

Registration number: 02366942 (England and Wales)

Northern Electric plc

Annual Report and Consolidated Financial Statements

for the Year Ended 31 December 2018



Northern Electric plc

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Northern Electric plc
Company Information

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Northern Electric plc
Strategic Report for the Year Ended 31 December 2018

The directors present their annual reports and financial statements for the year ended 31 December 2018 of Northern Electric plc (the "Company"), which have been drawn up and are presented in accordance with the Companies Act 2006.

Business model

The Company is part of the Northern Powergrid Holdings Company group of companies (the "Northern Powergrid Group") and acts as a holding company of Northern Powergrid (Northeast) Limited ("NPg Northeast"), Integrated Utility Services Limited ("IUS") and Northern Powergrid Metering Limited ("Northern Powergrid Metering"), collectively, (the "Group").

NPg Northeast is an authorised distributor under the Electricity Act 1989 and holds an electricity distribution licence granted by the Secretary of State. As a distribution network operator ("DNO"), NPg Northeast distributes electricity, at voltages of up to 132 kilovolts ("kV"), to approximately 1.6 million customers connected to its electricity distribution network within its distribution services area in the northeast of England. IUS provides engineering contracting services and Northern Powergrid Metering rents meters to energy suppliers.

The majority of revenue generated by NPg Northeast is controlled by a distribution price control formula which is set out in the electricity distribution licence. The price control formula does not directly constrain profits from year to year, but is a control on revenue that operates independently of a significant portion of NPg Northeast's costs. Allowed revenue is recovered from electricity suppliers via the application of Distribution use of System charges. These charges account for approximately 15% of the electricity end users overall electricity bill.

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

Core Principle	Strategic objective	Key Performance Indicators ("KPI")
Financial strength	Strong finances that enable improvement and growth.	Operating profit Maintenance of investment grade credit ratings Cash flow measures
Customer service	Delivering exceptional customer service.	Broad measure of customer satisfaction Stakeholder Engagement rank
Operational excellence	High-quality, efficient operators running a smart reliable energy system.	Customer Minutes Lost Customer Interruptions Network investment High voltage restoration time
Employee commitment	High-performing people doing rewarding jobs in a safe and secure workplace.	Occupational Safety and Health Administration Rate Preventable Vehicle Accidents Lost time accidents Restricted duty accidents Medical treatment accidents Operational incidents Absence rate
Environmental respect	Leaders in environmental respect and low carbon technologies.	Total Oil/Fluid Lost SF6 Gas discharges Environmental Incidents Carbon Footprint
Regulatory integrity	Trustworthy, fair and balanced, creating win-win outcomes.	Quarterly certification process

The Core Principles (which are applied by the Northern Powergrid's parent company, Berkshire Hathaway Energy Company ("Berkshire Hathaway Energy")), set out the basis on which the Company generates shareholder value over the longer term and also define the Group's values and vision. Each core principle is defined by a number of strategic objectives (which correspond to NPg Northeast's 2015 to 2023 regulatory well justified business plan) and are measured through financial and non-financial KPIs. The report focuses on each core principle and the performance of each KPI throughout the financial year in order to provide a summary of the success in achieving each strategic objective.

Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)

FINANCIAL STRENGTH

Strategic objective: Strong finances that enable improvement and growth.

KPI	2018	2017
Operating Profit	£ 173.9 million	£ 180.2 million
Cash from operating activities	£ 231.4 million	£ 205.7 million
Cash used in investing activities	£ 232.8 million	£ 280.1 million
Credit Rating (Standard & Poor's)	A	A

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

Performance during the year: The Group continued to maintain good control in respect of both its capital and operating costs by effectively managing the financial risks that could have had an adverse impact on its business. The ED1 price control has been set for eight years (1 April 2015 to 31 March 2023) and provides the Group with some stability in terms of its income until 31 March 2023.

Revenue: The Group's revenue at £419.0 million was £15.5 million higher than the prior year due to higher distribution system revenues, higher smart metering revenue, higher amortisation of deferred revenue and introduction of assessment and design fees offset by lower contracting revenue.

Operating profit and position at the year-end: The Group's operating profit of £173.9 million was £6.3 million lower than the previous year, primarily reflecting higher depreciation, higher business rates and higher pension deficit payments, offset by higher revenues. The statement of financial position on pages 25 and 26 shows that, as at 31 December 2018, the Group had total equity of £1,169.3 million (2017: £1,111.8 million). The directors consider the Group to have a strong financial position which, when coupled with the preference of Berkshire Hathaway Energy, for operating with lower levels of debt than equivalent companies in the sector, creates a stable base for continued strong performance during the ED1 period.

Finance costs and investments: Finance costs net of investment income at £44.0 million were £3.7 million higher than the prior year due to higher borrowings and lower capitalised interest.

Taxation: The effective tax rate in the year was 19.0%. Tax charge for the year was £24.9 million which was lower than the prior year of £28.8 million mainly due to a reduction in accounting profits and prior year adjustments in comparison to 2017. Details of the income tax expense are provided in note 10 to the financial statements.

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

Cash flow: Movements in cash flows were as follows:

- **Operating activities:** Cash flow from operating activities at £231.4 million was £25.7 million higher than the previous year, mainly due to higher earnings before interest, tax and depreciation, and favourable working capital.
- **Investing activities:** Cash flow used in investing activities at £232.8 million was £47.3 million lower than the previous year, mainly due to lower capital deployed offset by lower receipt of customer contributions.
- **Financing activities:** Cash flow from financing activities at £13.0 million was £77.5 million lower than the previous year, mainly due to lower net borrowing in the year offset by no dividend paid in 2018.

Pensions: The Company is a participating employer in the Group of the Electricity Supply Pension Scheme (the "DB Scheme"), a defined benefit scheme. Further details of the Group's commitments to the DB Scheme and the associated deficit repair payments are provided in note 25 to the financial statements. The Group also participates in the Northern Powergrid Pension Scheme, which is a defined contribution scheme.

Insurance: As part of its insurance and risk strategy, the Group has in place insurance policies, which cover risks associated with employees, third party motor and public liability. The Group carries appropriate excesses on those policies and is effectively self-insured up to the level of those excesses. Consequently, risk management in respect of safety, the Group's motor fleet and employee health and wellbeing is extremely important, given the contribution it makes to the elimination or reduction of exposure to those risks.

Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)

CUSTOMER SERVICE

Strategic objective: Delivering exceptional customer service.

KPI	2018	2017
BMCS	86.8%	87.2%
BMCS Rank (out of 14)	11	9
BMCS Power Cuts	87.7%	88.2%
BMCS General Enquiries	90.1%	90.7%
BMCS Connections	84.8%	85.1%
SECV Rank (out of 6) (combined with Northern Powergrid (Yorkshire) plc)	2	3

Strategic focus: To improve the service delivered to customers.

Performance during the year: Under the broad measure of customer satisfaction (“BMCS”), an independent market research company carried out telephone surveys with the NPg Northeast’s customers to find out how satisfied they were with services related to unplanned or planned power cuts, quotations and subsequent connections, and general enquiries. NPg Northeast recorded overall satisfaction scores that were comparable to the prior year (2018: 86.8% versus 2017: 87.2%). The BMCS rank achieved of 11 declined in comparison to the prior year (2017: 9). The change was predominantly attributed to a reduction in the BMCS Power Cuts scores which accounted for approximately one quarter of the overall score.

To address the decline in BMCS and to further enhance the service provided to customers, a number of initiatives from NPg Northeast’s customer service improvement plan were implemented during the year. This included the continued development of the customer relationship management system, enhancement of *pro-active customer communications* via text, interactive voice response and social media, as well as focus on improving self-service offerings to customers.

The Quality Framework (developed to deliver exceptional customer service) was further enhanced and an additional communication with customers was introduced to confirm satisfaction with the service provided and confirmation that the work in question had been completed.

Connections to the network

Strategic focus: To reduce routine, small works end-to-end connections lead times by 30% during the ED1 period, actively facilitate the development of competition from independent connections providers (“ICPs”) and deliver the major works service improvement plan as part of the Office for Gas and Electricity Markets (“Ofgem”) Incentive on Connections Engagement (“ICE”).

Performance during the year: Reducing end-to-end connections lead times continues to pose a challenge. The NPg Northeast has invested more time at the start of the quotations process (including offering customers the option of a site visit) to avoid delays later on, and remains confident it will achieve the 30% reduction by the end of the ED1 period. Within connections services (the performance of which is measured by the BMCS connections KPI), work to improve the level of customer service within the small works connections business continued. In support of this, the processes implemented during 2017, which introduced a single point of customer contact for the delivery of small works connections and the online service alteration quotation facility, were further embedded during 2018.

NPg Northeast continued to encourage competition in connections by providing dual quotations, enabling ICPs to self-determine and approve points of connection to the network, and simplifying the authorisation process for ICPs’ operational staff.

In relation to NPg Northeast’s ICE commitments for the 2017/18 regulatory period, the 26 actions included in the service improvement plan were successfully delivered.

**Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)**

Corporate responsibility

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

Performance during the year: NPg Northeast continued to work closely with key partners such as local authorities, local enterprise partnerships, Members of Parliament and local resilience forums, particularly during periods of severe weather. Collaboration with stakeholders in the wider energy industry included consultations on the emerging plans for the transition to Distribution System Operator (“DSO”).

In April 2018, NPg Northeast (with Northern Powergrid (Yorkshire) plc) put forward its Stakeholder Engagement and Customer Vulnerability (“SECV”) submission to Ofgem in respect of work undertaken during the previous year. The submission provided an overview of activities and case studies, which included a series of roundtable events with key stakeholders to gather feedback on priorities in areas such as safety, environment, customer service, reliability and availability to inform the annual strategic planning process.

Following the submission to Ofgem’s panel, the position of NPg Northeast with Northern Powergrid (Yorkshire) plc in the context of the wider DNO group increased from third place to second. The improvement demonstrated the effectiveness of comprehensive, open dialogue with stakeholders on key issues which formed part of the refreshed engagement strategy updated in 2018.

Throughout the year, a number of tailored education and safety programmes were also delivered including, ‘Look up - It’s live’, a campaign to promote safety messages to the rural community; Make the Grade in Energy, an education, skills and employability programme, Energy Heroes, targeted at the primary school pupils to promote awareness of energy costs and ways of saving energy whilst developing their mathematical skills; and attendance at The Big Bang Fair, which encourages young people to pursue science, technology, engineering and maths subjects.

The stakeholder summit was successfully launched during the year to broaden the range of stakeholders engaging with NPg Northeast and to provide an annual update of the NPg Northeast’s progress in delivering the well justified business plan.

OPERATIONAL EXCELLENCE

Strategic objective: High-quality, efficient operators running a smart reliable energy system.

KPI	NPg Northeast			
	2017/18		2016/17	
	Actual	Target	Actual	Target
Customer minutes lost	44.6	<61.9	45.2	<64.1
Customer interruptions	51.8	<62.1	53.3	<62.7
KPI	2018		2017	
High voltage restoration time	61		57	
Network investment	170.0		186.4	

Strategic focus: To enhance the reliability of the network in support of the commitment to achieve 8% fewer unplanned power cuts and reduce the average length of unplanned power cuts by 20% during the ED1 period.

Performance during the year: Customer minutes lost (“CML”) and customer interruptions (“CI”) are the KPIs set by Ofgem and used by NPg Northeast to measure the quality of supply and system performance. Both CML and CI are measured on a regulatory year basis which commences on 1 April of any given year and concludes on 31 March of the subsequent year. CML measures the average number of supply minutes lost for every connected customer due to both planned and unplanned power cuts that last for three minutes or longer. CI measures the average number of supply interruptions per every 100 connected customers due to planned and unplanned power cuts that last for three minutes or longer. Performance during the year was better than Ofgem’s target for both CML and CI.

Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)

NPg Northeast invested £170.0 million during the year through its approved network investment strategy (2017: £186.4 million), which has been designed to deliver improvements and increase the network's resilience. Various major projects were undertaken to reinforce the primary network, refurbish transformers, rebuild overhead lines, remove and replace oil-filled cables, change deteriorated poles, replace switchgear and install and commission new remote control points.

Enhancements to the network also continued through investment in the use of technology. This included the deployment of over 500 smart fuses to restore supplies in under three minutes to customers affected by intermittent faults, and the roll out of 100 next generation innovative low-voltage technology devices to perform multiple restorations of customers' supplies, again in under three minutes. In addition, NPg Northeast continued to further expand the automated power restoration system, designed to restore power to the network in a safe manner in under three minutes. In relation to high-voltage restoration, NPg Northeast's high-voltage restoration performance during the calendar year 2018 averaged 61 minutes (2017: 55.8 minutes), after allowing for severe weather incidents and other exemptions.

EMPLOYEE COMMITMENT

Strategic objective: High-performing people doing rewarding jobs in a safe and secure workplace.

KPI	2018		2017	
	Actual	Target	Actual	Target
Occupational safety and health administration rate	0.26	0.26	0.44	0.26
Preventable vehicle accidents	14	12	12	13
Lost time accidents	1	1	2	1
Restricted duty accidents	0	0	1	0
Medical treatment accidents	2	1	0	1
Operational incidents	4	5	2	5
KPI	2018		2017	
Absence rate	3.34%		2.90%	

Health and safety

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

Performance during the year: In common with the Berkshire Hathaway Energy group, the Northern Powergrid Group measures its safety performance in terms of the Occupational Safety and Health Administration ("OSHA") rate, which is a measure used in the United States ("US") to capture safety incidents down to minor levels of medical treatment. The Northern Powergrid Group achieved its OSHA rate of 0.26 (2017: 0.44) recording a total of six recordable incidents against a target of six or fewer. NPg Northeast narrowly failed to meet the Preventable Vehicle Accidents target. The failure was primarily the result of a series of relatively minor driving incidents. NPg Northeast continues to take action to seek to improve driving standards. The Group's long term safety record suggests that it is one of the safest in its sector.

Improving safety performance remains a priority and the way in which this is achieved is set out in NPg Northeast's SHIP. The SHIP focuses on leadership engagement, supervisory oversight, and workplace risk management. These three areas are supported by driver training, operational safety seminars, stand-down briefings and regular safety reports and newsflashes.

The health and wellbeing of staff, is a key priority of the Northern Powergrid Group and forms an integral part of the SHIP. Existing support includes the availability of an independent employee assistance service, which is a confidential, self-referral counselling and information service to assist with personal or work-related problems and access to services including counselling and physiotherapy referrals. A number of new initiatives focused specifically on mental health and wellbeing were launched during the year. These included the recruitment of mental health first aid volunteers, providing mental health awareness training and a series of mental health campaigns in conjunction with the United Kingdom mental health awareness week.

**Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)**

NPg Northeast's OHSAS 18001 health and safety management systems successfully retained certification.

Employees

Strategic focus: To emphasise the importance of leadership and high standards of performance by engaging, collaborating and working with employees and their trade union representatives.

Performance during the year: NPg Northeast conducted an externally facilitated employee survey to benchmark the level of employee engagement against top performing organisations and to identify areas for improvement. In response to feedback from the most recent survey, a number of commitments were made in respect of communication and to enhance the quality and quantity of time spent discussing personal objectives and development.

During the year, 82 new recruits (2017: 68) joined NPg Northeast and Northern Powergrid (Yorkshire) plc's workforce renewal programme.

NPg Northeast has adopted the Berkshire Hathaway Energy code of business conduct, which details the commitment to ethics and compliance with the law, provides reporting mechanisms for known or suspected ethical or legal violations, and establishes minimum standards of behaviour expected of all employees. In support of this, a "speaking up" process is in place enabling all employees to raise concerns of unethical acts, malpractice or impropriety (including bribery or corruption), and an anonymous help line operated by an independent company is also available.

At 31 December 2018, the Group had 1,297 employees (2017: 1,271).

ENVIRONMENTAL RESPECT

Strategic objective: Leaders in environmental respect and low carbon technologies.

KPI	2018		2017	
	Actual	Target	Actual	Target
Total oil/fluid lost (litres)	14,179	<12,400	14,066	<12,600
SF6 gas discharges (kg)	17.95	<30.00	33.33	<34.00
Environmental incidents	5	<4	4	<5
KPI	2018		2017	
Carbon footprint (tonnes)	21,393		22,757	

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

Performance during the year: NPg Northeast and IUS both operate a United Kingdom Accreditation Service scheme for environmental management and are certified to the environmental management systems standard ISO 14001:2015. The ISO 14001 standard is designed to enhance environmental performance, fulfil compliance obligations and achieve environmental objectives, all of which contribute to the achievement of the Northern Powergrid Group's KPIs. A full recertification assessment was carried out in March 2017 and surveillance audits are carried out twice per year, the last one being conducted in November 2018. Continued certification was confirmed following each audit.

NPg Northeast's and IUS' carbon footprint reporting framework is certified under the Certified Emissions Measurement and Reduction Scheme for compliance with ISO 14064-1:2006. The last full audit was undertaken in November 2018, where continued certification was confirmed. Initiatives including the implementation of telematics in fleet vehicles facilitated a further improvement in reducing NPg Northeast's carbon footprint during the year to 21,393 tonnes (2017: 22,757 tonnes).

Northern Electric plc Strategic Report for the Year Ended 31 December 2018 (continued)

In support of the target to further reduce oil and fluid loss, the 2018 annual environmental improvement plan included replacing fluid-filled cables and locating cable fluid leaks more quickly which resulted in a total fluid loss of 14,179 litres (2017: 14,066). The total oil and fluid loss target was missed due to a number of leaks from underground cables. NPg Northeast continues to take steps and implement innovative solutions to minimise oil and fluid loss across the network. Additional activity to minimise NPg Northeast's impact on the environment included placing overhead lines underground in National Parks and Areas of Outstanding Natural Beauty and protecting wildlife and habitat.

Sustainability

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

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

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

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

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

REGULATORY INTEGRITY

Strategic objective: Trustworthy, fair and balanced, creating win-win outcomes.

KPI: Completion of the Northern Powergrid Group's quarterly regulatory compliance affirmation process

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

Performance during the year: Under the RIIO (revenue = incentives + innovation + outputs) model for regulation, price controls are set for a fixed period. The ED1 price control became effective on 1 April 2015 and is due to end on 31 March 2023. NPg Northeast's opening base allowed revenue (excluding the effects of incentive schemes and any deferred revenues from the prior price control) has been set to remain constant for each year from 2016/17 through to 31 March 2023. Nominal opening base allowed revenues will increase in line with inflation (as measured by the United Kingdom's Retail Prices Index).

In order to assure compliance with licence and other regulatory obligations, Northern Powergrid Group operates a regulatory compliance affirmation process, under which ownership of approximately 2,000 regulatory obligations are assigned to around 80 responsible managers. Those responsible managers are required to review compliance with the relevant obligations on a quarterly basis and report on any identified non-compliances or perceived risks which are then addressed by members of the executive team. To minimise the risk of NPg Northeast breaching its licence conditions and other statutory requirements (which could lead to financial penalties), the board of directors review the outcome of each quarter's exercise.

NPg Northeast submitted a risk-based data-assurance plan to Ofgem for the regulatory year ahead, together with a report detailing the assurance work actually carried out in the regulatory year just ended and the findings of that work.

Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)

PRINCIPAL RISKS AND UNCERTAINTIES

The Northern Powergrid Group operates a structured and disciplined approach to the management of risk as part of its overall risk management policy and in support of its financial reporting practices. A robust system is in place to facilitate the identification of new risks, including those associated with the achievement of the Group's strategic objectives and Core Principles. Once identified, key risks and their respective controls and mitigation plans are continually assessed and formally reviewed by the Governance and Risk Management Group ("GRMG"), which reports to the Audit Committee.

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

Risks

Cyber security

Unauthorised access or compromise of the Information Technology or Operational Technology networks, resulting in loss of network control and availability.

Mitigations:

- Robust cyber security risk mitigation programme is in place.
- Accreditation under the ISO 27001 Information Security (process security) standard for certain discrete business areas.
- Compliance with the Centre for Internet Security Critical Security Controls.
- Monitored by the Information Security Executive Committee and the board.

Regulatory and policy positioning

Decisions taken resulting in negative impacts to our business model.

Mitigations:

- NPg Northeast's policy position supporting the expanded role of DSO is being set out.
- Innovation projects in place to develop and demonstrate future technologies and commercial practices.
- Regulatory and stakeholder engagement programme.
- The NPg Northeast is actively involved in consultations on the RIIO-2 price controls.

Network resilience

Loss of the operational network due to significant weather events, targeted physical attack or catastrophic asset failure resulting in sustained or widespread loss of essential supply.

Mitigations:

- Major incident and crisis management policies, plans and governance arrangements are in place.
- An industry mutual aid agreement exists.
- Network investment ensures grid resilience.
- Grid resilience programme and audits.

Northern Electric plc
Strategic Report for the Year Ended 31 December 2018 (continued)

Safety

Fatality or serious harm caused to an employee or a third party.

Mitigations:

- Overseen by the Health and Safety Committee.
- Clear policies and procedures exist that comply with legislation to ensure the safety of the employees and customers.
- Health and safety training is provided to employees on a continuous basis.
- Audit programme and inspection regimes are in place.
- ISO18001 safety management system in place.

