Scottish Hydro Electric Power Distribution plc

Directors report and financial statements

Year ended 31 March 2017

Registered No.: SC213460

Scottish Hydro Electric Power Distribution plc

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Scottish Hydro Electric Power Distribution plc

Directors and Other Information

Directors	Gregor Alexander (Chairman) Steven Kennedy Stuart Hogarth David Gardner Colin Nicol Robert McDonald Dale Cargill Rachel McEwen David Rutherford (Non-Executive Director) Gary Steel (Non-Executive Director)
Registered office	Inveralmond House 200 Dunkeld Road Perth PH1 3AQ
Secretary	Mark McLaughlin
Auditor	KPMG LLP Chartered Accountants 319 St Vincent Street Glasgow G2 5AS
Registered number	SC213460

Scottish Hydro Electric Power Distribution plc

Strategic Report

The Strategic Report sets out the main trends and factors underlying the development and performance of Scottish Hydro Electric Power Distribution plc (the "Company") during the year ended 31 March 2017, as well as those matters which are likely to affect its future development and performance.

The business, its objectives and strategy

The Company is a wholly owned subsidiary of SSE plc (the "Group"). The Company distributes electricity to around 860,000 customers in the North of Scotland. It currently has over 48,000 kilometres of electricity mains on commission. The Company also provides electricity connections within the Company's licensed area and owns and operates a number of the out of area electricity networks in the rest of Scotland.

The Company is the subject of incentive-based regulation by the industry regulator, the Office of Gas and Electricity Markets (Ofgem), which sets the prices that can be charged for the use of the electricity network, the allowed capital and operating expenditure, within a framework known as the Price Control. In broad terms, Ofgem seeks to strike the right balance between attracting investment in electricity networks, encouraging companies to operate the networks as efficiently as possible and ensuring that prices for customers are no higher than they need to be. Ofgem also places specific incentives on companies to improve their efficiency and quality of service. The Company is currently in RIIO-ED1 (Revenue = Incentives + Innovation + Outputs) Price Control period which runs for eight years from 1 April 2015 until 31 March 2023.

The Company's strategy and main objectives are to:

- comply fully with all electricity network safety standards and environmental requirements;
- ensure that the electricity network is managed as efficiently as possible, including maintaining tight controls over operational expenditure;
- provide good performance in areas such as reliability of supply, customer service and innovation and thus earn additional incentive-based revenue under the various Ofgem schemes;
- deliver efficient and innovative capital expenditure programmes, so that the number and duration of power cuts experienced by customers is kept to a minimum;
- grow the Regulated Asset Value ("RAV") of the business and so secure increased revenue;
- engage constructively with the regulator, Ofgem, to secure regulatory outcomes that meet the needs of customers and investors; and
- engage with the wider networks industry and other stakeholders to define and implement the process of distribution companies moving to a Distribution System Operator (DSO) role.

Business performance overview

The key performance indicators of the Company and the related performance during the year to 31 March 2017 were as follows (comparisons with the same period to 31 March 2016):

Financial / Operational	**2017**	2016	% change
Capital expenditure - £m	**143.4**	116.5	23.1
Operating profit - £m	**120.7**	100.4	20.2
Regulated asset value (RAV) - £bn	**1.0**	1.0	-
Non Financial / Management	**2017**	2016	% change
Customer Minutes Lost - number per customer	**60**	55	9.1
Customer Interruptions - number per 100 customers	**68**	66	3.0
Electricity distributed (TWh)	**7.7**	7.9	(2.5)

The increase in operating profit is primarily due to an increase in regulated revenue, primarily driven by the profile of base regulated revenue and receipt of income due from the under recovery of revenue in 2014/15 of £10.8m. This was partially offset by an increase in depreciation and operating costs.

If in any year, regulated network companies' revenue is greater (over recovery) or lower (under recovery) than is allowed under the ED1 Price Control, the difference is carried forward and the subsequent prices the companies may charge are adjusted. Under the regulatory framework, distribution tariffs are set two years in advance which means the over/under recovery built

Business performance overview (continued)

into tariffs is a forecast and will differ from the actual outturn. Any difference is reflected in tariffs two years later meaning any difference in the 2016/17 forecast compared to actual will be fully unwound through revenue by 2021, making this is in essence a four year cycle. In 2016/17 there was an over recovery of approximately £2.5m.

During the year, the Company's Customer Minutes Lost increased to 60 minutes per customer and Customer Interruptions increased to 68 per 100 customers. Despite this small rise in both CI and CML metrics, the Company continues to outperform the pre-determined targets set by Ofgem, see the 'Keeping the lights on' section for more details.

Volume of electricity distributed

The total volume of electricity distributed by the company during 2016/17 was 7.7TWh, compared with 7.9TWh in the previous year. Under the RIIO-ED1, the volume of electricity distributed does not affect the Company's overall allowed revenue (although it does have an impact on the timing of revenue collection).

Investing in network resilience

Capital expenditure was £143.4m in the year to 31 March 2017, the second year of the RIIO-EDI price control, and was higher than in 2015/16. This is due to a prioritisation on investment in our network, in line with our business plan, during 2016/17 as opposed to a focus on the restructuring of the business during 2015/16.

The range of capital expenditure includes asset replacement and major refurbishment of key infrastructure assets as well as ongoing investment in rural assets. For example, the Company invested in the upgrading of the electricity network between Bridge of Earn and Abernethy, improving the security of supply between the two Perthshire towns. This investment is designed to improve network security to customers in the event of high voltage faults and also to cope with higher demand in the area. There was also investment in Ross-shire during the year, which involved the replacement of electricity poles and the installation of enhanced lightning protection along the line. This included the replacement of distribution poles between Grudie, Aultbea and Gairloch and Grudie, Ullapool and Lochinver.

Delivering for customers

Now in the second year of the RIIO-ED1 price control, the Company continues to adapt to the regulatory framework and has delivered significant changes to its operations, processes and standards to ensure the needs of its customers remain at the forefront of decision making.

The outcomes of the incentive based framework within which the Company operates are increasingly dependent on customer opinion and feedback. Financial performance is reflected against: the Interruption Incentive Scheme; Ofgem Customer Satisfaction Measures; Incentive in Connections Engagement; Complaints Performance and Stakeholder Engagement and Customer Vulnerability.

By making the concerted effort to focus on its people and its processes, through an ongoing Business Transformation programme, the Company has made significant changes to ensure it is meeting its customers' needs and delivering against the measures as set by the RIIO-ED1 price control. This has ensured it is able to deliver outputs aligned to the expectations of its customers, stakeholders and the regulator while delivering a fair financial return to investors.

Keeping the lights on

As part of RIIO-ED1, the Company is incentivised on its performance against the loss of electricity supply through the recording of Customer Interruptions (CI) and Customers Minutes Lost (CML), which include both planned and unplanned supply interruptions.

During 2016/17, Customer Interruptions rose to 68 (2015/16: 66) per 100 customers. Customer Minutes Lost rose to 60 minutes (2015/16: 55) per customer.

Keeping the lights on (continued)

The Company's commitment to providing a safe and secure electricity supply and to minimise unplanned interruptions requires a continuous programme of investment in the network. During 2016/17, the Company's programme of network investment included reinforcements, upgrades to automation and tree cutting. The success of the programme is providing an improved service for customers as well as a fair return for the Company through the incentive mechanism.

The regional operations model, now in its second year, continues to deliver benefits in operational efficiency and in the improved service the Company provides to its customers and communities. This includes faster response times thanks to a focus on speed of fault restoration and targeting investment in key circuits to improve network reliability.

As a result, the Company expects to earn £0.8m (2015/16: £2.5m) in additional incentive revenue from the Interruptions incentive Scheme (IIS).

Adopting a clear and distinctive identity and increasing customer satisfaction

In September 2016, SSE's three electricity networks businesses, which includes the Company, Southern Electric Power Distribution plc (SEPD) and Scottish Hydro Electric Transmission plc (SHET), adopted a common trading name as Scottish and Southern Electricity Networks (SSEN). This new name and an accompanying rebranding process were developed following extensive engagement with customers, employees and other stakeholders.

This change responds to the operating environment under the RIIO Price Controls which incentivises all network operators to engage effectively with their customers and stakeholders in developing and implementing their business plans. SSEN believes that adopting a clearer, simpler and more distinctive identity will help to deliver improved accountability to the communities it serves, supporting its performance against key incentives.

In 2016/17, the Company has made improvements to its customer service processes and in the way it engages and communicates with its customers. This has increased customer awareness of the Company and has helped to improve broad measure incentive performance.

By improving customer contact experience, including the use of proactive outbound calls, performance against the RIIO-ED1 customer satisfaction measure increased, to £1.6m (2015/16: £1.5m). Complaints performance also rose, with the Company resolving 85% of complaints within 24 hours (2015/16: 67%) and 99% within 31 days (2015/16: 97%), resulting in no incentive penalty (potential penalty is £1.0m). This improved performance will feed into the Company's regulated income in 2018/19.

