

Northern Gas Networks Limited

Annual Report and accounts
for the year ended 31 March 2020

Registered number: 05167070

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Strategic report

For the year ended 31 March 2020

The directors present their Annual Report on the affairs of the company, together with the accounts and auditor's report, for the year ended 31 March 2020. The accounts are presented under Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

Review of the business

The company's purpose is to provide safe and secure gas supplies to the people and the businesses within the distribution network, being the North of England. The company's vision of success is to be consistently viewed by the regulators, Ofgem and the Health and Safety Executive ("HSE") as being market leading in safety management, efficiency and customer service, which in turn will generate value to the shareholders of the company.

Financial and operational review

Operating profit for the year is £213.3m (2019 - £187.4m) with revenue increasing by £40.4m based on Ofgem allowances, and cost increases of £14.5m. The main drivers of the cost increase were: (1) additional depreciation and amortisation increase of £8.2m following continued investment in the network; (2) an increase in costs of sales of £1.1m; (3) central network rates increase of £1.0m; investment impairment of £1.4m; and (5) general cost increases driven by inflation.

At the end of the year, the group's undrawn borrowing facilities available for use amounted to £100.0m (2019 - £160.0m). The company has debt at the 31 March 2020 with a principal value of £1,490.8m (2019 - £1,532.6m) as follows:

| Debt instrument | Maturity date | Interest rate / basis | Principal amount (£m) | Book value (£m) |
|--|---------------|-----------------------|-----------------------|-----------------|
| Fixed rate bond held as intercompany loan* | Jun 2027 | 4.875% fixed | 250.0 | 313.3 |
| Fixed rate bond held as intercompany loan* | Nov 2035 | 4.875% fixed | 255.0 | 393.5 |
| Fixed rate bond held as intercompany loan* | Mar 2040 | 5.625% fixed | 200.0 | 196.9 |
| US Private Placement notes | Jan 2029 | 2.84% fixed | 50.0 | 53.0 |
| US Private Placement notes | Jan 2031 | 2.97% fixed | 150.0 | 162.8 |
| US Private Placement notes | Jun 2039 | 2.71% fixed | 100.0 | 99.7 |
| European Investment Bank fixed rate loan | Dec 2024 | 3.446% fixed | 40.0 | 40.0 |
| European Investment Bank floating rate loans <i>See note 14 for breakdown</i> | Various | 3 mth Libor + margin | 360.0 | 360.0 |
| European Investment Bank amortising loan | Mar 2034 | 3 mth Libor + 0.86% | 25.8 | 25.8 |
| Revolving Credit Facility drawings <i>Facility matures October 2022</i> | Apr 2020 | 1 month Libor +0.40% | 60.0 | 59.7 |

*Bonds are held by the subsidiary Northern Gas Networks Finance plc, and loaned to the company.

Net debt (principal value net of cash) in the year decreased by £34.3m, with cash reducing by £7.6m and debt reducing by £41.8m. The decrease was principally driven by the repayment of a £200.0m bond (was held as an intercompany loan) in June 2019 funded through receiving £100.0m of new US Private placement notes in June 2019, the drawing down a further £60.0m on the revolving credit facility, and by the reduction in cash.

Strategic report (continued)

Interest payable in the year on the above debt and that held within the year, net of associated interest rate swaps used to hedge the debt (amounted to £50.5m (2019 - £52.0m) as detailed in note 3. Details of the way interest rate swaps are used to manage interest rate exposures, and the impact this has on finance costs, are included in the section on interest rate risk on page 4.

The tax charge for the year was £83.7m (2019 - £26.9m). In March 2020 the group restated deferred tax balances to 19% from 17% following the announcement from the Government that the previously enacted legislation to take UK corporation tax rates to 17% rate was to be removed. The one off impact of the change in the tax rates was a £35.7m tax charge. In the year, following review by the directors, a provision in relation to deferred tax of £13.7m was also recognised relating to the tax deductibility of an intangible asset, for which further details are provided in note 7. Excluding the impact of these one off charges the tax charge would have been £34.3m in the year which represents an effective tax rate of 21% (2019 – 19%).

Capital additions in the year across tangible and intangible assets was £167.9 (2019 - £166.3m) principally focused on investment in network assets including replacement expenditure and a new SAP system. The group had net assets of £662.2m at 31 March 2020 (2019 - £652.7m). Debt to RAV of the Northern Gas Networks group at the end of the year was 64.5% (2019 – 64.1%), being well within the internal target of 70%.

Key performance indicators (KPIs)

The key financial and non-financial performance indicators used by the Board of Directors in their monitoring of the company, focus on the areas of safety management, efficiency and customer service and include:

| | Year ended 31 March 2020 | Year ended 31 March 2019 |
|--|-----------------------------|-----------------------------|
| Financial performance (efficiency) | | |
| Operating profit | £213.3 | £187.4m |
| Dividends paid | £97.0m | £93.5m |
| Group external debt less cash/Regulatory asset value (debt:RAV) | 64.5% | 64.1% |
| Customer services | | |
| Quarterly customer satisfaction survey scores | 9 out of 10 | 9 out of 10 |
| Safety management | | |
| Number of lost time injuries to employees and contractors (LTIs) | 2 | 2 |
| Reported injuries to members of the general public (MOPs) | 0 | 0 |

All of the targets for the above KPI's have been achieved. Financial performance is discussed above within the financial and operational review. Customer service and safety management remains central to how NGN operate, and during the year we have continued to perform well. We have achieved an overall score of 9 out of 10 for customer satisfaction survey scores, as well as winning three awards in the November 2019 UK Customer Experience Awards. We continue to lead the industry with regard to MOPs and LTIs and continue to achieve our annual target of no more than 2 MOPs and 2 LTIs.

Strategic report (continued)

Principal risks and uncertainties

The company's principal risks and uncertainties are set out below. They reflect any risks associated with COVID-19, further details of which are provided on page 5.

Regulatory environment, revenue and costs

The gas industry is subject to extensive legal and regulatory obligations and controls which Northern Gas Networks Limited ("NGN"), as the licensed entity, must comply with. All key commitments made in the current price control are being delivered. The application and possible changes of these laws, regulations and regulatory standards could have an adverse effect on the operations and financial position of the group or in the case of misreporting, a fine.

Mitigation

The company engages with the regulatory authority extensively at all levels of seniority to understand future plans and potential impacts on the business. The business responds to all potential changes which impact on the business and seek to mitigate any adverse impacts. The business has in place an extensive set of policies and procedures to ensure compliance with legal and regulatory obligations. The implications of the next price control, RIIO-GD2, are being assessed although this does not start until 1 April 2021. The final business plan for RIIO-GD2 will be released by Ofgem in late 2020. Early indications obtained from Ofgem suggest the groups initially submitted business plan will be close to final settlements. The Board have frequent communication with the company to assess RIIO-GD2.

Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or a member of the general public. Any such incident could have an adverse effect primarily for individuals concerned, but also on the reputation of the company, or lead to potential prosecution or reduced productivity.

Mitigation

Health and Safety is our priority. The business has an Environment Health & Safety team that ensure compliance with our management safety system and monitor it on a monthly basis with key KPIs.

Network performance (including cyber risk)

If the network assets were to fail it could result in a loss in supply of gas to customers and associated adverse publicity and an unexpected increase in costs. The biggest cyber risk to NGN is the loss of control over the network.

Mitigation

The company has a set of policies and procedures that we adhere to, to ensure the integrity of the network and ensure that the people who work on the network are qualified and competent. The company has comprehensive IT infrastructure governance which covers cyber risk.

Employees

The success of the company depends to a significant extent on the contribution of its employees and the employees of operational contractors. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business. The ability to adapt in a climate of change is dependent on the appointment and retention of a high calibre, competent, flexible, quality conscious and customer focused workforce all of whom are committed to business success and are given appropriate training.

Strategic report (continued)

Mitigation

NGN's succession planning strategies mean that development of existing staff is crucial.

The company, as an equal opportunities employer, ensures that no job applicant receives less favourable treatment because of his or her age, colour, disability, ethnic or national origin, gender, marital status or sexuality or is disadvantaged by conditions or requirements which are irrelevant to performance and the company's needs. The company has published its gender pay gap analysis which can be found at <http://www.northerngasnetworks.co.uk>

The company comply with all UK human rights laws and has a process to assess risk in this area, including an employee grievance procedure. The company also has a fraud policy statement which protects employees from bribery and corruption. No issues have been reported in the year.

Financial risk management objectives and policies

The company's financial instruments, other than derivatives, comprise borrowings, cash, overdrafts and various items such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the company's operations. The company also enters into derivative transactions, principally interest rate swaps. The purpose of such transactions is to manage the interest rate risks arising from the company's sources of finance. The main risks arising from the company's financial instruments are interest rate risk, credit risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

Interest rate risk

Interest rate risk is the risk of debt costs being in excess of that expected. The long term approach adopted in minimising interest rate exposures on debt is as follows:

- To have a balanced debt portfolio comprising a mixture of nominal and index-linked debt aiming to achieve a degree of symmetry with the Regulator's broad approach to setting cost of debt allowances and so as to maintain a debt portfolio consistent with those of comparable utility companies; and
- To structure debt maturities and interest rate hedges in such a way as to provide protection against adverse movements in the indexed regulatory cost of debt allowance.

Credit risk

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

Liquidity risk

The maturities of all debt and committed debt facilities other than amortising loans, are managed such that at any one time all have a time to maturity of more than one year and that at least 50% by value have a time to maturity of more

Strategic report (continued)

than five years. Debt and facility maturities are staggered to avoid excessive concentrations in any twelve month period as well as the period around regulatory reset dates where possible.

COVID-19

The Board continue to assess the impact of COVID-19 on the company. The safety of our customers and employees is of paramount importance, and as a result, non-essential operations stopped from 24 March 2020, following the announcement from the UK Government that the UK should be on 'lock down'. Non-essential operations equates to the majority of repx and capex work, along with non-essential maintenance leaving only emergency work (gas escapes) and essential maintenance as active work streams.

With regard to essential work being carried out, operational staff wear additional personnel protective equipment (PPE) and exercise social distancing when possible. As a consequence, PPE expenditure has increased in the short to medium term but the impact of this is predominately within the March 2021 calendar year. The investment in technology over the last few years means that support staff are able to work from home without any issues and this has been actively encouraged except when working in the office is essential. Two support teams are safety critical (network pressure control team and emergency dispatch team) and so continue to work from an office.

The company has been monitoring staff sickness and those in self isolation. Management have been working on the assumption that essential operations can continue with a staff reduction of 25%, although the company has not encountered anywhere near this level of reduction.

Due to the nature of the business, the revenue of the company is unlikely to be impacted in the short term. The group is participating in a revenue collection deferral scheme which defers the revenue cash receipts from the summer of 2020 until the 2021/22 regulatory year. This scheme is fully supported by Ofgem meaning the group have no debt exposure. This cash flow decrease is less than the cash flow increase arising from the group's election to defer VAT payments, this being the only financial package taken of those offered by the government.

To summarise the financial implications, which are predominately within the March 2021 financial year: (1) the company has encountered additional PPE costs, the impact of which is reduced by corresponding corporation tax savings; (2) there have been cash out flow savings due to reduced repx and capex activity and VAT deferrals which are in excess of the deferral of revenue receipts; (3) the Board will continue to monitor Ofgem's view with regard to revenue although any reduction is unquantifiable at this stage; and (4) no asset impairment is considered necessary at the date of these accounts.

