

Registration number: 3043097

South Eastern Power Networks plc

Annual Report and Financial Statements

for the Year Ended 31 March 2022

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STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

South Eastern Power Networks plc (the "Company") is a wholly owned subsidiary of the UK Power Networks Group (the "Group"). The vision of the Group sets the direction and guides the decisions that are taken by the Company.

The Group's vision is to be a leading performer in the electricity distribution industry through being:

- an employer of choice;
- a respected and trusted corporate citizen; and
- sustainably cost efficient.

The principal values which define how the Group expects its employees to behave and how the Group wants to be perceived by its stakeholders are:

- Integrity
- Respect
- Continuous improvement
- Responsibility
- Diversity and inclusiveness
- Unity

The Group's vision and values are discussed in more detail on pages 27 and 28.

Business model

The Company distributes electricity to approximately 2.3 million homes and businesses in the South East of England via a network of underground cables and overhead lines, taking power from National Grid at high voltage and transforming it down to lower voltage before delivery to customer premises.

The Company's objectives are to:

- maintain the safety and reliability of the electricity network;
- efficiently connect new customers to the electricity network, including power generators;
- restore supply as quickly as possible to customers who experience interruption;
- innovate to continually improve efficiency and the service provided to customers;
- facilitate the transition to a low carbon economy by investing in assets, processes and initiatives that enable low carbon technology to be connected to the network;
- reduce the environmental impact of the Company's own operations;
- extend and upgrade the network to meet the future needs of customers;
- keep costs to customers as low as possible; and
- support customers in vulnerable circumstances and see they are not left behind during the complex energy transition.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Business model continued

The key performance indicators used to measure progress against the Company's safety, efficiency and customer service objectives are discussed on pages 6 to 10.

The Group includes:

- three electricity distribution businesses: Eastern Power Networks plc, South Eastern Power Networks plc and London Power Networks plc;
- a management business: UK Power Networks (Operations) Limited;
- a transport services provider: UK Power Networks (Transport) Limited;
- a groundworks services provider: UK Power Networks (South East Services) Limited; and
- a contracting business which manages a number of private networks and infrastructures: subsidiaries of UK Power Networks Services Holdings Limited.

The Company employs no staff (2021: none). Staff are employed by UK Power Networks (Operations) Limited, which operates the distribution network on the Company's behalf with the support of UK Power Networks (Transport) Limited and UK Power Networks (South East Services) Limited.

The Company has an important contribution to make in supporting the UK's transition to a low carbon economy. This is discussed on pages 16 to 19.

The Company operates within a regulated environment with the majority of the Company's revenue being set as part of a price control review by the industry regulator, the Office of Gas and Electricity Markets ("Ofgem" or "the Regulator"). Each price control provides for the licensed distributor to earn a level of "allowed" revenue. The total amount of allowed revenue takes into account a number of factors including the capital expenditure plans of the business, an efficient level of operating costs, the cost of financing the business as well as a return on the regulated asset value. It is also possible to earn a level of additional incentive based revenue for strong operational performance.

In addition to allowed revenues the Company collects income to cover the cost of connecting new customers to the network. Connections work which can only be carried out by the Company, for technical and safety reasons or as defined by the Regulator, is referred to as "non contestable" and is charged at cost to the customer. Work that other providers can undertake is referred to as "contestable" and is charged to the customer at a 4% (2021: 4%) regulated margin except in market segments where UK Power Networks has passed a competition test set by the Regulator in which case the margin regulation is removed.

The Company's performance is benchmarked against other licensed DNOs with the most efficient networks establishing an 'efficient frontier' or standard against which other DNOs are evaluated. Ofgem sets allowances and a regime of potential incentives and penalties based on the detailed assessment of business plans submitted by the DNOs. The income streams of the Company are considered to be stable, giving the business a lower risk profile which is reflected in the allowed rate of return on the regulated asset value.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Business model continued

Price control RIIO-ED1

The current price control RIIO-ED1 applies for an eight year period from 1 April 2015 to 31 March 2023 and determines the allowed revenue the Company is able to collect from its customers and the outputs the Company is required to deliver, until 2023. RIIO stands for “Revenues driven by Incentives, Innovation and Outputs”.

Allowed revenue covers the cost of operating and maintaining the network through an “in year” allowance for regulatory expenditure plus the regulatory return and regulatory depreciation on that regulatory expenditure which enters the Regulatory Asset Base, pass-through costs, incentives, tax, and pensions. The Company has the opportunity to outperform the allowed revenue either by delivering its agreed outputs at a cost below the regulatory cost allowances or through its performance against the RIIO-ED1 incentive mechanisms.

The RIIO model identifies six output categories with a range of incentive mechanisms attached:

- **Safety:** The provision of a safe network in compliance with Health and Safety Executive ("HSE") safety standards. In this category there is a strong reputational incentive and the penalty of fines if standards are breached.
- **Customer service:** DNOs are incentivised to think about their customers' needs and how best to engage with them through the Broad Measure of Customer Service ("BMCS") which incorporates measures of customer satisfaction, customer complaints and stakeholder engagement.
- **Social Obligation:** The Regulator expects the DNOs to develop a specific strategy to improve the service to vulnerable customers which feeds into the BMCS.
- **Network availability and reliability:** RIIO-ED1 has incentive mechanisms to improve the performance of the network, the most important of which is the Interruptions Incentive Scheme ("IIS") based on the number of customer minutes lost and the number of customer interruptions measured against DNO specific targets.
- **Connections:** There are strong incentives for the DNOs to focus on improving the service of connecting customers to the network. As within the BMCS, RIIO-ED1 has a “time to quote” and a “time to connect” incentive to reduce customer waiting times and an engagement incentive to encourage the DNOs to understand and satisfy the particular needs of a broad range of their customers.
- **Environmental performance:** The allowance for undergrounding of overhead lines in Areas of Outstanding Natural Beauty and National Parks continues, as well as the requirement for the DNOs to report their Business Carbon Footprint ("BCF") in annual league tables. DNOs are incentivised to integrate carbon and other environmental considerations within their day-to-day business through reputational environmental reporting requirements.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Business model continued

The business plan for RIIO-ED1 lays out the Company's commitments to deliver measurable outputs against specific targets, within the six categories listed above. Progress in achieving these targets is reported in an annual RIIO-ED1 Business Plan Commitment report, the most recent of which was published in October 2021 for the year ended 31 March 2021 (available on the Group's website at www.ukpowernetworks.co.uk/about-us/business-plan-2015-2023). The report examines the progress relating to the Group's 77 commitments agreed for RIIO-ED1 and indicates whether specific annual outputs have been achieved and if the Group's three DNOs are on target to meet their eight year output objectives. At 31 March 2022 over 95% of these commitments have either already met or on track to be delivered by the end of RIIO-ED1.