Environment

Failure to prevent network assets from having a significant negative impact on the environment.

Mitigations:

- Incident response process and robust policies and procedures in place.
- Programme to reduce fluid loss and NPg Northeast's business carbon footprint.
- Investment in technology to minimise environmental incidents and 'self-heal' the network.
- Asset inspection programme.
- ISO14001 environmental management system in place.

Information security

Unauthorised access or loss of large volumes of data or sensitive data.

Mitigations:

- Robust cyber security risk mitigation programme is in place.
- Accreditation under the ISO 27001 Information Security (process security) standard for certain discrete business areas.
- Compliance with the Centre for Internet Security Critical Security Controls.
- Monitored by the Information Security Executive Committee and the board.

Efficiency and output performance

Failure to maintain cost and output performance competitiveness in the industry.

Mitigations:

- Robust business planning process.
- Monthly financial controls in place including detailed review of actuals against budget, competitive tendering process, and capital expenditure approvals process.
- Monthly executive business performance review.
- Comprehensive "Efficient Output Delivery" programme.

Northern Electric plc Strategic Report for the Year Ended 31 December 2018 (continued)

Financial risks

The exposure to interest rate, tax, liquidity and treasury risks.

Mitigations:

- Monitored by the Treasury Committee quarterly.
- The Group is financed by long-term borrowings at fixed and floating rates and has access to short-term borrowing facilities at floating rates of interest.
- As at 31 December 2018, 96% of the Group's long-term borrowings were at fixed rates and the average maturity for these borrowings was 9 years. The Group uses interest rate swaps to mitigate exposure to uncertain future interest rates.
- Financial covenant monitoring is in place.

Resource availability

Access to and availability of skilled resource resulting in an inability to deliver work programmes during the ED1 period.

Mitigations:

- Mix of direct labour and contracted resource is used.
- Workforce renewal programmes in place to recruit and retain employees.
- On-going training and development builds internal capability.
- Employee engagement and health and well-being initiatives are in place.

Brexit

The Brexit negotiations are not considered a principal risk to the Group.

Internal control

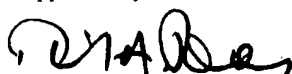
A rigorous internal control environment exists within the Group to support the financial reporting process, the key features of which include regular reporting, a series of operational and financial policies, investigations undertaken by internal audit and a stringent process for ensuring the implementation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

In accordance with Berkshire Hathaway Energy's requirements to comply with the US Sarbanes-Oxley Act, the Group undertakes a quarterly risk control assessment confirming that the effectiveness of the system of internal controls has been reviewed during the year. A self-certification process is in place, in support of this review, whereby certain senior managers are required to confirm that the system of internal control in their area of the business is operating effectively. Consequently, the directors believe that a robust system of risk assessment and management is in place.

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

The Group is committed to maintaining the highest ethical standards in the conduct of its business and, implements Berkshire Hathaway Energy's code of business conduct, details of which can be found on page 7. The Group has robust procedures in place to meet the requirements of the Bribery Act 2010. Every employee must undertake the code of business conduct training each year, which includes training in respect of the Group's anti-corruption and anti-bribery policy.

Approved by the Board on 15 April 2019 and signed on its behalf by:



P A Jones
Director

Northern Electric plc Directors' Report for the Year Ended 31 December 2018

The directors present their annual report and the audited consolidated financial statements for the year ended 31 December 2018.

Dividends

During the year, an interim dividend of £nil was paid (2017: £22.7 million). The directors recommend that no final dividend be paid in respect of the year (2017: £nil).

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

Research and development

The Group supports a programme of research that is expected to contribute to higher standards of performance and a more cost-effective operation of its business. The new projects initiated during the year have been detailed in the 'sustainability' section on page 8.

During the year, the Group invested £2.4 million (2017: £1.5 million) (note 5 to the financial statements) in its research and development activities.

Future developments and future outlook

The financial position of the Group, as at 31 December 2018, is shown in the consolidated statement of financial position on pages 25 and 26. There have been no significant events since the year end and the directors intend that:

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

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

Directors

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

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

During the year, no director was interested in any contract which was significant in relation to the business of the Company or the Group. During the year and up to the date of approval of the Directors' Report, an indemnity contained in the Company's Articles of Association was in force for the benefit of the directors of the Company and as directors of associated companies, which was a qualifying third party indemnity provision for the purposes of the Companies Act 2006.

Political donations

During the year, no contributions were made to political organisations (2017: £nil).

Northern Electric plc Directors' Report for the Year Ended 31 December 2018 (continued)

Financial instruments

Financial risk management

Details of financial risks are included in the Principal Risks and Uncertainties on page 9 to 11 of the Strategic Report and in note 29 to the financial statements.

Financial derivatives

As at 31 December 2018 the Group held one derivative financial instrument (2017: one) to mitigate the interest rate risk on a floating interest rate loan. More details on derivative financial instruments are available in note to the financial statements.

Employee consultation

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

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

During the year, the President and Chief Executive Officer of the Northern Powergrid Group continued to provide employees with updates on the Northern Powergrid Group's financial, organisational, safety and customer service performance through regular electronic briefings.

Disabled employees

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

In accordance with Section 414C of the Companies Act 2006 disclosures concerning relations with employees and greenhouse gas emissions can be found on pages 6 and 7 of the Strategic Report.

Vote holder and issuer notification

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

Directors' biographies

Thomas E Fielden

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

Thomas H France

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

Northern Electric plc Directors' Report for the Year Ended 31 December 2018 (continued)

Patrick J Goodman

Mr Goodman is executive vice president and chief financial officer of Berkshire Hathaway Energy. Mr Goodman is responsible for managing all aspects of Berkshire Hathaway Energy's financial operations. Mr Goodman serves as a director of PacifiCorp, Northern Powergrid, AltaLink, HomeServices of America, Inc., Kern River Gas Transmission Company and Northern Natural Gas Company. Mr Goodman supports the evaluation, negotiation and closing of Berkshire Hathaway Energy's domestic and international financings, acquisitions and project developments. Additionally, he manages all accounting, financial reporting, tax, budgeting, long-range financial planning and internal audit functions for Berkshire Hathaway Energy. Mr Goodman has been the chief financial officer since 1999 and has served in various financial positions, including chief accounting officer since joining the Company in 1995. Mr Goodman has more than 25 years of experience in public accounting and management and is a certified public accountant. He received his accounting degree from the University of Nebraska at Omaha.

Philip A Jones

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

John N Reynolds OBE

Mr. Reynolds was appointed in January 2011 as a director of Northern Powergrid Holdings Company and in October 2017 as Chairman of the audit committee. Mr Reynolds is the Chief Executive Officer of Castle Water. He is a Fellow of the Institution of Engineering & Technology, a Fellow of the Energy Institute and is a former commission member of the Water Industry Commission for Scotland. Mr Reynolds chaired the Church of England Ethical Investment Advisory Group, and is a former council member of the Central Finance Board of the Methodist Church. He is the author of a number of books and articles on business ethics. Mr. Reynolds previously held senior management roles at HSBC and Houlihan Lokey.

CORPORATE GOVERNANCE STATEMENT

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

Diversity policy

The Northern Powergrid Group has adopted a number of policies (including the policy on diversity at work and code of business conduct) that collectively comprise the policy on diversity. Diversity is actively supported through recruitment, educational programmes, employee opportunities and the Global Days of Service charitable support programme. All appointments (which includes board, board committee, and senior management appointments) are based on merit with due regard for diversity, including gender.

Audit committee

The board of Northern Powergrid Holdings Company has established an audit committee for the Northern Powergrid Group under delegated terms of reference which carries out the functions required by DTR 7.1.3 R.

Committee members

- J N Reynolds, non-executive Director (Chairman)
- T E Fielden, Finance Director
- M Knowles, independent member - Northern Powergrid Holdings Company (appointed 17 July 2018)

Northern Electric plc
Directors' Report for the Year Ended 31 December 2018 (continued)

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

In preparing these financial statements, International Accounting Standard 1 requires the directors to:

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

The directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's and the Group's transactions and disclose with reasonable accuracy at any time the financial position of the Company and the Group 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 the Group and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities. The directors are responsible for the maintenance and integrity of the corporate and financial information included on the Group's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

Directors' responsibility statement pursuant to DTR 4

Each of the directors as at the date of the annual reports and financial statements, whose names and functions are set out on page 12 in the Report of the Directors confirms that, to the best of their knowledge:

- the financial statements, prepared in accordance with applicable UK law and in conformity with IFRS, give a true and fair view of the assets, liabilities, financial position and profit of the Company and the undertakings included in the consolidation taken as a whole;
- the management report (which is comprised of the Strategic Report and the Report of the Directors) includes a fair review of the development and performance of the business and the position of the Company and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties it faces; and
- the annual report and financial statements, taken as a whole, are fair, balanced and understandable and provide the information necessary for shareholders.

Non-financial information statement

In accordance with Section 414CB(7) of the Companies Act 2006, the directors have elected to set out the information required by Section 414CB (1) to (6) in the group annual report and audited consolidated financial statements of Northern Powergrid Holdings Company, a copy of which can be found on Northern Powergrid's corporate website.

Northern Electric plc
Directors' Report for the Year Ended 31 December 2018 (continued)

Going Concern

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

When considering if to continue to adopt the going concern basis in preparing the annual report and financial statements, the directors have taken into account a number of factors, including the following:

- The Group's main subsidiaries, NPg Northeast, is a stable electricity distribution businesses operating an essential public service and are regulated by the Gas and Electricity Markets Authority ("GEMA"). In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Group is profitable with strong underlying cash flows. The Company and NPg Northeast hold investment grade credit ratings;
- The Group is financed by long-term borrowings with an average maturity of 8 years and has access to short-term committed borrowing facilities of £97 million;
- The Northern Powergrid Group plans to issue long-term borrowings within the next 12 months and early indications from our relationship banks suggest there is an active market with appetite to invest; and
- The Group has prepared forecasts which taking into account reasonable possible changes in trading performance, show that the Group has sufficient resources to settle its liabilities as they fall due. The directors have had discussions with the bank who have indicated that they would continue to provide the short term facilities to the Group for the foreseeable future on acceptable terms.

Consequently, after making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual reports and financial statements.

Disclosure of information to the auditor

Each director has taken steps that they ought to have taken as a director in order to make themselves aware of any relevant audit information and to establish that the company's auditor is aware of that information. The directors confirm that there is no relevant information that they know of and of which they know the auditor is unaware.

Reappointment of auditor

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

Approved by the Board on 15 April 2019 and signed on its behalf by:



P A Jones
Director

Northern Electric plc

Independent Auditor's Report to the Members of Northern Electric plc

Opinion

In our opinion:

- the financial statements of Northern Electric plc (the 'parent company') and its subsidiaries (the 'group') give a true and fair view of the state of the group's and of the parent company's affairs as at 31 December 2018 and of the group's profit for the year then ended;
- the group financial statements have been properly prepared in accordance with International Financial Reporting Standards (IFRSs) as adopted by the European Union;
- the parent company financial statements have been properly prepared in accordance with IFRSs as adopted by the European Union and as applied in accordance with the provisions of the Companies Act 2006; and
- the financial statements have been prepared in accordance with the requirements of the Companies Act 2006 and, as regards the group financial statements, Article 4 of the IAS Regulation.

We have audited the financial statements which comprise:

- the consolidated income statement;
- the consolidated statement of comprehensive income;
- the consolidated and parent company statement of financial position;
- the consolidated and parent company statements of changes in equity;
- the consolidated and parent company cash flow statement; and
- the related notes 1 to 34.

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

Summary of our audit approach

The key audit matters that we identified in the current year were:

- Accounting for capital spend - overhead allocation model
- Valuation of defined benefit obligations

Materiality: The materiality that we used for the group financial statements was £6.5m which was determined on the basis of 5% of income before tax.

Scoping: The focus of our audit work was on the main regulated business, Northern Powergrid (Northeast) Ltd and the significant sub-consolidations in the group.

Significant changes in our approach: There has not been a significant change in our approach since the prior year, however, the valuation of the defined benefit obligations is now a key audit matter because of the increased settlements in the scheme and the sensitivities of the assumptions utilised to value the obligation.

Conclusions relating to going concern

We have nothing to report in respect of the following matters in relation to which the ISAs (UK) require us to report to you where:

- the directors' use of the going concern basis of accounting in the 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 group's or the parent 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.

Northern Electric plc
Independent Auditor's Report to the Members of Northern Electric plc (continued)

Key audit matters

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

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

Accounting for capital spend - overhead allocation model

Key audit matter description

Total additions to property, plant and equipment in the year in Northern Powergrid (Northeast) were £173m (2017: £192m) with the majority of the additions to the electricity distribution system, as disclosed in note 11 to the financial statements. These additions include capitalised overheads. A portion of the overheads are capitalised to the extent that they are considered to relate to capital additions that have taken place during the year.

The calculation of capitalised overheads remains an area at risk of potential bias due to the level of subjectivity in the percentage of overheads capitalised, which also creates a potential fraud risk. In particular, the key risk is that management's judgement in the percentage amounts capitalised are not reflective of the capital spend, as disclosed in notes 2, including the note relating to critical judgements in applying accounting policies.

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

- We have evaluated the design and implementation of controls surrounding accounting for capital spend.
- We have analysed the capital spend and the overhead allocation percentages in the year and compared these to prior year to identify any unusual fluctuations. We have also analysed current policies in place and assessed their suitability in line with IAS 16, along with reviewing the approach management takes towards assessing capitalised overheads and any changes introduced in the current year.
- We have obtained relevant industry benchmarks for the proportions for capitalisation, using these benchmarks to challenge management as to the appropriateness of their judgement.
- We have performed testing of the total overheads included within the allocation model which are subsequently capitalised based on management's assessment of percentage allocation.

Key observations

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

Valuation of defined benefit obligations

Key audit matter description

The key judgements relate to the determination of the present value of defined benefit obligation. The present value of the funding asset was £85m, with an underlying obligation of £1,468m. The present value of the defined benefit obligation is actuarially derived and is subject to judgement in the assumption setting. Due to the continued settlements in the year for the scheme we have noted additional risk around the valuation modelling of each settlement and the impact to the actuarial assumptions due to the change in the profile of the membership of the scheme. The accounting policy and disclosure is found in note 26.

Northern Electric plc

Independent Auditor's Report to the Members of Northern Electric plc (continued)

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

- We have evaluated the design and implementation of the review of the actuary report at the year end.
- We have obtained and tested the underlying data and assumptions utilised by the actuary in the calculation of the pension obligation.
- We have challenged the settlement model utilised by independently recalculating the model based on assumptions we would have expected the model to utilise, and have tested the underlying data used in the model to derecognise the obligation.
- We have considered the estimates of experienced actuaries and challenged management assumptions and judgements by using specialists to benchmark assumptions, and we derived an independent calculation on settlements required.

Key observations

We concluded that each of the assumptions used by management to estimate the defined benefit obligation are consistent with the requirements of IAS 19 and are in a reasonable range when compared to comparable schemes and our internal benchmarks, albeit slightly towards the optimistic end. In the prior year the assumptions were consistently towards the optimistic end.

Our application of materiality

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

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

Group financial statements

- **Materiality:** £6.5m (2017: £7m)
- **Basis for determining materiality:** 5% of income before tax
- **Rationale for the benchmark applied:** The group contains large trading entities. The industry revenue is highly regulated, therefore, there is a focus on profit.

Parent company financial statements

- **Materiality:** £7m (2017: £7m)
- **Basis for determining materiality:** 3% of adjusted net assets
- **Rationale for the benchmark applied:** Total equity shows how much the value of shareholdings are in the company and as such investor value. The company is not trading as such incurs no revenue.

We agreed with the Board of Directors that we would report to the Board all audit differences in excess of £0.32m (2017: £0.25m), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Board of Directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

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

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

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

Northern Electric plc

Independent Auditor's Report to the Members of Northern Electric plc (continued)

Other information

The directors are responsible for the other information. The other information comprises the information included in the annual report, other than the financial statements and our auditor's report thereon. Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

In connection with our audit of the financial statements, our responsibility is to read the other information and, in doing so, consider whether the other information is materially inconsistent with the financial statements or our knowledge obtained in the audit or otherwise appears to be materially misstated. If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether there is a material misstatement in the financial statements or a material misstatement of the other information. If, based on the work we have performed, we conclude that there is a material misstatement of this other information, we are required to report that fact.

We have nothing to report in this regard.

Responsibilities of directors

As explained more fully in the Statement of Directors Responsibilities (set out on page 15), the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view, and for such internal control as the directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

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

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.

Details of the extent to which the audit was considered capable of detecting irregularities, including fraud are set out below.

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.

Extent to which the audit was considered capable of detecting irregularities, including fraud

We identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and then design and perform audit procedures responsive to those risks, including obtaining audit evidence that is sufficient and appropriate to provide a basis for our opinion.

Identifying and assessing potential risks related to irregularities

In identifying and assessing risks of material misstatement in respect of irregularities, including fraud and non-compliance with laws and regulations, our procedures included the following:

- enquiring of management and the Board, including obtaining and reviewing supporting documentation, concerning the group's policies and procedures relating to:
 - identifying, evaluating and complying with laws and regulations and whether they were aware of any instances of non-compliance;
 - detecting and responding to the risks of fraud and whether they have knowledge of any actual, suspected or alleged fraud;
 - the internal controls established to mitigate risks related to fraud or non-compliance with laws and regulations;

Northern Electric plc

Independent Auditor's Report to the Members of Northern Electric plc (continued)

- discussing among the engagement team and involving relevant internal specialists, including tax, valuations, pensions, IT and industry specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud. As part of this discussion, we considered the risk of potential bias due to the level of subjectivity in determining the percentage of overheads capitalised to property, plant and equipment, and judgements in pensions valuations; and
- obtaining an understanding of the legal and regulatory framework that the group operates in, focusing on those laws and regulations that had a direct effect on the financial statements or that had a fundamental effect on the operations of the group. The key laws and regulations we considered in this context included the UK Companies Act, pensions legislation and tax legislation. In addition, compliance with Ofgem regulations were fundamental to the company's ability to continue as a going concern.

Audit response to risks identified

As a result of performing the above, we identified accounting for capital spend - overhead allocation model as a key audit matter, in addition to valuation of defined benefit obligations. The key audit matters section of our report explains the matters in more detail and also describes the specific procedures we performed in response to that key audit matters. Our additional procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with relevant laws and regulations discussed above;
- enquiring of management, the Board and legal counsel concerning actual and potential litigation and claims;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- reading minutes of meetings of those charged with governance, reviewing internal audit reports and reviewing correspondence with HMRC and Ofgem; and
- in addressing the risk of fraud through management override of controls, testing the appropriateness of journal entries and other adjustments; assessing whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluating the business rationale of any significant transactions that are unusual or outside the normal course of business.

We also communicated relevant identified laws and regulations and potential fraud risks to all engagement team members including internal specialists, and remained alert to any indications of fraud or non-compliance with laws and regulations throughout the audit.

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 group and of the parent company and their environment obtained in the course of the audit, we have not identified any material misstatements in the strategic report or the directors' report.

Northern Electric plc
Independent Auditor's Report to the Members of Northern Electric plc (continued)

Matters on which we are required to report by exception

Adequacy of explanations received and accounting records

Under the Companies Act 2006 we are required to report to you if, in our opinion:

- we have not received all the information and explanations we require for our audit; or
- adequate accounting records have not been kept by the parent company, or returns adequate for our audit have not been received from branches not visited by us; or
- the parent company financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

Directors' remuneration

Under the Companies Act 2006 we are also required to report if in our opinion certain disclosures of directors' remuneration have not been made.

We have nothing to report in respect of this matter.

Other matters

Auditor tenure

Following the recommendation of the Board of Directors, we were appointed by the Board of Northern Powergrid Holdings Company in 1998 to audit the financial statements for the year ending 31 December 1998 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 21 years, covering the years ending 31 December 1998 to 31 December 2018.

Consistency of the audit report with the additional report to the audit committee

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

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.



David M Johnson FCA (Senior Statutory Auditor)
For and on behalf of Deloitte LLP, Statutory Auditor
Newcastle upon Tyne
Tyne and Wear

30 April 2019

Northern Electric plc
Consolidated Income Statement for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Revenue	3	418,973	403,441
Cost of sales		<u>(33,096)</u>	<u>(41,615)</u>
Gross profit		385,877	361,826
Distribution costs		(116,624)	(107,931)
Administrative expenses		<u>(95,316)</u>	<u>(73,679)</u>
Operating profit	5	173,937	180,216
Other gains	4	909	331
Finance income	6	1,549	1,100
Finance costs	6	<u>(45,513)</u>	<u>(41,404)</u>
Profit before tax		130,882	140,243
Income tax expense	10	<u>(24,864)</u>	<u>(28,805)</u>
Profit for the year		<u>106,018</u>	<u>111,438</u>
Profit attributable to:			
Owners of the Company		<u>106,018</u>	<u>111,438</u>

The above results were derived from continuing operations.