The Board has reviewed updated financial forecasts which factor in the implications of COVID-19, and do not consider the impact to either influence going concern, or result in any asset impairment. The impact of COVID-19 has been reflected within the principle risks and uncertainties set out on pages 3-5.

Brexit

The company continues to consider the potential impact of Brexit on its business, through the transition period and beyond. For now, existing laws and trading arrangements are unchanged. Based on the assessment of the latest available information, our principal risk continues to be that there could be a sustained period when the import of certain

Strategic report (continued)

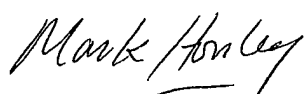
raw materials could be challenging, which could curtail planned work if inventory levels were depleted. In mitigation, group stock levels of critical spares have been elevated as at 31 March 2020. These products are not perishable and as such the financial risk of holding additional stock is minimal.

The company holds EIB debt of £425.8m however this debt will not need to be repaid as a consequence of Brexit.

Statement of corporate governance arrangements

The Directors present a corporate governance statement (see page 12) under the guidance of Accounting Regulations Section 7:26 of the Companies Act 2006. As far as the Directors are aware all legal requirements under section 172 of the Companies Act have been complied with during the period and up to the date of signing the accounts. Within the corporate governance statement reference is made as to how the Directors engage with the employees of the company and how they have regard to employee interests, and the effect of that regard, including on the principle decisions taken by the company during the financial year. The statement also details how the Directors have maintained relationships with key suppliers and customers.

Approved by the Board and signed on its behalf by

A handwritten signature in black ink, appearing to read 'Mark Horsley', with a horizontal line underneath the name.

M J Horsley, Director

22 July 2020

Directors' report

For the year ended 31 March 2020

The directors present their annual report on the affairs of the company, together with the accounts and auditor's report for the year ended 31 March 2020. The following disclosures have been disclosed in the strategic report but are cross referenced here: principal activities, business review including KPI's, principal risks and uncertainties, and financial risk management objectives and policies. A Corporate Governance Statement is presented on page 12.

Directors

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

| | | | |
|-------------|---------------------------|------------|-----------------------------|
| A J Hunter | (Chairman) | P Rogerson | (independent non-executive) |
| M J Horsley | (Chief Executive Officer) | J Burnham | (independent non-executive) |
| H L Kam | | | |
| C T Wan | | | |
| N D McGee | | | |
| D N Macrae | | | |
| L S Chan | | | |
| C C Tsai | | | |
| S D Beer | | | |

The Board of Directors

The daily operations of the business are managed by a Senior Management Team ("SMT") and the Chief Executive Officer ("CEO"). All significant decisions are referred to the Board of Directors ("the Board").

The Board meets at least five times a year. The number of Board meetings held during the year and attendees (including alternates) at the Board meetings are detailed below:

| Year ended 31 March 2020 | | Year ended 31 March 2019 | |
|--------------------------|--------------|--------------------------|--------------|
| Date | Attendees | Date | Attendees |
| 10 April 2019 | 11 out of 11 | 18 April 2018 | 9 out of 11 |
| 10 July 2019 | 10 out of 11 | 18 July 2018 | 10 out of 11 |
| 25 September 2019 | 11 out of 11 | 19 September 2018 | 11 out of 11 |
| 15 November 2019 | 10 out of 11 | 16 November 2018 | 10 out of 11 |
| 21 November 2019 | 9 out of 11 | 23 January 2019 | 11 out of 11 |
| 21 January 2020 | 11 out of 11 | | |

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT. The Board is ultimately responsible for the system of internal controls and for the review of their overall effectiveness.

Dividends

The directors do not recommend payment of a final dividend. Interim dividends of £0.76 per share were paid on 20 June 2019 and of £3.22 per share were paid on 20 December 2019 making a total of £3.99 per share for the year (2019 – £3.84). See note 8 for details. Declared dividends are in line with the expectations of the Board.

Directors' report (continued)

Directors indemnities

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

Future developments and events after the balance sheet date

As mentioned within the Strategic report the company continues to monitor the impact of COVID-19, Brexit and RIIO-DG2 negotiations, to consider the potential impacts on its business. As at the date of the signing of these accounts, no further disclosures in these areas are deemed necessary. There are not other material post balance sheet events.

Financial instruments

Financial instruments have been disclosed within note 15 and associated risks discussed within the strategic reports.

Going concern

The accounts have been prepared on a going concern basis. The company's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out in the strategic report and above. This includes the implication of RIIO-GD2, Brexit and COVID-19. In addition, note 13-15 to the accounts includes further details of the group's debt position and details of its derivatives and other financial instruments. The group is able to pay its liabilities as they fall due, due to the reliability of regulated revenue under RIIO-GD1.

The directors have made enquiries and reviewed the forecasts, and in light of the group facilities available, have a reasonable expectation that the company has adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and accounts.

Disabled employees / employee engagement

Applications for employment by disabled persons are always fully considered, bearing in mind the aptitudes of the applicant concerned. In the event of employees becoming disabled every effort is made to ensure that their employment with the company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of all other employees. Details of employee engagement can be found in the corporate governance statement.

Energy and carbon

The company recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements and higher standards where possible. The company is committed to the protection of the environment in the region it serves as well as climate change. The company's environmental management systems are certified under ISO 14001 and OHSAS 18001. The company is committed to reducing its carbon emissions under Regulatory Instructions and Guidance (RIGS). The overall target is a year-on-year emissions reduction of c0.5% across RIIO-GD1 followed by a further c0.5% reduction in RIIO-GD2.

Directors' report (continued)

Energy and carbon (continued)

We report using an operational control approach, on all material emissions which NGN are accountable for across the entire business covering all work streams and geography. Details of what has been included within each reported scope is listed in the table below. Unreported emissions, which would form part of scope 3, are deemed insignificant compared to shrinkage. These include employee commuting, some forms of waste generated in operations, end of life treatment of solid products and some gas emissions.

The emissions reduction program is managed by the Head of HS&E within the company, supported by the senior management team and Board as needed. Reported data has not been externally verified, as permitted, due to robust internal processes.

Reported emissions follow 'Greenhouse Gas Emissions Reporting Guidance (June 2013)' as provided by the Department for Environment, Food and Rural Affairs (Defra). The conversion factors used for emission disclosures follow Ofgem guidance.

| Business Carbon Footprint | Performance | | | |
|--|-----------------------------|---------|---|----------|
| | tonnes of CO ₂ e | | tonnes of CO ₂ e per £m turnover | |
| | 2020 | 2019 | 2020 | 2019 |
| Shrinkage | 379,547 | 395,240 | 843.38 | 964.93 |
| Scope 1: energy consumption (excl electricity), commercial vehicles and business miles | 5,290 | 5,347 | 11.75 | 13.05 |
| Scope 2: electricity consumption | 1,211 | 1,389 | 2.69 | 3.39 |
| Scope 3: indirect emissions – PE pipe, contractor vehicle, rail, air and ferry travel | 15,793 | 15,095 | 35.09 | 36.85 |
| Total | 401,841 | 417,071 | 892.92 | 1,018.23 |

As shown in the table shrinkage remains the key element of emissions which is being targeted through efficient gas pressure management, gas escape management and gas mains replacement. Other activity to reduce emissions include fleet upgrading, vehicle route planning, driver efficiency tracking, use of carbon efficient technology in depot and office refurbishments, increased use of teleconferencing and a contractor carbon awareness program.

Supplier payment policy

The company's policy is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment.

Directors' report (continued)

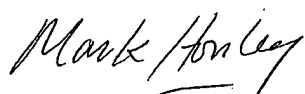
Auditor

Each of the persons who is a director at the date of approval of this report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 418 of the Companies Act 2006. The directors will place a resolution before the annual general meeting to reappoint Deloitte LLP as auditor for the ensuing year.

Authorise for issue by the Board



M J Horsley, Director

22 July 2020

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

Directors' responsibilities statement

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

Company law requires the directors to prepare financial statements for each financial year. Under that law the directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law), including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law the directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They are also responsible for safeguarding the assets of the company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Corporate governance statement

For the year ended 31 March 2020

Scope of statement

NGN is not a listed entity, but as a large private company is required to prepare a corporate governance statement under Accounting Regulations Section 7:26 of the Companies Act 2006. This statement has been prepared using most of the 'Wates Principles' to provide a clear message on the business model, future strategies and core values and of NGN. It describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) of Companies Act, as listed below:

- the likely consequences of any decision in the long term (approving the strategic direction and values);
- the interests of the company's employees;
- the desirability of the company maintaining a reputation for high standards of business conduct;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment; and
- the need to act fairly as between members of the company.

The company is committed to pursuing leading governance practices as appropriate.

Overview of the Board

The Board of Northern Gas Networks Limited is comprised of eleven directors as at 31 March 2020, who are appointed by the shareholders and two of which are independent non-executive directors. All are independent of the day to day management of the company with the exception of the CEO who is a Board member and leads the company senior management team (SMT) who in turn manage the company. The Board are presented with information by the CEO and SMT to enable them to influence all the key business decisions of NGN. This arrangement ensures the shareholders are involved in making all the key business decisions through their appointed directors.

Board Members

The Board members who held office during the year are listed within the Directors' report.

The position of the Chairman of the Board is held by A Hunter. The position of Chief Executive Officer (CEO) is held by M J Horsley. These positions are separate with a view to maintaining an effective segregation of duties between management of the Board and the day to day management of the business.

P Rogerson and J Burnham are independent non-executive members of the Board.

Corporate governance statement (continued)

Board Meetings

The Board hold at least five scheduled meetings throughout the year. Comprehensive papers are presented to the Board both for information and approval which facilitate debate on the performance and future direction of the company. The number of Board meetings held during the year and attendees, including alternates, at the Board meetings is detailed in the Directors report.

Evaluation of the Board

Evaluation of the performance of the Board is conducted by virtue of their appointments being made and monitored by the shareholders. The performance of the CEO is assessed by the Board on an annual basis under the remit of the remuneration committee. The performance of each SMT member is assessed annually by the CEO as part of NGN's performance management process.

Overview of the committees

The Board has six committees, as listed below, to assist in the execution of its duties and to allow a detailed consideration of complex issues.

All Board members are entitled to attend all committees under the terms of reference, with the minimum requirement being a quorum of at least two members from different shareholders. The attendance of the committees is also largely the same as for the Board. The audit and treasury committees are chaired by L S Chan, the risk management and compliance committees are chaired by C Tsai and the remuneration and nominations committee are chaired by A Hunter.