Plans for the next price control from 1 April 2023 to 31 March 2028 are discussed on page 21.

Review of the business

Operating performance

The Company performed well during the year in terms of safety, network performance and customer service which is discussed on pages 6 to 7 within Key Performance Indicators.

Market update

The UK Energy sector experienced instability at the end of 2021 which has continued in 2022, exacerbated by the war in Ukraine. An increase in wholesale energy prices has resulted in a number of energy suppliers going out of business including some of the Company's debtors. This has resulted in an increase in the provision for bad debts of £6.8m for the year ended 31 March 2022. The Company is able to recover the cost of these bad debts from suppliers, through the price control mechanism via higher tariffs.

An additional financial impact of supplier failures is that the Company can incur charges under the supplier of last resort ("SOLR") scheme managed by Ofgem. When customers of a failed supplier transfer to an appointed SOLR, that SOLR may submit a claim to Ofgem for losses incurred as a result of the SOLR arrangement, for example whole sale energy costs, additional administrative costs or inherited credit balances of affected customers. Once agreed with Ofgem the SOLR may then request payment of the claim from the DNOs.

For the year ended 31 March 2022 the Company has received SOLR claims of approximately £77m. It has been agreed with Ofgem that the majority of these claims will be payable and recovered from the broader customer base via an increase in tariffs from 1 April 2022. These claims therefore do not have a significant impact to the financial statements with payment of the related claims offset by higher in year revenues. There will be a temporary working capital impact due to a timing difference between the receipt of revenue and payment of claims, but this is not considered material and will resolve by May 2023.

In the event of continued instability in the energy markets the Company could be impacted by further bad debt and SOLR claims.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Review of the business continued

Storm events

In February 2022 the Company experienced significant damage across its network as a result of storms Eunice and Franklin. Storm Eunice was the biggest storm for more than a decade, causing the equivalent of a months worth of faults in a single day. As a result of the storms the Company incurred charges to the income statement of approximately £8.6m, including compensation and goodwill payments made to customers.

Financial performance for the year ended 31 March 2022

Turnover has increased from £455.5m in the prior year to £493.3m primarily driven by tariff increases under the regulatory price control and higher electricity demand from businesses.

Earnings before interest, taxation, depreciation and amortisation (EBITDA) has increased from £333.3m to £353.2m reflecting the higher turnover partially offset by an increase in operating costs.

Despite the increase in EBITDA profit after tax has reduced by £45.2m from £157.3m to £112.1m. This is primarily the result of the corporation tax rate change enacted on 24 May 2021, increasing the rate from 19% to 25% with effect from 1 April 2023. The revaluation of the Company's long term deferred tax liabilities at the new rate of 25% has resulted in a one off deferred tax charge of £49.8m to profit or loss in the year.

Gross capital expenditure on tangible assets was £223.5m, an increase of £21.0m compared to the prior year due to higher work volumes. This expenditure predominantly relates to improvements to the electricity network. Capital expenditure net of customer contributions increased by £15.8m.

Key performance indicators (KPIs)

The key performance indicators used by the Board of Directors in their monitoring of the performance of the Company focus on the areas of safety, network performance and reliability, customer service and financial performance.

Safety

The Group's highest priority is the safety of employees, contractors and the general public. Working with electricity is potentially a dangerous activity with electrocution and falling from height presenting the most serious risks. In order to reinforce the importance which the Group places on safety, a comprehensive safety awareness campaign is regularly ongoing for all operational staff.

Lost time incidents ("LTIs"), defined as the number of injuries to employees or contractors which result in lost time of one day or more, is a key safety measure. The circumstances of each LTI are reported and investigated in detail with the aim of preventing the recurrence of such incidents. Findings from the investigations are used to improve training and safety procedures as well as raise awareness across the organisation.

The Group recorded 2 LTIs in the year ended 31 March 2022 which is an improvement on the 5 LTIs recorded in the prior year and is an industry leading safety performance.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Key performance indicators continued

Network performance

The principal measures used to assess network performance are customer minutes lost ("CMLs") and customer interruptions ("CIs").

CMLs are the average length of time customers are without power for three minutes or longer and represent availability of supply.

CIs, the number of interruptions per 100 customers, are an indicator of network reliability.

The table below shows an improvement in both CIs and CMLs compared to the prior year. The Company remains ahead of targets set by Ofgem.

	Year ended 31 March 2022	Year ended 31 March 2021
* Customer Minutes Lost per customer (CMLs)	31.7	31.9
* Customer Interruptions per 100 customers (CIs)	39.8	44.3

* The CMLs and CIs disclosed above exclude the impact of exceptional weather events (as defined by Ofgem) and are provisional, pending Ofgem's annual review. The comparatives have been restated to reflect any changes resulting from Ofgem's prior year assessment.

Customer satisfaction

Ofgem measures customer satisfaction of all the DNOs and this is one of the most important measures of performance. The customer satisfaction survey captures customers' experiences of the services provided by the DNOs, for interruptions, minor connections and general enquiries. This rating is referred to as the Broad Measure of Customer Satisfaction or "BMCS".

The Company's average score has maintained at 92% from the prior year, remaining well above the industry-wide target of 82%.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Key performance indicators continued

Financial key performance indicators

The Company's key financial performance indicators are set out in the table below.