Ahead of winter 2016/17, SSEN delivered an awareness campaign, including advertising on TV, radio and digital outputs. The campaign promoted the new national single emergency power cut number 105; what to do during a storm; and to promote the services it provides for customers, including those who may need extra help through SSEN's Priority Service Register. This was followed up by a customer communication delivered to all customers in the distribution area in January 2017. As well as driving a general increase in awareness of SSEN, these measures have resulted in a three-fold increase in sign-ups to SSEN's Priority Service Register.

Protecting vulnerable customers

The Company delivered a number of initiatives in 2016/17 to help protect its most vulnerable customers.

In November 2016, SSEN became the first network operator to meet the requirements of the British Standard Inclusive Service Provision (ISP) BS18477:2010 for two years in a row. The achievement outlines the critical procedures to ensure inclusive services are available and accessible to all customers equally, regardless of their personal circumstances.

In 2016/17, SSEN created a vulnerability mapping portal, which provides detailed demographic information about its communities. The bespoke tool allows SSEN to make informed decisions about assistance during power cuts, planned supply interruptions and where to promote its Priority Service Register.

Protecting vulnerable customers (continued)

The Company has established a Resilient Communities Fund, supporting 27 community groups across its network area in the north of Scotland with awards of up to £20,000 for projects that will protect the welfare of those most vulnerable, enhance community facilities or improve communication during an emergency weather event.

During the year, communities across the north of Scotland benefitted from £166,000 in grant-funding from the Company to help them prepare for severe winter storms and become more resilient in emergency situations.

Preparing for a new, flexible energy system

In their joint Call for Evidence in November 2016, BEIS and Ofgem put forward their view on the transition from the traditional Distribution Network Operator model to a prominent Distributed System Operator (DSO) role. The Company believes this transition will meet the needs of a flexible and de-carbonised electricity system, serving to protect customers' interests whilst ensuring the network remains resilient and affordable.

Work is undertaken jointly with our sister Company SEPD. During 2016/17, these joint innovation projects provided some significant findings, which will ultimately inform this transition:

- The New Thames Valley Vision project explored a number of innovative methods, including network monitoring, battery storage and thermal storage. This was done to anticipate and manage the growth of new technologies connecting to the electricity network, including electric vehicles, heat pumps and solar panels. Its findings detail how network reinforcement can be avoided by the use of smart technologies, such as Active Network Management.
- Following the My Electric Avenue project, which identified the impact of electric vehicles on the electricity network; a new project has been launched from the findings – Smart EV. The aim of the project is to create and collaborate with other DNOs, National Grid, DECC and Ofgem on an industry-accepted solution for managing future EV charging, in the form of an Engineering Recommendation. This will help DNOs protect the LV network and allow EVs to connect to networks.
- The Shetland-based Northern Isles New Energy Solutions (NINES) project allowed the Company to use large and small scale energy storage solutions and new monitoring and control systems, to deliver an Active Network Management (ANM) solution on the islands. It allowed for a 200% increase in renewable energy contribution on Shetland by helping to manage grid constraints more efficiently in real time. The project's findings can be modelled across the wider-GB electricity network and they will play a vital role in it adapting to a flexible and de-carbonised electricity system.

These innovation projects are designed to help anticipate and prepare the electricity network operators for future energy scenarios. The Company continues to deploy technologies, such as Constrained Managed Zones and LiDAR technology, at a business-as-usual level to develop a system that is transparent, reliable and affordable.

The Company will continue to engage with industry, policy-makers and the regulator in support of a phased approach to the DSO transition whereby impacts can be carefully reviewed and the best interests of customers maintained.

Making progress on a new energy solution for Shetland

The Shetland isles are not connected to the GB Main Island Transmission System and all Shetland's energy needs are met from a range of generation sources located on the islands, underpinned by the existing Lerwick Power Station. As Lerwick Power Station is reaching the end of its operational life, the Company has conducted a competitive tender to secure the future of Shetland's electricity supply. This process has identified the most economic and efficient solution to meet Shetland's needs, as required by the energy regulator Ofgem. The Company has identified a preferred bidder for the Shetland New Energy Solution and, following a consultation by Ofgem, contracts are expected to be signed in late 2017.

Adapting to National Marine Plan in submarine cable replacement programme

The implementation of Scotland's National Marine Plan has introduced a number of changes to Marine Planning Policy which may have implications for the way in which subsea cables are installed within Scotland's waters. The Marine Plan now includes a clear preference for burial or protection as opposed to the approach successfully adopted by the Company over many decades of surface laying its subsea cables.

Adapting to National Marine Plan in submarine cable replacement programme (continued)

The Company has developed a Cost Benefit Analysis methodology to support each subsea cable licence application to Marine Scotland. The CBA is designed to ensure that all stakeholder views are considered and factored into the proposed installation method and that any additional costs are justified through a robust economic and evidenced based analysis.

The Company expects to submit its first application to Marine Scotland under the new marine planning regime, supported by the output of its CBA methodology, in the summer of 2017.

Electricity Distribution priorities

The Company's priorities in the 2017/18 and beyond are to:

- operate safely and meet all compliance requirements;
- provide an excellent service to all customers who rely on their networks and related services;
- deliver required outputs while maintaining tight controls over expenditure;
- maintain good progress in the safe delivery of new assets;
- progress innovations that will improve network reliability, efficiency and customer service and inform industry-wide improvements;
- develop and maintain effective stakeholder relationships and conduct constructive engagement with regulators and legislators, advocating clarity and stability in the regulatory framework; and
- progress the transition towards operating in a DSO environment.

Values and responsibilities

The Group and the Company believes that the behaviours and culture of an organisation should be guided by its values, and that an organisation's values should be at its core. The Group has six core values which seek to bind the behaviour and attitude of its employees and those it works with. They are:

- Safety: We believe all accidents are preventable, so we do everything safely and responsibly or not at all.
- Service: We give our customers service we are proud of and make commitments that we deliver.
- Efficiency: We keep things simple, do the work that adds value and avoid wasting money, materials, energy or time.
- Sustainability: Our decisions and actions are ethical, responsible and balanced, helping to achieve environmental, social and economic wellbeing for current and future generations.
- Excellence: We strive to get better, smarter and more innovative and be the best in everything we do.
- Teamwork: We support and value our colleagues and enjoy working together as a team in an open and honest way.

Understanding and managing our principal risks

To help ensure it is able to provide the energy people need and deliver value over the long term, the Group has continued to develop its Risk Management Framework, including its Principal Risks and its Risk Appetite Statement. For further detail on how the Group manages risk see the Risk Management Frameworks section in the SSE plc Annual Report (www.sse.com).

The Group Risk Management Policy requires the Managing Director of each Division to implement a Divisional Risk Approach to support their business in identifying, understanding and managing its key risks. Each division carries out an annual Assurance Evaluation with key Group policies, with the output and any areas of required improvement reported to the Group's Chief Executive.

The risks faced by the Company have been considered by the Company Board during the financial year. These have been reviewed in line with the Group approach to risk. Risk workshops have been attended by the Networks Management Committee and Company's Board members during the year in order to aid identification of the risks specific to the business. As a result of this process, the main risks were identified which have the potential to threaten the business model, future performance, solvency or liquidity of the Company. An overview of these risks and the mitigating actions are as follows:

Understanding and managing our principal risks (continued)