Attendance including alternates of committees in the year is shown below:

| Date of Committee | Audit Committee | Compliance Committee | Risk Management Committee | Treasury Committee | Remuneration Committee | Nominations Committee |
|-------------------|-----------------|----------------------|---------------------------|--------------------|------------------------|-----------------------|
| 2020 | | | | | | |
| Jun 19 | 6 out of 6 | 7 out of 7 | 7 out of 7 | 7 out of 7 | n/a | n/a |
| Sep 19 | 6 out of 6 | 7 out of 7 | 7 out of 7 | 7 out of 7 | n/a | n/a |
| Jan 20 | 4 out of 6 | 5 out of 7 | 5 out of 7 | 5 out of 7 | 4 out of 7 | n/a |
| 2019 | | | | | | |
| Jun 18 | 5 out of 6 | 6 out of 7 | 6 out of 7 | 6 out of 7 | n/a | n/a |
| Aug 18 | 4 out of 6 | 5 out of 7 | 5 out of 7 | 5 out of 7 | n/a | n/a |
| Jan 19 | 5 out of 6 | 6 out of 7 | 6 out of 7 | 6 out of 7 | 7 out of 7 | n/a |

Corporate governance statement (continued)

Audit committee

The audit committee assists the Board with its responsibilities for financial reporting, maintaining an efficient system of internal control and internal and external audit processes. In addition, the committee provides an avenue for communication between internal audit, the external auditors and the Board. The activities of the committee are reported to and considered by the Board. The committee also reviews auditor independence where non-audit services are provided and the auditors confirm their independence as part of their reporting to the audit committee.

Compliance committee

The compliance committee assists the Board with its responsibilities to oversee compliance with obligations determined by statute, legislation, regulation (including licence obligations), contract or agreement. This committee considers, inter alia, reports on the application of the regulatory compliance process which covers licence and network code obligations.

Risk management committee

The risk management committee is responsible for reviewing the risk profile of the business and oversight of risk management processes. The committee provides the Board with regular reports of activities and findings. The business has a formal risk management policy. In addition, an integrated risk management framework is in place that includes a regular review of the business risk exposures. At each meeting of the risk management committee, the high level risk register is considered including any movement in the assessment of risk or changes in measurement or relative position to each other.

Treasury committee

The treasury committee assists the Board in fulfilling its oversight responsibilities with respect to compliance with its treasury policy, strategy and procedure development. The committee recommends any changes or amendments as appropriate. It also ensures that management undertakes to identify, monitor and manage treasury risks in a manner consistent with corporate strategy and objectives and its treasury policy.

Remuneration committee

The remuneration committee reviews and makes recommendations to the Board on overall remuneration policy of the company and determines the salary and bonus entitlement for the CEO, the SMT and all other company employees. The activities of the remuneration committee are reported to the Board at least annually.

Nominations committee

The nominations committee exists to consider potential changes to independent Board membership and to assess the performance of these Directors.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees

The Board is responsible for and makes key decisions on the following areas.

Approving the strategic direction and values, with consideration of the likely consequences in the long term

The Board is responsible to the shareholders for the strategic direction of the company in both the short and long term and seeks to balance the best interests of the company with the objective of enhancing shareholder value.

The long term primary objectives which reflect the strategic value of the company have been established since acquisition in 2005, that being to be a top performing gas distribution network with regard to safety, customer satisfaction and efficiency of delivery. The Board ensure they are aware of how well the company is performing in these areas through the establishment of KPIs which are reported upon at Board meetings, and the Board have linked the remuneration of the SMT to achieving Board approved targets in these areas.

Each autumn the Board invites the CEO to present the performance targets of the company over the next 5 years, with reference to the strategic direction of the company. If approved the Board set these targets as the budget for the following financial year (short term objectives).

In 2019 and 2020 the SMT have been working on the business plan for the next price control period which commences in April 2021, and so the Board have established a steering group combined of NGN staff and shareholder representation. This group has created a medium-term business plan as submitted to Ofgem, which will form the basis of the company's future regulated revenue and ensures the strategic direction and values of the Board are reflected.

The Board approved the existing corporate values of NGN: intellectually curious; trail blazing, heartfelt; empowered, happy and customer focus. To encourage the demonstration of these values, employee performance objectives include the demonstration of these values.

Interests of the company's employees including evaluating the performance and remuneration of employees

The Board has fully encouraged the SMT to make NGN an employee of choice and supports the decisions made by the SMT with regard to employee engagement and evaluation.

The Board and SMT place considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees. This is achieved through various communications including: the CEO's call which are live teleconference broad-casts and include a question and answer section, and are available to be listened to in all offices and depots; regular business chats where groups gather and discuss what is occurring in the business and has SMT representation; email and letter communication when formal communication is needed.

Some employees are eligible to receive an annual bonus related to the overall financial and operational performance of the NGN group along with individual performance against set objectives. Other employees receive monthly incentive payments based on performance against operational efficiency, safety and customer targets.

Corporate governance statement (continued)

Employees are encouraged to influence their own working environment and are able to present changes in working practices, subject to meeting the desired company criteria over customer, safety and efficiency targets.

The overall control environment of the company, to protect the shareholders' investment and manage risk

The Board expect the SMT of the company to develop and maintain a control environment which protects the company's assets. The Board ensure this is achieved through several processes including the establishment of a risk register which is reported to the Board three times a year via the risk management committee. This register quantifies the impact of risks facing NGN, both on a financial and non-financial basis, and documents the likelihood of the risk occurring, along with the controls which exist to mitigate the risk.

The Board have established an internal audit function which undertakes independent appraisals and provides assurance on the adequacy and effectiveness of business controls. All internal audit work is carried out according to the relevant best practice standards. The schedule of work carried out by internal audit is planned and Board approved so that key or higher risk areas are reviewed on a recurring basis, and all findings are reported by internal audit to the audit committee.

In the calendar year the Board approved the establishment of a data governance team, whose focus is ensuring assurance over the accurate capture and reporting of data to third parties, ensuring a further layer of control.

Some of the key controls of the company are those surrounding the financial processes of the company and the Board request a summary of all such financial controls to be documented each year in a document call the Directors Questionnaire. This document is signed by the SMT and is representation to the Board that the SMT have maintained a suitable financial control environment throughout the period, which supports the financial statements for that year. The Board also request the internal and external auditors to review the Directors Questionnaire, so to ensure the document is a true reflection of the control environment in place.

At the end of the financial year COVID-19 became a key consideration for the Board, following the announcement by the UK Government of a UK 'lock down'. The Board established weekly reporting from NGN management, covering safety, operational performance and financial risk.

Maintaining a reputation for high standards of business conduct

As a company we believe that we are trusted by our stakeholders and have a good reputation for high standards of professionalism within the business we conduct.

As part of this the Board look for a strong control environment which is managed through the SMT as detailed in the section above (see 'the overall control environment of the company, to protect the shareholders' investment and manage risk'). As noted in that section the Board review NGN's risk register which includes a quantification of non-financial risks, one of which is reputational risk, which covers the impact of changes in business standards.

The reputation of the company is maintained by the behaviour of its employees and so the Board have approved a code of conduct which is a guide to the professional standards expected of employees. Fraud policies and

Corporate governance statement (continued)

whistleblowing policies also exist to protect the reputation of NGN, should any detrimental employee behaviour exist. Suitable recruitment practices exist to minimise this risk.

Maintaining relationships with key suppliers, customers and other

Under the delegated authority of the Board the SMT has established a dedicated commercial services team covering all elements of procurement and supplier relations. All contracts are signed off by members of the SMT having first been reviewed by the NGN legal department and having agreed terms with the supplier. Within the commercial services team there is a dedicated contract management function which supports in pre-contract activity and also post-contract work including the review of variations, again to ensure a strong relationship with suppliers. NGN seek to treat all suppliers fairly through compliance with the policies of the Official Journal of the European Union (OJEU).

The Board are focused on maintaining strong relationships with NGN's customers to ensure this is to the benefit of both parties. NGN's primary customers are shippers, who transport gas through the network, and the communities (both businesses and residents) in which NGN work. Shipper relationships are managed through the application of Unified Network Code, the regulations established by Ofgem, and this regulation ensures fair working practice is maintained. The impact of NGN's work on community customers is important to the Board and NGN not only monitor feedback through customer feedback scores, but also spend time engaging with communities to understand how NGN could work differently to the benefit of such communities (see next section, 'monitoring the impact of the company: environmental matters and community impact').

Other key stakeholders include, Ofgem and the HSE with whom NGN have ongoing relationships. NGN have designated regulation and health and safety teams who work with these stakeholders.

Monitoring the impact of the company: environmental matters and community impact

Stakeholder engagement is of utmost importance to NGN and encouraged by the Board via delegation to the SMT.

In the current financial year NGN has continued to engage with local communities to understand how NGN could work differently to the benefit of such communities, and some of these findings have fed into NGN's business plan for the next price control. NGN continue to invest in local communities by providing free energy to vulnerable customers, and this has been rewarded with two accolades at the Corporate Social Responsibility awards in November 2019. Carbon monoxide awareness is another scheme we continue to push at NGN.

NGN's environmental impact and carbon footprint is an area of focus which the Board is encouraging the SMT to look at. To facilitate a greater understanding of this NGN report environmental data and report policies and procedures via shareholder submissions on an annual basis. These feed into group wide Dow Jones Sustainability Index and Hang Seng Corporate Sustainability Index submissions.

Dividend payments

The Board approve any dividend declarations that are recommended by the CEO with the payment of such dividends made subsequent to such approvals.

Corporate governance statement (continued)

Maintenance of the need to act fairly between members of the company

The Board is comprised of directors who are appointed by the shareholders of the group. As such each shareholder has representation and the ability to contribute to all Board meetings and so influence the decisions made by the Board.

The shareholder agreement in place for NGN is a legal entitlement for each shareholder to have this representation and as such the shareholders are appropriately protected.

Independent auditor's report of Northern Gas Networks Limited (continued)

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Northern Gas Networks Limited (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 March 2020 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the statement of accounting policies; and
- the related notes 1 to 21.

The financial reporting framework that has been applied in their preparation is applicable law and United Kingdom Accounting Standards, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland" (United Kingdom Generally Accepted Accounting Practice).

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 company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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.

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

Independent auditor's report of Northern Gas Networks Limited (continued)

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.

We have nothing to report in respect of these matters.

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 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 company or to cease operations, or have no realistic alternative but to do so.

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 FRC's website at: www.frc.org.uk/auditorsresponsibilities. This description forms part of our auditor's report.

Report on other legal and regulatory requirements

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

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

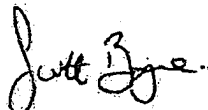
- adequate accounting records have not been kept, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns; or
- certain disclosures of directors' remuneration specified by law are not made; or
- we have not received all the information and explanations we require for our audit.

We have nothing to report in respect of these matters.

Independent auditor's report of Northern Gas Networks Limited (continued)

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

A handwritten signature in black ink, appearing to read 'Scott Bayne'.

Scott Bayne FCA (Senior Statutory Auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

Leeds, United Kingdom

22 July 2020

Profit and loss account

For the year ended 31 March 2020

| | Notes | 2020 £'000 | 2019 £'000 |
|--|-------|---------------|---------------|
| Turnover | 1 | 450,031 | 409,603 |
| Cost of sales | | (10,594) | (9,534) |
| Gross profit | | 439,437 | 400,069 |
| Other operating expenses | 2 | (226,152) | (212,690) |
| Operating profit | | 213,285 | 187,379 |
| Finance charges (net) | 3 | (47,940) | (44,791) |
| Profit on ordinary activities before taxation | 4 | 165,345 | 142,588 |
| Tax on profit on ordinary activities | 7 | (83,727) | (26,906) |
| Profit for the financial year | | 81,618 | 115,682 |

The above results arise from continuing operations.

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

The accompanying notes are an integral part of this profit and loss account.