		Year ended 31 March 2022	Year ended 31 March 2021
Financial key performance indicators			
Turnover (£m)		493.3	455.5
EBITDA (£m)	1	353.2	333.3
Profit after tax (£m)		112.1	157.3
Gross capital expenditure on tangible assets (£m)		223.5	202.5
Capital expenditure on tangible assets net of customer contributions received (£m)		167.5	151.7
		As at 31 March 2022	As at 31 March 2021
Regulatory asset value (RAV) (£m)	2	2,038.5	1,862.3
RAV gearing	3	61%	65%

1 EBITDA is a non-statutory measure, and is calculated by adding back amortisation and depreciation to operating profit.

2 RAV is the Regulatory Asset Value of the business. The 31 March 2022 RAV presented is provisional at the date the accounts are signed. Discussion with Ofgem may result in RAV being increased or decreased. The prior year comparatives have been restated to reflect the latest agreed position.

3 RAV gearing is the ratio of net debt (as defined within certain of the Company's covenant arrangements), to the RAV.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Key performance indicators continued

*Financial key performance indicators continued**EBITDA*

The EBITDA measure excludes the effect of interest, taxation, depreciation and amortisation from earnings and thus reflects the operational performance of the business. It is also the basis for certain of the Company's covenant metrics. The closest statutory measure is operating profit which is reconciled to EBITDA as follows:

	Year ended 31 March 2022	Year ended 31 March 2021
Operating profit (£m)	255.7	238.4
Depreciation of tangible fixed assets (£m)	89.0	85.3
Amortisation of intangible assets (£m)	8.5	9.6
EBITDA (£m)	353.2	333.3

Operating profit is presented in the profit and loss account. Depreciation and amortisation are disclosed in note 5 to the financial statements. Removing the effect of depreciation and amortisation from operating profit provides a clearer measure of operating efficiencies within the business and enables comparison with industry peers.

Capital expenditure

Gross capital expenditure is a measure of the Company's investment in the electricity distribution network during the year. Capital expenditure net of customer contributions, as calculated in the table below, is also monitored because the contributions received from customers as payment for connections to the network, are directly attributable to those network assets.

	Year ended 31 March 2022	Year ended 31 March 2021
Gross capital expenditure on tangible assets (£m)	223.5	202.5
Less: Customer contributions received in the year (£m)	(56.0)	(50.8)
Capital expenditure net of customer contributions (£m)	167.5	151.7

Gross capital expenditure on tangible assets is disclosed in note 10 to the financial statements and customer contributions received are disclosed in note 20 to the financial statements.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Key performance indicators continued

Financial key performance indicators continued

RAV gearing

The proportion of debt measured against the Regulatory Asset Value of the business indicates the capacity of the business to source additional finance. This is a key metric for the Company's covenant arrangements with pension trustees and providers of finance which is monitored on a regular monthly basis. The RAV gearing ratio remains within pension and bank covenant targets, improving from 65% at 31 March 2021 to 61% at 31 March 2022. The improvement reflects the growth in the RAV due to continued investment and recent rises in the RPI.

Risk identification and management

There are a variety of mechanisms in place to manage the Company's risks. The Group has an embedded risk awareness culture to understand and manage significant business risks. The risk management framework sets out policies, procedures and responsibilities designed to assess, mitigate, monitor and report risks.

A subcommittee of the Group Board, the Risk Management and Compliance committee, oversees the risk management function and makes annual assessments of changes to significant risks and the effectiveness of the risk management processes.

Control procedures have been implemented throughout the Group to mitigate the risks identified. Compliance with internal controls is monitored through three lines of defence being:

- management control;
- oversight and challenge; and
- assurance provided by the Internal Audit function and third party assurance providers.

The Group's system of risk management and internal control is described in more detail on pages 33 to 35.

Principal risks and uncertainties

As well as the opportunities the Group has to grow and develop its business, certain risks and uncertainties are faced in achieving its objectives.

The Company's principal risks and uncertainties, and a summary of actions by the Group to mitigate them, are set out below. There are no significant changes compared to prior year.

Covid-19 has not had a material impact to the Company to date and is not currently considered a principal risk, however the Group continues to monitor key measures such as infection rates and to follow Government guidance.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Risk	Mitigation
Inadequate response to major adverse events	Senior Management addresses this risk in three main forums: the Organisational Resilience Leadership team, the Incident Leadership team and the Strategic Operational team. Mitigating measures include: • Business Continuity Plans and policies and procedures giving clear guidance of actions to be taken, roles and responsibilities (Organisational resilience is rated 4/5 by the Emergency Planning College). • Scenario planning to stress test the business continuity plans for each business unit. • Regular communications via email, the intranet and frequent video briefings from the CEO, keeping employees informed of the response plan, procedures and changing risks. • Monitoring by senior management of key performance areas which could be impacted by the event e.g. network safety and performance, customer satisfaction levels, employee health and absenteeism, PPE allocation, adherence to new policies and procedures, financial impacts. • Review and reprioritisation of work on the network as required, in response to the changing risks. This includes recovery plans to monitor work back-logs against strategic targets and resume work as quickly as possible if projects are impacted by the event. • Storms and flooding The Group has a well developed plan for dealing with storms and other major weather events setting out roles, responsibilities and co-ordination processes for employees.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Risk	Mitigation
Health and safety incidents	
There is a risk that a fatality or serious injury occurs involving a member of staff, a contractor, a member of the public or a third party. Any such incident could lead to a prosecution or a fine and have an adverse impact on the reputation of the Company.	The Group aims to create and foster a culture in which safety is the highest priority in the minds of everyone who works for and on behalf of UK Power Networks. Safety measures include: • A health and safety strategy and action plan which sets out the policies and procedures of the Group. • Task risk assessments and on-site inspections to ensure that safety procedures are followed. • A range of “Stay Safe” training programmes aimed at staff, contractors and members of the public, to promote safety and increase awareness of the dangers of working with electricity. • Active monitoring, investigation and reporting of safety incidents, including near misses, to the Safety, Health and Environmental Committee which reviews the completion of follow up actions to improve safety procedures. • Communication of incidents and lessons learnt through monthly safety messages to staff. • Innovative renewal of health and safety messaging to keep safety fresh and front of mind across the organisation. • Control and monitoring of the health and safety practices of contractors to see that the Group’s safety procedures are understood and followed. • The Group maintains accreditation to 45001 (Health & Safety Management).