- **Safety, Health and Environment** – The Company's operations are in many cases undertaken in hazardous environments and involve working with high voltage electricity in a wide variety of locations. Our operations require the storage of a significant volume of water, fuel, oil and other chemicals, and any uncontrolled release of these could result in injury to our staff, contractors or members of the public and damage to the environment. Safety is the number one value and priority for the Group and Company. There is a Safety Management System in place to support people at work and ensure their safety and significant focus on both technical and behavioural safety training. In addition crisis management and business continuity plans are in place to manage and recover from any significant events.
- **Regulation, Legislation and Compliance** – Regulation, legislation and compliance affecting the Company is complex and fast-moving. Changes, either explicit or indirect, can lead to additional obligations and can have a significant effect on the profitability of our asset base. This risk is mitigated jointly by Company management and staff along with the Group's dedicated Corporate Affairs, Regulation, Legal and Compliance departments which provide advice to the Company on the interpretation of political and regulatory change. In addition there is proactive engagement with regulators, politicians, officials and other stakeholders on these issues.
- **Network Resilience & Integrity** – The Company has an obligation to maintain and enhance its network and ensure its resilience. A robust asset management and quality assurance process is in place to ensure that equipment is of the correct standard and specification to provide a safe, efficient and reliable network now and in the future. The impact of adverse weather on our network infrastructure is an annual event and due to perceived impacts of global climate change, it is anticipated that the volume and impact of these events will increase. The Company has many years experience in dealing with these events and there is significant effort directed to forecasting such events and ensuring that there are plans in place to deal with them. This involves early deployment of staff to potentially affected areas and ensuring sufficient staff and other resources are available to effectively deal with any disruption.
- **Networks Change Transformation** – The energy industry is undergoing constant technological and regulatory change. It is important that the Company is able to stay at the forefront of the industry by identifying emerging trends and developing strategies to exploit competitive opportunities. Through the ED1 settlement, the Company has proposed significant reductions in the overall cost and improvements in the standard of service that customers can expect to receive. To deliver this successfully, we will need to transform our business and people, delivering major cost efficiencies, new IT systems and improvements in customer service. The projects to deliver these business transformations are large and complex. These projects will draw on resources from across the business and poor management of these resources, poor integration or inadequate scoping of project requirements and benefits could impact on business as usual activities, increase project costs and adversely affect service standards. The Company has installed appropriate governance processes and procedures at Board and Leadership team levels to monitor the transformation process.
- **Supply Chain & Contractor Performance** – The Company continues to deliver its capital investment programme with a number of ongoing network construction and IT projects. It is critical that these projects are delivered on time, on budget and to high quality standard given the long term nature of the business. The Company will typically manage the development process and organise the delivery of the project by third party contractors, taking a pro-active oversight role during the procurement and construction phase. Whilst this model ensures that the correct skills are leveraged, there is a risk of supplier failures, faulty components, and quality defects. The Group-wide Large Capital Projects Governance framework helps to mitigate this risk by ensuring a consistent approach to project development and delivery as well as proactive engagement with the supply chain.
- **Price Control Governance and Management** – The Company needs to meet its RIIO-ED1 published business plan obligations or risk financial penalties and the resultant reputational risk (these deliverables include meeting the Totex project milestones and output measures, ensuring data quality and accuracy, achieving stakeholder satisfaction and environmental outputs and facilitating a new energy solution for Shetland). The structure of the business, management oversight and the governance frameworks in place are designed in order to ensure that this risk is monitored and mitigated.
- **Cyber Security** - With the increased incidence of cyber attacks over recent years there is a risk to the Company's key systems and, as a result, the network could be compromised or rendered unavailable. To mitigate this risk, the Group and Company are investing in a long term security programme including liaising with relevant external stakeholders and ensuring staff awareness of IT security issues and their importance.

Understanding and managing our principal risks (continued)

- **Alternative technologies** – Technological developments may identify alternative or more efficient means of distributing electricity. It is important that the business is aware of and keeps pace with the application of these technological improvements in order to improve efficiency and value to the end consumer. The Company has a dedicated team who look at incremental technologies aimed at increasing the reliability and efficiency of network assets as well as converting these new technologies into business as usual.

Employees

The Group and Company wants to be a great place to work; characterised by the engaged, motivated and committed people who already work throughout the company and an ability to attract a talented and diverse range of new people to meet changing business needs.

That is why the Group and the Company has clear priorities for how it:

- engages with the people who work for the Group and recognises the different needs they have;
- creates sustainable employment opportunities that attract a talented and diverse range of new people into all levels of the business;
- invests for the future to ensure each individual can perform to the best of their ability; and
- ensures it is constantly seeking to do the right things, particularly in how people are treated throughout the company.

Of all employees in the Company, 84% are men and 16% are women. It is Company policy, where possible, to provide employment opportunities for disabled people. Staff who become disabled are supported in continuing employment through identification of suitable jobs and the provision of necessary retraining.

Rewarding employee contribution

Performance management is undertaken comprehensively throughout the Group. Its objective is to create a framework for continuous feedback and improvement in line with business goals. Above all, this approach is designed to ensure the safe operation of the Group's businesses and the reliable provision of service to customers. Alongside assessing performance against agreed objectives, the process assesses the extent to which each individual, including the senior management team; demonstrate their support for the Group's core values of Safety, Service, Excellence, Sustainability, Efficiency, and Teamwork.

The opportunity to grow and develop a career has the greatest impact on employee commitment but it is also understood that employee benefits make an important contribution to both employee engagement and the attractiveness of SSE as a place to choose to work.

- **Employee benefits**: a significantly enhanced package of employee benefits was established in 2016/17. A more flexible and family friendly package includes significant improvement to parental benefits, more flexibility for unexpected situations and a new 'gradual return to work' offer for returning mothers. This package has been deliberately designed to reflect modern lives and support the Group's efforts to become a more inclusive and diverse organisation. There has also been a strong focus on delivering additional health related benefits to support employee wellbeing.
- **Sharing success**: the Group actively encourages it employees to own SSE shares, offering both an employee Share Incentive Plan (SIP) and a Sharesave scheme, with participation rates at 73% and 41% respectively.
- **The Group pension schemes**: the Group has taken measures to help employees plan and save for their financial future and has proactively enrolled new employees onto its pension schemes since 2005. 97% of the Group's employees in 2016/17 chose to save for their future through one of the Group's pension schemes. Recent supplier negotiations have improved the value that employees get from these schemes, with affinity benefits and reduced management charges.

Employee participation

The Group's long-established teamwork value has been an enduring value that guides employees in their day-to-day working lives.

Employee participation (continued)

The Group has undertaken an annual survey of employee opinion for many years. A review of the survey in 2016/17 considered feedback and decided to adjust the frequency of the survey every two years to allow sufficient time to understand, plan and report back on progress with action plans to all employees. An employee opinion survey has been run in early summer of 2017. The objective of the new survey is to gather instructive data on the Group's and the Company's business culture, as well as gather signals on issues such as inclusiveness, engagement and strategy.

As part of the Group, the Company has significant resources which it can draw upon to meet its service commitments. The Company benefits from Group-wide treasury management functions in order to provide adequate financing, with undrawn facilities totalling £1.5bn available to the Group at 31 March 2017 which could be made available to the Company as required.

Social and community issues

The Company considers its relationship with the community it serves as a core part of its operations. Engagement with local users and the wider stakeholder community is a fundamental principle underlying the RIIO-ED1 price control, and the Company has a detailed stakeholder engagement plan in place to ensure that it is sufficiently informed by its customers and the community which it serves.

At a time in which the energy networks must be more responsive to stakeholder and customer needs, in March 2016, SSEN established an independent Stakeholder Advisory Panel. With membership from charities and external industry bodies, it works alongside the Board to help scrutinise key areas of business performance, the commitments made under the RIIO-ED1 price control and future plans. The Panel consists of a Chair and six members, recruited to reflect a broad range of external interests, skills, knowledge and experiences. Through its work, the panel brings stakeholder insight and challenge to SSEN's decision-making and long-term direction at the highest level, helping to drive improvement in key processes and outcomes for customers.

Internal control

The Group's Board performs a review of the effectiveness of the system of internal control annually across the Group.

The Directors acknowledge that they have responsibility for the Company's systems of internal control and risk management and for monitoring their effectiveness. The purpose of these systems is to manage, rather than eliminate, the risk of failure to achieve business objectives, and provide reasonable assurance as to the quality of management information and to maintain proper control over the income, expenditure, assets and liabilities of the Company.

No system of control can, however, provide absolute assurance against material misstatement or loss. Accordingly, the Directors have regard to what controls, in their judgement, are appropriate to the Company's business, to the materiality of the risks inherent in the business, and to the relative costs and benefits of implementing specific controls. This process is regularly reviewed by the Board and has been in place for the whole year.

Control is maintained through: an organisation structure with clearly defined responsibilities; authority levels and lines of reporting; the appointment of suitably qualified staff in specialised business areas; and continuing investment in high quality information systems. These methods of control are subject to periodic review as to their implementation and continued suitability.

There are established procedures in place for regular budgeting and reporting of financial information. The Company's performance is reviewed by the Board as well as the Group Board. Reports include variance analysis and projected forecasts of the year compared to approved budgets and non-financial performance indicators.

There are Group policies in place covering a wide range of issues and risks such as financial authorisations, IT procedures, health, safety and environmental risks, crisis management, and a policy on ethical principles. The business risks associated with the Company's operations are regularly assessed by the Directors.

The effectiveness of the systems of internal control is monitored by the Group internal audit department. Their reports, which include where appropriate relevant action plans, are distributed to senior managers and Directors.

Environment

The Group and Company have been collaborating with stakeholders to understand the impacts of carbon reduction ambitions on the resilience of its business. From the scenario analysis it was found the Company's assets in distribution were found to be vital to the UK's electricity system over the long term. The important conclusion from the review was that the long term viability of the Company's existing portfolio of assets is secure in every scenario it assessed.

While the Company plays its part to mitigate climate change, it must also adapt its business to the impacts of rising global temperatures. Extreme weather events are a material climate adaptation risk that impacts the resilience of the Company's distribution network. As a result the Company has invested in maintenance and emergency response solutions. This includes new technology that identifies faults on lines; tree cutting along networks; resilience funds for local communities to support climate adaptation initiatives; and emergency response procedures to ensure the lights are kept on.