Statement of comprehensive income
For the year ended 31 March 2020

| | 2020 £'000 | 2019 £'000 |
|--|----------------|----------------|
| Profit for the financial year | 81,618 | 115,682 |
| Re-measurement of defined benefit asset (note 19) | 41,967 | (14,550) |
| Losses in respect of cash flow hedges | (18,060) | (9,516) |
| Transferred to profit or loss in respect of cash flow hedges | 6,188 | 5,617 |
| Tax relating to components of other comprehensive income | (5,194) | 3,136 |
| Comprehensive income relating to the year | 106,519 | 100,369 |

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

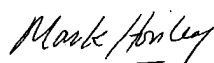
The accompanying notes are an integral part of this statement of comprehensive income.

Balance sheet
As at 31 March 2020

| | Notes | 2020 £'000 | 2019 £'000 |
|--|-------|--------------------|--------------------|
| Fixed assets | | | |
| Intangible assets | 9 | 167,121 | 163,014 |
| Tangible fixed assets | 10 | 2,528,200 | 2,451,382 |
| Investments | 11 | 10,206 | 12,611 |
| | | <u>2,705,527</u> | <u>2,627,007</u> |
| Current assets | | | |
| Debtors – amounts falling due within one year | 12 | 100,598 | 204,588 |
| amounts falling due after one year | 12 | 459,879 | 345,562 |
| Cash at bank and in hand | | 13,613 | 21,172 |
| | | <u>574,090</u> | <u>571,322</u> |
| Creditors: Amounts falling due within one year | 13 | <u>(193,240)</u> | <u>(356,476)</u> |
| Net current assets | | <u>380,850</u> | <u>214,846</u> |
| Total assets less current liabilities | | <u>3,086,377</u> | <u>2,841,853</u> |
| Creditors: Amounts falling due after more than one year | 14 | <u>(2,064,518)</u> | <u>(1,879,304)</u> |
| Provisions for liabilities | 16 | <u>(359,703)</u> | <u>(309,892)</u> |
| Net assets | | <u>662,156</u> | <u>652,657</u> |
| Capital and reserves | | | |
| Called-up share capital | 17 | 24,328 | 24,328 |
| Hedging reserve | | (31,699) | (22,629) |
| Profit and loss account | | <u>669,527</u> | <u>650,958</u> |
| Shareholders' funds | | <u>662,156</u> | <u>652,657</u> |

The accompanying notes are an integral part of this balance sheet.

The accounts of Northern Gas Networks Limited, Registered number 05167070, were approved by the Board of Directors and authorised for issue on 22 July 2020 and signed on its behalf by:



M J Horsley
Director
22 July 2020

Statement of changes in equity

For the year ended 31 March 2020

| | Called up share capital £'000 | Hedging reserve £'000 | Profit and loss account £'000 | Total £'000 |
|--|-------------------------------------|-----------------------------|--|----------------|
| At 1 April 2018 | 24,328 | (19,392) | 640,802 | 645,738 |
| Profit for the financial year | - | - | 115,682 | 115,682 |
| Remeasurement of defined benefit liability (note 19) | - | - | (14,550) | (14,550) |
| Tax on remeasurement of defined benefit liability | - | - | 2,474 | 2,474 |
| Cash flow hedges: losses arising during the year | - | (3,899) | - | (3,899) |
| Tax on cash flow hedges movement | - | 662 | - | 662 |
| Total comprehensive income | - | (3,237) | 103,606 | 100,369 |
| Dividends paid on equity shares (note 8) | - | - | (93,450) | (93,450) |
| At 31 March 2019 | 24,328 | (22,629) | 650,958 | 652,657 |
| Profit for the financial year | - | - | 81,618 | 83,504 |
| Remeasurement of defined benefit liability (note 19) | - | - | 41,967 | 41,967 |
| Tax on remeasurement of defined benefit liability | - | - | (7,996) | (7,996) |
| Cash flow hedges: losses arising during the year | - | (11,872) | - | (11,872) |
| Tax on cash flow hedges movement | - | 2,802 | - | 2,802 |
| Total comprehensive income | - | (9,070) | 115,589 | 106,519 |
| Dividends paid on equity shares (note 8) | - | - | (97,020) | (97,020) |
| At 31 March 2020 | 24,328 | (31,699) | 669,527 | 662,156 |

Statement of accounting policies

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

Basis of accounting

Northern Gas Networks Limited is a company incorporated in the United Kingdom under the Companies Act. The company is a private company limited by shares and is registered in England and Wales. The address of the company and its registered office is 1100 Century Way, Leeds, LS15 8TU. The accounts have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council. The Company has applied the amendments to FRS 102 issued by the FRC in December 2017 with effect from 1 January 2019. The transitional provisions relating to the triennial review amendments have not resulted in any restatements of comparative information by the Company. Principal activities and the nature of operations are shown in the strategic report.

The company is not required to prepare group accounts as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited (NGNH) which prepares consolidated accounts which are publicly available. The company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it. Exemptions have been taken in relation to presentation of cash flow statements and remuneration of key management personnel. The functional currency is considered to be pounds sterling because that is the currency of the primary economic environment in which the group operates. The financial statements are also presented in pounds sterling.

Going concern

The group's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out in the strategic report and above. In addition notes 13 - 15 and the Directors' report include further details of the group's debt position and details of its derivatives and other financial instruments. The group is able to pay its liabilities as they fall due, due to the reliability of regulated revenue. The group has significant liquid resources and uses long term debt instruments to mitigate any liquidity risk as detailed in the strategic report.

The company continues to consider the potential impact of Brexit on its business, through the transition period and beyond. For now, existing laws and trading arrangements are unchanged. Based on the assessment of the latest available information, our principal risk continues to be that there could be a sustained period when the import of certain raw materials could be challenging, which could curtail planned work if inventory levels were depleted. In mitigation, stock levels of critical spares have been elevated as at 31 March 2020 held in Northern Gas Networks Operations Limited.

The implications of the next price control, RIIO-GD2, are not yet finalised with final proposals expected in late 2020. Correspondence with Ofgem to date indicates that the latest expectation of management, which formed the basis of the financial plan to December 2024 presented to the Board, will be close to the final outcome. The Board are confident that the outcome does not realise any risk to going concern.

The directors have made enquiries and reviewed the forecasts, including sensitivity analysis which include the impact of COVID-19 as detailed in the strategic report, and in light of the facilities available to the group, have a reasonable

Statement of accounting policies (continued)

expectation that the company and 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 Report and accounts.

Intangible assets – goodwill

Goodwill arising on the acquisition of subsidiary undertakings and businesses, representing any excess of the fair value of the consideration given over the fair value of the identifiable assets and liabilities acquired, is capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment.

Intangible assets – licence

The Gas Transporter Licence (licence) has been recognised as a separately identifiable intangible asset, the value of which has been derived from an independent valuation. The licence has been capitalised and written off on a straight line basis over its useful economic life, which is estimated to be 40 years in line with the acquired asset base. Provision is made for any impairment.

Intangible assets – computer software

Costs associated with maintaining computer software are recognised as expenses are incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the company are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software so that it will be available for use;
- management intends to complete the software and use of it;
- there is an ability to use the software;
- it can be demonstrated how the software will generate probable future economic benefit;
- adequate technical, financial and other resources to complete the development and to use the software are available; and
- the expenditure attributable to the software during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software include the software development employee costs and an appropriate portion of relevant overheads. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period.

Computer software development costs recognised as assets are amortised over their estimated useful lives on a straight line basis, which range from 3 to 10 years. Computer software under construction is not amortised until it is ready for use. Development costs have been capitalised in accordance with FRS 102 Section 18 Intangible Assets other than Goodwill and are therefore not treated, for dividend purposes, as a realised loss

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes internal labour costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and

Statement of accounting policies (continued)

credited on a straight-line basis to the profit and loss account over the estimated economic lives of the assets. No residual value is estimated for assets. Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

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

Investments

Fixed asset investments are shown at cost less any provision for impairment. Current asset investments are stated at the lower of cost and net realisable value.

Replacement expenditure (repex)

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing sections of pipe. This expenditure is principally undertaken to maintain the safety of the network and is capitalised.

Stocks

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

Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the UK tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the company's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the accounts. A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted. Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the accounts. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Statement of accounting policies (continued)

Taxation (continued)

Deferred tax is measured using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date that are expected to apply to the reversal of the timing difference. Deferred tax is measured on a non-discounted basis.

Provisions

Gas holder decommissioning and restructuring costs are provided for in full and discounted when the impact is considered to be material. Environmental costs are provided for in full, the liability being based on a probability basis. Claims costs are provided for in full and discounted, the unwinding of the discount being included within the profit and loss account as a financing charge.

Turnover

Turnover represents income receivable for the distribution of gas and provision of other services in the normal course of business, net of Value Added Tax. Turnover includes an assessment of transportation services supplied to customers between the date of the last meter reading and the year end. Turnover is recognised in the month the service is provided.

Pension costs

The company has obligations for a defined benefit scheme. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments which are included within operating costs. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total comprehensive income.

The defined benefit scheme is funded with the assets of the scheme held separately from those of the group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. A resulting defined benefit asset is presented within debtors gross, with the deferred tax shown within provisions. Assets are only recognised when the company has a legal right to cash on windup.

The company also operates defined contribution schemes. The amount charged to the profit and loss account in respect of pension costs and other post-retirement benefits is the contributions payable in the period. Differences between contributions payable in the period and contributions actually paid are shown as either accruals or prepayments in the consolidated balance sheet.

Statement of accounting policies (continued)

Leases

Assets held under finance leases and other similar contracts, which confer rights and obligations similar to those attached to owned assets, are capitalised as tangible fixed assets and are depreciated over the shorter of the lease terms and their useful economic lives. The capital elements of future lease obligations are recorded as liabilities, while the interest elements are charged to the profit and loss account over the period of the leases to produce a constant rate of charge on the balance of capital repayments outstanding. Hire purchase transactions are dealt with similarly, except that assets are depreciated over their useful economic lives.

Rentals under operating leases are charged on a straight-line basis over the lease term, even if the payments are not made on such a basis. Benefits received and receivable as an incentive to sign an operating lease are similarly spread on a straight-line basis over the lease term, except where the period to the review date on which the rent is first expected to be adjusted to the prevailing market rate is shorter than the full lease term, in which case the shorter period is used.

Financial instruments

Financial assets and financial liabilities are recognised when the company becomes a party to the contractual provisions of the instrument. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

Financial assets and liabilities

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value (which is normally the transaction price excluding transaction costs), unless the arrangement constitutes a financing transaction. If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Financial assets and liabilities are only offset in the statement of financial position when, and only when there exists a legally enforceable right to set off the recognised amounts and the company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

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

- a) The contractual return to the holder is (i) a fixed amount; (ii) a positive fixed rate or a positive variable rate; or (iii) a combination of a positive or a negative fixed rate and a positive variable rate.

Statement of accounting policies (continued)

Financial instruments (continued)

- b) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged. The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that (i) the new rate satisfies condition (a) and the variation is not contingent on future events other than (1) a change of a contractual variable rate; (2) to protect the holder against credit deterioration of the issuer; (3) changes in levies applied by a central bank or arising from changes in relevant taxation or law; or (ii) the new rate is a market rate of interest and satisfies condition (a).
- c) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods.
- d) Contractual provisions that permit the issuer to prepay a debt instrument or permit the holder to put it back to the issuer before maturity are not contingent on future events, other than to protect the holder against the credit deterioration of the issuer or a change in control of the issuer, or to protect the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.
- e) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c).