Northern Electric plc**Consolidated Statement of Comprehensive Income for the Year Ended 31 December 2018**

	Note	2018 £ 000	2017 £ 000
Profit for the year		106,018	111,438
Items that will not be reclassified subsequently to profit or loss			
Remeasurements of post employment benefit obligations (net)	25	(49,566)	48,538
Items that may be reclassified subsequently to profit or loss			
Gain/(loss) on cash flow hedges (net)		<u>1,076</u>	<u>(287)</u>
Total comprehensive income for the year		<u>57,528</u>	<u>159,689</u>
Total comprehensive income attributable to:			
Owners of the Company		<u>57,528</u>	<u>159,689</u>

The notes on pages 32 to 97 form an integral part of these financial statements.

Northern Electric plc
(Registration number: 02366942)
Consolidated Statement of Financial Position as at 31 December 2018

	Note	31 December 2018 £ 000	31 December 2017 £ 000
Assets			
Non-current assets			
Property, plant and equipment	11	2,686,862	2,551,472
Intangible assets	12	50,638	47,568
Equity accounted investments	13	3,494	3,428
Retirement benefit obligations	25	84,600	116,900
Trade and other receivables	15	6,877	6,358
Other non-current financial assets		837	-
		<u>2,833,308</u>	<u>2,725,726</u>
Current assets			
Inventories	14	13,409	13,382
Trade and other receivables	15	78,010	84,600
Cash and cash equivalents	16	28,143	16,612
Restricted cash	17	13,809	2,182
Contract assets	3	6,005	9,721
Other current financial assets		114	-
		<u>139,490</u>	<u>126,497</u>
Total assets		<u>2,972,798</u>	<u>2,852,223</u>
Equity and liabilities			
Equity			
Share capital	18	(72,173)	(72,173)
Share premium		(158,748)	(158,748)
Capital redemption reserve		(6,185)	(6,185)
Cash flow hedging reserve	19	(789)	287
Retained earnings		<u>(931,396)</u>	<u>(874,944)</u>
Equity attributable to owners of the Company		<u>(1,169,291)</u>	<u>(1,111,763)</u>
Non-current liabilities			
Loans and borrowings	20	(670,361)	(694,092)
Deferred revenue	24	(597,215)	(584,348)
Deferred tax liabilities	10	(98,555)	(102,552)
Other non-current financial liabilities		-	(327)
		<u>(1,366,131)</u>	<u>(1,381,319)</u>

The notes on pages 32 to 97 form an integral part of these financial statements.

Northern Electric plc
(Registration number: 02366942)
Consolidated Statement of Financial Position as at 31 December 2018 (continued)

	Note	31 December 2018 £ 000	31 December 2017 £ 000
Current liabilities			
Trade and other payables	23	(110,901)	(122,378)
Loans and borrowings	20	(297,803)	(203,972)
Income tax liability		(3,106)	(7,421)
Deferred revenue	24	(22,780)	(22,450)
Provisions	22	(2,786)	(2,901)
Other current financial liabilities		-	(19)
		<u>(437,376)</u>	<u>(359,141)</u>
Total liabilities		<u>(1,803,507)</u>	<u>(1,740,460)</u>
Total equity and liabilities		<u>(2,972,798)</u>	<u>(2,852,223)</u>

Approved by the Board on 15 April 2019 and signed on its behalf by:



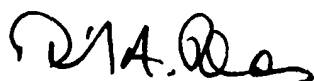
P A Jones
 Director

Northern Electric plc
(Registration number: 02366942)
Statement of Financial Position as at 31 December 2018

	Note	31 December 2018 £ 000	31 December 2017 £ 000
Assets			
Non-current assets			
Property, plant and equipment	11	1,555	1,587
Investments in subsidiaries, joint ventures and associates	13	243,285	328,070
Deferred tax asset	10	118	137
		<u>244,958</u>	<u>329,794</u>
Current assets			
Trade and other receivables	15	302	3,762
Income tax asset		2,843	1,684
Cash and cash equivalents	16	43,633	-
		<u>46,778</u>	<u>5,446</u>
Total assets		<u>291,736</u>	<u>335,240</u>
Equity and liabilities			
Equity			
Share capital	18	(72,173)	(72,173)
Share premium		(158,748)	(158,748)
Capital redemption reserve		(6,185)	(6,185)
Retained earnings		(39,409)	(14,797)
Total equity		<u>(276,515)</u>	<u>(251,903)</u>
Non-current liabilities			
Loans and borrowings	20	(1,117)	(1,117)
Current liabilities			
Trade and other payables	23	(3,913)	(6,073)
Loans and borrowings	20	(8,656)	(74,537)
Provisions	22	(1,535)	(1,610)
		<u>(14,104)</u>	<u>(82,220)</u>
Total liabilities		<u>(15,221)</u>	<u>(83,337)</u>
Total equity and liabilities		<u>(291,736)</u>	<u>(335,240)</u>

The Directors have taken the exemption offered under section 408 of the Act from publishing a separate statement of profit or loss. The Company reported a profit for the financial year ended 31 December 2018 of £24.6m (2017: £14.1m).

Approved by the Board on 15 April 2019 and signed on its behalf by:



P A Jones
 Director

Northern Electric plc

Consolidated Statement of Changes in Equity for the Year Ended 31 December 2018

	Share capital £ 000	Share premium £ 000	Capital redemption reserve £ 000	Cash flow hedging reserve £ 000	Retained earnings £ 000
At 1 January 2018	72,173	158,748	6,185	(287)	874,944
Profit for the year	-	-	-	-	106,018
Other comprehensive income	-	-	-	1,076	(49,566)
Total comprehensive income	-	-	-	1,076	56,452
At 31 December 2018	<u>72,173</u>	<u>158,748</u>	<u>6,185</u>	<u>789</u>	<u>931,396</u>
					Total £ 000
At 1 January 2018					1,111,763
Profit for the year					106,018
Other comprehensive income					(48,490)
Total comprehensive income					57,528
At 31 December 2018					<u>1,169,291</u>
					Total £ 000
At 1 January 2017	72,173	158,748	6,185	-	737,668
Profit for the year	-	-	-	-	111,438
Other comprehensive income	-	-	-	(287)	48,538
Total comprehensive income	-	-	-	(287)	159,976
Dividends	-	-	-	-	(22,700)
At 31 December 2017	<u>72,173</u>	<u>158,748</u>	<u>6,185</u>	<u>(287)</u>	<u>874,944</u>
					Total £ 000
At 1 January 2017					974,774
Profit for the year					111,438
Other comprehensive income					48,251
Total comprehensive income					159,689
Dividends					(22,700)
At 31 December 2017					<u>1,111,763</u>

The notes on pages 32 to 97 form an integral part of these financial statements.

Northern Electric plc
Statement of Changes in Equity for the Year Ended 31 December 2018

	Share capital £ 000	Share premium £ 000	Capital redemption reserve £ 000	Retained earnings £ 000	Total £ 000
At 1 January 2018	72,173	158,748	6,185	14,797	251,903
Profit for the year	-	-	-	24,612	24,612
Total comprehensive income	-	-	-	24,612	24,612
At 31 December 2018	<u>72,173</u>	<u>158,748</u>	<u>6,185</u>	<u>39,409</u>	<u>276,515</u>
	Share capital £ 000	Share premium £ 000	Capital redemption reserve £ 000	Retained earnings £ 000	Total £ 000
At 1 January 2017	72,173	158,748	6,185	23,391	260,497
Profit for the year	-	-	-	14,106	14,106
Total comprehensive income	-	-	-	14,106	14,106
Dividends	-	-	-	(22,700)	(22,700)
At 31 December 2017	<u>72,173</u>	<u>158,748</u>	<u>6,185</u>	<u>14,797</u>	<u>251,903</u>

Northern Electric plc

Consolidated Statement of Cash Flows for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Cash flows from operating activities			
Profit for the year		106,018	111,438
Depreciation and amortisation	5	121,715	102,551
Amortisation of deferred revenue		(22,355)	(21,210)
Profit on disposal of property plant and equipment	4	(909)	(331)
Retirement benefit obligation		(27,700)	(27,600)
Finance income	6	(1,549)	(1,100)
Finance costs	6	45,513	41,404
Income tax expense	10	24,864	28,805
		<u>245,597</u>	<u>233,957</u>
Increase in inventories	14	(27)	(546)
Decrease/(increase) in trade and other receivables	15	6,071	(11,454)
(Decrease)/increase in trade and other payables	23	(917)	1,814
Decrease in contract assets	3	3,716	2,821
(Decrease)/increase in provisions	22	(115)	376
		<u>254,325</u>	<u>226,968</u>
Cash generated from operations			
Income taxes paid		<u>(22,962)</u>	<u>(21,261)</u>
Net cash flow from operating activities		<u>231,363</u>	<u>205,707</u>
Cash flows used in investing activities			
Acquisitions of property plant and equipment		(259,786)	(321,520)
Proceeds from sale of property plant and equipment		1,325	331
Acquisition of intangible assets	12	(10,357)	(11,417)
Receipt of customer contributions		34,543	51,485
Interest received		730	435
Dividend income	6	753	556
		<u>(232,792)</u>	<u>(280,130)</u>
Net cash flows used in investing activities			
Cash flows used in financing activities			
Proceeds from long-term borrowing draw downs		40,000	155,011
Repayment of long-term borrowing		(51,046)	-
Proceeds from short-term borrowing		44,526	-
Movement in intercompany treasury account		35,302	2,808
Movement in restricted cash		(11,627)	(2,182)
Interest paid		(44,195)	(42,417)
Dividends paid	26	-	(22,700)
		<u>12,960</u>	<u>90,520</u>
Net cash flows used in financing activities			
Net increase in cash and cash equivalents		11,531	16,097
Cash and cash equivalents at 1 January		<u>16,612</u>	<u>515</u>
Cash and cash equivalents at 31 December		<u>28,143</u>	<u>16,612</u>

The notes on pages 32 to 97 form an integral part of these financial statements.

Northern Electric plc
Statement of Cash Flows for the Year Ended 31 December 2018

	Note	2018 £ 000	2017 £ 000
Cash flows from operating activities			
Profit for the year		24,612	14,106
Adjustments to cash flows from non-cash items			
Depreciation and amortisation	5	32	47
Loss from disposals of investments		84,785	-
Finance income		(116,646)	(23,209)
Finance costs		9,379	9,413
Income tax expense		(458)	1,371
		<u>1,704</u>	<u>1,728</u>
Working capital adjustments			
Decrease/(increase) in trade and other receivables	15	3,460	(3,384)
(Decrease)/increase in trade and other payables	23	(2,115)	2,835
Decrease in provisions	22	(75)	(103)
Cash generated from operations		2,974	1,076
Income taxes (paid)/received		(727)	97
Net cash flow from operating activities		<u>2,247</u>	<u>1,173</u>
Cash flows from investing activities			
Interest received		803	509
Dividend income		115,843	22,700
Net cash flows from investing activities		<u>116,646</u>	<u>23,209</u>
Cash flows from financing activities			
Movement in intercompany treasury account		(68,549)	4,015
Interest paid		(379)	(427)
Proceeds from bank borrowing draw downs		2,668	3,716
Interest on preference shares		(9,001)	(9,001)
Dividends paid	26	-	(22,700)
Foreign exchange (gains) / losses		1	15
Net cash flows from financing activities		<u>(75,260)</u>	<u>(24,382)</u>
Net increase in cash and cash equivalents		43,633	-
Cash and cash equivalents at 1 January		-	-
Cash and cash equivalents at 31 December		<u><u>43,633</u></u>	<u><u>-</u></u>

The notes on pages 32 to 97 form an integral part of these financial statements.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018

1 General information

The company is a public company limited by share capital, incorporated in England and Wales and domiciled in the United Kingdom.

The address of its registered office is:

Lloyds Court
78 Grey Street
Newcastle upon Tyne
Tyne and Wear
NE1 6AF
United Kingdom

2 Accounting policies

Statement of compliance

The Group financial statements have been prepared in accordance with International Financial Reporting Standards and its interpretations adopted by the EU ("adopted IFRS's").

Summary of significant accounting policies and key accounting estimates

The principal accounting policies applied in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

Basis of preparation

The financial statements have been prepared in accordance with adopted IFRSs and under the historical cost convention as modified by financial instruments recognised at fair value.

The preparation of financial statements in conformity with IFRS requires the use of certain critical accounting estimates. It also requires management to exercise its judgement in the process of applying the Group's accounting policies.

Going Concern

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

When considering if to continue to adopt the going concern basis in preparing the annual report and financial statements, the directors have taken into account a number of factors, including the following:

- The Group's main subsidiaries, NPg Northeast, is a stable electricity distribution businesses operating an essential public service and are regulated by the Gas and Electricity Markets Authority ("GEMA"). In carrying out its functions, GEMA has a statutory duty under the Electricity Act 1989 to have regard to the need to secure that licence holders are able to finance the activities, which are the subject of obligations under Part 1 of the Electricity Act 1989 (including the obligations imposed by the electricity distribution licence) or by the Utilities Act 2000;
- The Group is profitable with strong underlying cash flows. The Company and NPg Northeast hold investment grade credit ratings;
- The Group is financed by long-term borrowings with an average maturity of 8 years and has access to short-term committed borrowing facilities of £97 million;
- The Northern Powergrid Group plans to issue long-term borrowings within the next 12 months and early indications from our relationship banks suggest there is an active market with appetite to invest; and

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

- The Group has prepared forecasts which, taking into account reasonable possible changes in trading performance, show that the Group has sufficient resources to settle its liabilities as they fall due. The directors have had discussions with the bank who have indicated that they would continue to provide the short-term facilities to the Group for the foreseeable future on acceptable terms.

Consequently, after making enquiries, the directors have a reasonable expectation that the Company and the Group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the annual reports and financial statements.

Basis of consolidation

The Group financial statements consolidate the financial statements of the Company and its subsidiary undertakings drawn up to 31 December 2018.

A subsidiary is an entity controlled by the Company. Control is achieved where the Company has the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

The results of subsidiaries acquired or disposed of during the year are included in the income statement from the effective date of acquisition or up to the effective date of disposal, as appropriate. Where necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by the group.

The purchase method of accounting is used to account for business combinations that result in the acquisition of subsidiaries by the group. The cost of a business combination is measured as the fair value of the assets given, equity instruments issued and liabilities incurred or assumed at the date of exchange, plus costs directly attributable to the business combination. Identifiable assets acquired and liabilities and contingent liabilities assumed in a business combination are measured initially at their fair values at the acquisition date. Any excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised is recorded as goodwill.

Inter-company transactions, balances and unrealised gains on transactions between the Company and its subsidiaries, which are related parties, are eliminated in full.

Intra-group losses are also eliminated but may indicate an impairment that requires recognition in the consolidated financial statements.

Accounting policies of subsidiaries have been changed where necessary to ensure consistency with the policies adopted by the group. Non-controlling interests in the net assets of consolidated subsidiaries are identified separately from the Group's equity therein. Non-controlling interests consist of the amount of those interests at the date of the original business combination and the non-controlling shareholder's share of changes in equity since the date of the combination. Total comprehensive income is attributed to non-controlling interests even if this results in the non-controlling interests having a deficit balance.

Critical judgements in applying accounting policies

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

- The split of operating and capital expenditure and the allocation of overheads to property, plant and equipment: The allocation of overheads to capital is derived from a detailed analysis of the costs and their cost drivers which is reviewed on annual basis. The percentage allocation of overheads across the workstream categories are obtained from section managers who are asked to provide reasoning and supporting evidence for the allocation. Finance then undertake a financial impact assessment review and the rationale to ensure it complies with IFRS. The amount of overheads capitalised in the year was £40.8 million (2017: £41.4 million).

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Key sources of estimation uncertainty

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

- Assumptions used when evaluating long-term pension plans - these assumptions and their possible impacts are disclosed in note 25.

Changes in accounting policy

The following have been applied for the first time from 1 January 2018 and have had an effect on the financial statements:

IFRS 9 - Financial instruments

In the current year, the Company has applied IFRS 9 Financial Instruments (as revised in July 2014) and the related consequential amendments to other IFRSs in advance of their effective dates. IFRS 9 introduces new requirements for 1) the classification and measurement of financial assets and financial liabilities, 2) impairment for financial assets and 3) general hedge accounting. Details of these new requirements as well as their impact on the Company's financial statements are described below. The Company has applied IFRS 9 in accordance with the transition provisions set out in IFRS 9.

(a) Classifications and measurement of financial assets

The date of initial application (i.e. the date on which the Company has assessed its existing financial assets and financial liabilities in terms of the requirements of IFRS 9) is 1 January 2018. Accordingly, the Company has applied the requirements of IFRS 9 to instruments that have not been derecognised as at 1 January 2018 and has not applied the requirements to instruments that have already been derecognised as at 1 January 2018. Comparative amounts in relation to instruments that have not been derecognised as at 1 January 2018 have been restated where appropriate.

All recognised financial assets that are within the scope of IFRS 9 are required to be subsequently measured at amortised cost or fair value on the basis of the entity's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, specifically:

- debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at amortised cost;
- debt investments that are held within a business model whose objective is both to collect the contractual cash flows and to sell the debt instruments, and that have contractual cash flows that are solely payments of principal and interest on the principal amount outstanding, are subsequently measured at fair value through other comprehensive income (FVTOCI); and
- all other debt investments and equity investments are subsequently measured at fair value through profit or loss (FVTPL).

Despite the foregoing, the Company may make the following irrevocable election / designation at initial recognition of a financial asset:

- the Company may irrevocably elect to present subsequent changes in fair value of an equity investment that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which IFRS 3 applies in other comprehensive income; and
- the Company may irrevocably designate a debt investment that meets the amortised cost or FVTOCI criteria as measured at FVTPL if doing so eliminates or significantly reduces an accounting mismatch.

In the current year, the Company has not designated any debt investments that meet the amortised cost or FVTOCI criteria as measured at FVTPL.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

When a debt investment measured at FVTOCI is derecognised, the cumulative gain or loss previously recognised in other comprehensive income is reclassified from equity to profit or loss as a reclassification adjustment. In contrast, for an equity investment designated as measured at FVTOCI, the cumulative gain or loss previously recognised in other comprehensive income is not subsequently reclassified to profit or loss.

Debt instruments that are subsequently measured at amortised cost or at FVTOCI are subject to impairment. See (b) below.

The directors of the Company reviewed and assessed the Company's existing financial assets as at 1 January 2018 based on the facts and circumstances that existed at that date and concluded that the initial application of IFRS 9 has had the following impact on the Company's financial assets as regards their classification and measurement:

- financial assets classified as held-to-maturity and loans and receivables under IAS 39 that were measured at amortised cost continue to be measured at amortised cost under IFRS 9 as they are held within a business model to collect contractual cash flows and these cash flows consist solely of payments of principal and interest on the principal amount outstanding; and
- financial assets that were measured at FVTPL under IAS 39 continue to be measured as such under IFRS 9.

Note (e) below tabulates the change in classification of the Company's financial assets upon application of IFRS 9. None of the reclassifications of financial assets have had any impact on the Company's financial position, profit or loss, other comprehensive income or total comprehensive income for both years.

(b) Impairment of financial assets

In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires the Company to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition of the financial assets. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.

Specifically, IFRS 9 requires the Company to recognise a loss allowance for expected credit losses on i) debt investments subsequently measured at amortised cost or at FVTOCI, ii) lease receivables, iii) contract assets and iv) loan commitments and financial guarantee contracts to which the impairment requirements of IFRS 9 apply. In particular, IFRS 9 requires the Company to measure the loss allowance for a financial instrument at an amount equal to the lifetime ECL if the credit risk on that financial instrument has increased significantly since initial recognition, or if the financial instrument is a purchased or originated credit-impaired financial asset. On the other hand, if the credit risk on a financial instrument has not increased significantly since initial recognition (except for a purchased or originated credit-impaired financial asset), the Company is required to measure the loss allowance for that financial instrument at an amount equal to 12 month ECL. IFRS 9 also provides a simplified approach for measuring the loss allowance at an amount equal to lifetime ECL for trade receivables, contract assets and lease receivables in certain circumstances.

As at 1 January 2018, the directors of the Company reviewed and assessed the Company's existing financial assets, amounts due from customers and financial guarantee contracts for impairment using reasonable and supportable information that is available without undue cost or effort in accordance with the requirements of IFRS 9 to determine the credit risk of the respective items at the date they were initially recognised, and compared that to the credit risk as at 1 January 2018 and 1 January 2017. The result of the assessment is as follows:

- Trade and other receivables: The Company applies the simplified approach and recognises lifetime ECL for these assets.
- Cash and bank balances: All bank balances are assessed to have low credit risk at each reporting date as they are held with reputable international banking institutions.

(c) Classification and measurement of financial liabilities

One major change introduced by IFRS 9 in the classification and measurement of financial liabilities relates to the accounting for changes in the fair value of a financial liability designated as at FVTPL attributable to changes in the credit risk of the issuer.

The application of the IFRS 9 impairment requirements has not resulted in additional loss allowance to be recognised in the current year (2017: £nil).

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Specifically, IFRS 9 requires that the changes in the fair value of the financial liability that is attributable to changes in the credit risk of that liability be presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss, but are instead transferred to retained earnings when the financial liability is derecognised. Previously, under IAS 39, the entire amount of the change in the fair value of the financial liability designated as at FVTPL was presented in profit or loss. This change in accounting policy has not affected the Company.

