u>	<u>755,740</u>
Payments received on account	44,726	37,438
Income tax liabilities	109,973	93,226
Other taxes and social security	2,906	5,036
Accruals	44,102	51,946
Deferred revenue	606,798	583,288
Provisions	2,901	2,525
Total non-financial liabilities	<u>811,406</u>	<u>773,459</u>
Total liabilities	<u>1,740,460</u>	<u>1,529,199</u>

	2017	2016
	£'000	£'000
Company:		
Loans and payables at amortised cost	81,203	70,632
Total financial liabilities	<u>81,203</u>	<u>70,632</u>
Income tax liabilities	-	2,758
Other taxes and social security	-	54
Accruals	524	466
Provisions	1,610	1,661
Total non-financial liabilities	<u>2,134</u>	<u>4,939</u>
Total liabilities	<u>83,337</u>	<u>75,571</u>

Deferred Revenue

	2017	2016
	£'000	£'000
At 1 January	583,228	546,590
Additions	44,780	55,980
Amortisation	(21,210)	(19,342)
At 31 December	<u>606,798</u>	<u>583,228</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 2017 (2016: £nil).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

20. BORROWINGS

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

Group

	Book Value		Fair Value	
	2017	2016	2017	2016
	£'000	£'000	£'000	£'000
Loans	653,234	497,685	742,503	599,169
Cumulative preference shares	3,368	3,368	182,585	167,790
Amounts owed to Group undertakings	241,463	102,930	291,215	153,191
	<u>898,065</u>	<u>603,983</u>	<u>1,216,303</u>	<u>920,150</u>
The borrowings are repayable as follows:				
On demand or within one year	203,972	16,569	203,972	16,569
Between one and five years	292,045	218,268	317,957	256,576
After five years	402,048	369,146	694,374	647,005
	<u>898,065</u>	<u>603,983</u>	<u>1,216,303</u>	<u>920,150</u>
Analysis of borrowings:				
Short-term loan	10	11	10	11
Inter-company short-term loan	141,447	2,914	141,447	2,914
Bond 2020 - 8.875%	101,345	101,192	122,791	130,276
Bond 2035 - 5.125%	153,034	152,959	207,238	207,505
Amortising loan 2026 - 2.736%**	155,298	-	155,298	-
Cumulative preference shares	3,368	3,368	182,585	167,790
European Investment Bank 2018 - 4.065%*	41,427	41,419	41,444	42,974
European Investment Bank 2019 - 4.241%*	41,489	41,481	43,015	44,655
European Investment Bank 2020 - 4.386%*	40,503	40,495	43,426	44,990
European Investment Bank 2027 - 2.564%	120,128	120,128	129,281	128,758
Yorkshire Electricity Group plc 2037 - 5.9%	100,016	100,016	149,768	150,277
	<u>898,065</u>	<u>603,983</u>	<u>1,216,303</u>	<u>920,150</u>

** Loan is 85% swapped at a fixed rate of 2.8182%, with the remaining 15% floating at 3 month LIBOR plus 1.75%.

Company

	£'000	£'000	£'000	£'000
The borrowings are repayable as follows:				
On demand or within one year	74,537	66,806	74,537	2,395
After five years	1,117	1,117	180,334	229,950
	<u>75,654</u>	<u>67,923</u>	<u>254,871</u>	<u>232,345</u>
Analysis of borrowings:				
Short term loans	22	2,395	22	2,395
Inter-company short-term loan	72,264	62,161	72,264	62,160
Cumulative preference shares	3,367	3,367	182,585	167,790
	<u>75,654</u>	<u>67,923</u>	<u>254,871</u>	<u>232,345</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

20. BORROWINGS - continued

Of the total financial liabilities, £656.6 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% and 3% of the long term loans are at a floating rate of 3 month LIBOR plus 1.75%, 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 2017 and 2016. As at 31 December 2017 and 2016 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;
- 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 2017, the Group had available £137 million (2016: £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 2017, 97% (2016: 100%) of the Group's long-term borrowings were at fixed rates and the average maturity for these borrowings was 9 years (2016: 11 years).