Debt instruments that are classified as payable or receivable within one year on initial recognition and which meet the above conditions are measured at the undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment.

With the exception of some hedging instruments, other debt instruments not meeting these conditions are measured at fair value through profit or loss. Commitments to make and receive loans which meet the conditions mentioned above are measured at cost (which may be nil) less impairment.

Financial assets are derecognised when and only when a) the contractual rights to the cash flows from the financial asset expire or are settled, b) the company transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or c) the company, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

Cash is treated as a basic financial instrument in accordance with FRS102. Cash and cash equivalents represent cash held and readily available overnight deposits.

Derivative financial instruments

The company only holds or issues derivative financial instruments to manage interest rate exposures or commodity price risks in respect of expected gas usage. The principal derivatives used are interest rate swaps. The company does not hold or issue any derivative financial instruments for speculative purposes.

Statement of accounting policies (continued)

Derivative financial instruments (continued)

Interest rate swaps are entered into for the purpose of matching or eliminating risk from potential movements in interest rates associated with the borrowing requirements of the company. The interest rate swaps are accounted for at fair value on the balance sheet with movements in fair value being recognised through either the profit and loss account or cash flow hedge reserve.

The company applies the recognition and movement principles of IFRS 9: Financial Instruments, as applicable within FRS 102.

Fair value accounting

The best evidence of fair value is a quoted price for an identical asset in an active market. When quoted prices are unavailable, the price of a recent transaction for an identical asset provides evidence of fair value as long as there has not been a significant change in economic circumstances or a significant lapse of time since the transaction took place. If the market is not active and recent transactions of an identical asset on their own are not a good estimate of fair value, the fair value is estimated by using a valuation technique.

Hedge accounting

The company designates certain derivatives as hedging instruments in cash flow hedges and certain others as hedging instruments in Fair Value hedges. At the inception of the hedge relationship, the entity documents the economic relationship between the hedging instrument and the hedged item, along with its risk management objectives and clear identification of the risk in the hedged item that is being hedged by the hedging instrument. Furthermore, at the inception of the hedge the Company determines and documents causes for hedge ineffectiveness.

Amounts payable or receivable in respect of the interest rate swaps are recognised within net interest payable in the profit and loss account over the life of the financial instrument.

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

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

Interest receivable

Interest receivable is recognised on an accruals basis in accordance with FRS102.

Statement of accounting policies (continued)

Critical accounting judgments and key sources of estimation uncertainty

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

Critical judgements in applying the group's accounting policies

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

Key sources of estimation uncertainty

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

Fair value of financial instruments

Some of the group's assets and liabilities are measured at fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the company uses market-observable data to the extent it is available, using an individual trade basis provided by an external reporting system meaning market assumptions are applied by the third party and not by the company. Further details can be found within note 15.

Pension arrangements

Note 19 contains information about the principal actuarial assumptions used in the determination of defined benefit pension obligations. These key assumptions include discount rates, inflation and mortality rates and have been determined following advice received from an independent qualified actuary. The scheme net surplus of £65m (consisting of assets of £464m and liabilities of £399m) was based on underlying scheme asset valuations as at 31 March 2020. Valuations as at 31 March 2020 for £46m of the £464m constituting 10% of total assets were valued at 31 March 2020 in respect of property funds. The property valuers' have included a material uncertainty on the value of the properties at the valuation date. Management has considered each fund where a material uncertainty has been included by the valuer and concluded that this does not lead to a material change to the value disclosed as at the balance sheet date.

Notes to the accounts

For the year ended 31 March 2020

1 Turnover and post balance sheet events

The directors consider that the company has only one class of business. The company's turnover is generated wholly from within the UK, principally being from gas distribution in the North of England.

There are no post balance sheet events to report.

2 Other operating expenses

| | 2020 £'000 | 2019 £'000 |
|-------------------------|----------------|----------------|
| Distribution costs | 167,506 | 158,753 |
| Administrative expenses | 58,646 | 53,937 |
| | <u>226,152</u> | <u>212,690</u> |

3 Finance charges (net)

| | 2020 £'000 | 2019 £'000 |
|--------------------------------------|---------------|---------------|
| Interest payable and similar charges | 50,531 | 51,962 |
| Less: investment income | (378) | (293) |
| Other finance (income) charges | (2,213) | (6,878) |
| | <u>47,940</u> | <u>44,791</u> |

Interest payable and similar charges

| | 2020 £'000 | 2019 £'000 |
|-------------------------------|---------------|---------------|
| Bank loans and overdrafts | 12,275 | 5,165 |
| Intercompany interest payable | 39,822 | 48,590 |
| | <u>52,097</u> | <u>53,755</u> |
| Finance costs capitalised | (1,566) | (1,793) |
| | <u>50,531</u> | <u>51,962</u> |

Finance costs have been capitalised based on a cost of debt capitalisation rate of 3.40% (2019 – 3.60%). Cumulative capitalised costs amount to £15.3m (2019 - £13.8m).

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Investment income

| | 2020 £'000 | 2019 £'000 |
|--|---------------|---------------|
| Interest receivable and similar income | (378) | (293) |
| | <u>(378)</u> | <u>(293)</u> |

Other finance (income) charges

| | 2020 £'000 | 2019 £'000 |
|--|----------------|----------------|
| Asset backed contribution pension movement | (2,909) | (3,041) |
| Fair value movement on financial investments (see note 15) | 773 | (3,251) |
| Exchange rate differences | 155 | 109 |
| Unwinding of discount on provisions (see note 16) | 259 | 105 |
| Net return on pension scheme (see note 19) | (491) | (800) |
| | <u>(2,213)</u> | <u>(6,878)</u> |

4 Profit on ordinary activities before taxation

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

| | 2020 £'000 | 2019 £'000 |
|--|---------------|---------------|
| Depreciation and amounts written off tangible fixed assets (see note 10) | 74,385 | 71,016 |
| Amortisation of intangible fixed assets included in administrative expenses (note 9) | 12,588 | 7,595 |
| Profit on disposal of fixed assets | (745) | (438) |
| Operating lease rentals - vehicles | 680 | 1,028 |
| Operating lease rentals - property | 1,519 | 1,421 |
| Fees payable to the company's auditor for the audit of the company's annual accounts | <u>88</u> | <u>88</u> |

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated accounts of the parent company are required to disclose such fees on a consolidated basis.

Notes to the accounts (continued)

5 Staff costs

The below disclosures relate to staff within Northern Gas Networks Operations Limited, a subsidiary of the company who recharges all its payroll costs to the company. The company itself has no employees.

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

| | 2020 Number | 2019 Number |
|----------------|----------------|----------------|
| Administration | 127 | 129 |
| Operations | 1,339 | 1,302 |
| Total | <u>1,466</u> | <u>1,431</u> |

| | 2020 £'000 | 2019 £'000 |
|---|---------------|---------------|
| Their aggregate remuneration comprised: | | |
| Wages and salaries | 62,332 | 61,106 |
| Social security costs | 6,320 | 6,592 |
| Pension costs | 6,697 | 6,944 |
| | <u>75,349</u> | <u>74,642</u> |

Notes to the accounts (continued)

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

| | Non-Executive Directors | | Executive Directors | |
|--|-------------------------|-----------|---------------------|--------------|
| | 2020 | 2019 | 2020 | 2019 |
| | £'000 | £'000 | £'000 | £'000 |
| Emoluments | 75 | 70 | 911 | 886 |
| Amounts receivable (other than shares) under long-term incentive schemes | - | - | 244 | 237 |
| | <u>75</u> | <u>70</u> | <u>1,155</u> | <u>1,123</u> |

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

Pensions

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

Highest paid director

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

| | 2020 | 2019 |
|------------|--------------|--------------|
| | £'000 | £'000 |
| Emoluments | <u>1,155</u> | <u>1,123</u> |

Transactions

There have been no transactions with directors in the year (2019 – £nil) other than as set out above in respect of remuneration. Only directors are deemed to be key personnel.

Notes to the accounts (continued)

7 Tax on profit on ordinary activities

The tax charge comprises:

| | 2020 £'000 | 2019 £'000 |
|---|---------------|---------------|
| Current tax | | |
| UK corporation tax | 38,457 | 30,153 |
| Adjustments in respect of prior periods | (1,763) | (5,428) |
| Total current tax | <u>36,694</u> | <u>24,725</u> |
| Deferred tax | | |
| Current period - origination and reversal of timing differences | 7,850 | (3,228) |
| Effect of increase in tax rate on opening liability | 35,650 | - |
| Adjustments in respect of prior periods | 3,533 | 5,409 |
| Total deferred tax | <u>47,033</u> | <u>2,181</u> |
| Total tax on profit on ordinary activities | <u>83,727</u> | <u>26,906</u> |

The differences between the total tax shown above and the amount calculated by applying the standard rate of UK corporation tax to the profit before tax is as follows:

| | 2020 £'000 | 2019 £'000 |
|--|----------------|----------------|
| Profit on ordinary activities before tax | <u>165,345</u> | <u>142,588</u> |
| Tax on profit on ordinary activities at standard UK corporation tax rate of 19.0% (2019 – 19.0%) | 31,416 | 27,092 |
| Effects of: | | |
| Expenses not deductible for tax purposes | 605 | 123 |
| Income not taxable in determining taxable profit | (586) | (497) |
| Differences in tax rates | - | 207 |
| Interest not deductible for tax purposes | 1,140 | - |
| Change in tax rate on opening position* | 35,654 | - |
| Deferred tax on intangible** | 13,729 | - |
| Adjustments in respect of prior year | 1,769 | (19) |
| Total tax charge for the period | <u>83,727</u> | <u>26,906</u> |

The company earns its profits in the UK. Therefore, the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 19.0% (2019 – 19.0%).

Notes to the accounts (continued)

7 Tax on profit on ordinary activities (continues)

The planned level of capital investment is expected to remain at similar levels as current investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years, at a similar level to the current period. Deferred taxation is measured at tax rates that are expected to apply in the periods in which temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date. Accordingly, 19% has been applied when calculating deferred tax assets and liabilities as at 31 March 2020.

* In March 2020 the group restated deferred tax balances to 19% from 17% following the announcement from the Government that the previously enacted legislation to take UK corporation tax rates to 17% rate was to be removed. The impact of this one off charge was £35.7m.

** In the year deferred tax of £13.7m was recognised on an intangible for which the tax deductibility is under enquiry with HMRC, and this reflects the latest status of the enquiry. In determining the estimated provision at the year end, the directors would highlight that the range of possible outcomes could result in an adjustment to the deferred tax recognised, however the directors do not consider that it is likely that any subsequent adjustment would be material. To illustrate, a 1% adjustment in the level of tax deduction would result in a £0.3m adjustment in the deferred tax provision required.