More information on the Group's approach to managing our environmental impact is contained in the 2016/17 Annual Report, on page 18 at www.sse.com.

Key contractual arrangements

The Directors consider the Service Level Agreement in place between the Company and SSE Services plc for the provision of corporate services to be essential for the continuance of the Company's operations in the short-to-medium term. Due to its nature, the risk of this contract being terminated is low.

There are a number of contracts with both internal and external parties for the provision of services to maintain and develop the Company's distribution network. It is not believed that any of these contracts are of sufficient size or concentration to result in a dependence on any one external supplier.

Resources available

During the year the Group extended its existing £1.5bn revolving credit and bilateral facilities by invoking the one year extension options with the facilities now maturing in August 2021 (£1.3bn) and November 2021 (£0.2bn). As at 31 March 2017, they were undrawn.

The Company has 1,276 employees which it calls on to maintain its distribution network and carry out investment in future developments. The Company also draws upon Group shared services covering central functions such as finance, HR, regulation, health and safety, company secretarial and insurance services. All such services are provided under an appropriate Service Level Agreement. In addition to these employees, the services of key contractors are called upon in a number of large capital projects to ensure that these projects are delivered on time and on budget.

Capital structure

The Company regards its capital as comprising its equity, cash and borrowings. Its objective in managing capital is to maintain a strong balance sheet and credit rating so as to maintain investor, creditor and market confidence and to sustain future development of the business. The capital structure is kept under review and the directors believe that Group and Company both continue to maintain one of the strongest balance sheets in the global utility sector. The directors consider that this gives the Company significant competitive advantage in terms of cost of funding and supporting new developments.

Treasury policy, objectives and financial risk management

The Group's treasury policy is designed to be prudent and flexible. In line with that, cash from operations is first used to finance maintenance capital expenditure and then dividend payments, with further growth in capital expenditure and investment generally financed by a combination of cash from operations, bank borrowings and bond issuance.

Exposure to interest rate risk arises in the normal course of the Company's business. Derivative financial instruments are entered into to hedge exposure to risk. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained in note 17.

Strategic Report (continued)

Treasury policy, objectives and financial risk management (continued)

The Company's financial risk is managed as part of the wider Group risk management policy. For more information regarding financial risk management, please see page 176 of the Group's 2017 Annual Report at www.sse.com.

Liquidity

The Group's Treasury function acts on behalf of the Company and is responsible for managing the banking and liquidity requirements of the Group, risk management relating to interest rate and foreign exchange exposures and managing the credit risk relating to the banking counterparties with which it transacts. Short term liquidity is reviewed daily by Treasury, while the longer term liquidity position is reviewed on a regular basis by the Board. The department's operations are governed by policies determined by the Board and any breaches of these policies are reported to the Risk and Trading Committee and Audit Committee.

Borrowings and facilities

The Company has loans of £432.7m (2016 – £430.4m) of which £300.0m (2016 – £300.0m) is due to other Group companies and £132.7m (2016 – £130.4m) is in the form of an index-linked bond. Of the total, interest is paid at fixed rates on £300.0m (2016 - £300.0m) and inflation-linked rates on £132.7m (2016 – £130.4m).

As at 31 March 2017, the weighted average interest rate payable was 4.68% (2016 – 4.67%) and the weighted average remaining term was 15.61 years (2016 – 16.48 years).

Taxation

The Company's effective current tax rate is 18.5% compared with 20.9% in the previous year after prior year adjustments. The headline effective tax rate, which includes the impact of substantively enacted changes in the UK corporation tax rate, is 15.4% compared with 9.3% in the previous year.

Dividend

Following a review of distributable reserves, the Directors declared, approved and paid a dividend of £50m (2016 – £50m) in the year.

Pensions

21% (2016 - 30%) of employees of the Company are members of the Scottish Hydro Electric Pension Scheme, which, at 31 March 2017 on an IAS 19 basis adjusted for IFRIC 14 had a surplus, net of deferred tax, of £341.5m included in the Group accounts (2016 – surplus £8.2m).

On behalf of the board

Gregor Alexander
Director
19 July 2017

Scottish Hydro Electric Power Distribution plc

Corporate Governance Statement

As a subsidiary company of SSE plc ("The Group"), Scottish Hydro Electric Power Distribution plc ("The Company") operates within the Group's corporate governance framework. The Company does not have listed shares and therefore is not subject to the UK Corporate Governance Code and has not voluntarily applied the UK Corporate Governance Code. The information below, therefore, is in relation to the Group only and is included solely for information.

The Group's corporate governance policies are described in the Group's Annual Report and Accounts 2017 under Governance on pages 54 to 100 available at www.sse.com.

The Board of the Group considers that it complied in full with the UK Corporate Governance Code 2014 during 2016/17, with the exception of the provision C3.7 that the external audit contract be put out to tender at least every ten years. This remains unchanged from last year and a full explanation of the Group's reasons for non-compliance, including details of the timeline to address the position are set out in the Audit Committee Report on page 74 of the Group's annual report to 31 March 2017.

SSE plc Group ("the Group")

The Group has a responsibility to meet its objectives and operate sustainably for the benefit of all of its stakeholders, which includes upholding the commitments it has made to its shareholders and customers through its financial objective and core purpose. It is the role of the Board to ensure that these are achieved, and this is supported primarily through setting the Group's longer term strategy, providing the leadership and support necessary to ensure that it can be delivered responsibly within accepted levels of risk. Implementation and delivery of this strategy is managed through the careful delegation of authority in line with the Corporate Governance Framework, with oversight being retained through regular reporting, which includes an ongoing dialogue between the Board, the Executive Committee, their respective sub-Committees and other key individuals within the business.

The Group's core purpose is to provide the energy people need in a reliable and sustainable way while abiding by its core values: safety; service; efficiency; sustainability; excellence; and teamwork.

Each year the Group describes how it has applied the Main Principles of the UK Corporate Governance Code and in line with its 'comply or explain' model details any departures from its specific provisions. A departure is only ever made when it is deemed appropriate to do so, and good governance can be achieved by other means.

For 2016/17 the Board is reporting against the 2014 version of the Code and confirm compliance with its provisions with the exception of provision C3.7 explained above.

There are four principal Board committees; an Audit Committee, a Remuneration Committee, a Safety, Health and Environment Advisory Committee and a Nomination Committee. The details of the appointees and work undertaken by these committees are included in the published annual report of the Group, which is available at www.sse.com.

The composition of the Board has remained unchanged during the reporting year. The Board comprises the Chairman, two Executive Directors, a Senior Independent Director and five independent non-Executive Directors. This gives the Board a good balance of independence and experience, ensuring that no one individual or group of individuals has undue influence over the Board's decision making.

The Audit Committee and the Health, Safety and Environmental Committee receive reports in respect of the Company's business performance and the relevant findings of these committees will be advised to the Company Board where appropriate.

Scottish Hydro Electric Power Distribution plc ("The Company")

Board of Directors

During the year the Board consisted of eight Executive Directors, one of whom is an Executive Director of the Group and one of whom is a member of the Group's Executive Committee. None of the Directors are Directors of Group Companies involved in Retail or Wholesale activities. The Group Executive Director is the Chairman of the Board. Company Board meetings were held on eight occasions during the course of the year. The Company does not have a Nomination, Remuneration or Audit Committee. These functions are dealt with in conjunction with the relevant committee of the Group Board. There were two independent Non-Executive Directors on the Board during the course of the financial year as required under the terms of Standard Condition 43A of the Company's regulatory licence.

The Board operates under approved terms of reference. The Board set the strategic aims of the Company, supervises management, monitors and reports on performance, approves investment and is responsible for all statutory and regulatory approvals.

Attendance at meetings of the Board during 2016/17, expressed as a number of meetings attended out of number eligible to attend is set out below:

Director	**Attendance**
Gregor Alexander	8 of 8
Steven Kennedy	7 of 8
Stuart Hogarth	6 of 8
David Gardner	7 of 8
Colin Nicol	7 of 8
Robert McDonald	7 of 8
Dale Cargill	8 of 8
Rachel McEwen	8 of 8
David Rutherford (Non-Executive Director)	7 of 8
Gary Steel (Non-Executive Director)	8 of 8

Board evaluation

In 2015/16 the effectiveness of the Board was assessed internally through a formal and rigorous external evaluation process, the results of which were used to develop actions and agree areas for improvement in 2016/17. For this reporting year an internal evaluation was conducted, and was specifically designed to allow any progress made throughout the year to be measured. As well as confirming the areas in which the Board has performed well, or in which improvements have been made, the evaluation identified areas of focus for 2017/18.