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

20. BORROWINGS - continued

Group

	2017 £'000	2016 £'000
Secured – at Amortised Cost		
Northern Powergrid Metering Limited bond	<u>155,298</u>	<u>-</u>
Total secured loans	<u>155,298</u>	<u>-</u>
Unsecured – at Amortised Cost		
Short term borrowings	10	11
Inter-company short term borrowings	241,463	102,930
Bonds	497,926	497,674
Preference shares	<u>3,368</u>	<u>3,368</u>
Total unsecured loans	<u>742,767</u>	<u>603,983</u>

All the Company's borrowings are unsecured.

21. DERIVATIVE FINANCIAL INSTRUMENTS

Derivatives are financial instruments that derive their value from the price of an underlying item such as interest rates, foreign exchange rates, credit spreads, commodities, equity or other indices. In accordance with Board approved policies, derivatives are transacted to manage our exposure to fluctuations in interest rate. The Group uses derivatives to manage these risks from our financing portfolio to optimise the overall cost of accessing the debt capital markets.

Derivative financial instruments are initially recognised at fair value and subsequently remeasured at fair value at each reporting date. Changes in fair values are recorded in the period they arise, in either the income statement or other comprehensive income depending on the applicable accounting standards. Where the fair value of a derivative is positive it is carried as a derivative asset, and where negative as a derivative liability. The fair value of the financial derivatives is calculated by discounting all future cash flows using the market yield curve at the reporting date (level 2 inputs). The market yield curve and fair value is obtained from external sources. In the absence of sufficient market data, fair values would be based on the quoted market price of similar derivatives.

All derivative financial instruments relate to cash flow hedges.

	Notional principal value		Fair value			
	2017	2016	2017	2016	2017	2016
	£'000	£'000	Asset £'000	Liability £'000	Asset £'000	Liability £'000
Less than 1 year	9,389	-	-	19	-	-
1 to 2 years	19,239	-	-	39	-	-
2 to 5 years	61,348	-	-	125	-	-
More than 5 years	<u>80,024</u>	<u>-</u>	<u>-</u>	<u>163</u>	<u>-</u>	<u>-</u>
	<u>170,000</u>	<u>-</u>	<u>-</u>	<u>346</u>	<u>-</u>	<u>-</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

21. DERIVATIVE FINANCIAL INSTRUMENTS - continued

The interest rate swaps are settled on a quarterly basis and are based on receiving a floating rate of 3-month LIBOR and paying a fixed rate of 1.0682%. The Group will settle the difference between the fixed and floating interest rate on a net basis.

All interest rate swap contracts exchanging floating rate interest amounts for fixed rate interest amounts are designated as cash flow hedges to reduce the Group's cash flow exposure resulting from variable interest rate borrowings. The interest rate swaps and interest payments on the underlying loan occur simultaneously and the amount accumulated in equity is reclassified to profit or loss over the period that the floating rate interest payments on debt affect profit or loss.

22. LEASING AGREEMENTS

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

Group

	2017	2016
	£'000	£'000
Within one year	5,448	5,772
Between one and five years	15,715	14,530
In more than five years	<u>2,842</u>	<u>2,921</u>
	<u>24,005</u>	<u>23,223</u>
Minimum lease payments made under operating leases recognised in the year	<u>6,245</u>	<u>5,447</u>

Operating lease commitments relate to fleet vehicles with terms of up to 7 years and operational and non-operational land and buildings with terms of up to 50 years. No purchase options are available on the Group's operating leases and no restrictions are imposed by the lease arrangements.