8 Dividends on equity shares

| | 2020 £'000 | 2019 £'000 |
|--|---------------|---------------|
| Equity shares | | |
| - interim dividend paid of £0.76 (2019 - £0.73) per ordinary share | 18,600 | 17,750 |
| - interim dividend paid of £3.22 (2019 - £3.11) per ordinary share | 78,420 | 75,700 |
| | <u>97,020</u> | <u>93,450</u> |

Notes to the accounts (continued)

9 Intangible assets

| | Licence £'000 | Goodwill £'000 | Software £'000 | Software in the course of construction £'000 | Total £'000 |
|-----------------------|------------------|-------------------|-------------------|---|----------------|
| Cost | | | | | |
| At 1 April 2019 | 161,200 | 3,257 | 33,530 | 40,422 | 238,409 |
| Additions | - | - | - | 16,695 | 16,695 |
| Transfers | - | - | 53,035 | (53,035) | - |
| At 31 March 2020 | <u>161,200</u> | <u>3,257</u> | <u>86,565</u> | <u>4,082</u> | <u>255,104</u> |
| Amortisation | | | | | |
| At 1 April 2019 | 55,751 | 1,124 | 18,520 | - | 75,395 |
| Charge for the year | <u>4,027</u> | <u>84</u> | <u>8,477</u> | <u>-</u> | <u>12,588</u> |
| At 31 March 2020 | <u>59,778</u> | <u>1,208</u> | <u>26,997</u> | <u>-</u> | <u>87,983</u> |
| Net book value | | | | | |
| At 31 March 2020 | <u>101,422</u> | <u>2,049</u> | <u>59,568</u> | <u>4,082</u> | <u>167,121</u> |
| At 31 March 2019 | <u>105,449</u> | <u>2,133</u> | <u>15,010</u> | <u>40,422</u> | <u>163,014</u> |

Goodwill and licences are described within the accounting policies note of the accounts. Within software the biggest individual assets are those related to the new SAP system which become operational within the period and had a carrying value of £42.0m at 31 March 2020 and a useful economic life ending in 2029.

Notes to the accounts (continued)

10 Tangible fixed assets

| | Land and buildings £'000 | Gas distribution assets £'000 | Motor vehicles £'000 | Reclassified Other equipment £'000 | Reclassified Assets in the course of construction £'000 | Total £'000 |
|-----------------------|--------------------------------|--|----------------------------|---|---|------------------|
| Cost | | | | | | |
| At 1 April 2019 | 8,479 | 2,934,407 | 23,350 | 110,275 | 19,250 | 3,095,761 |
| Additions | 329 | 99,754 | 46 | 1,888 | 49,219 | 151,236 |
| Disposals | (4) | - | (641) | - | - | (645) |
| Transfers | 3,766 | 31,724 | - | 272 | (35,762) | - |
| At 31 March 2020 | <u>12,570</u> | <u>3,065,885</u> | <u>22,755</u> | <u>112,435</u> | <u>32,707</u> | <u>3,246,352</u> |
| Depreciation | | | | | | |
| At 1 April 2019 | 5,199 | 545,071 | 11,048 | 83,061 | - | 644,379 |
| Charge for the period | 831 | 61,686 | 2,467 | 9,401 | - | 74,385 |
| Disposals | (4) | - | (608) | - | - | (612) |
| At 31 March 2020 | <u>6,026</u> | <u>606,757</u> | <u>12,907</u> | <u>92,462</u> | <u>-</u> | <u>718,152</u> |
| Net book value | | | | | | |
| At 31 March 2020 | <u>6,544</u> | <u>2,459,128</u> | <u>9,848</u> | <u>19,973</u> | <u>32,707</u> | <u>2,528,200</u> |
| At 31 March 2019 | <u>3,280</u> | <u>2,389,336</u> | <u>12,302</u> | <u>27,214</u> | <u>19,250</u> | <u>2,451,382</u> |

Undepreciated freehold land equates to £774,000 at 31 March 2020 (2019 - £774,000).

Notes to the accounts (continued)

11 Investments

| | 2020 £'000 | 2019 £'000 |
|-------------------------|---------------|---------------|
| Subsidiary undertakings | 10,102 | 12,507 |
| Other investments | 104 | 104 |
| | <u>10,206</u> | <u>12,611</u> |

The reduction in the carrying value of the subsidiary undertaking relates to Northern Gas Networks Pension Funding Limited Partnership.

The company has an investment in the following subsidiary undertakings:

| Subsidiary undertaking | Country of incorporation | Principal activity | Holding | % |
|---|--------------------------|------------------------|------------------------------|-----|
| Northern Gas Networks Finance Plc ("NGNF") | England & Wales | Financing | 49,999 ordinary shares of £1 | 100 |
| Northern Gas Networks Operations Limited ("NGNOL") | England & Wales | Gas network operations | 2 ordinary shares of £1 | 100 |
| Northern Gas Networks Pensions Trustee Limited ("NGNPT") | England & Wales | Pension scheme trustee | 1 ordinary share of £1 | 100 |
| Northern Gas Networks General Partners Limited | Scotland | Pension partnership | 100 ordinary shares of £1 | 100 |
| Northern Gas Networks Pension Funding Limited Partnership | Scotland | Pension partnership | n/a | n/a |

All subsidiaries have a registered address of 1100 Century Way, Leeds, LS15 8TU, with the exception of Northern Gas Networks General Partner Limited and Northern Gas Networks Pension Funding Limited Partnership whose registered office is 1st Floor, City Point, Haymarket Terrace, Edinburgh, EH12 5HD, Scotland.

The other investment represents a 10.38% holding in Xoserve Limited, which provides information, data processing, invoicing and supply point administration services to the company. Xoserve Limited is registered in England & Wales.

The company also holds 1 ordinary share of £1 in Smart Energy Code Company Limited (registered in England & Wales) which represents a holding of 1.15%.

Notes to the accounts (continued)

11 Investments (continued)

Subsidiary undertakings

| | £'000 |
|--|---------------|
| Cost and net book value | |
| At 1 April 2019 | 12,507 |
| Impairment in the year | (1,400) |
| Repayment against investment in the year | (1,005) |
| At 31 March 2020 | <u>10,102</u> |

During the year the investment in NGNOL was impaired by £1.4m.

Other investments

| | £'000 |
|-----------------------------------|------------|
| Cost and net book value | |
| At 1 April 2019 and 31 March 2020 | <u>104</u> |

12 Debtors

| | 2020 £'000 | 2019 £'000 |
|---|----------------|----------------|
| Amounts falling due within one year | | |
| Deposits with banks | - | 90,000 |
| Trade debtors | 657 | 1,252 |
| Other debtors | 56,166 | 57,607 |
| Accrued income | 38,837 | 35,387 |
| Prepayments | - | 9,692 |
| Derivative financial assets (note 15) | 4,938 | 10,650 |
| | <u>100,598</u> | <u>204,588</u> |
| Amounts falling due after more than one year | | |
| Defined benefit pension scheme (see note 19) | 65,412 | 16,935 |
| Derivative financial assets (note 15) | 394,467 | 328,627 |
| | <u>459,879</u> | <u>345,562</u> |
| | <u>560,477</u> | <u>550,150</u> |

Deposits with banks represent, cash held with banks which are on short term deposit and have been deemed as a cash equivalent in the group accounts which includes a cash flow statement.

Notes to the accounts (continued)

13 Creditors: Amounts falling due within one year

| | 2020 £'000 | 2019 £'000 |
|--|----------------|----------------|
| Bank loans | 59,667 | - |
| Amounts owed to group undertakings | 52,704 | 258,007 |
| Derivative financial liabilities (see note 15) | 538 | 10,726 |
| Payments received on account | 5,645 | 1,270 |
| Trade creditors | - | 72 |
| UK corporation tax | 41,514 | 46,803 |
| Other taxation and social security | 19,410 | 20,667 |
| Accruals and deferred income | 13,762 | 18,931 |
| | <u>193,240</u> | <u>356,476</u> |

The bank loan comprises a £60.0m loan with £20.0m at an interest rate of 0.639% repayable on 20 April 2020 and £40.0m at an interest rate of 0.644% repayable on 30 April 2020. Amounts owed to group undertakings is unsecured, interest free and repayable on demand. The balances arise in relation to rechargeable services provided by other group companies.

14 Creditors: Amounts falling due after more than one year

| | 2020 £'000 | 2019 £'000 |
|--|------------------|------------------|
| Loan note | 65,563 | 68,009 |
| Bank loans | 425,789 | 427,632 |
| Amounts owed to group undertakings | 905,092 | 879,348 |
| Deferred income | 131,387 | 124,780 |
| Derivative financial liabilities (see note 15) | 221,192 | 172,935 |
| USPP 2029 loan | 52,982 | 51,267 |
| USPP 2031 loan | 162,813 | 155,333 |
| USPP 2039 loan | 99,700 | - |
| | <u>2,064,518</u> | <u>1,879,304</u> |

The £65.6m (2019 - £68.0m) loan note is held with Northern Gas Networks Pension Funding Limited Partnership with interest being variable with RPI.

The amounts owed to group undertakings are an interest bearing loan of £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035 with interest of 4.875% plus a margin to cover related costs, and an interest bearing loan of £197.9m repayable in 2040 with interest of 5.625% plus a margin to cover related costs. The sum total of these loans is £702.9m with a carrying value in the balance sheet being £865.8m. The difference represents the fair value adjustments on the portion of the loan from Northern Gas Networks Finance Plc that is in a Fair Value hedge relationship.

Notes to the accounts (continued)

14 Creditors: Amounts falling due after more than one year (continued)

Creditors falling due after more than one year represented by debt and other financial instruments are as follows:

| Debt instrument | Maturity date | Interest rate / basis | Principal amount (£m) | Fair value adjustment (£m) | Unamortised costs & discounts (£m) | Book value (£m) |
|---|---------------|---|-----------------------|----------------------------|------------------------------------|-----------------|
| US Private Placements | | | | | | |
| US Private Placement notes | 10/01/2029 | 2.84% fixed | 50.0 | 3.1 | (0.1) | 53.0 |
| US Private Placement notes | 10/01/2031 | 2.97% fixed | 150.0 | 13.3 | (0.5) | 162.8 |
| US Private Placement notes | 26/06/2039 | 2.71% fixed | 100.0 | - | (0.3) | 99.7 |
| Bank Loans | | | | | | |
| European Investment Bank fixed rate loan | 20/12/2024 | 3.446% fixed | 40.0 | - | - | 40.0 |
| European Investment Bank floating rate loan | 23/01/2023 | 3 month Libor + 0.357% | 25.0 | - | - | 25.0 |
| European Investment Bank floating rate loan | 30/03/2024 | 3 month Libor + 0.624% | 100.0 | - | - | 100.0 |
| European Investment Bank floating rate loan | 24/06/2024 | 3 month Libor + 0.548% | 25.0 | - | - | 25.0 |
| European Investment Bank floating rate loan | 30/07/2024 | 3 month Libor + 0.458% | 60.0 | - | - | 60.0 |
| European Investment Bank floating rate loan | 31/03/2027 | 3 month Libor + 0.534% | 30.0 | - | - | 30.0 |
| European Investment Bank floating rate loan | 28/02/2028 | 3 month Libor + 0.627% | 30.0 | - | - | 30.0 |
| European Investment Bank floating rate loan | 20/12/2028 | 3 month Libor + 0.934% | 40.0 | - | - | 40.0 |
| European Investment Bank floating rate loan | 29/03/2029 | 3 month Libor + 0.834% | 50.0 | - | - | 50.0 |
| European Investment Bank amortising loan | 25/03/2034 | 3 month Libor + 0.860% | 25.8 | - | - | 25.8 |
| Derivative Financial Liabilities | | | | | | |
| Interest rate derivatives designated as fair value hedges | Various | Receive fixed, pay 6 Month Libor + margin | - | - | - | 0.0 |
| Interest rate derivatives designated as cash flow hedges | Various | Pay fixed, receive 3 or 6 month Libor | - | - | - | 30.9 |
| Other interest rate derivatives | Various | Various | - | - | - | 190.3 |
| Intercompany loans | | | | | | |
| Amounts owed to group undertakings (amounts due >1 year)* | Various | Various | 702.9 | 202.2 | - | 905.1 |

* This intercompany loan balance pertains to fixed rate bonds dealt by NGNF. NGNF is the bond issuer to the market within the group. The bonds are then passed to its parent, NGN, as a series of intercompany loans with terms that mirror the issued bonds.