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Risk	Mitigation
Failure of network assets	
There are significant risks associated with network assets where failure of asset management procedures, systems or equipment could result in a major outage, major fine or a serious injury/fatality. Customer service and continuity/quality of supply are important regulatory requirements and poor performance in these areas can result in financial penalties. Any significant incident could cause adverse publicity and impact negatively on the reputation of the Company.	The reliability of the Company's network is a key performance indicator and is closely monitored. Investment in the network is prioritised to those projects which are likely to have a beneficial impact on reliability. The Group strives to continually innovate to improve the ways in which it identifies and manages the risk of outages. The results of Inspection and Maintenance programmes, Compliance Monitoring, Asset Health index monitoring and other asset risk assessments are reported to senior management on a monthly basis and feed into long term asset management plans. The Group maintains accreditations in 55001 (Asset Management), 9001 (Quality) and 14001 (Environment).
Regulatory risks	
The Company is subject to extensive regulatory obligations which may be impacted by the prevailing political and economic climate. The following risks could result in lower financial returns reputational damage, breach of licence conditions or fines:	Examples of mitigating measures:
Risk of non-compliance with regulatory requirements.	The Group operates a Regulatory Compliance programme to understand regulatory risks and obligations and implement controls and processes to meet compliance requirements.
Risk of not achieving the output and cost efficiency targets agreed with the Regulator within the price control framework. An increase in costs due to higher levels of inflation and supply chain disruption.	The Asset Portfolio Planning (APP) tool tracks long term projects allowing monthly review of actual versus planned expenditure and monitoring progress at a project level.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Risk	Mitigation
Regulatory risks continued	
	• Close collaboration and mitigation planning with suppliers during the Brexit transition, has maintained supply chain resilience. This focus and monitoring has continued in the environment of supply chain shortages of key components and logistical challenges. • The strategic planning cycle includes bottom up budgeting as well as top down target setting with specific actions to deliver on agreed cost targets. The saving plans of each business unit are monitored by senior management on a monthly basis. Management actively manages costs to limit the impacts of inflation. The Group is able to offset higher costs via an increase in future revenue tariffs linked to inflation.
Risk of more challenging targets being set under the new price control RIIO-ED2 from 1 April 2023.	• Governance of the RIIO-ED2 process by a Board Sub Committee which meets on a regular basis. • Extensive engagement and consultation with Ofgem in developing the business plan for RIIO-ED2.
Risk of not meeting the accelerated demand on the network resulting from the uptake of low carbon technologies under the challenging timelines set by the government.	• An ongoing research and engagement programme to understand the needs, expectations and low carbon ambitions of customers and other stakeholders (e.g. the Department of Business, Energy, and Industrial Strategy BEIS, Local authorities, Councils, other networks). The objective is to shape the Group's vision and strategy, improve services and solutions for customers, learn and share best practice and influence behaviours, policy and regulation • Forecasts of the net zero impacts on the network with scenario modelling of the uptake of electric vehicles, decarbonised heat, distributed generation and battery storage. • Detailed resource planning for a range of net zero scenarios as part of workforce and supplier chain resilience plans with the aim of increasing the flexibility of delivery capabilities.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Risk	Mitigation
Regulatory risks continued	Understanding the impact of changes in the economy and regulatory environment on funding requirements and maintaining the Group's ability to raise finance at acceptable rates when required. Debt covenant and credit metrics are monitored monthly. Debt maturities are spread.
Major Failure or Cyber security breach of IT Systems:	A failure or cyber security breach of core IT systems could have a considerable impact on business operations. If the breach or failure is related to control systems, the Company's ability to operate the network could be impacted. Data breaches could result in legal or regulatory non-compliance with resulting financial penalties and reputational damage. - In response to the political tension between Russia and Ukraine, the UK Government warned of heightened cyber threats. The UK National Cyber Security Centre (NCSC) published cyber guidance and advised UK organisations to take action. The Group meets these requirements and has put in place additional measures to manage the risk. - A Cyber Security Improvement Programme operates to reduce risks, strengthen controls and maintain compliance with changes in standards and legislation. - The Group focuses its activities across three domains: operating a cyber security management system; maintaining cyber hygiene; and proactively testing resilience. - The Group focuses its activities across three domains: operating a cyber security management system; maintaining cyber hygiene; and proactively testing resilience. - All security policies and standards are closely aligned to ISO 27001 and are compliant with the requirements of applicable legislation. - The Group operates a training programme to see that its staff are aware of cyber risks and know how to minimise and manage those risks, as well as how to respond in the event of a suspected breach.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

The challenge of climate change

Climate change is one of the key challenges of our time and is of key importance to the Company's customers, stakeholders and Ofgem. The Company operates in an industry characterised by long term investment to ensure a stable energy supply for customers. This creates both risks and opportunities in relation to future performance. These are managed at a Group level so the discussion below relates to the Group as whole, as well as to the Company.

Governance

The Board of Directors provides strategic direction with respect to the Group's environmental performance.

An Environmental, Social and Governance ('ESG') Subcommittee of the Group Board has been established during the year. The ESG Committee's primary function is to assist the Group Board in ensuring that the Group has a suitable and sufficient strategy in place to deliver the key ESG based commitments in the Group's RIIO-ED2 final business plan submission. The Committee also provides oversight of the future development of strategy and policy as the external ESG environment evolves, and reports performance against ESG targets.

Risk Management

Climate related risks are considered as part of the Group's risk management framework and process, which can be found on pages 33 to 35. Governance procedures have been implemented to identify risks and opportunities faced by the Group, supported by the Risk, Control and Compliance Policy.