Director induction, training and development

On joining the Board, all non-Executive Directors receive an induction tailored to their individual requirements. The comprehensive programme is facilitated by the Chairman and Company Secretary and involves briefings and meetings with key individuals from each business area and supporting Group functions. During the induction programme each Director is invited to identify areas in which they would like additional meetings or further information.

Throughout the reporting year the Directors develop and refresh their knowledge through various training sessions and a number of internally and externally facilitated engagements, with individual development needs being reviewed as part of the annual Board evaluation process. Directors are encouraged to request additional information and support at any time as required, with the necessary resources being made available to them.

Scottish Hydro Electric Power Distribution plc ("The Company") (continued)

Going Concern

The Directors consider that the Company has adequate resources to continue in operational existence for the foreseeable future. In making their assessment, the Directors have considered future cash flows, the level of headroom on long-term loans and bonds and the financial support available from the Group. The Financial Statements are therefore prepared on a going concern basis.

Viability Statement

The Board has voluntarily carried out an assessment of the longer term viability of the Company consistent with the assessment and governance approach undertaken at Group level by SSE plc.

In doing so, the Board has assessed the prospects of the Company over the next 3 financial years to 31st March 2020. The Directors have determined that as this time horizon aligns with the Company's strategy planning period and committed networks resilience projects, a reasonable degree of confidence over the forecasting assumptions modelled can be established.

This statement is included solely for information.

In making this statement the Directors have considered the resilience of the Company taking into account its current position, the Principal Risks it faces and the control measures in place to mitigate each of them. In particular the Directors recognise the significance of the Company's regulated revenue stream, strong balance sheet and access to available resources including the SSE Group's committed lending facilities of £1.5bn.

To support this statement, stress testing of scenarios relating to each of the Principal Risks facing the Company has been undertaken. Examples include failure to meet regulatory reporting deadlines (for Statutory and Regulatory Compliance) and failure to implement key system upgrades (for Networks Change Transformation).

Upon the basis of the analysis undertaken, the Directors have a reasonable expectation that the Company will be able to continue to meet its liabilities as they fall due in the period to 31st March 2020.

Scottish Hydro Electric Power Distribution plc

Directors' Report

The Directors present their report together with the audited Financial Statements for the year ended 31 March 2017.

Reporting requirements on the Company's principal activities and future developments, its principal risks and uncertainties and its key performance can be found in the Strategic Report.

1 Principal activities

The Company is responsible for managing an electricity distribution network, serving around 860,000 customers in the North of Scotland. Distribution of electricity and the level of capital investment within the network area is a monopoly activity and is closely regulated by the Office of Gas and Electricity Markets (Ofgem) within a framework known as the Price Control. The Company also carries out the business of provision of new electrical connections services within its licensed area and the construction and management of out-of-area electricity networks in Scotland. A full review of the year is contained within the Strategic Report section of these Accounts.

2 Results and Dividends

The profit for the financial year amounted to £72.6m (2016 - £61.7m). A final dividend of £50.0m (2016 - £50.0m) was declared, approved and paid by the Board during the year.

3 Directors

The Directors and Secretary who served during the year are as listed on page 1. In accordance with the Articles of Association of the Company the Directors are not required to retire by rotation.

4 Corporate governance

The Corporate Governance statement for the Company is outlined on page 12.

5 Auditor

The Directors who held office at the date of approval of this Directors' Report confirm that, so far as they are each aware, there is no relevant audit information of which the Company's auditor is unaware; and each Director has taken all the steps that ought to have been taken as a Director to be aware of any relevant audit information and to establish that the Company's auditor is aware of that information.

In accordance with Section 489 of the Companies Act 2006, a resolution for the re-appointment of KPMG LLP as auditors of the Company and Group is to be proposed at the forthcoming Annual General Meeting of the Group.

On behalf of the Board:

Mark McLaughlin
Company Secretary
19 July 2017

Scottish Hydro Electric Power Distribution plc

Statement of Directors' responsibilities in respect of the Strategic Report, the Directors' Report and the financial statements

The Directors are responsible for preparing the Strategic Report, the Directors' Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law they have elected to prepare the financial statements in accordance with UK Accounting Standards and applicable law (UK Generally Accepted Accounting Practice) including FRS 101 Reduced Disclosures Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that year. In preparing these financial statements, the Directors are required to:

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

The Directors are responsible for keeping adequate accounting records that are sufficient to show and explain the Company's transactions and disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements comply with the Companies Act 2006. They have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

On behalf of the Board:

Gregor Alexander
19 July 2017

Independent Auditor's Report to the Members of Scottish Hydro Electric Power Distribution plc

We have audited the financial statements of Scottish Hydro Electric Power Distribution plc for the year ended 31 March 2017 set out on pages 18 to 34. The financial reporting framework that has been applied in their preparation is applicable law and UK Accounting Standards (UK Generally Accepted Accounting Practice), including FRS 101 Reduced Disclosure Framework.

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.

Respective responsibilities of directors and auditor

As explained more fully in the Directors' Responsibilities Statement set out on page 16, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view. Our responsibility is to audit, and express an opinion on, the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

A description of the scope of an audit of financial statements is provided on the Financial Reporting Council's website at www.frc.org.uk/auditscopeukprivate.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the state of the company's affairs as at 31 March 2017 and of its profit for the year then ended;
- have been properly prepared in accordance with UK Generally Accepted Accounting Practice; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

Opinion on other matter prescribed by the Companies Act 2006

In our opinion the information given in the Strategic Report and the Directors' Report for the financial year is consistent with the financial statements.

Based solely on the work required to be undertaken in the course of the audit of the financial statements and from reading the Strategic Report and the Directors' Report:

- we have not identified material misstatements in those reports; and
- in our opinion, those reports have been prepared in accordance with the Companies Act 2006.

Matters on which we are required to report by exception

We have nothing to report in respect of the following matters where the Companies Act 2006 requires us to report to you if, in our opinion:

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

Gordon Herbertson (Senior Statutory Auditor)
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
319 St Vincent Street
Glasgow
G2 5AS

19 July 2017

Scottish Hydro Electric Power Distribution plc

Profit and Loss Account
for the year ended 31 March 2017

	Note	2017 £m	2016 £m
Turnover		**382.5**	332.3
Cost of sales		**(49.7)**	(36.9)
Gross profit		**332.8**	295.4
Distribution costs		**(197.6)**	(179.2)
Administrative costs		**(14.5)**	(15.8)
Operating profit	2	**120.7**	100.4
Interest payable and similar charges	4	**(34.8)**	(32.4)
Profit before taxation		**85.9**	68.0
Tax on profit	5	**(13.3)**	(6.3)
Profit for the financial year		**72.6**	61.7

Continuing operations

The above results are derived from continuing activities.

The accompanying notes are an integral part of these financial statements.

Scottish Hydro Electric Power Distribution plc

Statement of Other Comprehensive Income
for the year ended 31 March 2017

	2017 **£m**	2016 £m
Profit for the financial year	**72.6**	61.7
Other comprehensive income		
(Loss)/Gain on effective portion of cash flow hedges	**(0.4)**	0.3
Taxation on cashflow hedges	**0.1**	(0.1)
Other comprehensive income (loss)/gain	**(0.3)**	0.2
Total other comprehensive income relating to the financial year	**72.3**	61.9

Scottish Hydro Electric Power Distribution plc

Balance Sheet
as at 31 March 2017

	Note	2017 £m	2016 £m
Fixed assets			
Tangible fixed assets	7	**1,080.7**	1,040.3
Intangible assets	8	**12.7**	7.1
		1,093.4	1,047.4
Current assets			
Stocks	9	**2.5**	2.5
Debtors:			
amounts falling due within one year	10	**53.4**	59.6
Total current assets		**55.9**	62.1
Current liabilities			
Creditors: amounts falling due within one year	11	**(133.3)**	(114.0)
Net current liabilities		**(77.4)**	(51.9)
Total assets less current liabilities		**1,016.0**	995.5
Creditors: amounts falling due after more than one year	12	**(750.1)**	(751.7)
Derivative financial liabilities	17	**(17.2)**	(15.6)
Deferred taxation	14	**(67.7)**	(70.4)
Net assets		**181.0**	157.8
Capital and reserves			
Called up share capital	15	**62.0**	62.0
Profit and loss account		**119.6**	96.1
Hedge reserve		**(0.6)**	(0.3)
Equity Shareholders' funds		**181.0**	157.8

These financial statements were approved by the Directors on 19 July 2017 and signed on their behalf by:

Gregor Alexander
Director
Company registered number: SC213460

Scottish Hydro Electric Power Distribution plc

Statement of Changes in Equity
for the year ended 31 March 2017

	Share capital £m	Retained earnings £m	Hedge reserve £m	Total equity £m
Balance at 1 April 2015	**62.0**	**82.2**	**0.2**	**144.4**
Profit for the financial year	-	61.7	-	**61.7**
Credit in respect of employee share awards	-	1.5	-	**1.5**
Dividends paid (note 6)	-	(50.0)	-	**(50.0)**
Other comprehensive income	-	0.7	(0.5)	**0.2**
Balance at 31 March 2016	**62.0**	**96.1**	**(0.3)**	**157.8**
Balance at 1 April 2016	**62.0**	**96.1**	**(0.3)**	**157.8**
Profit for the financial year	-	72.6	-	**72.6**
Credit in respect of employee share awards	-	0.9	-	**0.9**
Dividends paid (note 6)	-	(50.0)	-	**(50.0)**
Other comprehensive income	-	-	(0.3)	**(0.3)**
Balance at 31 March 2017	**62.0**	**119.6**	**(0.6)**	**181.0**

Scottish Hydro Electric Power Distribution plc

Cash Flow Statement
for the year ended 31 March 2017

	Note	2017 £m	2016 £m
Cash flows from operating activities			
Profit for the year		**72.6**	61.7
Add back: taxation		**13.3**	6.3
Add back: net finance costs		**34.8**	32.4
Operating profit		**120.7**	100.4
Depreciation on tangible fixed assets		**103.0**	86.4
Amortisation of intangible assets		**1.3**	0.3
Customer contribution and capital grants released		**(3.5)**	(3.6)
Increase in stocks		**-**	(0.3)
Decrease in debtors		**3.5**	12.8
Decrease in creditors		**(14.8)**	(17.5)
Movement in intercompany		**38.2**	24.9
Charge in respect of employee share awards		**0.9**	1.5
Net cash inflow from operating activities		**249.3**	204.9
Interest paid		**(30.0)**	(29.1)
Returns on investments and servicing of finance		**(30.0)**	(29.1)
Corporation tax paid		**(14.5)**	(16.7)
Taxation		**(14.5)**	(16.7)
Purchase of tangible fixed assets		**(147.9)**	(104.6)
Expenditure on intangible assets		**(6.9)**	(4.5)
Capital expenditure and financial investment		**(154.8)**	(109.1)
Equity dividends paid	6	**(50.0)**	(50.0)
Net cash inflow before management of liquid resources and financing		-	-
Reconciliation of net cash flow to movement in net funds			
Increase/(decrease) in cash in the year		**-**	-
Net funds at start of the year		**-**	-
Net funds at end of the year		**-**	-

Notes on the Financial statements for the year ended 31 March 2017

1 Significant accounting policies

The Company is a public company incorporated, domiciled, and registered, in Scotland. Its registration number is SC213460, and registered office is Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ.

The following accounting policies have been applied consistently in dealing with items which are considered material in relation to the Company's financial statements.

Basis of preparation
The financial statements have been prepared in accordance with all applicable United Kingdom accounting standards. The principal accounting policies are summarised below and have been applied consistently.

In preparing these financial statements, the Company has applied the recognition, measurement and disclosure requirements of International Financial Reporting Standards as adopted by the EU ('Adopted IFRS'), but has made amendments, where necessary, in order to comply with the Companies Act 2006 and has set out below where advantages of the FRS 101 disclosure exemptions has been taken.

In these financial statements, the Company has applied the exemptions available under FRS 101 in respect of the following disclosures:

- The effect of new, but not yet effective, IFRSs;
- Related party disclosures; and
- Comparative period reconciliations for tangible fixed assets, intangible assets and share capital.

As the consolidated financial statements of SSE plc include the equivalent disclosure, the Company has also taken advantage of the exemptions, under FRS 101, available in respect of the following disclosures:

- Certain disclosures, required by IAS 36 Impairment of assets, in respect of the impairment of goodwill and intangible assets; and
- Certain disclosures, required by IFRS 13 Fair Value Measurement and IFRS 7 Financial Instruments Disclosure.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements.

During the year, the Group and Company reviewed the presentation of information in the financial statements in order to improve the clarity, relevance and understandability of the statements. This review resulted in the removal of employee share based payments disclosures on the basis of materiality.

The accounts have been prepared on a going concern basis. See the Corporate Governance Statement at page 14 for details of the directors' assessment that the Company has adequate resources for the foreseeable future.

Turnover
Turnover from use of electricity networks is derived from the allowed revenue as defined by the parameters in the distribution licence regulations, which informs the tariffs we set. Revenue recognised is based on the volume of electricity distributed and the set customer tariff. Where this revenue differs from the allowed revenue, there may be an over- or under-recovery of revenue which will be reflected in future financial year's allowed revenue as set out in the regulatory licence and relevant industry codes. No accounting adjustment is made for over- or under-recoveries in the year that they arise. Turnover includes an estimate of the value of electricity distribution services provided to customers between the date of the last meter reading and the year end. In addition, turnover is also recognised on the value of customer contributions towards new connections, diversions and modifications to existing networks that occurred in the year.

Where the Company has an ongoing obligation to provide services, revenues are recognised as the service is performed and amounts billed in advance are treated as deferred income and excluded from current revenue. For network connections activity from 1 April 2014, the revenue recognition rules of IFRIC 18 have been applied as a result of the transition to FRS 101. Income is recognised on completion of the associated capital works.

1 Significant accounting policies (continued)

Foreign currencies
Transactions in foreign currencies are translated to the Company's functional currencies at the foreign exchange rate ruling at the date of the transaction. Monetary assets and liabilities denominated in foreign currencies at the balance sheet date are retranslated to the functional currency at the foreign exchange rate ruling at that date. Foreign exchange differences arising on translation are recognised in the profit and loss account except for differences arising on the retranslation of qualifying cash flow hedges, which are recognised in other comprehensive income.

Research
Expenditure on research activities is recognised in the profit and loss account as an expense as incurred.

Taxation
Tax on the profit or loss for the year comprises current and deferred tax. Tax is recognised in the profit and loss account except to the extent that it relates to items recognised directly in equity or other comprehensive income, in which case it is recognised directly in equity or other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the balance sheet date, and any adjustment to tax payable in respect of previous years.

Deferred tax is provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. The amount of deferred tax provided is based on the expected manner of realisation or settlement of the carrying amount of assets and liabilities, using tax rates enacted or substantively enacted at the balance sheet date.

A deferred tax asset is recognised only to the extent that it is probable that future taxable profits will be available against which the temporary difference can be utilised.

Tangible fixed assets
Tangible fixed assets are stated at cost less accumulated depreciation.

Depreciation is charged to the profit and loss account on a straight-line basis over the estimated useful lives of each part of an item of tangible fixed assets. The estimated useful lives are as follows:

	Years
Network assets	5 to 80
Non-operational assets:	
Fixtures, equipment, plant and machinery, vehicles and mobile plant	5 to 10

An item of property, plant and equipment (PPE) is derecognised on disposal. Where no future economic benefits are expected to arise from the continued use of an item of PPE, the asset is fully written off.

Assets under the course of construction are transferred to the corresponding asset category in the month following expenditure. All additions to tangible fixed assets are depreciated from the month after the expenditure has been incurred. This is a refinement to the previous depreciation policy whereby assets were transferred to the relevant category at the end of the financial year and were depreciated from the financial year after the expenditure was incurred. . The financial impact of this is an increase in the depreciation charge for the current year of £1.5m. Considering a similar level and mix of capex, this would have a similar monetary impact in future years. In conjunction with this refinement, a review of asset lives was conducted and appropriate adjustments made.

Expenditure incurred to replace a component of a tangible fixed asset that is accounted for separately is capitalised. Other subsequent expenditure is capitalised only when it increases the future economic benefits of the tangible fixed asset to which it relates.

1 Significant accounting policies (continued)

Intangible assets
Included within intangible assets are application software license fees, software development work, software upgrades and purchased PC software packages. Amortisation is over 10 years

Capitalised interest
Interest directly attributable to the acquisition, construction or production of major capital projects, which are projects that necessarily take a substantial period of time to get ready for their intended use, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use, and depreciated as part of the total cost over the useful life of the asset.

Customer contributions
Customer contributions towards construction or acquisition of new Out-of-Area networks, and capital grants received pre 1 April 2014 are recorded as deferred income and released to the profit and loss account over the estimated life used in calculating contributions. Deferred income also includes outstanding balances of customer contributions on new connections to existing networks pre business separation in 2001. Where there is no ongoing service obligation, customer contributions received post 1 April 2014 are taken to income in the period, in line with IFRIC 18 Transfers of assets from customers.

Operating leases
Payments made under operating leases are recognised in the profit and loss account on a straight-line basis over the term of the lease.

Stocks
Stocks are stated at the lower of cost and net realisable value.

Pensions
Some of the Company's employees are members of a group wide defined benefit pension plan. As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the group. The Company then recognises a cost equal to its contribution payable for the period. Obligations for contributions to defined contribution pension plans are recognised as an expense in the profit and loss account in the periods during which services are rendered by employees.