Company

	2017	2016
	£'000	£'000
Within one year	89	172
Between one and five years	-	88
	<u>89</u>	<u>260</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

22. PROVISIONS

	Group		Company	
	2017	2016	2017	2016
	£'000	£'000	£'000	£'000
Other provisions	<u>2,901</u>	<u>2,525</u>	<u>1,610</u>	<u>1,713</u>
Analysed as follows:				
Current	1,211	722	1,610	8
Non-current	<u>1,690</u>	<u>1,803</u>	-	<u>1,705</u>
	<u>2,901</u>	<u>2,525</u>	<u>1,610</u>	<u>1,713</u>
	Claims	Other	Total	
	£'000	£'000	£'000	
At 1 January 2017	290	2,235	2,525	
Utilised/paid in the year	(619)	(451)	(1,069)	
Charged to statement of profit or loss	<u>1,194</u>	<u>253</u>	<u>1,446</u>	
At 31 December 2017	<u>865</u>	<u>2,037</u>	<u>2,902</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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

23. DEFERRED TAX

	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Other	Total
Group	£'000	£'000	£'000	£'000	£'000
At 1 January 2017	87,158	3,875	(1,214)	(357)	89,462
Charge to the statement of profit or loss	1,693	(2,925)	(94)	(43)	(1,369)
Charge to other comprehensive income	-	-	14,518	(59)	14,459
At 31 December 2017	<u>88,851</u>	<u>950</u>	<u>13,210</u>	<u>(459)</u>	<u>102,552</u>
	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Other	Total
	£'000	£'000	£'000	£'000	£'000
At 1 January 2016	89,204	6,016	9,295	344	104,859
Charge/(credit) to the statement of profit or loss	(2,046)	(2,141)	(1,932)	(701)	(6,820)
Charge 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>
	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Total	
Company	£'000	£'000	£'000	£'000	
At 1 January 2017	(18)	3,066	(290)	2,758	
Charge/(credit) to statement of profit or loss	4	(2,914)	16	(2,894)	
At 31 December 2017	<u>(14)</u>	<u>152</u>	<u>(274)</u>	<u>136</u>	
	Accelerated tax depreciation	Rollover/ holdover relief	Retirement benefit (obligations/ assets)	Total	
	£'000	£'000	£'000	£'000	
At 1 January 2016	(23)	5,129	(297)	4,809	
Charge/(credit) to statement of profit or loss	5	(2,063)	7	(2,051)	
At 31 December 2016	<u>(18)</u>	<u>3,066</u>	<u>(290)</u>	<u>2,758</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 2017**

27. 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 Trustee's actuarial advisors, Aon Hewitt, as at 31 March 2016. 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) such that the DB Scheme is fully funded over time on the basis of suitably prudent assumptions. The next funding valuation is due no later than 31 March 2019, at which progress towards full-funding will be reviewed.

Agreement was reached during August 2017 with the Trustees to repair the funding deficit of £194.9m as at 31 March 2016 over the 9 year period to 31 March 2025, subject to the actuarial assumptions adopted for the triennial valuation as at 31 March 2016 being borne out in practice. The agreement includes payments of £2.3m per month to be made over the remaining 8 years and 3 months of the recovery plan. This amount is in 2017/18 prices and will be updated on 1 April 2018 and on each 1 April thereafter in line with annual changes in RPI inflation.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

Funding requirements - continued

The contributions payable by the Northern Powergrid Group to the DB Scheme in respect of future benefits which are accruing increased from 34.2% to 43.6% of pensionable pay from 1 September 2017. These contributions were determined as part of the 31 March 2016 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 2019 valuation. In addition, the Company pays contributions to cover the expenses of running the DB Scheme which increased from 3.0% to 3.6% of pensionable pay from 1 September 2017.

The Northern Powergrid Group's total contributions to the DB Scheme for the next financial year are expected to be £45.4M.