The Group actively monitors and manages risks, including risks relating to climate change. Its key activities to manage climate risk are as follows:

- The Group has implemented a Climate Resilience Strategy which assesses the threat and potential impacts different climate change scenarios could have on its operations. It uses the UK Climate Projections (UKCP18) to identify the climate hazards under the highest emission scenario, addressing eight hazards including flooding, extreme high temperatures and winds.
- It also works actively with the Energy Networks Association to collaboratively identify and assess the climate change hazards to the networks, and identify solutions.
- The Group has business continuity plans in place to respond to major events, which may include climate related events that could affect its operations. These continuity plans are actively monitored and tested as part of the Group's resilience planning.
- Insurance policies are in place to mitigate the financial impact of significant adverse events, including those relating to climate events and natural disasters.
- The Group's environmental management systems are compliant with ISO14001.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

The challenge of climate change continued

Risk management continued

Climate change and the transition to net zero present opportunities for the Group in terms of new markets. As the transition to electric vehicles, renewable energy and heat decarbonisation accelerates this is likely to result in an increase in electricity demand and related infrastructure. This could benefit the Group in terms of higher future revenues.

A potential physical risk to the Group from climate change is the impact of adverse changes or variability in weather patterns. In particular, the severity or frequency of storms, high winds or flooding which can have a negative impact in the form of increased damage and expenditure to the network. Other risks could include reputational damage, in the event the Group was unable to respond appropriately and being a blocker to decarbonisation.

Strategy

The Group actively engages with a wide range of stakeholders, including customers, community bodies, local government, industry experts and the Regulator, regarding its strategy and long-term objectives. The Group's business plan includes strategies to address climate change and sets out how the Group will contribute to the UK's ambition to reduce carbon emissions. This is a key feature in the business plan submitted to Ofgem for the next price control RIIO-ED2, from 1 April 2023 to 31 March 2028.

The Group has set an ambition to be the leading socially and economically responsible organisation in its sector and is committed to playing a leading role in limiting climate change. The Group's strategy is focused on:

1) Decarbonisation in line with our verified Science Based Target ('SBT')

We have set a leadership example for the sector by being the 1st DNO to achieve a verified Science Based Target for our full carbon footprint, including indirect scope 3 emissions.

2) Reducing our impact on the world's limited resources

We will embed circular economy principles, backed with robust measurement and data to improve the way in which we procure and use resources.

3) Increasing natural diversity

We will deliver stretching biodiversity improvements significantly greater than expected legislative requirements and publicly report our performance using independent measurement tools.

4) Reducing pollution produced by our business operations and network activity

We are committed to reducing NOx emissions, oil leakage from Fluid Filled Cables and continuing to facilitate the undergrounding of cables in Areas of Outstanding Natural Beauty and in national parks.

The Group's RIIO-ED2 business plan sets out specific targets in relation to the framework above, which are summarised on pages 18 to 19 in this report.

In addition to decarbonising its own activities the Group has a crucial role to play in allowing the quick and easy connection of low carbon technologies to its networks. The Group needs to be demand-driven and be able to adapt quickly to the needs of customers to avoid blocking the path to decarbonisation.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

The challenge of climate change continued

Strategy continued

The Group's strategy is to build its data resources and have early visibility of emerging customer and system needs by drawing on different types of market data for example from Low Carbon technology suppliers, survey of customer attitudes and engagement with local authorities. This will be combined with an in depth understanding of the Group's low voltage networks gained from smart metering data, advanced analytics and sensor technologies. In this way the Group aims to anticipate demand and invest in the right capacity at the right time to accommodate the roll out of low carbon technologies at an efficient cost.

Innovation is central to achieving the Group's strategy for responding to climate change. The Group seeks new ways to improve what it does for customers by identifying, developing and applying smart solutions to make the network more efficient, greener, safer and more reliable. Through its innovation team and smart grid team the Group is working towards 'a smart grid for all' that enables customers and communities to benefit from a decentralised, decarbonised and digitised electricity system.

Metrics and targets

The Group's current Green Action Plan launched in 2019 sets out targets for reducing its impact on the environment in relation to carbon emissions, waste, water usage, air and noise pollution and biodiversity. Progress against these targets is reported on the Group's website. In addition the Group produces a detailed annual environment report for Ofgem each year covering performance on all environmental fronts and business carbon footprint methodology. These can be found at www.ukpowernetworks.co.uk/about-us/environment-and-sustainability. The Group's RIIO-ED1 Business Plan includes social and environmental commitments. Progress in meeting these commitments is reported to Ofgem annually and published on the Group's website at www.ukpowernetworks.co.uk/about-us/business-plan-2015-2023.

The Group's annual report sets out in more detail how climate related risks and opportunities are governed, the Board's strategy for responding to climate change, it's risk management activities, and the use of metrics and targets to measure progress against the Group's strategy.

Looking ahead to RIIO-ED2 the Group has published the following commitments in its business plan. Performance and progress against these targets will be published annually in an Annual Environmental Report.

Decarbonisation in line with our verified Science Based Target ('SBT')

- For our full carbon footprint, including losses and indirect scope 3 emissions, we will exceed our reduction target approved by the Science Based Targets initiative (SBTi) at Well Below 2 °C. We will commit to the Business Ambition for 1.5°C SBTi campaign.
- We will reduce our directly controllable emissions (scope 1 & 2, excluding losses) exceeding a 1.5°C reduction trajectory and offset any remaining residual emission to achieve Net Zero by 2028 using high quality verified offsets.
- As part of our verified Science Based Target, we will work with our suppliers to reduce our supply chain carbon emissions (scope 3) by 25% by 2028, compared to a 2018/19 baseline.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

The challenge of climate change continued

Reducing our impact on the world's limited resources

- We will develop and implement a circular economy tool to address our high impact materials by the start of RIIO-ED2.
- We will recycle 80% of office, depot and network waste and 99.5% of street works material by the end of RIIO-ED2, with no recoverable waste to landfill by 2025.

Increasing natural diversity

- We will increase the biodiversity of new major substation developments by a net-gain of 10-20% and at 100 existing substation sites by a net-gain of 30% overall over the RIIO-ED2 period, compared to the beginning of the period, as measured by the DEFRA biodiversity tool.