Notes to the accounts (continued)

15 Derivatives and other financial instruments

The carrying values of the company's financial assets and liabilities are summarised by category below.

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

| | 2020 £'000 | 2019 £'000 |
|--|----------------|----------------|
| Financial assets | | |
| Measured at fair value through the profit and loss account | | |
| - Derivative financial assets (see note 12) | 223,710 | 209,884 |
| Measured at fair value and designated in an effective hedge relationship | | |
| - Derivative financial assets – cashflow hedges (see note 12) | - | 30 |
| - Derivative financial assets – fair value hedges (see note 12) | 175,695 | 129,363 |
| Measured at undiscounted amount receivable | | |
| - Trade and other debtors (see note 12) | 56,823 | 58,859 |
| - Accrued income (see note 12) | 38,837 | 35,387 |
| - Deposits with banks | - | 90,000 |
| Equity instruments measured at cost less impairment | | |
| - Fixed asset investments (see note 11) | 10,206 | 12,611 |
| | <u>505,271</u> | <u>536,134</u> |

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

| | 2020 £'000 | 2019 £'000 |
|---|------------------|------------------|
| Financial liabilities | | |
| Measured at fair value through the profit and loss account | | |
| - Derivative financial liabilities (see notes 13 and 14) | 190,800 | 165,151 |
| Measured at fair value and designated in an effective hedge relationship | | |
| - Derivative financial liabilities (see notes 13 and 14) | 30,930 | 18,510 |
| - Other financial liabilities – amounts owed to group undertakings (see note 13 and 14) | 905,092 | 1,077,548 |
| - Other financial liabilities – loans (see notes 13 and 14) | - | 7,254 |
| Measured at amortised cost | | |
| - Loan note (see note 14) | 65,563 | 68,009 |
| - Loans payable (see notes 13 and 14) | 576,281 | 626,978 |
| - Fair value hedge adjustment of live bonds & USPP notes (see notes 13 and 14) | 179,273 | 133,134 |
| - Fair value hedge adjustment – bonds previously in FV hedge relationship | 39,278 | 50,825 |
| - Amounts owed to group undertakings (note 13) | 34,088 | 59,807 |
| Measured at undiscounted amount payable | | |
| - Trade and other creditors (see note 13) | 5,645 | 1,342 |
| - Accruals and deferred income (see notes 13 and 14) | 145,149 | 143,711 |
| - Corporation tax (see note 13) | 41,957 | 46,803 |
| - Other taxation and social security (see note 13) | 38,026 | 20,667 |
| | <u>2,252,082</u> | <u>2,419,739</u> |

The company's income, expense, gains and losses in respect of financial instruments are summarised below:

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

| | 2020 £'000 | 2019 £'000 |
|---|----------------|----------------|
| Interest income and expense on items at amortised cost | | |
| - Total interest payable on financial liabilities at amortised cost | 55,179 | 60,137 |
| - Total interest receivable on financial assets measured at amortised cost | (378) | (293) |
| | <u>54,801</u> | <u>59,844</u> |
| Interest income and expense on derivatives | | |
| - Total interest receivable on financial assets measured at fair value through the P&L | (19,217) | (30,611) |
| - Total interest payable on financial liabilities measured at fair value through the P&L | 10,019 | 18,831 |
| - Total interest payable / (receivable) on financial assets designated in an effective hedging relationship: | | |
| - Cash flow hedges | - | 10 |
| - Fair value hedges | (3,335) | (653) |
| - Total interest payable / (receivable) on financial liabilities designated in an effective hedging relationship: | | |
| - Cash flow hedges | 5,996 | 5,733 |
| - Fair value hedges | - | - |
| | <u>(6,537)</u> | <u>(6,690)</u> |
| Fair value gains and losses | | |
| - On financial assets measured at fair value through the profit and loss account | (15,979) | 730 |
| - On financial liabilities measured at fair value through the profit and loss account | 26,070 | 13,296 |
| - On derivative financial assets designated in an effective hedging relationship – ineffectiveness on live cash flow hedges | - | 8 |
| - On derivative financial assets designated in an effective hedging relationship – live fair value hedges | (43,769) | (26,633) |
| - On financial assets formerly designated in an effective hedging relationship – amortisation of previous FV hedge adjustments | 540 | 540 |
| - On derivative financial liabilities designated in an effective hedging relationship – ineffectiveness on live cash flow hedges | (141) | (124) |
| - On derivative financial liabilities designated in an effective hedging relationship – live fair value hedges | 46,139 | 23,449 |
| - On financial liabilities formerly designated in an effective hedging relationship – amortisation of previous FV hedge adjustments | (12,087) | (14,517) |
| | <u>773</u> | <u>(3,251)</u> |
| Other net finance costs | <u>(1,097)</u> | <u>(5,112)</u> |
| | <u>47,940</u> | <u>44,791</u> |

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

Fair value gains and losses in finance costs include the amortisation of fair values "frozen" when accounting hedge designations were terminated (either voluntarily under FRS102 section 21 or because automatic de-designation was triggered for other reasons). Under the group's strategy of swapping fixed rate debt to floating rate and re-fixing with overlay swaps, certain fair value hedges were previously de-designated as a matter of routine under FRS102 under sections 11 and 12. As FRS102 permits interest rate swaps to be designated as cash flow hedges of aggregate floating rate exposures (fixed rate debt and swap to floating) the underlying Fair value hedges remain when the corresponding overlay swaps are transacted.

Other net finance costs includes bank and agency fees, pension accounting adjustments and other miscellaneous interest. The maturity of the carrying value of the company's derivatives in hedging relationships split between less than 1 year and greater than 1 year.

| | Current (less than 1 year) | | Greater than 1 year | |
|---|----------------------------|---------------|---------------------|---------------|
| | 2020 £'000 | 2019 £'000 | 2020 £'000 | 2019 £'000 |
| Derivatives that are designated and effective as hedging instruments carried at fair value | | | | |
| Cash flow hedges | | | | |
| Assets | - | - | - | 30 |
| Liabilities | - | (2,048) | (30,930) | (14,462) |
| Fair value hedges | | | | |
| Assets | - | - | 175,695 | 129,363 |
| Liabilities | - | - | - | - |
| | - | (2,048) | 144,765 | 112,901 |

Interest rate swaps are valued at present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates, adjusted for the Group's own credit risk when determining the fair value of derivatives liabilities and for counterparty credit risk when determining the fair value of derivatives assets.

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The following table details the notional principal amounts and remaining terms of interest rate swap contracts outstanding:

Interest rate swap contracts designated as hedges of variable interest rate risk of recognised financial liabilities:

| | Average contract fixed interest rate | | Notional principal value as at 31 March | | Fair value as at 31 March | |
|--|--------------------------------------|------|---|----------------|---------------------------|-----------------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| | % | % | £'000 | £'000 | £'000 | £'000 |
| Outstanding cash flow hedges of floating rate EIB loans | | | | | | |
| Less than 1 year | - | 4.91 | - | 50,000 | - | (2,048) |
| 1 to 2 years | - | - | - | - | - | - |
| 2 to 5 years | 2.24 | - | 160,789 | - | (11,987) | - |
| 5 years + | 1.29 | 1.64 | 225,000 | 411,316 | (11,563) | (16,431) |
| | | | <u>385,789</u> | <u>461,316</u> | <u>(23,550)</u> | <u>(18,479)</u> |

The receive floating pay fixed interest rate swaps that are designated as hedges are designed to swap the floating rate on various loans from the European Investment Bank to fixed rate for periods of up to ten years thereby eliminating the risk of adverse interest rate movements resulting in unexpected costs and cash flows over the life of the instruments. Where an individual derivative instrument has a maturity date after the maturity date of the hedged debt the expectation is that the underlying debt will be replaced like-for-like such that the forecast cash exposure remains highly probable.

Interest on the swaps is settled on a quarterly basis. The floating rate on the swaps is three month LIBOR. The Group settles the difference between the fixed and floating interest rate on a net basis.

| | Average contract fixed interest rate | | Notional principal value as at 31 March | | Fair value as at 31 March | |
|--|--------------------------------------|------|---|----------|---------------------------|----------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| | % | % | £'000 | £'000 | £'000 | £'000 |
| Outstanding cash flow hedges of other floating rate exposures | | | | | | |
| Less than 1 year | - | - | - | - | - | - |
| 1 to 2 years | - | - | - | - | - | - |
| 2 to 5 years | - | - | - | - | - | - |
| 5 years + | 1.13 | - | 160,000 | - | (7,380) | - |
| | | | <u>160,000</u> | <u>-</u> | <u>(7,380)</u> | <u>-</u> |

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The group's £250m 2027 and £255m 2035 bonds have been swapped to floating rate for life with a number of interest rate swaps on which the group receives a fixed rate equivalent to the coupon on the bonds and pays 6 month Libor plus a margin. In some cases these swaps have been designated as fair value hedges (see the table below). The receive floating pay fixed interest rate swaps analysed in the table above are designed to re-fix the rate on the floating rate exposure thus created for periods of ten years. They have been designated as Cash Flow hedges of the aggregate floating rate exposure created by the fixed rate bond portion and corresponding swap to floating rate. Where an individual derivative instrument has a maturity date after the maturity date of the hedged the expectation is that the underlying debt will be replaced like-for-like such that the forecast cash exposure remains highly probable.

Interest on the swaps is settled on a semi-annual basis. The floating rate on the swaps is six month LIBOR. The Group settles the difference between the fixed and floating interest rate on a net basis.

| | Average contract fixed interest rate | | Notional principal value as at 31 March | | Fair value as at 31 March | |
|---|--------------------------------------|------|---|----------------|---------------------------|----------------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| | % | % | £'000 | £'000 | £'000 | £'000 |
| Outstanding fair value hedges of bonds | | | | | | |
| Less than 1 year | - | - | - | - | - | - |
| 1 to 2 years | - | - | - | - | - | - |
| 2 to 5 years | - | - | - | - | - | - |
| 5 years plus | 4.88 | 4.88 | 350,000 | 350,000 | 160,430 | 122,507 |
| | | | <u>350,000</u> | <u>350,000</u> | <u>160,430</u> | <u>122,507</u> |

The receive fixed pay floating swaps analysed above hedge the exposure to changes in the fair value of the underlying portions of the group's 2027 and 2035 bonds that are attributable to changes in interest rates. As the start dates on the swaps vary (some are forward-starting) they also enable the interest rate on the underlying debt to be progressively re-fixed in line with the group's overall interest rate hedging strategy. The swaps settle on a semi-annual basis in the case of the floating rate legs and on an annual basis in the case of the fixed rate leg. The floating rate on the interest rate swaps is six month LIBOR. Interest will be settled on a gross basis as the settlement dates for the fixed and floating rate legs do not coincide.