Profit and other comprehensive income reported for 2018 and 2017 have not been affected as the Company did not have any financial liabilities designated as at FVTPL in the prior year.

(d) General hedge accounting

The new general hedge accounting requirements retain the three types of hedge accounting. However, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about the Company's risk management activities have also been introduced.

In accordance with IFRS 9's transition provisions for hedge accounting, the Group has applied the IFRS 9 hedge accounting requirements prospectively from the date of initial application on 1 January 2018. The Group's qualifying hedging relationships in place as at 1 January 2018 also qualified for hedge accounting in accordance with IFRS 9 and were therefore regarded as continuing hedging relationships. No rebalancing of any of the hedging relationships was necessary on 1 January 2018. As the critical terms of the hedging instruments match those of their corresponding hedged items, all hedging relationships continue to be effective under IFRS 9's effectiveness assessment requirements. The Group has also not designated any hedging relationships under IFRS 9 that would not have met the qualifying hedge accounting criteria under IAS 39.

Consistent with prior periods, the Group has continued to designate the change in fair value of the entire forward contract, i.e. including the forward element, as the hedging instrument in the Group's cash flow hedge and fair value hedge relationships.

The application of the IFRS 9 hedge accounting requirements has had no impact on the results and financial position of the Group for the current and/or prior years. Please refer to note 29 for detailed disclosures regarding the Group's risk management activities.

(e) Disclosures in relation to the initial application of IFRS 9

The below illustrates the classification and measurement of financial assets and financial liabilities under IFRS 9 and IAS 39 at the date of initial application, 1 January 2018.

- Trade receivables (note 15) - basic loans and receivables where the objective of the entity's business model for realising these assets is collecting contractual cash flows are recognised at amortised cost under both IFRS 9 and as loans and receivables under IAS 39, there was no change in carrying value;
- Cash and bank balances (note 16) - these were classified as financial assets at amortised cost under IFRS 9 and loans and receivables under IAS 39, there has been no change in carrying value.
- Investments in equity instruments (note 13) - Investments in equity instruments are designated as at FVTPL under IFRS 9 and IAS 39, there has been no change in carrying value.
- Intercompany treasury account (note 20) - the objective of the entity's business model for realising these assets is collecting contractual cash flows, as such they are recognised at amortised cost under IFRS 9 and as loans and receivables under IAS 39, there has been no change in carrying value;
- Trade and other payables (note 23) - were recognised as financial liabilities at amortised cost under both IFRS 9 and IAS 39, there has been no change in carrying value;

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

- Borrowings (note 20) - were recognised as financial liabilities at amortised cost under both IFRS 9 and IAS 39, there has been no change in carrying value; and
- Interest rate swaps (note 30) - these are classified as derivatives designated as hedging instruments under IAS 39 and IFRS 9, there was no change in carrying value.

There were no financial assets or financial liabilities which the Company had previously designated as at FVTPL under IAS 39 that were subject to reclassification, or which the Company has elected to reclassify upon the application of IFRS 9. There were no financial assets or financial liabilities which the Company has elected to designate as at FVTPL at the date of initial application of IFRS 9.

(f) Financial impact of initial application of IFRS 9

There has been no adjustment to financial statement line items because of the application of IFRS 9 for the current and prior years.

Amendments to IFRS 7

The consequential amendments to IFRS 7 have had no impact on the comparatives and therefore no restatement is required; they have resulted in more extensive disclosures in relation to the Group's exposure to credit risk in the financial risk review (note 28).

IFRS 15 - Revenue from contracts with customers

Revenue from Contracts with Customers establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 supersedes the current revenue recognition guidance including IAS 11 Construction Contracts, IAS 18 Revenue and the related interpretations. The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under IFRS 15, an entity recognises revenue when (or as) a performance obligation is satisfied. Apart from providing more extensive disclosures, the application of IFRS 15 has not had a significant impact on the financial position or performance of the Company.

None of the other standards, interpretations and amendments effective for the first time from 1 January 2018 have had a material effect on the financial statements.

New standards, interpretations and amendments not yet effective

The following newly issued but not yet effective standards, interpretations and amendments, which have not been applied in these financial statements, will or may have an effect on the Company financial statements in future:

IFRS 16 - Leases

IFRS 16 introduces a comprehensive model for the identification of lease arrangements and accounting treatments for both lessors and lessees. IFRS 16 will supersede the current lease guidance including IAS 17 Leases and the related interpretations when it becomes effective. IFRS 16 distinguishes between leases and service contracts on the basis of whether an identified asset is controlled by a customer. Distinctions between operating leases and finance leases are removed for lessee accounting, and is replaced by a model where right-of-use asset and a corresponding liability have to be recognised for all leases by lessees except for short term leases and leases of low-value assets. As of 31 December 2018, the Group has non-cancellable operating lease commitments of £26.2 million; IAS 17 does not require recognition of any right-of-use asset or liability for future payments for these leases. A preliminary assessment indicates that these arrangements will meet the definition of a lease under IFRS 16, and hence the Group will recognise a right-of-use asset and corresponding liability in respect of all these leases unless they qualify for low-value or short-term leases upon the application of IFRS 16. The directors of the Group anticipate that the application of IFRS 16 is unlikely to have a material impact on amounts reported in the statement of profit or loss.

None of the other standards, interpretations and amendments which are effective for periods beginning after 1 January 2018 and which have not been adopted early, are expected to have a material effect on the financial statements:

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Effective for periods beginning or after 1 January 2019

- Amendments to IAS 28 - Long-term interests in associates and joint ventures;
- Amendments to IAS 19 - Plan amendment, curtailment or settlement;
- Annual improvements to IFRS 2015-2017 cycle;

Effective for periods beginning or after 1 January 2020

- Amendments to IFRS 3 - Definition of a business;
- Amendments to IAS 1 and IAS 8 - Definition of material; and
- Amendments to References to the Conceptual Framework in IFRS Standards.

Revenue recognition

Recognition

The Group earns revenue from the provision of services relating to revenue from a contract to provide services is recognised by the following means:

- Distribution use of system income is recognised on a per GWh basis;
- Customer contributions for connections are amortised over the life of the corresponding asset;
- Contracting revenue is recognised in line with expenditure;
- Meter asset provision income is accounted for under lease accounting;
- Intercompany recharges for services provided are based on costs incurred; and
- Other revenue includes connections and disconnections from the network and are recognised by reference to the proportion of total costs of providing the service.

This revenue is recognised in the accounting period when the services are rendered at an amount that reflects the consideration to which the entity expects to be entitled in exchange for fulfilling its performance obligations to customers.

The principles in IFRS are applied to revenue recognition criteria using the following 5 step model:

1. Identify the contracts with the customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to the performance obligations in the contract
5. Recognise revenue when or as the entity satisfies its performance obligations

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Fee arrangements

Below are details of fee arrangements and how these are measured and recognised, for revenue from the provision of services:

- For regulated use of system income the revenue for the service is recognised on the basis of agreed charging methodologies on a per GWh basis.
- For fixed price for contracted service revenue is recognised based on the stage of completion and performance obligations met for actual services provided as a proportion of the total fixed fee agreed in the contract.
- For stage payment on long-term contracts revenue is recognised by reference to stage of manufacture at the year end date using contractual rates specified in the contract. Revenue on materials is measured at the actual amount of the material used on the contract at the price specified in the contract.

Performance obligations

The main performance obligations in contracts consist of the provision of a distribution network to electricity suppliers. For these contracts, through the distribution and connection use of system agreement (DCUSA) the delivery of performance obligations are measured at the balance sheet date by the number of GWh distributed by the system.

To calculate the transaction price of contracts is:

- DUoS - the transaction price is calculated in relation to allowed revenue;
- Engineering contracting - the transaction price of fixed fee and stage payment contracts is determined by the fee specified in the contract for the product;
- Meter asset provision - the transaction price of fixed fee contracts is determined by the fee specified in contract; and
- Vehicle provision - the transaction price of fixed fee contracts is determined by the fee specified in contract.

The performance obligations involved in engineering contracting work are accounted for as follows:

- Where the outcome of a contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, based on the proportion of contract costs incurred for work performed to date relative to the estimated total contract costs, except where this would not be representative of the stage of completion.
- Variations in contract work, claims and incentive payments are included to the extent that they have been agreed with the customer.
- Where the outcome of a contract cannot be estimated reliably, contract revenue is recognised to the extent of the costs incurred where it is probable they will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.
- When contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is shown as amounts due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is shown as the amounts due to customers for contract work. Amounts received before the related work is performed are included in the consolidated statement of financial position, as a liability, as advances received. Amounts billed for work performed but not yet paid by the customer are included in the consolidated statement of financial position under trade and other receivables.

Other performance obligations include but are not limited to:

- Provision of vehicles over a specified period accounted for under lease accounting;
- Provisions of exploration equipment over a specified period; and
- Passage of milestones and completion of installation of equipment for connections and engineering contracting.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Transaction price

To calculate the transaction price of contracts is:

- DUoS - the transaction price is calculated in relation to allowed revenue;
- Engineering contracting - the transaction price of fixed fee and stage payment contracts is determined by the fee specified in the contract for the product;
- Meter asset provision - the transaction price of fixed fee contracts is determined by the fee specified in contract.
- Vehicle provision - the transaction price of fixed fee contracts is determined by the fee specified in contract.

Where discounts to the contract price are applied the Group presents these as a discount from contract revenue at the point in time the discount terms are met by the customer.

Contract modifications

The Group's contracts are often amended for changes in contract specifications and requirements. Contract modification exists when the amendment either creates new or changes the existing enforceable rights and obligations. The effect of a contract modification on the transaction price and the Group's measure of progress for the performance obligation to which it relates, is recognised as an adjustment to revenue in one of the following ways:

- a. Prospectively as an additional separate contract;
- b. Prospectively as a termination of the existing contract and creation of a new contract;
- c. As part of the original contract using a cumulative catch up; or
- d. As a combination of b) and c).

The facts and circumstances of any contract modification are considered individually as the types of modifications will vary contract by contract and may result in different accounting outcomes. Judgement is applied in relation to the accounting for such modifications where the final terms or legal contracts have not been agreed prior to the period end as management need to determine if a modification has been approved and if it either creates new or changes existing enforceable rights and obligations of the parties. Depending upon the outcome of such negotiations, the timing and amount of revenue recognised may be different in the relevant accounting periods. Modification and amendments to contracts are undertaken via an agreed formal process. For example, if a change in scope has been approved but the corresponding change in price is still being negotiated, management use their judgement to estimate the change to the total transaction price.

Tax

The tax expense for the period comprises current and deferred tax. Tax is recognised in profit or loss, except that a change attributable to an item of income or expense recognised as other comprehensive income is also recognised directly in other comprehensive income.

The current income tax charge is calculated on the basis of tax rates and laws that have been enacted or substantively enacted by the reporting date in the countries where the Group operates and generates taxable income.

Deferred income tax is recognised on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the consolidated financial statements and on unused tax losses or tax credits in the group. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted by the reporting date.

The carrying amount of deferred tax assets are reviewed at each reporting date and a valuation allowance is set up against deferred tax assets so that the net carrying amount equals the highest amount that is more likely than not to be recovered based on current or future taxable profit.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Property, plant and equipment

Property, plant and equipment is stated in the statement of financial position at cost, less any subsequent accumulated depreciation and subsequent accumulated impairment losses.

The cost of property, plant and equipment includes directly attributable incremental costs incurred in their acquisition and installation.

Depreciation

Depreciation is charged so as to write off the cost of assets, other than land and properties under construction over their estimated useful lives, as follows:

Asset class	Depreciation method and rate
Distribution system assets	45 years
Distribution generation assets	15 years
Information technology equipment included in distribution system assets	up to 10 years
Freehold land & buildings	up to 60 years
Leasehold land & buildings	lower of lease period or 60 years
Metering equipment	up to 10 years
Fixtures and equipment	up to 10 years

Freehold land is not depreciated.

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

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

Intangible assets

Goodwill arising on the acquisition of an entity represents the excess of the cost of acquisition over the group's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities of the entity recognised at the date of acquisition. Goodwill is initially recognised as an asset at cost and is subsequently measured at cost less any accumulated impairment losses. Goodwill is held in the currency of the acquired entity and revalued to the closing rate at each reporting period date.

Goodwill is not subject to amortisation but is tested for impairment.

Negative goodwill arising on an acquisition is recognised directly in the income statement. On disposal of a subsidiary or a jointly controlled entity, the attributable amount of goodwill is included in the determination of the profit or loss recognised in the income statement on disposal.

Amortisation

Amortisation is provided on intangible assets so as to write off the cost, less any estimated residual value, over their expected useful economic life as follows:

Asset class	Amortisation method and rate
Software development	up to 15 years

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Investments in associates and joint ventures

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

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

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

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

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

Investments in subsidiaries

Investments in subsidiaries are account for at cost less impairment.

Cash and cash equivalents

Cash and cash equivalents comprise cash on hand and call deposits, and other short-term highly liquid investments that are readily convertible to a known amount of cash and are subject to an insignificant risk of changes in value.

Trade receivables

Trade receivables are amounts due from customers for merchandise sold or services performed in the ordinary course of business. If collection is expected in one year or less (or in the normal operating cycle of the business if longer), they are classified as current assets. If not, they are presented as non-current assets.

Trade receivables are recognised initially at the transaction price. They are subsequently measured at amortised cost using the effective interest method, less provision for impairment. A provision for the impairment of trade receivables is established when there is objective evidence that the Group will not be able to collect all amounts due according to the original terms of the receivables.

Inventories

Inventories are stated at the lower of cost and net realisable value. Cost is determined using the first-in, first-out (FIFO) method.

The cost of finished goods and work in progress comprises direct materials and, where applicable, direct labour costs and those overheads that have been incurred in bringing the inventories to their present location and condition. At each reporting date, inventories are assessed for impairment. If inventory is impaired, the carrying amount is reduced to its selling price less costs to complete and sell; the impairment loss is recognised immediately in profit or loss.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Trade payables

Trade payables are obligations to pay for goods or services that have been acquired in the ordinary course of business from suppliers. Accounts payable are classified as current liabilities if payment is due within one year or less (or in the normal operating cycle of the business if longer). If not, they are presented as non-current liabilities.

Trade payables are recognised initially at the transaction price and subsequently measured at amortised cost using the effective interest method.

Borrowings

All borrowings are initially recorded at the amount of proceeds received, net of transaction costs. Borrowings are subsequently carried at amortised cost, with the difference between the proceeds, net of transaction costs, and the amount due on redemption being recognised as a charge to the income statement over the period of the relevant borrowing.

Interest expense is recognised on the basis of the effective interest method and is included in finance costs.

Borrowings are classified as current liabilities unless the Group has an unconditional right to defer settlement of the liability for at least 12 months after the reporting date.

Provisions

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

Provisions are measured at the directors' best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

Share capital

Ordinary shares are classified as equity. Equity instruments are measured at the fair value of the cash or other resources received or receivable, net of the direct costs of issuing the equity instruments. If payment is deferred and the time value of money is material, the initial measurement is on a present value basis.

Dividends

Dividend distribution to the Company's shareholders is recognised as a liability in the Company's financial statements in the period in which the dividends are approved by the Company's shareholders.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Financial instruments

Initial recognition

Financial assets and financial liabilities comprise all assets and liabilities reflected in the statement of financial position, although excluding property, plant and equipment, investment properties, intangible assets, deferred tax assets, prepayments, deferred tax liabilities and employee benefits plan.

The Group recognises financial assets and financial liabilities in the statement of financial position when, and only when, the Group becomes party to the contractual provisions of the financial instrument.

Financial assets are initially recognised at fair value. Financial liabilities are initially recognised at fair value, representing the proceeds received net of premiums, discounts and transaction costs that are directly attributable to the financial liability.

All regular way purchases and sales of financial assets and financial liabilities classified as fair value through profit or loss ("FVTPL") are recognised on the trade date, i.e. the date on which the Group commits to purchase or sell the financial assets or financial liabilities. All regular way purchases and sales of other financial assets and financial liabilities are recognised on the settlement date, i.e. the date on which the asset or liability is received from or delivered to the counterparty. Regular way purchases or sales are purchases or sales of financial assets that require delivery within the timeframe generally established by regulation or convention in the marketplace.

Subsequent to initial measurement, financial assets and financial liabilities are measured at either amortised cost or fair value.

Classification and measurement

Financial instruments are classified at inception into one of the following categories, which then determine the subsequent measurement methodology:

Financial assets are classified into one of the following three categories:

- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income (FVTOCI); or
- financial assets at fair value through the profit or loss (FVTPL).

Financial liabilities are classified into one of the following two categories:

- financial liabilities at amortised cost; or
- financial liabilities at fair value through the profit or loss (FVTPL).

The classification and the basis for measurement are subject to the Group's business model for managing the financial assets and the contractual cash flow characteristics of the financial assets, as detailed below:

Financial assets at amortised cost

A financial asset is measured at amortised cost if it meets both of the following conditions and is not designated as at FVTPL:

- the assets are held within a business model whose objective is to hold assets in order to collect contractual cash flows; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

If either of the above two criteria is not met, the financial assets are classified and measured at fair value through the profit or loss (FVTPL).

If a financial asset meets the amortised cost criteria, the Group may choose to designate the financial asset at FVTPL. Such an election is irrevocable and applicable only if the FVTPL classification significantly reduces a measurement or recognition inconsistency.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Financial assets at fair value through other comprehensive income

A financial asset is measured at FVTOCI only if it meets both of the following conditions and is not designated as at FVPTL:

- the asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and
- the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

On initial recognition of an equity investments that is not held for trading, the Group may irrevocably elect to present subsequent changes in fair value in OCI. This election is made on an investment-by-investment basis.

If an equity investment is designated as FVTOCI, all gains and losses, except for dividend income, are recognised in other comprehensive income and are not subsequently included in the statement of income.

Financial assets at fair value through the profit or loss

Financial assets not otherwise classified above are classified and measured as FVTPL.

Financial liabilities at amortised cost

All financial liabilities, other than those classified as financial liabilities at FVTPL, are measured at amortised cost using the effective interest rate method.

Financial liabilities at fair value through the profit or loss

Financial liabilities not measured at amortised cost are classified and measured at FVTPL. This classification includes derivative liabilities.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Derecognition

Financial assets

The Group derecognises a financial asset when:

- the contractual rights to the cash flows from the financial asset expire;
- it transfers the right to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred; or
- the Group neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of the consideration received is recognised as a gain or loss in the profit or loss.

Any cumulative gain or loss recognised in OCI in respect of equity investment securities designated as FVTOCI is not recognised in profit or loss on derecognition of such securities. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the group is recognised as a separate asset or liability.

The Group enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised.

When the Group derecognises transferred financial assets in their entirety, but has continuing involvement in them then the entity should disclose for each type of continuing involvement at the reporting date:

- (a) The carrying amount of the assets and liabilities that are recognised in the entity's statement of financial position and represent the entity's continuing involvement in the derecognised financial assets, and the line items in which those assets and liabilities are recognised;
- (b) The fair value of the assets and liabilities that represent the entity's continuing involvement in the derecognised financial assets;
- (c) The amount that best represents the entity's maximum exposure to loss from its continuing involvement in the derecognised financial assets, and how the maximum exposure to loss is determined; and
- (d) The undiscounted cash outflows that would or may be required to repurchase the derecognised financial assets or other amounts payable to the transferee for the transferred assets.

Financial liabilities

The Group derecognises a financial liability when its contractual obligations are discharged, cancelled, or expire.

Modification of financial assets and financial liabilities

Financial assets

If the terms of a financial asset are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual rights to the cash flows from the original financial asset are deemed to expire. In this case the original financial asset is derecognised and a new financial asset is recognised at either amortised cost or fair value.

If the cash flows are not substantially different, then the modification does not result in derecognition of the financial asset. In this case, the Group recalculates the gross carrying amount of the financial asset and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Financial liabilities

If the terms of a financial liabilities are modified, the Group evaluates whether the cash flows of the modified asset are substantially different. If the cash flows are substantially different, then the contractual obligations from the cash flows from the original financial liabilities are deemed to expire. In this case the original financial liabilities are derecognised and new financial liabilities are recognised at either amortised cost or fair value.

If the cash flows are not substantially different, then the modification does not result in derecognition of the financial liabilities. In this case, the Group recalculates the gross carrying amount of the financial liabilities and recognises the amount arising from adjusting the gross carrying amount as a modification gain or loss in the statement of income.

Impairment of financial assets

Measurement of Expected Credit Losses

The Group recognises loss allowances for expected credit losses (ECL) on financial instruments that are not measured at FVPTL, namely:

- Financial assets that are debt instruments;
- Accounts and other receivables;
- Financial guarantee contracts issued; and
- Loan commitments issued.

The Group classifies its financial instruments into stage 1, stage 2 and stage 3, based on the applied impairment methodology, as described below:

Stage 1: for financial instruments where there has not been a significant increase in credit risk since initial recognition and that are not credit-impaired on origination, the Group recognises an allowance based on the 12-month ECL.

Stage 2: for financial instruments where there has been a significant increase in credit risk since initial recognition but they are not credit-impaired, the Group recognises an allowance for the lifetime ECL.