Equity and equity-related compensation benefits
SSE plc, the ultimate parent of the Company, operates a number of All Employee Share Schemes as described in the Remuneration Report of the Group. These schemes enable Group employees to acquire shares of the ultimate parent company. The employees of the Company are entitled, where applicable, to participate in these schemes. The Company has not been charged with the cash cost of acquiring shares on behalf of its employees, this cost is borne by the Ultimate Parent Company. Where the fair value of the options granted has been measured, the Company has recognised the expense as if the share based payments related to the Company's own shares.

The exercise prices of the sharesave scheme are set at a discount to market price at the date of the grant. The fair value of the sharesave scheme option granted is measured at the grant date by use of an option pricing model. The fair value of the options granted is recognised as an expense on a straight-line basis over the period that the scheme vests. Estimates are updated at each balance sheet date with any adjustment in respect of the current and prior years being recognised in the profit and loss account. The costs associated with the other main employee schemes, the share incentive plan and the deferred bonus scheme, are recognised over the period to which they relate.

Recognition of profits on contracts
Profit is recognised on long-term contracts on completion of the total contract. Provision is made for foreseeable losses.

Notes on the Financial statements (continued)
for the year ended 31 March 2017

1 Significant accounting policies (continued)

Derivative financial instruments and hedging
Derivative financial instruments are recognised at fair value. The gain or loss on re-measurement to fair value is recognised immediately in profit or loss. However, where derivatives qualify for hedge accounting, recognition of any resultant gain or loss depends on the nature of the item being hedged.

2 Expenses and auditor's remuneration

Operating profit is arrived at after charging/(crediting):

	2017	2016
	£m	£m
Depreciation of tangible fixed assets	**103.0**	86.4
Amortisation of intangible assets	**1.3**	0.3
Operating lease rentals - Land and Buildings	**4.7**	4.6
Release of deferred income in relation to customer contributions and capital grants	**(3.5)**	(3.6)
Net management fees in respect of services provided by group companies	**13.3**	15.0
Research costs	**1.1**	1.2

The Company incurred an audit fee of £0.05m (2016: £0.05m) and audit-related assurance service fees of £0.03m (2016: £0.03m) in the year.

3 Staff costs and numbers

	2017	2016
	£m	£m
Staff costs:		
Wages and salaries	**49.6**	46.9
Social security costs	**5.3**	4.6
Share based remuneration	**0.9**	1.5
Pension costs	**18.7**	21.4
	74.5	74.4
Less charged as capital expenditure	**(25.5)**	(20.2)
	49.0	54.2

Included within the above is a Share-based payment charge of £894,385 (2016: £1,493,509).

Employee numbers

	2017	2016
	Number	Number
Numbers employed at 31 March	**1,276**	1,281

	2017	2016
	Number	Number
The monthly average number of people employed by the Company during the year	**1,255**	1,235

	2017	2016
	£m	£m
Directors remuneration	**0.9**	0.8

The aggregate of remuneration and amounts receivable under long term incentive schemes of the highest paid director was £0.6m (2016: £0.6m).

3 Staff costs and numbers (continued)

	Number of directors 2017	2016
Retirement benefits are accruing to the following number of directors under:		
Defined benefit schemes	**2**	2

4 Interest payable and similar charges

	2017 £m	2016 £m
Interest payable to group companies	**27.1**	27.0
Bank loans and overdrafts	**6.8**	4.6
Movement on financing derivatives	**1.3**	1.2
Interest capitalised	**(0.4)**	(0.4)
	34.8	32.4

5 Taxation

	2017 £m	2016 £m
UK corporation tax		
Current tax on income for the period	**17.1**	14.3
Adjustment in respect of prior periods	**(1.2)**	(0.1)
Total current tax charge	**15.9**	14.2
Deferred tax (see note 14):		
Origination and reversal of temporary differences	**0.2**	(0.7)
Adjustment in respect of prior periods	**1.2**	0.6
Effect of change in tax rate	**(4.0)**	(7.8)
Total deferred tax	**(2.6)**	(7.9)
Total tax on profit	**13.3**	6.3

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

	2017 £m	2016 £m
Profit before taxation	**85.9**	68.0
Tax on profit at standard UK corporation tax rate of 20% (2016: 20%)	**17.2**	13.6
Effects of:		
Adjustment in respect of previous periods	**-**	0.5
Other items	**0.1**	-
Effect of change in tax rate on deferred tax	**(4.0)**	(7.8)
Total tax charge for year	**13.3**	6.3

Legislation to reduce the corporation tax rate from 20% to 19% from 1 April 2017 and to 18% from 1 April 2020 was substantively enacted on 26 October 2015. As these changes were substantively enacted at 31 March 2016, deferred tax at that date was calculated accordingly. Legislation was substantively enacted on 15 September 2016 to further reduce the corporation tax rate to 17% from 1 April 2020. As this change has been substantively enacted at the balance sheet date, deferred tax has been calculated accordingly and has had the effect of reducing the company's deferred tax liability at 31 March 2017 by £4.0m.

6 Dividends

	2017	2016
	£m	£m
Amounts recognised as distributions from equity:		
Final dividend of 80.6p (2016 – 80.6p) per share	**50.0**	50.0

The final dividend for the current year, £50.0m (2016: £50m), was declared and approved on 23 February 2017 and was paid to shareholders on 31 March 2017. The final dividend for the previous year was approved on 17 June 2015 and paid to shareholders on 30 June 2015.

7 Tangible fixed assets

	Network assets	**Assets under the course of construction (AUC)**	**Vehicles and miscellaneous equipment**	**Total**
	£m	**£m**	**£m**	**£m**
Cost:				
At 1 April 2016	1,938.7	2.4	79.6	2,020.7
Additions	47.6	95.8	-	143.4
Transfers from AUC to fully commissioned	87.3	(95.2)	7.9	-
Transfers between categories	(3.7)	-	3.7	-
At 31 March 2017	**2,069.9**	**3.0**	**91.2**	**2,164.1**
Accumulated depreciation:				
At 1 April 2016	(916.6)	-	(63.8)	(980.4)
Charge for the year	(99.9)	-	(3.1)	(103.0)
At 31 March 2017	**(1,016.5)**	**-**	**(66.9)**	**(1,083.4)**
Net book value:				
At 31 March 2017	**1,053.4**	**3.0**	**24.3**	**1,080.7**
At 31 March 2016	1,022.1	2.4	15.8	1,040.3

The above tangible fixed assets include £1.4m (2016: £1.0m) of capitalised interest, of which £0.4m was capitalised in the current year (2016: £0.4m). This is depreciated annually according to the useful economic life of the asset to which the capitalised interest relates.

8 Intangible assets

	Intangible Assets £m
Cost:	
At 1 April 2016	7.4
Additions	6.9
At 31 March 2017	**14.3**
Amortisation:	
At 1 April 2016	(0.3)
Charge for the year	(1.3)
At 31 March 2017	**(1.6)**
Net book value:	
At 31 March 2017	**12.7**
At 31 March 2016	7.1

9 Stocks

	2017 £m	2016 £m
Raw materials and consumables	**2.5**	2.5

10 Debtors

	2017 £m	2016 £m
Trade debtors	**11.2**	19.6
Prepayments and accrued income	**30.7**	25.8
Amounts owed by group undertakings	**11.5**	14.2
	53.4	59.6

11 **Creditors:** amounts falling due within one year

	2017 £m	2016 £m
Trade creditors	**2.2**	2.9
Amounts owed to group undertakings	**63.6**	69.7
Other creditors	**11.7**	9.5
Corporation tax payable	**9.7**	8.3
Accruals and deferred income	**46.1**	23.6
	133.3	114.0

Notes on the Financial statements (continued)
for the year ended 31 March 2017

12 Creditors: amounts falling due after more than one year

	2017 £m	2016 £m
Loans and borrowings (note 13)	**132.7**	130.4
Loans due to ultimate parent (note 13)	**300.0**	300.0
Accruals and deferred income	**96.0**	141.5
Amounts owed to group undertakings	**221.4**	179.8
	750.1	751.7

13 Interest bearing loans and borrowings

This note provides information about the contractual terms of the Company's interest bearing loans and borrowings which are held at amortised cost.

	Weighted Average Interest Rate 2017 %	Weighted Average Interest Rate 2016 %	2017 £m	2016 £m
5.90% Loan Stock repayable to SSE plc on 31 March 2022	**5.90**	5.90	**300.0**	300.0
1.4296% Index linked bond repayable on 20 October 2056	**1.92**	1.86	**132.7**	130.4
			432.7	430.4

14 Deferred taxation

Deferred tax assets and liabilities are attributable to the following:

	Assets 2017 £m	Assets 2016 £m	Liabilities 2017 £m	Liabilities 2016 £m	Net 2017 £m	Net 2016 £m
Accelerated capital allowances	**-**	-	**67.7**	70.3	**67.7**	70.3
Fair value movement on derivatives	**-**	-	**-**	0.1	**-**	0.1
Net tax liabilities	**-**	-	**67.7**	70.4	**67.7**	70.4

	1 April 2016 £m	Recognised in income £m	Recognised in equity £m	31 March 2017 £m
Movement in deferred tax during the year	70.4	(2.6)	(0.1)	**67.7**

	1 April 2015 £m	Recognised in income £m	Recognised in equity £m	31 March 2016 £m
Movement in deferred tax during prior year	78.2	(7.9)	0.1	70.4

No deferred tax arises on derivatives as the accounting base is the same as the tax base.