Reducing pollution produced by our business operations and network activity

- We will reduce NOx emissions by 33% over the RIIO-ED2 period compared to the beginning of the period.
- We will reduce annual leakage from Fluid Filled Cables by 15% by the end of the RIIO-ED2 period compared to the beginning of the period.
- We will continue to facilitate the undergrounding of nominated schemes to remove overhead lines within Areas of Outstanding Natural Beauty and National Parks, working closely with all relevant stakeholders to ensure that the full regulated allowance is spent to maximise the benefits of works within our protected landscapes.

Financial risk management objectives and policies

The Company is financed by a combination of equity and retained profits, bonds, Group loans and bank lending facilities. The Company's funding and liquidity are managed within a framework of documented treasury policies and guidelines.

At 31 March 2022 the Company had net debt of £1,333.7m (2021: £1,285.3m) comprising bonds of £1,334.6m (2021: £1,042.7m), loans from the European Investment Bank (EIB) of £165.0m (2021: £165.0m), and Group loans of £nil (2021: £79.0) offset by cash and cash equivalents of £165.9m (2021: £1.4m).

The Company's principal financial assets are its cash balances, trade and other receivables and loans to Group undertakings.

The Company's activities expose it to a number of financial risks, the most important of which are interest rate risk, credit risk and liquidity risk.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022**Financial risk management objectives and policies continued***Interest rate risk*

The interest rate exposure on the Company's debt is partially hedged in order to provide the desired mix of fixed and floating rate interest rates to achieve a balanced debt portfolio with a similar profile to that of the cost of debt allowance within Ofgem's price control. The use of financial derivatives is governed by the Group's treasury policies, which provide written principles on the use of financial derivatives to manage interest rate risks. The Group does not use derivative financial instruments for speculative purposes.

Credit and liquidity risk

The Company's credit risk is primarily attributable to its trade receivables. The amounts presented in the balance sheet are net of an impairment allowance for expected credit losses. The credit risk on liquid funds and financial instruments is limited because the counterparties are large recognised banks with investment grade credit-ratings assigned by international rating agencies. The Company does not have a significant concentration of credit risk, with exposure spread over a large number of counterparties and customers.

The Company generates cash primarily from Use of System charges which are payable within 14 days of the demand for payment. Payments are received in advance from customers requiring connection to the network, and suppliers and contractors are paid in accordance with negotiated terms. Other principal cash outflows include interest, taxation and dividends. The Company plans its working capital requirements to take account of expected cash inflows and outflows.

Liquidity risk is managed by spreading debt maturities over a range of dates which provides comfort that the Company is not subject to excessive financing risk in any one year. The Company is able to raise finance in financial markets supported by cash flows generated by the Regulatory Asset Value which in part determines the level of allowed revenue that may be recovered. The Company is required by the distribution licence to maintain an investment grade credit rating.

Pension commitments

A significant proportion of the Group's employees are members of two funded defined benefit pension schemes: the UK Power Networks Group of the Electricity Supply Pension Scheme (the UKPN Group Scheme); and the UK Power Networks Pension Scheme (the UKPNPS). Both defined benefit schemes are closed to new members. A defined contribution pension scheme, introduced in 2011, is open to all new employees. There is automatic enrolment to the scheme in the first month of employment but employees do have the choice to opt out.

The Company's share of the Group's defined benefit pension obligations accounted for under FRS 102 at 31 March 2022 amounts to a surplus of £239.8m (2021: surplus of £63.3m) in the UKPN Group scheme and a deficit of £25.0m (2021: deficit of £59.0m) in the UKPNPS scheme. The significant actuarial gains recognised in both schemes during the year, are driven mainly by an increase in the discount rate used to calculate the present value of scheme liabilities. The sensitivity of the valuation to changes in discount rate is shown on page 63 and further detail on the assumptions used to estimate the defined benefit obligation is provided in note 19 to the financial statements.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Taxation

The Company operates entirely within the United Kingdom and is subject to all the main charges which fall under UK legislation. These include corporation tax, VAT, national insurance, regulatory licence fees, local authority fees (such as road permits issued under the New Roads and Streetworks Act) and relevant rates.

The Company has a significant long term capital expenditure programme which generates a charge against taxable profit through capital allowances. The timing of the tax relief on these allowances has the effect of delaying the payment of corporation tax and giving rise to a deferred tax liability. At 31 March 2022 the Company's net deferred tax liability was £261.9m (2021: £156.2m). The increase compared to the prior year is predominantly due to the uplift of the deferred tax rate from 19% to 25% (as discussed on page 6) and the higher deferred tax liability arising from the defined benefit pension surplus.

Factors likely to affect future development and performance

The Company's business model is considered robust with stable income streams supported by regulated price controls. The Company's key long-term objectives are not expected to change significantly.

Those factors which could impact future development and performance include:

Price control:

The existing RIIO-ED1 price control expires on 31 March 2023. The Group's business plan for the next price control RIIO-ED2 which will operate from 1 April 2023 to 31 March 2028 was submitted to Ofgem in December 2021. The final determination of the price control is scheduled for December 2022 following review and consultation with Ofgem. The submitted business plan is available on the company website at www.ukpowernetworks.co.uk.

Initial feedback from Ofgem published in February 2022 by Ofgem indicates that the submitted business plan has been positively received and compares favourably with other DNOs. The Group has a reasonable expectation of a satisfactory outcome from the price review business plan process.

The principal challenge heading into RIIO-ED2 will be to maintain affordability to customers in light of the new demands of connecting low carbon technologies to the distribution network and facilitating the transition to net zero. The Group will need to make additional investment under RIIO-ED2 to support the rollout of electric vehicles, heat pumps and renewable generation. Planned investment provides for both additional network capacity and the establishment of a new Distribution System Operator ("DSO") function.

The Group's DSO strategy is to create a dynamic distribution system, with electricity demand and supply flexing in response to distribution-level conditions and market signals. This will lead to a smarter and more highly utilised distribution network, with faster and cheaper access for the low carbon technologies ("LCTs") that will be needed to help achieve Net Zero.