Stage 3: for credit-impaired financial instruments, the Group recognises the lifetime ECL.

The Group measures loss allowances at an amount equal to the lifetime ECL, except for the following, for which they are measured as a 12-month ECL:

- debt securities that are determined to have a low credit risk (equivalent to investment grade rating) at the reporting date; and
- other financial instruments on which the credit risk has not increased significantly since their initial recognition.

The Group considers a debt security to have low credit risk when their credit risk rating is equivalent to the globally understood definition of 'investment grade'.

A 12-month ECL is the portion of the ECL that results from default events on a financial instrument that are probable within 12 months from the reporting date.

Provisions for credit-impairment are recognised in the statement of income and are reflected in accumulated provision balances against each relevant financial instruments balance.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Evidence that the financial asset is credit-impaired include the following;

- Significant financial difficulties of the borrower or issuer;
- A breach of contract such as default or past due event;
- The restructuring of the loan or advance by the Group on terms that the group would not consider otherwise;
- It is becoming probable that the borrower will enter bankruptcy or other financial reorganisation;
- The disappearance of an active market for the security because of financial difficulties;
- There is other observable data relating to a Group of assets such as adverse changes in the payment status of borrowers or issuers in the group, or economic conditions that correlate with defaults in the Group.

For trade receivables, the Group applies the simplified approach, which requires expected lifetime losses to be recognised from initial recognition of the receivables.

To measure the expected credit losses, trade receivables and contract assets have been grouped based on shared credit risk characteristics and the days past due. The contract assets relate to unbilled work in progress and have substantially the same risk characteristics as the trade receivables for the same types of contracts. The Group has therefore concluded that the expected loss rates for trade receivables are a reasonable approximation of the loss rates for the contract assets.

The expected loss rates are based on the payment profiles of sales over a period of 36 months before 31 December 2018 and the corresponding historical credit losses experienced within this period. The historical loss rates are adjusted to reflect current and forward-looking information on macroeconomic factors affecting the ability of the customers to settle the receivables. The Group has identified the GDP and the unemployment rate of the countries in which it sells its goods and services to be the most relevant factors, and accordingly adjusts the historical loss rates based on expected changes in these factors.

Derivative financial instruments

Derivative financial instruments are contracts, the value of which is derived from one or more underlying financial instruments or indices, and include futures, forwards, swaps and options in the interest rate, foreign exchange, equity and credit markets.

Derivative financial instruments are recognised in the statement of financial position at fair value. Fair values are derived from prevailing market prices, discounted cash flow models or option pricing models as appropriate.

In statement of financial position, derivative financial instruments with positive fair values (unrealised gains) are included as assets and derivative financial instruments with negative fair values (unrealised losses) are included as liabilities.

The changes in the fair values of derivative financial instruments entered into for trading purposes are included in trading income.

Hedge accounting

Derivatives held for risk management purposes include all derivative assets and liabilities that are not classified as trading assets and liabilities.

The Group designates certain derivatives held for risk management as well as certain non-derivative financial instruments as hedging instruments in qualifying hedging relationships. On initial designation of the hedge, the Group formally documents the relationship between the hedging instruments and hedge items, including the risk management objective and strategy in undertaking the hedge, together with the method that will be used to assess the effectiveness of the hedging relationship. The Group makes an assessment, both at inception of the hedge relationship and on an ongoing basis, of whether the hedging instruments are expected to be highly effective in offsetting that changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated.

These hedging relationships are discussed below.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

2 Accounting policies (continued)

Cash flow hedges

The Group makes an assessment for a cash flow hedge of a forecast transaction, of whether the forecast transaction is highly probable to occur and presents an exposure to variations in cash flows that could ultimately affect profit or loss.

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognised asset or liability that could affect profit or loss, then the effective portion of changes in the fair value of the derivative is recognised in OCI and presented in the hedging reserve within equity. Any ineffective portion of changes in the fair value of the derivative is recognised immediately in profit or loss. The amount recognised in OCI is reclassified to profit or loss as a reclassification adjustment in the same period as the hedged cash flows affect profit or loss, and in the same line item in the statement of profit or loss and OCI.

If the hedging derivative expires or is sold, terminated or exercised, or the hedge no longer meets the criteria for cash flow hedge accounting, or the hedge designation is revoked, then hedge accounting is discontinued prospectively. However, if the derivative is novated to a central clearing counterparty by both parties as a consequence of laws or regulations without changes in its terms except for those that are necessary for the novation, then the derivative is not considered expired or terminated.

Accounting estimates and assumptions

The preparation of the financial statements requires management to make estimates and assumptions that affect the reported amounts of certain financial assets, liabilities, income and expenses.

The use of estimates and assumptions is principally limited to the determination of provisions for impairment, the valuation of financial instruments as explained in more detail below:-

Provisions for impairment

In determining impairment of financial assets, judgement is required in the estimation of the amount and timing of future cash flows as well as an assessment of whether the credit risk on the financial asset has increased significantly since initial recognition and incorporation of forward-looking information in the measurement of ECL.

Fair value of financial assets and liabilities

Where the fair value of financial assets and liabilities cannot be derived from active markets, they are determined using a variety of valuation techniques that include the use of mathematical models. The input to these models is derived from observable markets where available, but where this is not feasible, a degree of judgement is required in determining assumptions used in the models. Changes in assumptions used in the models could affect the reported fair value of financial assets and liabilities.

3 Revenue

The analysis of the Group's revenue for the year from continuing operations is as follows:

	2018	2017
	£ 000	£ 000
Distribution revenue	312,520	306,749
Amortisation of deferred revenue	22,355	21,210
Contracting revenue	21,353	33,036
Meter asset rental	58,579	37,482
Other revenue	4,166	4,964
	<u>418,973</u>	<u>403,441</u>

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

3 Revenue (continued)

The tables below represent the internal information provided to the President and Chief Executive Officer of the Group for the purposes of resource allocation and segmental performance appraisal. The Group operates in four principal areas of activity, those of the distribution of electricity, engineering contracting, gas exploration and smart meter rental in the United Kingdom.

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

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

The Group is separated into the following segments:

- Distribution - Northern Powergrid (Northeast) Limited
- Contracting - IUS Ltd
- Metering - Northern Powergrid Metering Limited
- Other - includes vehicle leasing, corporate services and property services.

	Distribution	Contracting	Metering	Other	Total
	£ 000	£ 000	£ 000	£ 000	£ 000
2018					
Revenue	334,875	21,353	58,579	4,166	418,973
Inter-segment sales	379	5,103	-	(5,482)	-
Total revenue	<u>335,254</u>	<u>26,456</u>	<u>58,579</u>	<u>(1,316)</u>	<u>418,973</u>
Operating profit	<u>127,184</u>	<u>356</u>	<u>21,194</u>	<u>25,203</u>	<u>173,937</u>
Other gains					909
Finance costs					(45,513)
Finance income					<u>1,549</u>
Profit before tax					<u>130,882</u>
Capital additions	184,037	110	78,288	(1,844)	260,591
Depreciation	88,620	61	34,756	(1,722)	121,715
Amortisation of deferred revenue	<u>(22,355)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(22,355)</u>
Segment assets	<u>2,551,933</u>	<u>10,106</u>	<u>364,157</u>	<u>43,030</u>	<u>2,969,226</u>
Unallocated corporate assets					<u>3,572</u>
Total assets					<u>2,972,798</u>
Segment liabilities	<u>(703,747)</u>	<u>(6,872)</u>	<u>(196,895)</u>	<u>(24,560)</u>	<u>(932,074)</u>
Unallocated corporate liabilities					<u>(871,433)</u>
Total liabilities					<u>(1,803,507)</u>
Segment net assets	<u>1,848,186</u>	<u>3,234</u>	<u>167,262</u>	<u>18,470</u>	<u>2,037,152</u>
Unallocated net corporate liabilities					<u>(867,861)</u>
Total net assets					<u>1,169,291</u>

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

3 Revenue (continued)

2017	Distribution £ 000	Contracting £ 000	Metering £ 000	Other £ 000	Total £ 000
Revenue	327,959	33,036	37,482	4,964	403,441
Inter-segment sales	342	3,662	-	(4,004)	-
Total revenue	<u>328,301</u>	<u>36,698</u>	<u>37,482</u>	<u>960</u>	<u>403,441</u>
Operating profit	<u>137,121</u>	<u>3,120</u>	<u>14,181</u>	<u>25,794</u>	<u>180,216</u>
Other gains					331
Finance costs					(41,404)
Finance income					<u>1,100</u>
Profit before tax					<u>140,243</u>
Capital additions	202,982	6	137,299	(2,453)	337,834
Depreciation and amortisation	82,019	47	22,165	(1,580)	102,651
Amortisation of deferred revenue	<u>(21,209)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(21,209)</u>
Segment assets	<u>2,462,379</u>	<u>16,206</u>	<u>278,174</u>	<u>73,242</u>	<u>2,830,001</u>
Unallocated corporate assets					<u>22,222</u>
Total assets					<u>2,852,223</u>
Segment liabilities	<u>(694,271)</u>	<u>(8,255)</u>	<u>(22,717)</u>	<u>(7,280)</u>	<u>(732,523)</u>
Unallocated corporate liabilities					<u>(1,007,937)</u>
Total liabilities					<u>(1,740,460)</u>
Segment net assets	<u>1,768,108</u>	<u>7,951</u>	<u>255,457</u>	<u>65,962</u>	<u>2,097,478</u>
Unallocated net corporate liabilities					<u>(985,715)</u>
Total net assets					<u>1,111,763</u>

External sales to RWE Npower plc in 2018 of £64.9 million (2017: £69.3 million) and to British Gas plc in 2018 of £41.4 million (2017: £48.3 million) are included within the Distribution segment.

Sale and purchases between different segments are made at commercial prices. Unallocated net corporate assets and liabilities include cash and cash equivalents of £nil (2017: £16.6 million), borrowings of £729.8 million (2017: £741.2 million) and taxation of £101.6 million (2017: £110.0 million).

Contract assets arise where goods or services are transferred to the customer before the customer pays consideration, or before payment is due. All contract assets relate to engineering contracting work within Integrated Utility Services. Contracts in progress at statement of financial position date:

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

3 Revenue (continued)

Assets recognised from costs to fulfil a contact with customers

	31 December 2018 £ 000	31 December 2017 £ 000
Contract costs incurred plus recognised profit less recognised losses to date	30,117	48,851
Less: progress billings	<u>(24,112)</u>	<u>(39,130)</u>
	<u>6,005</u>	<u>9,721</u>

At 31 December 2018, retentions held by customers for contract work amounted to £0.4 million (2017: £0.3 million).

Advances received from customers for contract work amounted to £nil (2017: £nil).

The Company had no contract assets at 31 December 2018 (2017: £nil).

4 Other gains and losses

The analysis of the Group's other gains and losses for the year is as follows:

	2018 £ 000	2017 £ 000
Gain on disposal of property, plant and equipment	<u>909</u>	<u>331</u>

5 Operating profit

Arrived at after charging/(crediting)

	2018 £ 000	2017 £ 000
Depreciation expense	114,428	97,845
Amortisation expense	7,287	4,706
Research and development	2,437	1,479
Loss allowance	2,350	361
Amortisation of deferred revenue	<u>(22,355)</u>	<u>(21,210)</u>

Amortisation is included in administration costs within the statement of profit or loss on page 23.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

6 Finance income and costs

	2018	2017
	£ 000	£ 000
Finance income		
Dividend income	62	46
Other finance income	1,487	1,054
Total finance income	<u>1,549</u>	<u>1,100</u>
Finance costs		
Interest on borrowings at amortised cost	(47,753)	(44,192)
Borrowing costs included in cost of qualifying asset	2,240	2,788
Total finance costs	<u>(45,513)</u>	<u>(41,404)</u>
Net finance costs	<u>(43,964)</u>	<u>(40,304)</u>

Borrowing costs included in the costs of qualifying assets during the year arose on the general borrowing pool and are calculated by applying a capitalisation rate of 5.33% within NPg Northeast (2017: 5.26%) to expenditure on such assets.

7 Staff costs

	2018	2017
	£ 000	£ 000
Salaries	60,946	63,699
Social security costs	7,102	7,049
Defined benefit pension cost	1,154	(869)
Defined contribution pension cost	2,803	2,312
	72,005	72,191
Less charged to property plant and equipment	<u>(40,784)</u>	<u>(41,372)</u>
	<u>31,221</u>	<u>30,819</u>

A large proportion of the Group's employees are members of the DB Scheme, details of which are given in the Employee Benefit Obligations note 25.

The average number of persons employed by the Group (including directors) during the year, analysed by category was as follows:

	2018	2017
	No.	No.
Distribution	1,108	1,072
Engineering contracting	153	159
Other	13	29
	<u>1,274</u>	<u>1,260</u>

The Company had an average of 13 employees during the year ended 31 December 2018 (2017: 29).

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

8 Directors' remuneration

The directors' remuneration for the year was as follows:

	2018 £	2017 £
Highest paid		
Short-term employee benefits	419,946	393,702
Other long-term benefits	547,789	466,273
	<u>967,735</u>	<u>859,975</u>
Total		
Short-term employee benefits	681,192	619,726
Post retirement benefits - defined contribution	8,577	3,366
Other long-term benefits	662,463	587,188
	<u>1,352,232</u>	<u>1,210,280</u>
Post retirement benefits		
Directors who are members of a defined contribution scheme	<u>2</u>	<u>2</u>
Directors who are members of a defined benefit scheme	<u>-</u>	<u>-</u>
	2018 £	2017 £
Key personnel remuneration		
Short-term employee benefits	663,680	527,765
Post retirement benefits - defined benefit	60,076	72,605
Post retirement benefits - defined contribution	49,411	51,338
Other long-term benefits	345,398	313,803
	<u>1,118,565</u>	<u>965,511</u>

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

9 Auditors' remuneration

The auditors' remuneration for the year was as follows:

	2018	2017
	£ 000	£ 000
Fees payable to the auditor for audit of the Company's annual accounts	26	26
Fees payable to the auditor for audit of the Company's subsidiaries pursuant to legislation	199	205
Total audit fees	225	231
Audit of regulatory reporting	45	45
Other services	7	22
Total auditors' remuneration	277	298

10 Income tax

Tax charged/(credited) in the income statement

	2018	2017
	£ 000	£ 000
Current taxation		
UK corporation tax	25,423	26,477
UK corporation tax adjustment to prior periods	(1,430)	3,697
	<u>23,993</u>	<u>30,174</u>
Deferred taxation		
Arising from origination and reversal of temporary differences	1,236	1,212
Deferred tax expense (credit) from unrecognised temporary difference from a prior period	722	(1,312)
Deferred tax expense (credit) relating to changes in tax rates or laws	(1,087)	(1,269)
Total deferred taxation	<u>871</u>	<u>(1,369)</u>
Tax expense in the income statement	<u>24,864</u>	<u>28,805</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

10 Income tax (continued)

The tax on profit before tax for the year is lower than the standard rate of corporation tax in the UK (2017 - higher than the standard rate of corporation tax in the UK) of 19.00% (2017 - 19.25%).

The differences are reconciled below:

	2018	2017
	£ 000	£ 000
Profit before tax	<u>130,882</u>	<u>140,243</u>
Corporation tax at standard rate	24,868	26,997
Effect of difference between corporation and deferred tax rates	(1,087)	(1,269)
Tax effect of result of joint venture entities	(144)	(119)
(Decrease)/increase in current tax from adjustment for prior periods	(1,430)	3,697
Permanent differences (including non-taxable dividends)	(92)	(149)
Pension contributions recognised in other comprehensive income	234	588
Deferred tax over provision for prior years	722	(1,312)
Non-deductible interest	1,710	1,733
Release of deferred tax in respect of prior year holdover relief claim	-	(1,369)
Other	<u>83</u>	<u>8</u>
Total tax charge	<u>24,864</u>	<u>28,805</u>

Finance Act No.2 2015 included provisions to reduce the corporation tax from 20% to 19% with effect from 1 April 2017 and Finance Act 2016 introduced a further reduction in the main rate of corporation tax to 17% from 1 April 2020. Accordingly deferred tax assets and liabilities have been calculated at the tax rates which will be in force when the underlying temporary differences are expected to reverse.

Amounts recognised in other comprehensive income

	2018		
	Before tax	Tax (expense)	Net of tax
	£ 000	benefit	£ 000
		£ 000	£ 000
Gain/(loss) on cash flow hedges (net)	1,296	(220)	1,076
Remeasurements of post employment benefit obligations (net)	<u>(60,000)</u>	<u>10,434</u>	<u>(49,566)</u>
	<u>(58,704)</u>	<u>10,214</u>	<u>(48,490)</u>
	2017		
	Before tax	Tax (expense)	Net of tax
	£ 000	benefit	£ 000
		£ 000	£ 000
Gain/(loss) on cash flow hedges (net)	(346)	59	(287)
Remeasurements of post employment benefit obligations (net)	<u>57,800</u>	<u>(9,262)</u>	<u>48,538</u>
	<u>57,454</u>	<u>(9,203)</u>	<u>48,251</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

10 Income tax (continued)

Deferred tax

Group

Deferred tax assets and liabilities

Deferred tax movement during the year:

	At 1 January 2018 £ 000	Recognised in income £ 000	Recognised in other comprehensive income £ 000	At 31 December 2018 £ 000
Accelerated tax depreciation	88,851	1,311	-	90,162
Rollover/holdover relief	950	(49)	-	901
Other items	(459)	(62)	221	(300)
Pension benefit obligations	13,210	(329)	(5,088)	7,793
Net tax assets/(liabilities)	<u>102,552</u>	<u>871</u>	<u>(4,867)</u>	<u>98,556</u>

Deferred tax movement during the prior year:

	At 1 January 2017 £ 000	Recognised in income £ 000	Recognised in other comprehensive income £ 000	At 31 December 2017 £ 000
Accelerated tax depreciation	87,158	1,693	-	88,851
Rollover/holdover relief	3,875	(2,925)	-	950
Other items	(357)	(43)	(59)	(459)
Pension benefit obligations	(1,214)	(94)	14,518	13,210
Net tax assets/(liabilities)	<u>89,462</u>	<u>(1,369)</u>	<u>14,459</u>	<u>102,552</u>

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

10 Income tax (continued)

Company

Deferred tax assets and liabilities

Deferred tax movement during the year:

	At 1 January 2018 £ 000	Recognised in income £ 000	At 31 December 2018 £ 000
Accelerated tax depreciation	(14)	3	(11)
Rollover/holdover relief	151	16	167
Pension benefit obligations	(274)	-	(274)
Net tax assets/(liabilities)	<u>(137)</u>	<u>19</u>	<u>(118)</u>

Deferred tax movement during the prior year:

	At 1 January 2017 £ 000	Recognised in income £ 000	At 31 December 2017 £ 000
Accelerated tax depreciation	(18)	4	(14)
Rollover/holdover relief	3,066	(2,915)	151
Pension benefit obligations	(290)	16	(274)
Net tax assets/(liabilities)	<u>2,758</u>	<u>(2,895)</u>	<u>(137)</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

11 Property, plant and equipment

Group

	Land and buildings £ 000	Distribution system £ 000	Metering equipment £ 000	Furniture, fittings and equipment £ 000	Total £ 000
Cost or valuation					
At 1 January 2017	6,534	3,043,253	222,913	72,740	3,345,440
Additions	-	186,418	137,299	2,700	326,417
Disposals	-	(7,024)	-	(423)	(7,447)
At 31 December 2017	<u>6,534</u>	<u>3,222,647</u>	<u>360,212</u>	<u>75,017</u>	<u>3,664,410</u>
At 1 January 2018	6,534	3,222,647	360,212	75,017	3,664,410
Additions	-	169,995	78,288	1,951	250,234
Disposals	-	(10,966)	(4,328)	(390)	(15,684)
At 31 December 2018	<u>6,534</u>	<u>3,381,676</u>	<u>434,172</u>	<u>76,578</u>	<u>3,898,960</u>
Depreciation					
At 1 January 2017	6,078	880,212	76,247	60,003	1,022,540
Charge for year	103	70,094	23,641	4,007	97,845
Eliminated on disposal	-	(7,024)	-	(423)	(7,447)
At 31 December 2017	<u>6,181</u>	<u>943,282</u>	<u>99,888</u>	<u>63,587</u>	<u>1,112,938</u>
At 1 January 2018	6,181	943,282	99,888	63,587	1,112,938
Charge for the year	103	70,448	39,681	4,196	114,428
Eliminated on disposal	-	(10,966)	(3,912)	(390)	(15,268)
At 31 December 2018	<u>6,284</u>	<u>1,002,764</u>	<u>135,657</u>	<u>67,393</u>	<u>1,212,098</u>
Carrying amount					
At 1 January 2017	<u>456</u>	<u>2,163,041</u>	<u>146,666</u>	<u>12,737</u>	<u>2,322,900</u>
At 31 December 2017	<u>353</u>	<u>2,279,365</u>	<u>260,324</u>	<u>11,430</u>	<u>2,551,472</u>
At 31 December 2018	<u>250</u>	<u>2,378,912</u>	<u>298,515</u>	<u>9,185</u>	<u>2,686,862</u>

The net book value of land and buildings above relates to leasehold land and buildings.