The Trust Deed provides the Northern Powergrid Group with an unconditional right to a refund of surplus assets assuming the full settlement of plan liabilities in the event of a plan wind-up. Furthermore, in the ordinary course of business the Trustees have no rights to unilaterally wind up, or otherwise augment the benefits due to members of the DB Scheme. Based on these rights, any net surplus in the scheme is recognised in full.

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 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

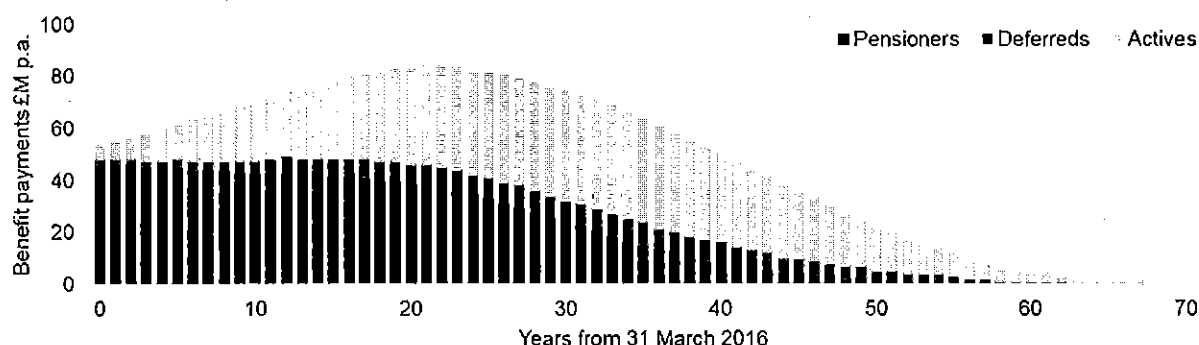
The Defined Benefit Obligation ("DBO") is the value of the DB Scheme's liabilities i.e. obligations, and includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 17 years based on the results of the 31 March 2016 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

Profile of the DB Scheme - continued

Estimated undiscounted benefit payments expected to be paid from the fund over its life, derived from the data used in the triennial valuation of the DB Scheme as at 31 March 2016 is shown on the following graph:



Investment objectives for the DB Scheme

The Trustees aim to achieve the scheme's investment objectives through investing partly in a diversified mix of growth assets which, over the long term, are expected to grow in value by more than low risk assets like cash and gilts. This is done with a broad liability driven investing framework that uses cash, gilts and other hedging instruments like swaps in a capital efficient way. In combination this efficiently captures the Trustees risk tolerances and return objectives relative to the scheme's liabilities.

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 DB Scheme's liabilities. The target hedging level is currently 75% (2016: 60%) of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

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 (44%) 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 (56%) as bonds and LDI, 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

27. EMPLOYEE BENEFIT OBLIGATIONS – continued

Risks associated with the DB Scheme - continued

Risk	Description	Mitigation
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 invests around 35% in LDI (included in the 56% above) which provides a hedge against higher-than-expected inflation increases on the DBO (rising inflation will increase both the DBO and the value of the LDI 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 Trustees insure certain benefits payable on death before retirement.

Other risks

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

The main risks associated with financial derivatives include: losses may exceed the initial margin, counterparty risk where the other party defaults on the contract; and liquidity risk where it may be difficult to close out a contract prior to expiry. These risks are managed by monitoring of investment managers to ensure they have reasonable levels of market exposure relative to the initial margin and positions are fully collateralised on a daily basis with secure cash or gilts collateral.

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 2017

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 2016. 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.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

Reporting at 31 December 2017 - continued

The results of the latest funding valuation at 31 March 2016 have been adjusted to 31 December 2017. Those adjustments take account of experience over the period since 31 March 2016, 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	2017 % p.a.	2016 % p.a.
RPI Inflation	2.95	3.00
Rate of long-term increase in salaries	3.45	3.00
Pension increases	2.85	2.90
Discount rate for scheme liabilities	2.60	2.70

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

Main demographic assumptions	2017	2016
Life expectancy for a male currently aged 60	26.7	27.1
Life expectancy for a female currently aged 60	28.8	28.8
Life expectancy at 60 for a male currently aged 45	28.1	28.6
Life expectancy at 60 for a female currently aged 45	29.9	30.6
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.