RIIO-ED2 could result in changes to incentive targets, allowable expenditure and allowable rate of return which could impact financial performance.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Factors likely to affect future development and performance continued

Innovation:

The Group has a dedicated innovation team seeking to deliver solutions in the following areas:

- Improving the performance of the network in terms of safety, reliability and efficiency. Projects aim to deliver measurable impacts on for example customer interruptions, customer minutes lost, carbon emissions and safety performance.
- Enabling low carbon technologies like electric vehicles, renewable energy and energy storage. Projects aim at improving network access through reducing time and cost to connect low carbon load, generation, and storage technologies.
- Developing the Company's future capabilities as a DSO to deliver a secure, reliable low carbon energy system that addresses its customers' evolving needs.

Market conditions and inflation:

As set out in the Business Review section, the Company has experienced an increase in bad debts and SOLR claims resulting from instability in energy markets. In the event of further or continued instability, the Company could experience additional charges and claims, which whilst recoverable via future tariff increases, could result in temporary working capital impacts.

During 2022 there has been a significant increase in rates of inflation, due in part to higher energy prices as well as global supply disruption. The Company ultimately benefits from higher rates of inflation in the form of an increase in RAV and increases in future revenue from use of system tariffs in future periods. However, financial performance can be adversely affected in the short-term by the impact of higher inflation on expenditure and inflation linked debt.

Going concern

The Company's business activities together with details regarding its risk management policies and its future development, performance and position are set out in the preceding paragraphs of this Strategic Report. Further detail in respect of its financial instruments and hedging activities are included in the relevant notes to the financial statements.

The Directors have performed an assessment of going concern based on detailed cash flow forecasts for a period of at least 12 months from the date of these financial statements as well as taking into consideration the following factors:

- The Company continues to perform well, is profitable with strong underlying cashflows and with predictable revenues regulated by Ofgem under an established price control mechanism. The Company has not been and does not expect to be significantly impacted by Covid-19.
- £145m of undrawn committed borrowings under the revolving credit facility and the flexibility provided by centralised Group treasury arrangements which allow short term funding from other Group companies if required.
- The financial covenants applicable to the Company's financing facilities.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Going concern continued

- The impact of a higher inflationary environment, which negatively impacts costs but increases future revenues via higher tariffs.
- The impact of higher market energy prices which has resulted in an increase in bad debts and supplier of last resort claims. As set out on page 5 this does not materially impact the financial position of the Company as these costs are recovered via an increase in future tariffs.
- The Company has a successful track record of raising finance, supported by an investment grade credit rating as required by its distribution licence, and forecast stability.

In assessing going concern the Directors have considered reasonably possible downside scenarios which could negatively impact the Company. These include an increase in costs resulting from storm events, higher than expected inflation, higher levels of bad debt and lower than expected revenues, which could be attributable to weather impacts on consumption or a worsening of Covid-19 related economic impacts.

Given the significant amount of liquidity available to the Company at 31 March 2022, the Group's forecasts under all reasonable scenarios show that there is significant headroom in respect of available liquidity and compliance with financial covenants. Stress testing has been performed and indicates that the level of decline in the Company's financial performance to result in a financial covenant breach is considered remote. Accordingly, the Directors are satisfied it is appropriate to adopt the going concern basis of accounting in the preparation of these financial statements.

Section 172 (1) statement

The Directors are aware of their duties under Section 172(1) of the Companies Act 2006, which requires them to act in the way which they consider, in good faith, would be most likely to promote the success of the Company for the benefit of its members as a whole and in doing so have regard (amongst other matters) to:

- a) the likely consequences of any decision in the long term;
- b) the interests of the Group's employees;
- c) the need to foster the Company's business relationships with suppliers, customers and others;
- d) the impact of the Company's operations on the community and the environment;
- e) the desirability of the Company maintaining a reputation for high standards of business conduct; and
- f) the need to act fairly as between members of the Company.

The Company operates in an industry characterised by long term investment to ensure a stable energy supply for customers. The consequences of the Company's strategy over the long term are considered in its long term business plans and projections, including a detailed business plan agreed with Ofgem at the start of each price control period, and the Company's own five year projections which are updated annually. Further information on the factors likely to affect future performance and how the Company will respond to them can be found on pages 21 to 22.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2022

Section 172 (1) statement continued

The Company actively engages with its stakeholders on a regular basis in order to identify trends and developments, inform policies and procedures, and re-align its strategy. The Company has identified its key stakeholders as: the Group's employees, customers, suppliers, the communities affected by the Company's operations, the Regulator and shareholders. Further information about how the Company has regard to the interests of these stakeholders, and how it fosters good business relationships with them, can be found on pages 36 to 39.

As described on pages 27 and 28, the Company's vision is to be a respected and trusted corporate citizen, operating within a set of values which are designed to promote high standards and fair and ethical behaviour.

Approved by the Board on 27 July 2022 and signed on its behalf by:



Basil Scarsella
Director

Newington House
237 Southwark Bridge Road
London
SE1 6NP
United Kingdom

DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2022

The Directors present their Annual Report including the Audited Financial Statements of the Company for the year ended 31 March 2022.

Details of the Company's financial risk management objectives and policies, future developments, going concern and the Section 172 statement on the duties of the Directors are included in the Strategic Report and form part of this report by cross reference.

Dividends

Dividends of £105.0m (2021: £37.0m) were paid during the year.

Political contributions

The Company made no political contributions during the year (2021: £nil).

Business relationships

The Company has identified its key stakeholders as: employees of the Group, customers, suppliers, the communities affected by the Company's operations, the regulator and shareholders. Further information about how the Group has regard to the interests of these stakeholders, and how it fosters good business relationships with them, can be found on pages 36 to 39.

Directors of the Company

The Directors who held office during the year and subsequently were as follows:

Andrew John Hunter (Chairman)

Hing Lam Kam

Neil Douglas McGee

Hok Shan Chong (resigned 21 May 2021)

Basil Scarsella

Charles Chao Chung Tsai

Loi Shun Chan

Mei Fan Ngan (resigned 21 May 2021)

Duncan Nicholas Macrae

Kee Ham Chan

Chi Tin Wan

Christopher Clarke

Paul Jeffery

DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2022

Directors of the Company continued

None of the Directors had a service contract with the Company in the current or prior year.