Expenditure recognised in the carrying amount of property, plant and equipment in the course of construction was as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Distribution system	<u>211,655</u>	<u>211,489</u>

The Company had no property, plant and equipment assets as at 31 December 2018 (2017: £nil).

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

11 Property, plant and equipment (continued)

Contractual commitments for the acquisition of property, plant and equipment were as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Distribution system	<u>20,500</u>	<u>19,400</u>

12 Intangible assets

Group

	Software development £ 000	Total £ 000
Cost or valuation		
At 1 January 2017	78,467	78,467
Additions	<u>11,417</u>	<u>11,417</u>
At 31 December 2017	<u>89,884</u>	<u>89,884</u>
At 1 January 2018	89,884	89,884
Additions	<u>10,357</u>	<u>10,357</u>
At 31 December 2018	<u>100,241</u>	<u>100,241</u>
Amortisation		
At 1 January 2017	37,610	37,610
Amortisation charge	<u>4,706</u>	<u>4,706</u>
At 31 December 2017	<u>42,316</u>	<u>42,316</u>
At 1 January 2018	42,316	42,316
Amortisation charge	<u>7,287</u>	<u>7,287</u>
At 31 December 2018	<u>49,603</u>	<u>49,603</u>
Carrying amount		
At 31 December 2018	<u>50,638</u>	<u>50,638</u>
At 31 December 2017	<u>47,568</u>	<u>47,568</u>
At 1 January 2017	<u>40,857</u>	<u>40,857</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

13 Investments

	Investment in joint ventures £ 000	Share in other undertakings £ 000	Total £ 000
At 1 January 2017	3,298	21	3,319
Investments in joint ventures profit	619	-	619
Investment in joint ventures dividends paid	(510)	-	(510)
At 31 December 2017	3,407	21	3,428
Investments in joint ventures profit	757	-	757
Investment in joint ventures dividends paid	(691)	-	(691)
At 31 December 2018	3,473	21	3,494

Summary of the company investments

	31 December 2018 £ 000	31 December 2017 £ 000
Investments in subsidiaries	243,285	328,070

Group subsidiaries

Details of the Group subsidiaries as at 31 December 2018 are as follows:

Name of subsidiary	Principal activity	Registered office and country of incorporation	Proportion of ownership interest and voting rights held	
			2018	2017
CE Electric Services Limited	Dormant	England and Wales	100%	100%
Central PowerGrid Limited	Dormant	England and Wales	100%	100%
East PowerGrid Limited	Dormant	England and Wales	100%	100%
Eastern PowerGrid Limited	Dormant	England and Wales	100%	100%
Infrastructure North Limited	Dormant	England and Wales	100%	100%
Integrated Utility Services Limited	Engineering contracting	England and Wales	100%	100%
IUS Limited	Dormant	England and Wales	100%	100%
Midlands PowerGrid Limited	Dormant	England and Wales	100%	100%
NEDL Limited	Dormant	England and Wales	100%	100%
North East PowerGrid Limited	Dormant	England and Wales	100%	100%
North Eastern PowerGrid Limited	Dormant	England and Wales	100%	100%

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

13 Investments (continued)

Name of subsidiary	Principal activity	Registered office and country of incorporation	Proportion of ownership interest and voting rights held	
			2018	2017
North PowerGrid Limited	Dormant	England and Wales	100%	100%
North West PowerGrid Limited	Dormant	England and Wales	100%	100%
North Western PowerGrid Limited	Dormant	England and Wales	100%	100%
Northern Electric Distribution Limited	Dormant	England and Wales	100%	100%
Northern Electric Properties Limited	Property holdings & management company	England and Wales	100%	100%
Northern Electric Share Scheme Trustee Limited	Dormant	England and Wales	100%	100%
Northern Electricity (North East) Limited	Dormant	England and Wales	100%	100%
Northern Electricity (Yorkshire) Limited	Dormant	England and Wales	100%	100%
Northern Electricity Limited	Dormant	England and Wales	100%	100%
Northern Electricity Networks Company (North East) Limited	Dormant	England and Wales	100%	100%
Northern Electricity Networks Company (Yorkshire) Limited	Dormant	England and Wales	100%	100%
Northern Electricity Networks Company Limited	Dormant	England and Wales	100%	100%
Northern Electrics Limited	Dormant	England and Wales	100%	100%
Northern Energy Funding Company Limited	Dormant	England and Wales	100%	100%
Northern Metering Services Limited	Dormant	England and Wales	100%	100%
Northern Powergrid Metering Limited	Meter asset provider	England and Wales	100%	100%
Northern Powergrid (Northeast) Limited	Distribution of electricity	England and Wales	100%	100%
Northern Powergrid (North West) Limited	Dormant	England and Wales	100%	100%
Northern Power Networks Company (North East) Limited	Dormant	England and Wales	100%	100%
Northern Power Networks Company (Yorkshire) Limited	Dormant	England and Wales	100%	100%

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

13 Investments (continued)

Name of subsidiary	Principal activity	Registered office and country of incorporation	Proportion of ownership interest and voting rights held	
			2018	2017
Northern Power Networks Company Limited	Dormant	England and Wales	100%	100%
Northern Transport Finance Limited	Car finance company	England and Wales	100%	100%
Northern Utility Services Limited	Dormant	England and Wales	100%	100%
PowerGrid (Central) Limited	Dormant	England and Wales	100%	100%
PowerGrid (East) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Eastern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Midlands) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North East) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North Eastern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Midlands) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North East) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North Eastern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North West) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North Western) Limited	Dormant	England and Wales	100%	100%
PowerGrid (North) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Northern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (South East) Limited	Dormant	England and Wales	100%	100%
PowerGrid (South Eastern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (South West) Limited	Dormant	England and Wales	100%	100%
PowerGrid (South Western) Limited	Dormant	England and Wales	100%	100%
PowerGrid (South) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Southern) Limited	Dormant	England and Wales	100%	100%
PowerGrid (West) Limited	Dormant	England and Wales	100%	100%

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

13 Investments (continued)

Name of subsidiary	Principal activity	Registered office and country of incorporation	Proportion of ownership interest and voting rights held	
			2018	2017
PowerGrid (Western) Limited	Dormant	England and Wales	100%	100%
PowerGrid (Yorkshire) Limited	Dormant	England and Wales	100%	100%
South East PowerGrid Limited	Dormant	England and Wales	100%	100%
South Eastern PowerGrid Limited	Dormant	England and Wales	100%	100%
South PowerGrid Limited	Dormant	England and Wales	100%	100%
South West PowerGrid Limited	Dormant	England and Wales	100%	100%
South Western Powergrid	Dormant	England and Wales	100%	100%
Southern PowerGrid Limited	Dormant	England and Wales	100%	100%
West PowerGrid Limited	Dormant	England and Wales	100%	100%
Western PowerGrid Limited	Dormant	England and Wales	100%	100%
YEDL Limited	Dormant	England and Wales	100%	100%
Yorkshire Electricity Distribution Limited	Dormant	England and Wales	100%	100%
Yorkshire PowerGrid Limited	Dormant	England and Wales	100%	100%
Northern Electric Finance plc	Finance company	England and Wales	100%	100%

Unless otherwise stated the registered office of the above companies is: Lloyds Court, 78 Grey Street, Newcastle upon Tyne, Tyne and Wear, NE1 6AF

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

13 Investments (continued)

Group joint ventures

Details of the Group joint ventures as at 31 December 2018 are as follows:

Name of Joint-ventures	Principal activity	Registered office	Proportion of ownership interest and voting rights held by the Group	
			2018	2017
Vehicle Lease and Service Limited	Transport services	Centre for Advanced Industry, 3rd Floor, Coble Dene, North Shields, NE29 6DE England and Wales	50%	50%
VLS Limited	Dormant	Centre for Advanced Industry, 3rd Floor, Coble Dene, North Shields, NE29 6DE England and Wales	50%	50%

Joint ventures and associates are not strategic to the Group's activities.

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

	31 December 2018 £ 000	31 December 2017 £ 000
Current assets	15,258	11,322
Non-current assets	18,815	19,244
Current liabilities	(11,501)	(10,328)
Non-current liabilities	(15,625)	(13,424)
Net assets	<u>6,947</u>	<u>6,814</u>
Group's share of net assets	<u>3,473</u>	<u>3,407</u>
Revenue	<u>17,810</u>	<u>18,711</u>
Profit for the year	<u>1,514</u>	<u>1,238</u>
Group's share of profit for the year	<u>757</u>	<u>619</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

14 Inventories

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Raw materials and consumables	12,422	12,284	-	-
Work in progress	449	799	-	-
Vehicle inventory	538	299	-	-
	<u>13,409</u>	<u>13,382</u>	<u>-</u>	<u>-</u>

15 Trade and other receivables

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Distribution use of system receivables	48,039	49,140	-	-
Trade receivables	22,845	21,765	70	60
Finance lease receivable	6,021	8,041	-	-
Loss allowance	(2,974)	(855)	-	-
Net trade receivables	73,931	78,091	70	60
Social security and other taxes	-	-	26	3,487
Prepayments	152	304	206	215
Other receivables	3,927	6,205	-	-
	<u>78,010</u>	<u>84,600</u>	<u>302</u>	<u>3,762</u>
Non-current trade receivables	6,877	6,358	-	-
	<u>84,887</u>	<u>90,958</u>	<u>302</u>	<u>3,762</u>

The average credit period on receivables is 30 days. No interest is charged on outstanding trade receivables.

The Group always measures the loss allowance for trade receivables at an amount equal to lifetime expected credit loss. The expected credit losses on trade receivables are estimated using a provision matrix by reference to past default experience of the debtor and an analysis of the debtor's current financial position, adjusted for factors that are specific to the debtors, general economic conditions of the industry in which the debtors operate and an assessment of both the current as well as the forecast direction of conditions at the reporting date.

There has been no change in the estimation techniques or significant assumptions made during the current reporting period.

The Group writes off a trade receivable when there is information indicating that the debtor is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the debtor has been placed under liquidation or has entered into bankruptcy proceedings. None of the trade receivables that have been written off is subject to enforcement activities.

As the Company's historical credit loss experience does shows significantly different loss patterns for different customer segments, the provision for loss allowance based on past due status is distinguished as follows:

- Distribution businesses: DUoS receivables, damages receivables, and other receivables;
- Metering: contracted meters, contracted churn, and non-contracted churn; and

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

- Engineering contracting.

Included in the loss allowance are specific trade receivables, with a balance of £4.3m (2017: £1.4m), which have been placed in administration. The impairment represents the difference between the carrying amount of the specific trade receivable and the present value of the expected liquidation dividend.

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

The movement in loss allowance for the year was as follows:

	31 December	31 December
	2018	2017
	£ 000	£ 000
At 1 January	758	647
Amounts utilised/written off in the year	(134)	(153)
Amounts recognised in the income statement	<u>2,350</u>	<u>361</u>
At 31 December	<u><u>2,974</u></u>	<u><u>855</u></u>

There has been no significant change in the gross amounts of trade receivables that has affected the estimation of loss allowance.

Significant increase in credit risk

In assessing whether the credit risk on a financial instrument has increased significantly since initial recognition, the Company compares the risk of a default occurring on a financial instrument at the reporting date with the risk of a default occurring on the financial instrument at the date of initial recognition. In making this assessment the Company considers historical experience as well as forward-looking information that is available without undue cost or effort. Forward-looking information includes the future prospects of the industries in which the Company's debtors operate obtained from economic expert reports, financial analysts, government bodies, relevant think-tanks and other similar organisations. In particular the following information is taken into account when assessing whether credit risk has increased significantly since initial recognition:

- existing or forecast adverse changes in business, financial or economic conditions that are expected to cause a significant decrease in the debtor's ability to meet its debt obligations;
- an actual or expected significant deterioration in the operating results of the debtor;
- significant increases in credit risk on other financial instruments of the same debtor; and
- an actual or expected significant adverse change in the regulatory, economic, or technological environment of the debtor that results in a significant decrease in the debtor's ability to meet its debt obligations.

Distribution use of system receivables

The customers served by the Group's distribution networks are supplied predominantly by a small number of electricity supply businesses with RWE NPower plc accounting for approximately 19% of distribution revenues in 2018 (2017: 22%) and British Gas plc accounting for approximately 13% of distribution revenues in 2018 (2017: 16%). Ofgem has determined a framework which sets credit limits for each supply business based on its credit rating or payment history and requires them to provide credit cover if their value at risk (measured as being equivalent to 45 days usage) exceeds the credit limit. Acceptable credit typically is provided in the form of a parent company guarantee, letter of credit or an escrow account.

Ofgem has indicated that, provided the Company has implemented credit control, billing and collection processes in line with best practice guidelines and can demonstrate compliance with the guidelines or is able to satisfactorily explain departure from the guidelines, any losses arising from supplier default will be recovered through an increase in future allowed income. Losses incurred to date have not been material therefore no ECL has been made on DUoS balances.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

The following is the expected credit loss for receivables past due:

	Not due £ 000	Current £ 000	1-3 months £ 000	3-6 months £ 000
2018				
Total balance	26,392	21,219	34	394
Less specific provisions	-	(190)	(4)	(387)
Balance eligible for ECL	26,392	21,029	30	7
Lifetime ECL	0%	0%	0%	0%
Expected credit loss	-	-	-	-
	Not due £ 000	Current £ 000	1-3 months £ 000	3-6 months £ 000
2017				
Total balance	25,536	23,115	-	246
Less specific provisions	-	-	-	(242)
Balance eligible for ECL	25,536	23,115	-	4
Lifetime ECL	0%	0%	0%	0%
Expected credit loss	-	-	-	-

Other distribution trade receivables

Sales of goods and services comprise all income streams which are not classified as UoS income. Examples of non-UoS income streams would be service alterations/disconnections, assessment and design fees, and recovery of amounts for damage caused by third parties to the distribution system. The average credit period on sales of goods and services is 30 days. Interest is not generally charged on the tradereceivables paid after the due date.

The following is the expected credit loss for receivables past due:

Non-damages receivables

	Not due £ 000	Current £ 000	1-6 months £ 000	6-12 months £ 000	Over 1 year £ 000
2018					
Total balance	1,960	1,018	2,247	1,058	273
Less other balances	(1,681)	(810)	(1,991)	(1,010)	(192)
Balance eligible for ECL	279	208	256	48	81
Lifetime ECL	0%	0%	0%	15%	20%
Expected credit loss	-	-	-	7	16
	Not due £ 000	Current £ 000	1-6 months £ 000	6-12 months £ 000	Over 1 year £ 000
2017					
Total balance	1,231	945	984	509	474
Less other balances	(1,212)	(751)	(849)	(490)	(440)
Balance eligible for ECL	19	194	135	19	34
Lifetime ECL	0%	0%	0%	15%	15%
Expected credit loss	-	-	-	3	5

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

Damages receivables

	0-6 months	6-12 months	1-2 years	2-3 years	Over 3 year
	£ 000	£ 000	£ 000	£ 000	£ 000
2018					
Total balance	871	788	525	186	19
Less specific provisions	-	(47)	(11)	(133)	-
Balance eligible for ECL	871	741	514	53	19
Lifetime ECL	10%	10%	15%	30%	60%
Expected credit loss	87	74	77	16	11
2017					
Total balance	675	536	280	31	6
Less specific provisions	-	(70)	(145)	-	-
Balance eligible for ECL	675	466	135	31	6
Lifetime ECL	10%	10%	15%	30%	60%
Expected credit loss	68	47	20	9	4

Meter asset provision

Included in trade receivables are balances relating to the provision of meters through Northern Powergrid Metering Limited. The average credit period on these receivables is 30 days. Interest is not generally charged on receivables paid after the due date.

The Group writes off a trade receivable when there is information indicating that the debtor is in severe financial difficulty and there is no realistic prospect of recovery, e.g. when the debtor has been placed under liquidation or has entered into bankruptcy proceedings, or when the debtor is over 1 year past due. None of the trade receivables that have been written off is subject to enforcement activities.

For receivables where there is no specific provisions, a provision is made for debts past their due date based on lifetime expected credit loss determined by reference to past default experience. The following is the expected credit loss for receivables past due:

Contracted

	Current	1-3 months	3-6 months	6-12 months	Over 1 year
	£ 000	£ 000	£ 000	£ 000	£ 000
2018					
Total balance	4,270	3,090	195	-	-
Less specific provisions	(152)	(360)	-	-	-
Balance eligible for ECL	4,118	2,730	195	-	-
Lifetime ECL	0%	0%	0%	50%	100%
Expected credit loss	-	-	-	-	-

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

	Current	1-3 months	3-6 months	6-12 months	Over 1 year
	£ 000	£ 000	£ 000	£ 000	£ 000
2017					
Total balance	3,662	266	-	-	-
Less specific provisions	-	-	-	-	-
Balance eligible for ECL	3,662	266	-	-	-
Lifetime ECL	0%	0%	0%	50%	100%
Expected credit loss	-	-	-	-	-
Contracted churn					
2018					
Total balance	258	382	56	-	-
Less specific provisions	(108)	(363)	(53)	-	-
Balance eligible for ECL	150	19	3	-	-
Lifetime ECL	0%	0%	10%	50%	100%
Expected credit loss	-	-	-	-	-
2017					
Total balance	141	16	8	-	-
Less specific provisions	-	-	(8)	-	-
Balance eligible for ECL	141	16	-	-	-
Lifetime ECL	0%	0%	10%	50%	100%
Expected credit loss	-	-	-	-	-
Non-contracted churn					
2018					
Total balance	1,713	318	4	-	-
Less specific provisions	(78)	(139)	(3)	-	-
Balance eligible for ECL	1,635	179	1	-	-
Lifetime ECL	0%	0%	10%	50%	100%
Expected credit loss	-	-	-	-	-
2017					
Total balance	2,147	175	31	-	-
Less specific provisions	-	-	-	-	-
Balance eligible for ECL	2,147	175	31	-	-
Lifetime ECL	0%	0%	10%	50%	100%
Expected credit loss	-	-	3	-	-

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

Engineering contracting receivables

The average credit period on engineering contracting receivables is 30 days. Interest is not generally charged on receivables paid after the due date. Included in the Group's construction contracts balance are debtors with a carrying amount of £1.2 million (2017: £3.0 million), which are past due at the reporting date for which the Group has provided for an irrecoverable amount of £0.2 million (2017: £0.4 million) based on past experience. The Group does not hold any collateral over these balances. The average age of these receivables is 115 days (2017: 76 days).

Included in the Group's construction contracts balance are debtors with a carrying amount of £nil (2017: £nil) which are past due at the reporting date for which the Group has not provided as there has not been a significant change in credit quality and the amounts are still considered recoverable. The Group does not hold any collateral over these balances.

The average credit period on sales of goods and services is 30 days. Interest is not generally charged on the trade receivables paid after the due date.

	Current	1-3 months	3-6 months	6-12 months	Over 1 year
2018	£ 000	£ 000	£ 000	£ 000	£ 000
Total balance	1,932	1,068	157	76	88
Less specific provisions	-	(58)	(4)	(35)	(88)
Balance eligible for ECL	1,932	1,010	153	41	-
Lifetime ECL	0%	1%	10%	50%	100%
Expected credit loss	-	10	15	21	-
2017	£ 000	£ 000	£ 000	£ 000	£ 000
Total balance	3,069	2,628	246	63	158
Less specific provisions	-	-	(1)	(5)	(158)
Balance eligible for ECL	3,069	2,628	245	58	-
Lifetime ECL	0%	1%	10%	50%	100%
Expected credit loss	-	26	25	29	-

Finance lease receivables

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

The interest rate inherent in the agreements is fixed at the contract date for all of the term of the agreement. The average effective interest rate contracted is approximately 6.5% (2017: 6.5%) per annum. None of these debts are past due and there are no indicators of impairment.

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

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

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

15 Trade and other receivables (continued)

	Minimum lease payments	Interest	Present value
	£ 000	£ 000	£ 000
2018			
Within one year	6,241	(220)	6,021
In two to five years	9,272	(2,991)	6,281
In over five years	2,842	(2,246)	596
	<u>18,355</u>	<u>(5,457)</u>	<u>12,898</u>
	Minimum lease payments	Interest	Present value
	£ 000	£ 000	£ 000
2017			
Within one year	5,932	(512)	5,420
In two to five years	10,483	(2,341)	8,142
In over five years	3,820	(2,983)	837
	<u>20,235</u>	<u>(5,836)</u>	<u>14,399</u>

Operating lease receivables

Operating leases relate to the metering assets owned by the Group with lease terms of 10 years, these are disclosed in note 11. The lessee does not have an option to purchase the meters at the expiry of the lease period.