15 Share capital

	2017 £m	2016 £m
Equity:		
Allotted, called up and fully paid:		
62,000,000 ordinary shares of £1.00 each	**62.0**	62.0

16 Pensions

21% (2016: 30%) of the Company's employees are members of the Scottish Hydro-Electric Pension Scheme which provides defined benefits based on final pensionable pay. As there is no contractual agreement or stated group policy for charging the net defined benefit cost of the plan to participating entities, the net defined benefit cost of the pension plan is recognised fully by the sponsoring employer, which is another member of the group.

New employees can opt to join a personal pension scheme which is a money purchase scheme with the Company matching the members' contributions up to a maximum of 6% of salary. The scheme is managed by Friends Life.

The Company's share of the total contribution payable to the pension schemes during the year was £10.7m (2016: £13.0m). In addition to this, the Company incurred a further charge, payable to SSE Services plc, of £8.0m (2016: £8.4m), which related to its share of the Scheme's deficit repair contributions for the year ended 31 March 2017.

17 Derivatives and financial instruments

Exposure to interest rate risk arises in the normal course of the Company's business. Derivative financial instruments are entered into to hedge exposure to risk. The objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year are explained below. The Group's Risk and Trading Committee, a standing committee of the Group's Executive Committee comprising three Executive Directors and senior managers from the Energy Portfolio Management and Finance functions, to oversee the control of these activities. This Committee is discussed further in the Annual Report of the Group.

The Group's Treasury department is responsible for managing the banking and liquidity requirements of the Company, risk management relating to interest rate and foreign exchange exposures, and for managing the credit risk relating to the banking counterparties with which it transacts. The department's operations are governed by policies determined by the Group's Executive Committee and any breaches of these policies are reported to the Risk and Trading Committee and Group's Audit Committee.

(i) Risk

Interest rate risk
Interest rate risk derives from the Company's exposure to changes in value of an asset or liability or future cash flows through changes in interest rates.

The Company's policy is to manage this risk by stipulating that a minimum of 50% of borrowings be subject to fixed rates of interest, either directly through the debt instruments themselves or through the use of derivative financial instruments. The floating rate borrowings are provided by banks including the European Investment Bank (EIB). Such instruments include interest rate swaps. These practices serve to reduce the volatility of the Company's financial performance.

Although interest rate derivatives are primarily used to hedge risk relating to current borrowings, under certain circumstances they may also be used to hedge future borrowings. Any such pre-hedging is unwound at the time of pricing the underlying debt, either through cash settlement on a net present value basis or by transacting offsetting trades. The floating rate borrowings mainly comprise cash advances from the European Investment Bank (EIB).

17 Derivatives and financial instruments (continued)

(i) Risk (continued)

Interest rate risk (continued)
The impact of a change in interest rates is dependent on the specific details of the financial asset or liability in question. Changes in fixed rate financial assets and liabilities, which account for the majority of cash, loans and borrowings, are not measured at fair value through the income statement. In addition to this, changes to fixed-to-floating hedging instruments which are recorded under cash flow hedge accounting also do not impact the income statement. Changes in variable rate instruments and hedging instruments and hedged items recorded under fair value hedge accounting are recorded through the income statement. The exposure measured is therefore based on variable rate debt and instruments.

Effective interest rate analysis
In respect of income earning financial assets and interest bearing financial liabilities, the following table indicates their effective interest rates as at the balance sheet date and the periods in which they re-price or mature:

At 31 March 2017

	Effective interest rate %	**Total £m**	Within 1 year £m	1 - 2 years £m	2 - 5 years £m	More than 5 years £m
Long term bonds	**1.9204**	**132.7**	-	-	-	132.7
Loan stock	**5.9000**	**300.0**	-	-	300.0	-
Interest rate swaps - fixed	**4.5156**	**17.2**	-	-	-	17.2

(ii) Fair values

The fair values of the Company's financial assets and financial derivatives, and the carrying amounts in the balance sheet are analysed below. Balances included in the analysis of primary financial assets and liabilities include cash and cash equivalents, loans and borrowings, trade debtors and trade creditors, all of which are disclosed separately.

Summary fair values
The fair values of the primary financial assets and liabilities together with their carrying values are as follows:

	2017 Carrying value £m	**2017 Fair Value £m**	2016 Carrying value £m	2016 Fair Value £m
Financial Assets				
Trade and intercompany debtors	**22.7**	**22.7**	33.8	33.8
Financial Liabilities				
Trade and intercompany creditors	**65.8**	**65.8**	72.6	72.6
Long-term intercompany	**221.4**	**221.4**	179.8	179.8
Long-term bonds	**132.7**	**242.7**	130.4	181.0
Loan stock	**300.0**	**366.2**	300.0	369.9
Derivative financial liabilities	**17.2**	**17.2**	15.6	15.6

Fair values have been determined with reference to closing market prices. Unless otherwise stated, carrying value approximates fair value.

17 Derivatives and financial instruments (continued)

Financial derivative instruments - disclosure

For disclosure purposes, derivative financial instruments are classified into two categories, operating derivatives and financing derivatives. The company utilises financing derivatives in the form of interest rate derivatives. Non-hedge accounted contracts are treated as held for trading (MTM). The carrying value is the same as the fair value for all instruments. All balances are stated gross of associated deferred taxation.

Basis of determining fair value

Closing rate market values have been used to determine the fair values of the interest rate and denominated long-term fixed rate debt. Estimates applied reflect the management's best estimates of these factors.

18 Capital commitments

	2017	2016
	£m	£m
Contracted but not provided for	**13.8**	6.6

19 Operating lease commitments

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

	2017		2016	
	Land & Buildings	**Other**	Land & Buildings	Other
	£m	**£m**	£m	£m
Operating leases which expire:				
Within one year	**0.5**	**4.8**	0.4	3.7
Between one and five years	**1.9**	**8.4**	0.5	6.8
In more than five years	**3.8**	**0.3**	2.3	0.2
	6.2	**13.5**	3.2	10.7

Leases as Lessee:

	2017	2016
	£m	£m
Amount included in the profit and loss account relating to the current year leasing arrangements	**4.7**	4.6

20 Commitments and contingencies

The Company has provided a guarantee in relation to £300m Euro bonds held by the Group. This guarantee has been provided jointly with Scottish Hydro Electric Transmission plc.

21 Net debt

	2017	2016
Reconciliation of net cash flow to movement in net debt	**£m**	£m
Other non-cash movement	**(2.3)**	(1.4)
Movement in net debt in the year	**(2.3)**	(1.4)
Net debt at 1 April	**(430.4)**	(429.0)
Net debt at 31 March	**(432.7)**	(430.4)

21 Net debt (continued)

Analysis of net debt

	As at 1 April 2016 £m	Increase in cash £m	Decrease in debt £m	Non-cash movements £m	**As at 31 March 2017 £m**
Net borrowings due after more than one year	(430.4)	-	-	(2.3)	**(432.7)**
	(430.4)	-	-	(2.3)	**(432.7)**

22 Related undertakings

The related undertakings in which the Company has a shareholding are listed below:

Company Name	Relation	Country of incorporation	Registered address (key)	2017 Holding %	2016 Holding %	Principal activity
Electralink Limited	Investment	England and Wales	A	**4.89**	4.89	Data Transfer Service Operator
Gemserv Limited	Investment	England and Wales	B	**2.78**	2.78	Market Design, Governance and Assurance Service Provider
DCUSA Limited	Investment	England and Wales	A	**1.69**	1.69	Billing Framework Operator
MRA Service Company Limited	Investment	England and Wales	B	**0.61**	0.61	Metering Point Administration Services Operator
Smart Energy Code Company Limited	Investment	England and Wales	B	**0.54**	0.85	Smart Metering Implementation Management

Registered Address Key

Address	Reference
Grafton House, 2-3 Golden Square, London, W1F 9HR	A
8 Fenchurch Place, London, EC3M 4AJ	B

23 Ultimate parent company

The Company is a subsidiary of SSE plc, which is the ultimate parent company and is registered in Scotland. The largest and smallest Group in which the results of the Company are consolidated is that headed by SSE plc. The consolidated financial statements of the Group (which include those of the Company) are available from the Company Secretary, SSE plc, Inveralmond House, 200 Dunkeld Road, Perth, PH1 3AQ or by accessing the Company's website at www.sse.com.