The amounts recognised in the balance sheet are set out below:

	2017 £m	2016 £m
Fair value of fund assets	1,746.0	1,754.4
Present value of funded defined benefit obligations	(1,629.1)	(1,722.9)
Funded status	116.1	31.5
Present value of unfunded defined benefit obligations	-	-
Unrecognised asset due to limit in para 64	-	-
Asset recognised on the balance sheet	116.1	31.5

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

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

Asset allocation	2017 £m	2016 £m
Developed market equity	187.9	338.6
Emerging market equity	7.3	12.9
Property	164.7	91.4
Reinsurance	83.4	71.3
Listed infrastructure	112.7	99.2
Investment grade corporate bonds	423.2	366.9
Other debt (non-investment grade)	43.4	30.3
Fixed interest gilts	28.2	52.4
Index-linked gilts	-	3.1
Liability driven investments	644.2	581.2
Cash	51.0	107.1
Total	<u>1,746.0</u>	<u>1,754.4</u>

Where available, the fair values above are determined as the quoted bid market value. All other fair values are provided by the fund managers. Where available, the fair values are quoted prices (eg listed equity, sovereign debt and corporate bonds). Unlisted investments (private equity) are included at values provided by the fund manager in accordance with the relevant guidance. Other significant assets are valued based on observable inputs such as yield curves.

The amounts recognised in comprehensive income are set out below:

	2017 £m	2016 £m
Service costs:		
Current service cost	17.9	14.9
Administration expenses	1.3	1.2
Past service cost (incl. curtailments)	-	-
Financing cost:		
Interest on net defined benefit asset	(1.8)	(3.7)
Pension expense recognised in profit and loss	<u>17.4</u>	<u>12.4</u>
Remeasurement in OCI:		
Return on plan assets in excess of that recognised in net interest	(64.7)	(200.9)
Actuarial losses due to changes in financial assumptions	49.7	311.5
Actuarial gains due to changes in demographic assumptions	(33.3)	-
Actuarial gains due to liability experience	(9.5)	(25.9)
Adjustments due to the limit in para 64	-	-
Total amount recognised in OCI	<u>(57.8)</u>	<u>84.7</u>
Total amount recognised in profit and loss and OCI	<u>(40.4)</u>	<u>97.1</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

As at 31 December 2017, the fair value of the DB Scheme's assets, which related to self-investment, amounted to £nil (2016: £nil).

Changes to the present value of the DBO during the year	2017 £m	2016 £m
Opening DBO	1,722.9	1,453.2
Current service cost	17.9	14.9
Interest expense on defined benefit obligation	45.1	53.0
Contributions by DB Scheme participants	0.9	1.0
Actuarial gains on DB Scheme liabilities arising from changes in demographic assumptions	(33.3)	-
Actuarial losses on DB Scheme liabilities arising from changes in financial assumptions	49.7	311.5
Actuarial gains on DB Scheme liabilities arising from experience	(9.5)	(25.9)
Benefits paid	(164.6)	(84.8)
Closing DBO	<u>1,629.1</u>	<u>1,722.9</u>

Changes to the fair value of the DB Scheme assets during the year	2017 £m	2016 £m
Opening fair value of the DB Scheme assets	1,754.4	1,541.3
Interest income on DB Scheme assets	46.9	56.7
Remeasurement gains on DB Scheme assets	64.7	200.9
Contributions by the employer	45.0	40.5
Contributions by DB Scheme participants	0.9	1.0
Benefits paid	(164.6)	(84.8)
Administration costs incurred	(1.3)	(1.2)
Net increase in assets from disposal/acquisition	-	-
Closing DBO	<u>1,746.0</u>	<u>1,754.4</u>