The total future value of minimum lease payments is as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Within one year	59,393	49,127
In two to five years	235,878	197,787
Over five years	188,359	205,047
	<u>483,630</u>	<u>451,961</u>

16 Cash and cash equivalents

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Cash at bank	28,143	16,612	-	-
Other cash and cash equivalents	-	-	43,633	-
	<u>28,143</u>	<u>16,612</u>	<u>43,633</u>	<u>-</u>

Cash and cash equivalents have a maturity of less than three months, are readily convertible to cash and are subject to an insignificant risk of changes in value. The carrying amount of these assets approximates their fair value. Other cash and cash equivalents include intercompany loans that are highly liquid and repayable on demand.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

17 Restricted cash

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Restricted cash	13,809	2,182	-	-

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

18 Share capital

Allotted, issued, and fully paid:

	Share value	Number	2018 £ 000	2017 £ 000
Ordinary shares	56 12/13p	127,689,809	72,173	72,173

The Company has one class of ordinary shares which carries no right to fixed income. Details of cumulative non-equity preference shares are contained in the borrowings note 20.

19 Reserves

Group

The changes to each component of equity resulting from items of other comprehensive income for the current year were as follows:

	Cash flow hedging reserve £ 000	Retained earnings £ 000	Total £ 000
Gain/(loss) on cash flow hedges (net)	1,076	-	1,076
Remeasurements of post employment benefit obligations (net)	-	(49,566)	(49,566)
	<u>1,076</u>	<u>(49,566)</u>	<u>(48,490)</u>

The changes to each component of equity resulting from items of other comprehensive income for the prior year were as follows:

	Cash flow hedging reserve £ 000	Retained earnings £ 000	Total £ 000
Gain/(loss) on cash flow hedges (net)	(287)	-	(287)
Remeasurements of post employment benefit obligations (net)	-	48,538	48,538
	<u>(287)</u>	<u>48,538</u>	<u>48,251</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

20 Loans and borrowings

	Group		Company	
	2018	2017	2018	2017
	£ 000	£ 000	£ 000	£ 000
Non-current loans and borrowings	670,361	694,092	1,117	1,117
Current loans and borrowings	297,803	203,972	8,656	74,537
	<u>968,164</u>	<u>898,064</u>	<u>9,773</u>	<u>75,654</u>

Group

	Carrying value		Fair value	
	2018	2017	2018	2017
	£ 000	£ 000	£ 000	£ 000
Short-term loans	44,566	10	44,566	10
Inter-company short-term loans	178,404	141,446	178,404	141,446
Bond 2020 - 8.875%	101,512	101,345	114,357	122,791
Bond 2035 - 5.125%	153,112	153,034	197,140	207,238
Amortising loan 2026 - 2.736%*	185,058	155,298	185,058	155,298
European Investment Bank 2018 - 4.065%	-	41,427	-	41,444
European Investment Bank 2019 - 4.241%	41,493	41,489	41,506	43,015
European Investment Bank 2020 - 4.386%	40,507	40,503	41,796	43,426
European Investment Bank 2027 - 2.564%	120,128	120,128	126,761	129,281
Yorkshire Electricity Group - 5.9%	100,016	100,016	141,879	149,768
Cumulative preference shares	3,368	3,368	141,879	182,585
	<u>968,164</u>	<u>898,064</u>	<u>1,213,346</u>	<u>1,216,302</u>

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

Company

	Carrying value		Fair value	
	2018	2017	2018	2017
	£ 000	£ 000	£ 000	£ 000
Short-term loans	6,405	22	6,405	22
Amounts owed to Group undertakings	-	72,265	24,881	72,264
Cumulative preference shares	3,368	3,367	154,111	182,585
	<u>9,773</u>	<u>75,654</u>	<u>185,397</u>	<u>254,871</u>

Of the total financial liabilities of £745.2 million relates to external borrowings and preference shares whose fair value is determined with reference to quoted market prices. The directors' estimates of the fair value of internal borrowings are determined in accordance with generally accepted pricing models based on discounted cash flow analysis using prices from observable current market transactions or dealer quotes for similar instruments. The valuation of liabilities set out above is based on Level 1 inputs.

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

20 Loans and borrowings (continued)

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

The terms of the cumulative preference shares:

- entitle holders, in priority to holders of all other classes of shares, to a fixed cumulative preferential dividend of 8.061p (net) per share per annum payable half-yearly in equal amounts on 31 March and 30 September;
- on a return of capital on a winding up, or otherwise, will carry the right to repayment of capital together with a premium of 99p per share and a sum equal to any arrears or accruals of dividend. This right is in priority to the rights of ordinary shareholders;
- carry the right to attend a general meeting of Northern Electric plc and vote if, at the date of the notice convening the meeting, payment of the dividend to which they are entitled is six months or more in arrears, or if a resolution is to be considered at the meeting for the winding-up of Northern Electric plc or abrogating, varying or modifying any of the special rights attaching to them; and
- are redeemable in the event of the revocation by the Secretary of State of Northern Electric plc's Public Electricity Supply Licence at the value given in (ii) above.

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

More details on the classification of loans and borrowings is available in note 28.

The Group's capital management and exposure to market and liquidity risk; including maturity analysis, in respect of loans and borrowings is disclosed in financial risk review note 29.

21 Obligations under leases and hire purchase contracts

Group

Operating leases

Operating lease commitments relate to fleet vehicles from Vehicle Lease and Service Ltd, a joint venture, with terms of up to 7 years and operational and non-operational land and buildings with terms of up to 50 years.

The total future value of minimum lease payments is as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Within one year	3,075	5,448
In two to five years	7,647	15,715
In over five years	901	2,842
	<u>11,623</u>	<u>24,005</u>

The amount of non-cancellable operating lease payments recognised as an expense during the year was £5,954,000 (2017 - £6,245,000)

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

21 Obligations under leases and hire purchase contracts (continued)

Company

Operating leases

The total future value of minimum lease payments is as follows:

	31 December	31 December
	2018	2017
	£ 000	£ 000
Within one year	8	89

22 Other provisions

Group

	Claims	Other	Total
	£ 000	£ 000	£ 000
At 1 January 2018	800	2,102	2,902
Additional provisions	945	601	1,546
Provisions used	<u>(1,292)</u>	<u>(370)</u>	<u>(1,662)</u>
At 31 December 2018	<u>453</u>	<u>2,333</u>	<u>2,786</u>
Current liabilities	<u>453</u>	<u>2,333</u>	<u>2,786</u>

Other: Relates primarily to environmental liabilities, wayleave disputes, provision for future safe disposal of transformers which contain oil contaminated with Polychlorinated Biphenyls (PCBs) and holidays in suspense. Settlement is expected substantially after the next 12 months.

Also included in 'Other' is a provision to cover the actuarial assessment of the costs of unfunded pension arrangements in respect of former employees. As at 31 December 2018 the provision relating to unfunded pensions is £1.5m (2017: £1.6m). This is expected to be realised over the next 20 years.

Company

	Other	Total
	provisions	£ 000
	£ 000	£ 000
At 1 January 2018	1,610	1,610
Additional provisions	58	58
Provisions used	<u>(133)</u>	<u>(133)</u>
At 31 December 2018	<u>1,535</u>	<u>1,535</u>

The Company's provisions relate to the actuarial assessment of the costs of unfunded pension arrangements in respect of former employees. As at 31 December 2018 the provision relating to unfunded pensions is £1.5m (2017: £1.6m). This is expected to be realised over the next 20 years.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

23 Trade and other payables

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Payments on account	43,717	44,726	-	-
Trade payables	3,112	5,683	1,125	3,243
Capital creditors	36,349	45,901	-	-
Accrued expenses	9,976	12,807	2,582	2,789
Social security and other taxes	7,515	2,906	74	49
Outstanding defined contribution pension costs	-	-	31	(16)
Other payables	10,232	10,355	101	8
	<u>110,901</u>	<u>122,378</u>	<u>3,913</u>	<u>6,073</u>

The directors consider that the carrying amount of other financial liabilities approximates their fair value, calculated by discounting future cash flows at market rate at the statement of financial position date. The valuation is based on Level 1 inputs. Trade creditors and accruals principally comprise amounts outstanding for trade purchases and on-going costs. Invoices are paid at the end of the month following the date of the invoice. The Group has financial risk management policies in place to ensure that all payables are paid within the credit timeframe. The standard payment term for trade payables is net monthly.

The Group's exposure to market and liquidity risks, including maturity analysis, related to trade and other payables is disclosed in the financial risk review note 29.

24 Deferred revenue

	Group		Company	
	31 December 2018 £ 000	31 December 2017 £ 000	31 December 2018 £ 000	31 December 2017 £ 000
Current	22,780	22,450	-	-
Non-current	597,215	584,348	-	-
	<u>619,995</u>	<u>606,798</u>	<u>-</u>	<u>-</u>

Deferred revenue relates to customer contributions towards distribution system assets. The Group's policy is to credit the customer contribution to revenue on a straight-line basis, in line with the useful life of the distribution system assets.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes

Defined benefit pension schemes
Electricity Supply Pension Scheme

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

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

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

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

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

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

Pension regulation

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

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

The Pensions Regulator has various powers including the power to:

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

Role of Trustees

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Funding requirements

UK legislation requires that pension schemes are funded prudently (i.e. to a level in excess of the current expected cost of providing benefits). The last actuarial valuation of the DB Scheme was carried out by the Trustee's actuarial advisors, Aon Hewitt, as at 31 March 2016. Such valuations are required by law to take place at intervals of no more than three years. Following each valuation, the Trustees and the Group must agree the contributions required (if any) such that the DB Scheme is fully funded over time on the basis of suitably prudent assumptions. The next funding valuation is due no later than 31 March 2019, at which progress towards full-funding will be reviewed.

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

Contributions payable to the pension scheme at the end of the year are £Nil (2017 - £Nil).

The expected contributions to the plan for the next reporting period are £43,000,000.

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

The contributions payable by the Group to the DB Scheme in respect of future benefits which are accruing increased from 34.2% to 43.6% of pensionable pay from 1 September 2017. These contributions were determined as part of the 31 March 2016 actuarial valuation and are payable in addition to the deficit repair contributions mentioned above. These rates will remain in place until such a time as a new schedule of contributions is agreed between the Trustees and the Group as part of the 31 March 2019 valuation. In addition, the Group pays contributions to cover the expenses of running the DB Scheme which increased from 3.0% to 3.6% of pensionable pay from 1 September 2017, then increased to 5.0% of pensionable pay from 1 November 2018.

Profile of the scheme

The defined benefit obligation ("DBO") includes benefits for current employees, former employees and current pensioners. The overall duration of the DB Scheme's obligation was assessed to be about 19 years based on the results of the 31 March 2016 funding valuation. This is the weighted-average time over which benefit payments are expected to be made.

As at 31 March 2016, broadly about 40% of the liabilities are attributable to current employees (duration about 24 years), 10% to former employees (duration about 25 years) and 50% to current pensioners (duration about 14 years).

Investment objectives for the DB Scheme

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

The Company and Trustees have agreed a long-term strategy for reducing investment risk as and when appropriate. This includes the use of Liability Driven Investment (LDI) from October 2016 to more closely match the nature and duration of the DB Scheme's liabilities through the use of derivatives such as swaps and repurchase agreements. The portfolio is designed to hedge a proportion of the interest rate and inflation risk inherent in the Scheme's liabilities. The target hedging level is currently 75% (2017: 75%) of the DB Scheme's liabilities as measured on the basis used for the funding valuation.

The trustees insure certain benefits which are payable on death before retirement.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Settlements

Settlement cashflows during 2018 exceeded the threshold (of service cost plus interest cost) resulting in a recognition in the pension expense. This was predominantly due to transfers out of the scheme to other pension arrangements being high, which was a continuation of the trend observed in 2017 when a settlement was also triggered.

The settlement was triggered and initially accounted for at 30 April 2018. As agreed with the company, we have carried out assessments at each subsequent quarter end over 2018 and accounted for settlements over each period based on market conditions at that time. The total assets paid out over the 12 month period to 31 December 2018 in respect of settlements were £153.2m.

As instructed, transfers out of the scheme, trivial commutation and commutation at retirement have been treated as settlements. Death lump sum benefits and the standard scheme lump sum benefit (of 3times pension) have not been included.

Risks

Volatile asset returns

The DBO is calculated using a discount rate set with reference to corporate bond yields. If assets underperform this discount rate, this will create an element of deficit. The DB Scheme aims to hold a significant proportion (44%) of its assets in return-seeking assets (such as equities) which, although expected to outperform corporate bonds in the long-term, create volatility and risk in the short-term.

Mitigation

The allocation to return-seeking assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from return-seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation.

Changes in bond yields

A decrease in corporate bond yields will increase the value placed on the DBO for accounting purposes, although this will be partially offset by an increase in the value of the DB Scheme's bond holdings.

Mitigation

The allocation to return-seeking assets is monitored to ensure it remains appropriate given the DB Scheme's long-term objectives. The Trustees regularly review the strategy from return-seeking assets and have diversified some return-seeking assets from equities into Reinsurance and Listed Infrastructure to reduce overall risk. To avoid concentration risk, the allocation to UK equity is restricted to 35% of the total equity allocation.

Inflation risk

A significant proportion of the DBO is indexed in line with price inflation (specifically in line with RPI) and higher inflation will lead to higher liabilities

Mitigation

The DB Scheme invests around 35% in LDI (included in the 56% above) which provides a hedge against higher-than-expected inflation increases on the DBO (rising inflation will increase both the DBO and the value of the LDI portfolio).

Life expectancy risk

The majority of the DB Scheme's obligations are to provide benefits for the pensionable lifetime of the member, so increases in life expectancy will result in an increase in the liabilities.

Mitigation

The DB Scheme regularly reviews actual experience of its membership against the actuarial assumptions underlying the future benefit projections and carries out detailed analysis when setting an appropriate scheme specific mortality assumption. The Trustees insure certain benefits payable on death before retirement.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Currency risk

To increase diversification, the DB Scheme invests in overseas assets. This leads to a risk that foreign currency movements negatively impact the value of assets in Sterling terms.

Mitigation

The DB Scheme hedges a proportion of the overseas investments currency risk for those overseas currencies that can be hedged efficiently. The DB Scheme's currency hedging ratio is currently 50% in respect of overseas developed market currencies.

Other risks

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

A particular legislative risk exists in relation to the equalisation of Guaranteed Minimum Pension ("GMP"), a quasi-state benefit accrued by many UK plans over the period 1978 to 1997 as a result of a UK government programme allowing pension plans to "contract out" of the State Second Pension.

On 26 October 2018, the High Court issued a judgement in a claim involving Lloyds Banking Group's defined benefit pension schemes. The judgement confirmed that the schemes should be amended to equalise benefits in relation to guaranteed minimum pensions (GMPs) for men and women.

The issues determined by the judgement arise in relation to many other occupational pension schemes. It is not yet agreed how benefits will be equalised in practice, however on the grounds that actual implementation will not lead to any further obligations, then we have estimated that equalising benefits will increase the liabilities of the DB Scheme by £5.7M. This has been reflected as a past service cost during 2018.

Reporting at 31 December 2018

For the purposes of this disclosure, the current and future pension costs of the Northern Powergrid Group have been assessed by Aon Hewitt, a qualified independent actuary, using the assumptions set out below, which the actuary has confirmed represent a reasonable best estimate of those costs. The review has been based on the same membership and other data as at 31 March 2016. The board of Northern Powergrid Holdings Company has accepted the advice of the actuary and formally approved the use of these assumptions for the purpose of calculating the pension cost of the Northern Powergrid Group.

The results of the latest funding valuation at 31 March 2016 have been adjusted 31 December 2018. Those adjustments take account of experience over the period since 31 March 2016, changes in market conditions, and differences in the financial and demographic assumptions. The present value of the DBO and the related current service cost were measured using the Projected Unit Credit Method.

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Principal actuarial assumptions

The significant actuarial assumptions used to determine the present value of the defined benefit obligation at the statement of financial position date are as follows:

	31 December 2018	31 December 2017
	%	%
Discount rate	2.90	2.60
Future salary increases	3.55	3.45
Future pension increases	2.95	2.85
Inflation	3.05	2.95
Proportion of pension exchanged for additional cash at retirement	<u>10.00</u>	<u>10.00</u>

Post retirement mortality assumptions

	31 December 2018	31 December 2017
	Years	Years
Life expectancy for male currently aged 60	26.60	26.70
Life expectancy for female currently aged 60	28.70	28.80
Life expectancy at 60 for male currently aged 45	27.90	28.10
Life expectancy at 60 for female currently aged 45	<u>29.90</u>	<u>29.90</u>

Reconciliation of scheme assets and liabilities to assets and liabilities recognised

The amounts recognised in the statement of financial position are as follows:

	31 December 2018	31 December 2017
	£ 000	£ 000
Fair value of scheme assets	1,552,300	1,746,000
Present value of scheme liabilities	<u>(1,467,700)</u>	<u>(1,629,100)</u>
Defined benefit pension scheme surplus	<u>84,600</u>	<u>116,900</u>

Scheme assets

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

	31 December 2018	31 December 2017
	£ 000	£ 000
Fair value at start of year	1,746,000	1,754,400
Interest income	45,900	46,900
Remeasurement (loss)/gains on scheme assets	(77,900)	64,700
Employer contributions	45,200	45,000
Contributions by scheme participants	700	900
Benefits paid	(206,300)	(164,600)
Administrative expenses paid	<u>(1,300)</u>	<u>(1,300)</u>
Fair value at end of year	<u>1,552,300</u>	<u>1,746,000</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Analysis of assets

The major categories of scheme assets are as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Developed market equity	215,200	187,900
Emerging market equity	6,600	7,300
Property	181,100	164,700
Reinsurance	78,600	83,400
Listed infrastructure	79,500	112,700
Investment grade corporate bonds	144,600	423,200
Other debt (non-investment grade)	120,900	43,400
Fixed interest gilts	6,600	28,200
Index-linked gilts	9,100	-
Liability driven investments	453,900	644,200
Cash	256,200	51,000
	<u>1,552,300</u>	<u>1,746,000</u>

The pension scheme has not invested in any of the Company's own financial instruments or in properties or other assets used by the Company.

Scheme liabilities

Changes in the present value of scheme liabilities are as follows:

	31 December 2018 £ 000	31 December 2017 £ 000
Present value at start of year	(1,629,100)	(1,722,900)
Current service cost	(14,300)	(17,900)
Past service cost	(5,700)	-
Actuarial gains and losses arising from changes in demographic assumptions	9,700	33,300
Actuarial gains and losses arising from changes in financial assumptions	33,300	(49,700)
Actuarial gains and losses arising from experience adjustments	(25,100)	9,500
Interest cost	(42,100)	(45,100)
Benefits paid	206,300	164,600
Contributions by scheme participants	(700)	(900)
Present value at end of year	<u>(1,467,700)</u>	<u>(1,629,100)</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

Amounts recognised in the income statement

	31 December 2018 £ 000	31 December 2017 £ 000
Current service cost	14,300	17,900
Past service cost	5,700	-
Administrative expenses paid	1,300	1,300
Net interest	<u>(3,800)</u>	<u>(1,800)</u>
Amounts recognised	<u>17,500</u>	<u>17,400</u>
Costs included in cost of qualifying assets	<u>(10,300)</u>	<u>(11,900)</u>
Total recognised in the income statement	<u><u>7,200</u></u>	<u><u>5,500</u></u>

Amounts taken to the Statement of Comprehensive Income

	31 December 2018 £ 000	31 December 2017 £ 000
Actuarial gains and losses arising from changes in demographic assumptions	(9,700)	(33,300)
Actuarial gains and losses arising from changes in financial assumptions	(33,300)	49,700
Actuarial gains and losses arising from experience adjustments	25,100	(9,500)
Return on plan assets, excluding amounts included in interest income/(expense)	<u>77,900</u>	<u>(64,700)</u>
Amounts recognised in the Statement of Comprehensive Income	<u><u>60,000</u></u>	<u><u>(57,800)</u></u>

Sensitivity analysis

Significant actuarial assumptions for determination of the defined benefit obligation are discount rate, inflation, and mortality. The sensitivity analyses below have been determined based on reasonably possible changes of the respective assumptions occurring at the end of the reporting period, while holding all other assumptions constant:

	31 December 2018			31 December 2017		
	+ 0.1%	0.0%	- 0.1%	+ 0.1%	0.0%	- 0.1%
Adjustment to discount rate	£ 000	£ 000	£ 000	£ 000	£ 000	£ 000
Present value of total obligation	<u>1,442,900</u>	<u>1,467,700</u>	<u>1,493,800</u>	<u>1,597,600</u>	<u>1,629,100</u>	<u>1,661,000</u>
	31 December 2018			31 December 2017		
	+ 0.1%	0.0%	- 0.1%	+ 0.1%	0.0%	- 0.1%
Adjustment to rate of inflation	£ 000	£ 000	£ 000	£ 000	£ 000	£ 000
Present value of total obligation	<u>1,490,800</u>	<u>1,467,700</u>	<u>1,446,100</u>	<u>1,656,100</u>	<u>1,629,100</u>	<u>1,602,400</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

25 Pension and other schemes (continued)

	31 December 2018			31 December 2017		
	+ 1 Year £ 000	None £ 000	- 1 Year £ 000	+ 1 Year £ 000	None £ 000	- 1 Year £ 000
Adjustment to mortality age rating assumption						
Present value of total obligation	<u>1,525,700</u>	<u>1,467,700</u>	<u>1,410,500</u>	<u>1,697,600</u>	<u>1,629,100</u>	<u>1,562,000</u>

The sensitivity analysis presented above may not be representative of the actual change in defined benefit obligation as it is unlikely that the changes in assumptions would occur in isolation of one another as some of the assumptions may be correlated.