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

| | Average contract fixed interest rate | | Notional principal value as at 31 March | | Fair value as at 31 March | |
|--|---|------|--|---------------|------------------------------|--------------|
| | 2020 | 2019 | 2020 | 2019 | 2020 | 2019 |
| | % | % | £'000 | £'000 | £'000 | £'000 |
| Outstanding fair value hedges of US Private Placement notes | | | | | | |
| Less than 1 year | - | - | - | - | - | - |
| 1 to 2 years | - | - | - | - | - | - |
| 2 to 5 years | - | - | - | - | - | - |
| 5 years plus | 2.94 | 2.94 | 20,000 | 10,000 | 15,264 | 6,856 |
| | | | <u>20,000</u> | <u>10,000</u> | <u>15,264</u> | <u>6,856</u> |

16 Provisions for liabilities excluding pension liability

| | Gas holder Decommissioning £'000 | Restructuring £'000 | Deferred tax £'000 | Environmental restoration £'000 | Other £'000 | Total £'000 |
|---|--|------------------------|-----------------------|---------------------------------------|----------------|----------------|
| At 1 April 2019 | 2,194 | 2,027 | 295,260 | 4,513 | 5,898 | 309,892 |
| Charged (credited) to profit and loss account | 128 | 346 | 47,035 | (1,087) | 1,416 | 47,838 |
| Credit to hedge reserve | - | - | (2,802) | - | - | (2,802) |
| Charge to pension reserve | - | - | 7,996 | - | - | 7,996 |
| Utilised in the year | (955) | (1,710) | - | (161) | (654) | (3,480) |
| Adjustment arising from discounting | - | - | - | - | 259 | 259 |
| At 31 March 2020 | <u>1,367</u> | <u>663</u> | <u>347,489</u> | <u>3,265</u> | <u>6,919</u> | <u>359,703</u> |

Notes to the accounts (continued)

16 Provisions for liabilities excluding pension liability (continued)

Deferred tax

Deferred tax is provided as follows:

| | 2020 £'000 | 2019 £'000 |
|---|----------------|----------------|
| Group | | |
| Accelerated capital allowances | 82,823 | 78,052 |
| Fixed asset differences | 241,447 | 216,031 |
| Other timing differences | 10,792 | (1,702) |
| Deferred tax on pension provision (see note 19) | 12,427 | 2,879 |
| | <u>347,489</u> | <u>295,260</u> |

Provision for deferred tax

Deferred tax is only recognised in respect of timing differences where transactions or events have occurred, that result in an obligation to pay more or less tax in the future, at the balance sheet date. The other timing differences relate to transitional FRS102 adjustments, financial instruments, intangible fixed assets and pensions.

Restructuring

Estimated costs of an over 55 early retirement programme offered to employees and a current redundancy programme. The restructuring provision value represents the anticipated liabilities at the balance sheet date. The timing of cash flow assumption is based on agreed retirement and leaving dates with employees which runs to 2021.

Environmental restoration

Estimated environmental restoration costs are provided where the group has a legal obligation to restore sites at the balance sheet date. The provision represents the estimated net present value for statutory decontamination of old gas sites. It also reflects the obligations associated with other environmental damage. The timing of the utilisation of the environmental restoration provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date. The provision has been calculated using the probability of cash flows method and management have used an expert to assess the probability of a restoration event and the potential cost. The cash exposure based on a worst case scenario is an additional expense of £0.9m but this is deemed highly unlikely based on historic trends.

Other

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability events. The timing of the utilisation of the other provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date. Sensitivity analysis shows that a movement of 1% on the applied discount rate would cause a £0.3m movement although this is deemed unlikely.

Gas holder decommissioning provision

The provision represents the estimated cost of removing gas holders from the network as committed under RIIO-GD1 and to be spent within RIIO-GD1. Sensitivity analysis was applied on the estimated unit cost of removal, with a 5% increase causing a £0.1m variance although this variance is deemed to be highly unlikely.

Notes to the accounts (continued)

17 Called-up share capital and reserves

Share capital

| | 2020 £000 | 2019 £000 |
|---|--------------|--------------|
| <i>Allotted, called-up and fully-paid</i> | | |
| 24,328,476 ordinary shares of £1 each | 24,328 | 24,328 |
| | <hr/> | <hr/> |

Profit and loss account

This is the accumulative earnings retained by the company.

Hedging reserve

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

18 Financial commitments

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

| | <u>Land and Buildings</u> | |
|------------------------------|---------------------------|---------------|
| Property leases | 2020 £'000 | 2019 £'000 |
| - within one year | 1,423 | 1,392 |
| - between one and two years | 1,059 | 1,136 |
| - between two and five years | 2,406 | 2,278 |
| - after five years | 1,806 | 2,286 |
| | <hr/> | <hr/> |
| | 6,692 | 7,092 |
| | <hr/> | <hr/> |

The company has entered into a Guarantee and Reimbursement Agreement with FGIC UK Limited ("FGIC") in conjunction with its subsidiary Northern Gas Networks Finance Plc ("the Issuer") in relation to the bonds issued by that company in November 2005 of £505.0m. The company guarantees the punctual payment of any and all sums and fees due to FGIC and undertakes to pay any amount due from the Issuer but not paid by it. The company also indemnifies FGIC against any loss or liability suffered, if any obligation guaranteed by FGIC is, or becomes, unenforceable, invalid or illegal. The amount of the loss or liability under the indemnity is equal to the amount FGIC would otherwise have been entitled to recover.

Notes to the accounts (continued)

19 Pension arrangements

The company has obligations for a defined benefit pension scheme. The last triennial valuation was done in March 2019. During the year a valuation of the pension scheme was carried out by a third party actuarial firm. The present value of the defined benefit obligations, the current service costs and past service costs were measured using the projected unit credit method.

The amounts recognised in the balance sheet are as follows:

| | 2020 £'000 | 2019 £'000 |
|-------------------------------------|---------------|---------------|
| Present value of funded obligations | (398,572) | (459,282) |
| Fair value of plan assets | 463,984 | 476,217 |
| Surplus (see note 12) | 65,412 | 16,935 |
| Related deferred tax (liability) | (12,428) | (2,879) |
| Net asset | 52,984 | 14,056 |
| Amounts in the balance sheet | | |
| - Asset | 52,984 | 14,056 |

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

| | 2020 £'000 | 2019 £'000 |
|---|---------------|---------------|
| <i>Amount charged to operating profit</i> | | |
| Current service costs | 2,939 | 3,114 |
| Past service costs | (1,003) | 2,800 |
| | 1,936 | 5,914 |
| <i>Amount credited to net finance charges</i> | | |
| Interest costs | 10,709 | 11,430 |
| Expected cost return on plan assets | (11,200) | (12,230) |
| Net return on pension scheme (see note 3) | (491) | (800) |
| Total | 1,445 | 5,114 |

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

| | 2020 £'000 | 2019 £'000 |
|----------------------------|---------------|---------------|
| Actuarial gains / (losses) | 41,967 | (14,550) |

Notes to the accounts (continued)

19 Pension arrangements (continued)

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

| | 2020 £'000 | 2019 £'000 |
|------------------|-----------------|-----------------|
| Actuarial losses | <u>(37,102)</u> | <u>(79,069)</u> |

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

| | 2020 £'000 | 2019 £'000 |
|------------------------------------|-----------------|-----------------|
| Opening defined benefit obligation | 459,282 | 456,393 |
| Service cost | 2,939 | 3,114 |
| Past service cost | (1,003) | 2,800 |
| Interest cost | 10,709 | 11,430 |
| Member contributions | 318 | 381 |
| Actuarial gains / (losses) | (46,287) | 38,479 |
| Benefits paid | <u>(27,386)</u> | <u>(53,315)</u> |
| Closing defined benefit obligation | <u>398,572</u> | <u>459,282</u> |

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

| | 2020 £'000 | 2019 £'000 |
|-----------------------------------|-----------------|-----------------|
| Opening fair value of plan assets | 476,217 | 482,951 |
| Expected return | 11,200 | 12,230 |
| Actuarial (losses) / gains | (4,320) | 23,929 |
| Employer contributions | 7,955 | 10,041 |
| Member contributions | 318 | 381 |
| Benefits paid | <u>(27,386)</u> | <u>(53,315)</u> |
| | <u>463,984</u> | <u>476,217</u> |

Notes to the accounts (continued)

19 Pension arrangements (continued)

The major categories of plan assets as a percentage of the total plan assets are as follows:

| | 31 March 2020 | 31 March 2019 |
|-------------------|---------------|---------------|
| | % | % |
| Equity securities | 29.8 | 27.8 |
| Bond securities | 59.2 | 55.8 |
| Property | 6.9 | 9.7 |
| Other | 4.1 | 6.7 |

To determine the overall expected rate of return on plan assets the group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the assets are invested and the expectations for future returns of each asset class in the plan. The expected return for each asset class was then weighted, based on the asset allocation in the plan to develop the assumption for the expected rate of return on plan assets. The actual return on plan assets is as follows:

| | 2020 £'000 | 2019 £'000 |
|------------------------------|---------------|---------------|
| Actual return on plan assets | 11,412 | 36,159 |

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

| | 2020 | 2019 |
|--|------------|------------|
| Discount rate | 2.4% | 2.4% |
| Future salary increases | 3.6% | 3.8% |
| Future pension increases | 2.0% | 3.3% |
| Inflation (CPI) | 2.6% | 3.3% |
| Inflation (RPI) | | |
| Life expectancy on retirement age 65; | | |
| - member aged 65 (retiring today) male | 21.2 years | 21.5 years |
| - member aged 65 (retiring today) female | 23.7 years | 23.4 years |
| - member aged 45 (retiring in 20 years) male | 23.5 years | 23.2 years |
| - member aged 45 (retiring in 20 years) female | 25.9 years | 25.3 years |

The group are in an "asset backed contribution" arrangement with its defined benefit pension scheme whereby the NGN Pension Funding Limited Partnership was funded to acquire a £70m loan note. The partnership members are Northern Gas Networks Limited, Northern Gas Networks Operations Limited, the defined benefit pension scheme and

Notes to the accounts (continued)

19 Pension arrangements (continued)

the Northern Gas Networks General Partner Limited. Contributions to the pension scheme of £4.2m (2019 - £4.2m) were made in the year.

The group also operates defined contribution schemes for which the pension charge for the period amounted to £2,633,000 (2019 - £3,666,000).

20 Related party transactions

The company is a wholly owned subsidiary and utilises the exemption contained in FRS 102 section 33 2.2, "Related Party Disclosures", not to disclose any transactions with wholly owned entities that are part of the group.

Balances with members of the NGNH group are detailed in notes 13 and 14.

21 Ultimate controlling party

The directors regard Northern Gas Networks Holdings Limited, a company incorporated in England and Wales, as the ultimate parent company and the ultimate controlling party.

Northern Gas Networks Holdings Limited is the parent company of the largest and smallest group of which the company is a member and for which group accounts are drawn up. Copies of the accounts are available from its registered office, 1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU.

The Shareholders of Northern Gas Networks Holdings Limited are a consortium comprising of:

PG (April) Limited (47.1%)

Beta Central Profits Limited (41.3%)

SAS Trustee Corporation (11.6%)