Actual return on DB Scheme assets	2017 £m	2016 £m
Interest income on DB Scheme assets	46.9	56.7
Re-measurement gain on DB Scheme assets	64.7	200.9
Actual return on DB Scheme assets	<u>111.6</u>	<u>257.6</u>

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

27. EMPLOYEE BENEFIT OBLIGATIONS - continued

Sensitivity to key assumptions

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

	Changes in DBO £m	Revised DBO £m
Current Figures	1,629.1	
Following a 10 bps decrease in the discount rate	31.9	1,661.0
Following a 10 bps increase in the discount rate	(31.5)	1,597.6
Following a 10 bps increase in the inflation assumption	27.0	1,656.1
Following a 10 bps decrease in the inflation assumption	(26.7)	1,602.4
Following a 1 year increase in life expectancy	68.5	1,697.6
Following a 1 year decrease in life expectancy	(67.1)	1,562.0

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.

28. DIRECTORS' ADVANCES, CREDITS AND GUARANTEES

During the year, 3 directors (2016: 2) and 4 key personnel (2016: 5) utilised the services provided by NTFL. The amounts included in finance lease receivables owed by these directors and key personnel total £20,000 (2016: £43,000) in respect of non-current and £38,000 (2016: £80,000) in respect of current receivables.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

29. 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:

Related Party	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income from/ (costs to) £'000	Borrowings to/(from) £'000
2017					
Integrated Utility Services Limited (registered in Eire)	-	(3,270)	230	-	-
Northern Powergrid Gas Limited	68	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,228)	-
Northern Powergrid (Yorkshire) plc	24,103	(12,732)	-	-	-
Vehicle Lease and Service Limited	33	(4,562)	351	519	-
Yorkshire Electricity Group plc	-	-	-	(7,238)	(241,463)
	<u>17,967</u>	<u>(16,731)</u>	<u>583</u>	<u>(12,674)</u>	<u>(241,463)</u>

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

29. RELATED PARTY DISCLOSURES - continued

	Sales to £'000	Purchases from £'000	Amounts owed from/(to) £'000	Finance/ investment income/ (costs from/(to) £'000	Borrowing s 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 (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>

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 2017

29. 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					
2017					
Integrated Utility Services Limited	98	(576)	-	-	-
Northern Powergrid Gas Limited	67	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,228)	-
Northern Powergrid (Northeast) Limited	5,983	(25)	-	21,700	-
Northern Powergrid (Yorkshire) plc	3,525	(2)	-	-	-
Northern Transport Finance Limited	19	-	-	-	-
Vehicle Lease and Service Limited	158	-	-	519	-
Yorkshire Electricity Group plc	-	-	-	426	(72,264)
	<u>9,850</u>	<u>(603)</u>	<u>-</u>	<u>16,417</u>	<u>(72,264)</u>

NORTHERN ELECTRIC PLC (REGISTERED NUMBER: 02366942)

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

29. 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					
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>

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.

30. ULTIMATE CONTROLLING PARTY

The immediate parent undertaking of Northern Electric plc Group is Northern Powergrid Limited (Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF). 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. (3555 Farnam Street, Omaha, Nebraska 68131) (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 largest parent undertaking to prepare group accounts in the UK, can both be obtained from the Company Secretary, Northern Powergrid Holdings Company, Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF.