26 Dividends

	31 December 2018 £ 000	31 December 2017 £ 000
Interim dividend of £Nil (2017 - £14.10) per ordinary share	<u>-</u>	<u>22,700</u>

27 Reconciliation of liabilities arising from financing activities

Group

	At 1 January 2018 £ 000	Financing cash flows £ 000	Other changes £ 000	At 31 December 2018 £ 000
Long term borrowings	756,608	(11,040)	(374)	745,194
Short term borrowings	<u>143,124</u>	<u>79,828</u>	<u>18</u>	<u>222,970</u>
	<u>899,732</u>	<u>68,788</u>	<u>(356)</u>	<u>968,164</u>
	At 1 January 2017 £ 000	Financing cash flows £ 000	Other changes £ 000	At 31 December 2017 £ 000
Long term borrowings	601,058	155,011	539	756,608
Short term borrowings	<u>140,316</u>	<u>2,808</u>	<u>-</u>	<u>143,124</u>
	<u>741,374</u>	<u>157,819</u>	<u>539</u>	<u>899,732</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Classification of financial and non-financial assets and financial and non-financial liabilities

Group

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2018 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial assets & liabilities at FVTOCI £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Non-current assets					
Property, plant and equipment	-	-	-	-	2,686,862
Intangible assets	-	-	-	-	50,638
Investments in subsidiaries, joint ventures and associates	-	3,494	-	-	-
Retirement benefit obligations	-	-	84,600	-	-
Trade and other receivables	6,877	-	-	-	-
Other non-current financial assets	-	-	837	-	-
	<u>6,877</u>	<u>3,494</u>	<u>85,437</u>	<u>-</u>	<u>2,737,500</u>
Current assets					
Inventories	-	-	-	-	13,409
Trade and other receivables	78,010	-	-	-	-
Cash and cash equivalents	28,143	-	-	-	-
Restricted cash	13,809	-	-	-	-
Contract assets	6,005	-	-	-	-
Other current financial assets	-	-	114	-	-
	<u>125,967</u>	<u>-</u>	<u>114</u>	<u>-</u>	<u>13,409</u>
Total assets	<u>132,844</u>	<u>3,494</u>	<u>85,551</u>	<u>-</u>	<u>2,750,909</u>
Non-current liabilities					
Loans and borrowings	-	-	-	(670,361)	-
Deferred revenue	-	-	-	(597,215)	-
Deferred tax liabilities	-	-	-	(98,555)	-
	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,366,131)</u>	<u>-</u>
Current liabilities					
Trade and other payables	-	-	-	(110,901)	-
Loans and borrowings	-	-	-	(297,803)	-
Income tax liability	-	-	-	(3,106)	-
Deferred revenue	-	-	-	(22,780)	-
Provisions	-	-	-	(1,491)	(1,295)
	<u>-</u>	<u>-</u>	<u>-</u>	<u>(436,081)</u>	<u>(1,295)</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>-</u>	<u>(1,802,212)</u>	<u>(1,295)</u>

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Classification of financial and non-financial assets and financial and non-financial liabilities (continued)

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2017 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial assets & liabilities at FVTOCI £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Non-current assets					
Property, plant and equipment	-	-	-	-	2,551,472
Intangible assets	-	-	-	-	47,568
Investments in subsidiaries, joint ventures and associates	-	3,428	-	-	-
Retirement benefit obligations	-	-	116,900	-	-
Trade and other receivables	6,358	-	-	-	-
	<u>6,358</u>	<u>3,428</u>	<u>116,900</u>	<u>-</u>	<u>2,599,040</u>
Current assets					
Inventories	-	-	-	-	13,382
Trade and other receivables	84,600	-	-	-	-
Cash and cash equivalents	16,612	-	-	-	-
Restricted cash	2,182	-	-	-	-
Contract assets	9,721	-	-	-	-
	<u>113,115</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>13,382</u>
Total assets	<u>119,473</u>	<u>3,428</u>	<u>116,900</u>	<u>-</u>	<u>2,612,422</u>
Non-current liabilities					
Loans and borrowings	-	-	-	(694,092)	-
Deferred revenue	-	-	-	(584,348)	-
Deferred tax liabilities	-	-	-	(102,552)	-
Other non-current financial liabilities	-	-	(327)	-	-
	<u>-</u>	<u>-</u>	<u>(327)</u>	<u>(1,380,992)</u>	<u>-</u>
Current liabilities					
Trade and other payables	-	-	-	(122,378)	-
Loans and borrowings	-	-	-	(203,972)	-
Income tax liability	-	-	-	(7,421)	-
Deferred revenue	-	-	-	(22,450)	-
Provisions	-	-	-	(1,690)	(1,211)
Other current financial liabilities	-	-	(19)	-	-
	<u>-</u>	<u>-</u>	<u>(19)</u>	<u>(357,911)</u>	<u>(1,211)</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>(346)</u>	<u>(1,738,903)</u>	<u>(1,211)</u>

Fair values are derived from level 1 inputs.

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Classification of financial and non-financial assets and financial and non-financial liabilities (continued)

Company

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2018 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Assets				
Non-current assets				
Property, plant and equipment	-	-	-	1,555
Investments in subsidiaries, joint ventures and associates	-	243,285	-	-
Deferred tax asset	118	-	-	-
	<u>118</u>	<u>243,285</u>	<u>-</u>	<u>1,555</u>
Current assets				
Trade and other receivables	302	-	-	-
Income tax asset	2,843	-	-	-
Cash and cash equivalents	43,633	-	-	-
	<u>46,778</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>46,896</u>	<u>243,285</u>	<u>-</u>	<u>1,555</u>
Liabilities				
Non-current liabilities				
Loans and borrowings	-	-	(1,117)	-
Current liabilities				
Trade and other payables	-	-	(3,913)	-
Loans and borrowings	-	-	(8,656)	-
Provisions	-	-	(1,535)	-
	<u>-</u>	<u>-</u>	<u>(14,104)</u>	<u>-</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>(15,221)</u>	<u>-</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

28 Classification of financial and non-financial assets and financial and non-financial liabilities (continued)

The classification of financial assets and financial liabilities by accounting categorisation for the period ending 31 December 2017 was as follows:

	Financial assets at amortised cost £ 000	Financial assets & liabilities at FVTPL £ 000	Financial liabilities at amortised cost £ 000	Non-financial assets & liabilities £ 000
Assets				
Non-current assets				
Property, plant and equipment	-	-	-	1,587
Investments in subsidiaries, joint ventures and associates	-	328,070	-	-
Deferred tax asset	137	-	-	-
	<u>137</u>	<u>328,070</u>	<u>-</u>	<u>1,587</u>
Current assets				
Trade and other receivables	3,762	-	-	-
Income tax asset	1,684	-	-	-
	<u>5,446</u>	<u>-</u>	<u>-</u>	<u>-</u>
Total assets	<u>5,583</u>	<u>328,070</u>	<u>-</u>	<u>1,587</u>
Liabilities				
Non-current liabilities				
Loans and borrowings	-	-	(1,117)	-
Current liabilities				
Trade and other payables	-	-	(6,073)	-
Loans and borrowings	-	-	(74,537)	-
Provisions	-	-	(1,610)	-
	<u>-</u>	<u>-</u>	<u>(82,220)</u>	<u>-</u>
Total liabilities	<u>-</u>	<u>-</u>	<u>(83,337)</u>	<u>-</u>

29 Financial risk review

Capital management

The Group manages its capital centrally to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance. The Group's overall strategy remains unchanged from 2017.

The capital structure of the Group consists of net debt (borrowings as detailed in note 20) offset by equity of the Company (comprising issued capital, reserves and retained earnings as detailed in notes 18 and 19).

At 31 December 2018, the Group had available £53.0m (2017: £137.0m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

29 Financial risk review (continued)

At 31 December 2018, 96% of the Group's long-term borrowings were at fixed rates (2017: 97%) and the average maturity for these borrowings was 9 years (2017: 9).

Credit risk

Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in financial loss to the Group. The Group has adopted a policy of only dealing with creditworthy counterparties. The Group's exposure and the credit ratings of its counterparties are continuously monitored and the aggregate value of transactions concluded is spread amongst approved counterparties. The carrying amount of financial assets recorded in the financial statements, which is net of impairment losses, represents the Group's maximum exposure to credit risk as no collateral or other credit enhancements are held.

The Group's income is primarily generated from use of system revenue from electricity suppliers; suppliers are credit checked by independent ratings agencies. Impaired income from DUoS will be recovered in future periods through system charges and is therefore of no material risk to the Group. The Company's receivables are subject to expected credit loss calculations disclosed further within the trade receivables (note 15). The Group's credit risk exposure is shown below:

Group

		Gross carrying amount £ 000	Loss allowance £ 000	Net carrying amount £ 000
2018	Notes			
Trade and other receivables	15	87,861	(2,974)	84,887
Cash and short-term deposits	16	28,143	-	28,143
Contracts	3	6,005	-	6,005
	15	<u>122,009</u>	<u>(2,974)</u>	<u>119,035</u>
		Gross carrying amount £ 000	Loss allowance £ 000	Net carrying amount £ 000
2017	Notes			
Trade and other receivables	15	91,813	(855)	90,958
Cash and short-term deposits	16	16,612	-	16,612
Contracts	3	9,721	-	9,721
	15	<u>118,146</u>	<u>(855)</u>	<u>117,291</u>

For trade receivables the Group has applied the simplified approach in IFRS 9 to measure the loss allowance at lifetime ECL. The Group determines the expected credit losses on these items by using a provision matrix, estimated based on historical credit loss experience based on the past due status of the debtors, adjusted as appropriate to reflect current conditions and estimates of future economic conditions. Accordingly, the credit risk profile of these assets is presented based on their past due status in terms of the provision matrix. Note 15 includes further details on the loss allowance for these assets.

The carrying amount of the Group's financial assets at FVTPL as disclosed in note 28 best represents their respective maximum exposure to credit risk. The Group holds no collateral over any of these balances.

Company

		Gross carrying amount £ 000	Loss allowance £ 000	Net carrying amount £ 000
2018	Notes			
Trade and other receivables	15	<u>276</u>	-	<u>276</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

29 Financial risk review (continued)

	Notes	Gross carrying amount £ 000	Loss allowance £ 000	Net carrying amount £ 000
2017				
Trade and other receivables	15	<u>275</u>	<u>-</u>	<u>275</u>

Amounts due from Group undertakings are regarded as low credit risk as the Group has a strong capacity to meet its contractual cash flow obligations and maintains an investment grade credit rating.

Liquidity risk

Ultimate responsibility of liquidity risk management rests with the board of directors, which has established an appropriate liquidity risk management framework for the management of the Company's short, medium, and long-term funding and liquidity management requirements. The Company manages liquidity by maintaining adequate reserves, banking facilities and reserve borrowing facilities, by continuously monitoring forecast and actual cash flows, and by matching the maturity profiles of financial assets and liabilities.

The Group has access to £150 million under a five-year committed revolving credit facility provided by Lloyds Bank plc, The Royal Bank of Scotland plc and Abbey National Treasury Services plc., which expires on 30 April 2020. In addition, the Group has access to a £38 million overdraft facility provided by Lloyds Bank plc, which is reviewed annually, these borrowings are repayable on demand. At 31 December 2018, the Company had available £53m (2017: £137m) of undrawn committed borrowing facilities in respect of which all conditions precedent had been met.

Maturity analysis for financial liabilities

The following table sets out the remaining contractual maturities of financial liabilities by type.

Group	Less than 3 months £ 000	3 months - 1 year £ 000	1-5 years £ 000	More than 5 years £ 000	Total £ 000
2018					
Non-interest bearing	70,301	-	-	-	70,301
Short-term interest bearing	44,458	-	-	-	44,458
Long-term interest bearing	43,405	53,280	329,178	629,054	1,054,917
	<u>158,164</u>	<u>53,280</u>	<u>329,178</u>	<u>629,054</u>	<u>1,169,676</u>
2017					
Non-interest bearing	71,524	-	-	-	71,524
Short-term interest bearing	2,925	-	-	-	2,925
Long-term interest bearing	5,031	25,539	325,057	590,486	946,113
	<u>79,480</u>	<u>25,539</u>	<u>325,057</u>	<u>590,486</u>	<u>1,020,562</u>

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

29 Financial risk review (continued)

Company

	Less than 3 months £ 000	3 months - 1 year £ 000	1-5 years £ 000	More than 5 years £ 000	Total £ 000
2018					
Non-interest bearing	6,073	-	-	-	6,073
Short-term interest bearing	72,286	-	-	-	72,286
Long-term interest bearing	-	9,001	36,004	226,144	271,149
	<u>78,359</u>	<u>9,001</u>	<u>36,004</u>	<u>226,144</u>	<u>349,508</u>
	Less than 3 months £ 000	3 months - 1 year £ 000	1-5 years £ 000	More than 5 years £ 000	Total £ 000
2017					
Non-interest bearing	6,073	-	-	-	6,073
Short-term interest bearing	72,286	-	-	-	72,286
Long-term interest bearing	-	9,001	36,004	226,144	271,149
	<u>78,359</u>	<u>9,001</u>	<u>36,004</u>	<u>226,144</u>	<u>349,508</u>

Market risk

Market risk is the risk of loss arising from movements in market variables such as interest rates, exchange rates and commodity prices. Risks are mitigated by utilising appropriate risk management products.

The Group's policy on interest rate risk is designed to limit the Group's exposure to floating interest rates. Consistent with this policy, at 31 December 2017 the Group had 96% (2016: 97%) of net debt at fixed rates. Short-term loans are charged at a floating rate of LIBOR plus 0.35%, thus exposing the Group to cash flow interest rate risk. A 1% movement in interest rates would subject the Group to an approximate change in interest costs of £0.5m per year. This is considered to be an acceptable level of risk. All other loans are at fixed interest rates and expose the Group to fair value interest rate risk.

More information on the use of cash flow hedges to manage interest rate risk on is available in note 30.

The Group is not subject to significant risk relating to foreign exchange.

The Group is not exposed to commodity price risk.

30 Derivatives held for risk management and hedge accounting

Group

Derivatives held for risk management

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

The following table provides a reconciliation by risk category of components of equity and analysis of other comprehensive income items (net of tax) resulting from hedge accounting. All derivative financial instruments relate to cash flow hedges.

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

30 Derivatives held for risk management and hedge accounting (continued)

	2018		2017	
	Assets £ 000	Liabilities £ 000	Assets £ 000	Liabilities £ 000
Non-current	837	-	-	(327)
Current	114	-	-	(19)
	<u>951</u>	<u>-</u>	<u>-</u>	<u>(346)</u>

The maturity of financial instruments was as follows:

	3 months to 1 year £ 000	1 to 5 years £ 000	More than 5 years £ 000	Total £ 000
2018				
Notional principal	19,239	83,195	58,177	160,611
Cash flow hedge	<u>114</u>	<u>492</u>	<u>345</u>	<u>951</u>
2017				
Notional principal	9,389	80,587	80,024	170,000
Cash flow hedge	<u>(19)</u>	<u>(164)</u>	<u>(163)</u>	<u>(346)</u>

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

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

Further details of the Group's risk management is available in the strategic report, pages 9 to 11, and in financial risk review, note 29.

Effectiveness testing

The Company is using regression analysis to assess the effectiveness of the interest rate swap on a retrospective and prospective basis throughout the term of the hedging relationship. The dollar offset method was also performed at inception, showing zero ineffectiveness.

Nature of the risk being hedged

The Company is hedging the risk of variability in cash flows indexed to 3-month LIBOR. Further details of the Group's risk management is available in the strategic report, pages 9 to 11, and in financial risk review, note 29.

31 Related party transactions

Directors' advances, credits and guarantees

During the year, 2 directors (2017: 2) and 5 key personnel (2017: 4) utilised the services provided by Northern Transport Finance Limited. The amounts included in finance lease receivables owed by these directors and key personnel were £23,000 in respect of current receivables (2017: £20,000), and £94,000 in respect of non-current receivables (2017: £38,000).

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

31 Related party transactions (continued)

Group

	Sales to	Purchases	Amounts	Finance	Borrowings
	£ 000	from	owed	income/(costs)	to/(from)
2018	£ 000	£ 000	from/(to)	£ 000	£ 000
Integrated Utility Services (Eire)	296	(3,393)	-	-	-
Northern Powergrid Gas Limited	41	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,228)	-
Northern Powergrid (Yorkshire) plc	23,640	(12,129)	-	-	-
Vehicle Lease and Service Limited	16	(5,659)	-	757	-
Yorkshire Electricity Group	-	-	-	(8,602)	(278,404)
	<u>23,993</u>	<u>(21,181)</u>	<u>-</u>	<u>(14,073)</u>	<u>(278,404)</u>

	Sales to	Purchases	Amounts	Finance	Borrowings
	£ 000	from	owed	income/(costs)	to/(from)
2017	£ 000	£ 000	from/(to)	£ 000	£ 000
Integrated Utility Services (Eire)	-	(3,270)	230	-	-
Northern Powergrid Gas Limited	68	-	-	-	-
Northern Powergrid Limited	-	-	-	(6,228)	-
Northern Powergrid (Yorkshire) plc	24,103	(12,732)	-	-	-
Vehicle Lease and Service Limited	33	(4,562)	-	519	-
Yorkshire Electricity Group	-	-	-	(7,238)	(241,463)
	<u>24,204</u>	<u>(20,564)</u>	<u>230</u>	<u>(12,947)</u>	<u>(241,463)</u>

Company

	Sales to	Purchases	Finance	Borrowings
	£ 000	from	income/(costs)	to/(from)
2018	£ 000	£ 000	£ 000	£ 000
Integrated Utility Services (Eire)	72	(464)	-	-
Northern Powergrid Gas Limited	41	-	-	-
Northern Powergrid Limited	-	-	(6,228)	-
Northern Powergrid (Northeast) Limited	4,919	(15)	23,700	-
Northern Powergrid (Yorkshire) plc	2,500	(2)	-	-
Northern Transport Finance Limited	11	-	-	-
Vehicle Lease and Service Limited	74	-	757	-
Northern Electric & Gas Limited	-	-	92,143	-
Yorkshire Electricity Group	-	-	(257)	43,633
	<u>7,617</u>	<u>(481)</u>	<u>110,115</u>	<u>43,633</u>

Northern Electric plc**Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)****31 Related party transactions.(continued)**

	Sales to	Purchases	Finance	Borrowings
	£ 000	from	income/(costs)	to/(from)
2017	£ 000	£ 000	£ 000	£ 000
Integrated Utility Services (Eire)	98	(576)	-	-
Northern Powergrid Gas Limited	67	-	-	-
Northern Powergrid Limited	-	-	(6,228)	-
Northern Powergrid (Northeast) Limited	5,983	(25)	21,700	-
Northern Powergrid (Yorkshire) plc	3,525	(2)	-	-
Northern Transport Finance Limited	19	-	-	-
Vehicle Lease and Service Limited	158	-	519	-
Yorkshire Electricity Group	-	-	(426)	(72,264)
	<u>9,850</u>	<u>(603)</u>	<u>15,565</u>	<u>(72,264)</u>

32 Parent and ultimate parent undertaking

The company's immediate parent is Northern Powergrid Limited.

The ultimate parent is Berkshire Hathaway Inc.. These financial statements are available upon request from 3555 Farnam Street, Omaha, Nebraska 68131

Relationship between entity and parents

The parent of the largest group in which these financial statements are consolidated is Berkshire Hathaway Inc., incorporated in United States of America.

The address of Berkshire Hathaway Inc. is:
3555 Farnam Street, Omaha, Nebraska 68131

The parent of the smallest group in which these financial statements are consolidated is Northern Powergrid Holdings Company, incorporated in England and Wales.

The address of Northern Powergrid Holdings Company is:
Lloyds Court, 78 Grey Street, Newcastle upon Tyne, Tyne and Wear, NE1 6AF

33 Other reserves

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

Northern Electric plc
Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

34 Notice of annual general meeting

Notice is hereby given that the Annual General Meeting of Northern Electric plc will be held at Lloyds Court, 78 Grey Street, Newcastle upon Tyne, NE1 6AF on Wednesday 19 June 2019 at 11.00 am.

The following resolutions will be proposed as ordinary resolutions:

Annual Report and Accounts

- 1 To receive and consider the strategic, directors' and auditor's reports and the Group accounts for the year ended 31 December 2018.

Dividend

- 2 To declare that no final dividend be paid for the year ended 31 December 2018.

Re-election of Directors

- 3 To re-elect Mr T H France as a director.
- 4 To re-elect Mr P J Goodman as a director.

The Auditors

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

By order of the board

Jennifer Riley
Company Secretary
15 April 2019

Registered office:

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

Notes:

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

Northern Electric plc

Notes to the Financial Statements for the Year Ended 31 December 2018 (continued)

34 Notice of annual general meeting (continued)

- 5 Any corporation which is a member can appoint one or more corporate representatives who may exercise on its behalf all of its powers as a member provided that they do not do so in relation to the same shares.
- 6 The current price of the Company's preference shares can be obtained from the website of the London Stock Exchange at www.londonstockexchange.com.