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017

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

Group

	2017	2016
	£'000	£'000
Profit before income tax	140,243	143,918
Depreciation charges	102,551	87,421
Profit on disposal of fixed assets	(331)	(522)
Amortisation of deferred revenue	(21,210)	(19,342)
Retirement benefit obligations	(27,604)	(28,753)
Decrease in provisions	378	(468)
Finance costs	41,404	39,139
Finance income	(481)	(1,100)
Income from joint ventures	(619)	(254)
	<u>234,331</u>	<u>220,039</u>
(Increase)/decrease in inventories	(546)	615
Increase in trade and other receivables	(9,518)	(10,367)
Increase in trade and other payables	<u>1,231</u>	<u>7,593</u>
Cash generated from operations	<u>225,498</u>	<u>217,880</u>

Company

	2017	2016
	£'000	£'000
Profit before income tax	15,477	13,392
Depreciation charges	47	47
(Increase)/Decrease in provisions	(103)	52
Finance costs	9,428	9,096
Finance income	<u>(23,209)</u>	<u>(22,347)</u>
	<u>1,640</u>	<u>240</u>
Decrease in trade and other receivables	42	110
(Decrease)/increase in trade and other payables	<u>(591)</u>	<u>428</u>
Cash generated from operations	<u>1,091</u>	<u>778</u>

32. 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 2017**

33. 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 20 June 2018 at 11.00 am

The following resolutions will be proposed as ordinary resolutions:

Annual Report and Accounts

1. To receive and consider the strategic, directors' and auditor's reports and the Group accounts for the year ended 31 December 2017.

Dividend

2. To declare that no final dividend be paid for the year ended 31 December 2017.

Election and Re-election of Directors

3. To elect Mr J N Reynolds as a director.
4. To re-elect Dr P A Jones as a director.
5. To re-elect Mr T Fielden as a director.

The Auditors

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

Authority to allot shares

7. That:
 - a) the Directors be authorised to allot shares in the Company or grant rights to subscribe for, or convert any security into, shares in the Company up to a maximum nominal amount of £27,827,000;
 - b) this authority shall expire at close of business on 20 June 2023 or, if earlier, on the conclusion of the Company's annual general meeting in 2023, unless previously revoked or varied by the Company;
 - c) the Company may before such expiry make offers and agreements which would or might require shares to be allotted or rights to subscribe for, or convert securities into, shares to be granted after the expiry of this authority and the directors may allot shares or grant rights to subscribe for, or convert securities into, shares under any such offer or agreement as if the authority conferred hereby had not expired;
 - d) subject to paragraph (e), all existing authorities given to the directors pursuant to Section 551 of the Act shall be revoked by this resolution; and
 - e) That paragraph (d) shall be without prejudice to the continuing authority of the directors to allot shares, or grant rights to subscribe for or convert any security into shares, pursuant to an offer or agreement made by the Company before the expiry of the authority pursuant to which such offer or agreement was made.

The following resolution will be proposed as a special resolution:

Authority to dis-apply pre-emption rights

8. That, subject to the passing of and pursuant to the general authority conferred by resolution 7 in the notice convening this meeting and in place of all existing powers, the directors be and are hereby generally empowered pursuant to Section 570 of Act to allot equity securities (as defined in Section 560 of the Act) for cash, pursuant to the authority so conferred as if Section 561 of the Act did not apply to any such allotment. This power shall expire (unless previously renewed, varied or revoked by the Company in general meeting) at the close of business on 20 June 2023 or, if earlier, on the conclusion of the Company's annual general meeting in 2023, but the Company may make an offers or and agreements which would or might require equity securities to be allotted after expiry of this power and the directors may allot equity securities in pursuance of that offer or agreement as if this power had not expired.

**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS - continued
FOR THE YEAR ENDED 31 DECEMBER 2017**

33. NOTICE OF ANNUAL GENERAL MEETING - continued

By order of the board
Jennifer Riley
Company Secretary
24 April 2018

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

Notes:

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.
7. Resolution 7. The Companies Act 2006 provides that directors may only allot shares if authorised to do so by the Company's articles of association or by the shareholders in general meeting. This resolution replaces the resolution passed by the shareholders on 19 June 2013.
8. Special Resolution 8. This special resolution empowers the directors for the duration of the authority conferred by Resolution 7 to allot equity shares for cash without regard to the pre-emption provisions to which the ordinary shareholders would otherwise be entitled under Section 561 of the Companies Act 2006.