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

Disclosure of information to Auditor

Each of the persons who is a director of the Company at the date of approval of this Annual Report confirms that:

- so far as the Director is aware, there is no relevant audit information of which the Company's auditor is unaware; and
- the Director has taken all the steps that 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.

This confirmation is given and should be interpreted in accordance with the provisions of s418 of the Companies Act 2006.

Auditor

Deloitte LLP have expressed their willingness to continue in office as Auditor and a resolution to reappoint them will be proposed at the Annual General Meeting.

Approved by the Board on 27 July 2022 and signed on its behalf by:



Basil Scarsella
Director

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

The Company has adopted the Wates Corporate Governance Principles for Large Private Companies, as issued by the Financial Reporting Council (FRC), 2018.

The Company is a wholly owned subsidiary of UK Power Networks Holdings Limited and forms part of the UK Power Networks Holdings Group (the “Group”). The Group operates a range of governance principles and practices on a group-wide basis, which are adopted and implemented by its subsidiaries, including the Company, to the extent they are relevant to their operations.

The Companies (Miscellaneous Reporting) Regulations 2018 requires the Company to make a statement in relation to which corporate governance code it has adopted, and how it has adopted that code. The purpose of this report is to set out how corporate governance principles have been applied to the Company in the context of the Group. Relevant disclosures are included below in this Report on Corporate Governance, in the Statement of Directors’ Responsibilities, in the Directors’ Report and in the Strategic Report.

Principle 1 - Purpose and Leadership

Purpose, vision and values

The Company has a clear public purpose: to deliver electricity to the South East of England. The Group has articulated the vision and values to which the Company aspires in fulfilling its purpose, and these are set out below.

The vision of the Group is to be consistently the leading Distribution Network Operator through being:

an employer of choice:

- the safest, with an exemplary safety record
- an organisation that employees are proud to work for
- creating the most diverse and inclusive DNO and DSO
- having a highly skilled workforce for both today and long term
- strong and collaborative relationships with Trade Unions

a respected and trusted corporate citizen:

- the most reliable networks
- delivering the best customer satisfaction
- meeting the needs of customers in vulnerable circumstances, both now and in the future
- the most socially and environmentally responsible in its sector
- the most innovative, combining data, technology and new ideas
- ensuring its supply chain is efficient, sustainable and ethical

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 1 - Purpose and Leadership continued

sustainably cost efficient:

- delivering the lowest possible cost for customers
- delivering frontier efficiency in the work the Group does
- delivering on commitments in a collaborative way with others
- delivering profitable growth in the Connections business

The values of the Group underpin what the Company does. They define how the Company expects its representatives to behave and how the Company wants to be perceived by its stakeholders and those who come into contact with the business. The Company has adopted these values as follows:

Integrity: The Company will do what it says it will do and build trust and confidence by being honest to colleagues, partners and customers.

Respect: The Company will treat partners and customers in the way in which the Company would want to be treated.

Continuous improvement: The Company is committed to learning, development, innovation and achievement.

Responsibility: The Company will act in an ethical, safe and socially/environmentally aware manner.

Diversity and inclusiveness: The Company recognises and encourages the value which difference and constructive challenge can bring.

Unity: The Group is stronger together and this comes from a shared vision, a common purpose and a supportive and collaborative working environment.

The Board are committed to seeing that the vision and values are embedded in the Group, and reiterate them regularly. Internal bonus and incentive targets are based on the achievement of the vision, measuring both financial and non-financial metrics. The Group also operates a Living our Values award system, which promotes and recognises employees who demonstrate the values in their work.

Through open discussion, the vision and values are reviewed internally, and from time to time are modified to reflect the changing environment in which the Group operates. This is done through feedback from the annual employee survey, engagement with trade unions, and regular senior leadership forums. The vision will evolve for RIIO-ED2, following such stakeholder engagement and feedback, to include a fourth pillar "enabling the net zero transition for all".

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 2 - Board composition

The Board of the Company ("the Board") comprises the Chief Executive Officer ("CEO") of the Group, eight Directors appointed to represent the shareholders and two Sufficiently Independent Directors ("SIDs") appointed to comply with regulatory licence conditions.

The role of the SIDs as defined by the Regulator is to mitigate the risk that Directors with executive roles within the wider ownership group could become conflicted at times of crisis.

The CEO of the Group is the only Executive Board member. The other Directors do not hold executive roles and therefore maintain an acceptable level of independence from the executive management of the Company. As such, the appointment of an independent Chairman is not deemed necessary. The positions of the Chairman of the Board and CEO are held by separate individuals with a view to maintaining effective segregation of duties between management of the Board and the day-to-day management of the Company.

The Board of the Company is identical to the board of the parent UK Power Networks Holdings Ltd ("the Group Board") with the exception of three additional directors in the parent company and the two SIDs who are not members of the Group Board but do attend Group Board and Board Committee meetings.

The Group Board is the principle decision-making body of the Company and the Group. It has overall responsibility for leading and controlling the Group as well as the financial and operational performance of the Company. The Group Board and its sub-committees meet on a regular basis to conduct the affairs of the Group. The Board considers and acts on matters pertaining to the Company within this forum.

A total of six meetings of the Group Board were held during the year with ten to twelve members of the Company's Board present at each meeting.

Principle 3 - Directors' responsibilities

The Board is responsible to the Shareholders for the performance of the Company in both the short and the longer term and seeks to balance competing objectives in the best interests of the Company with the objective of enhancing shareholder value.

The powers of the Directors have been set out in the Company's Articles of Association. To ensure good corporate governance the Board has adopted a formal corporate governance statement and has clearly defined terms of reference setting out matters reserved for the Board.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 3 - Directors' responsibilities continued

The Directors make active contributions to the affairs of the Group Board which acts in the best interests of the Company. Furthermore, the Group Board has established formal committees with specific responsibilities to assist in the execution of its duties and to allow detailed consideration of complex issues.

Below the Group Board, executive responsibility rests with the CEO Basil Scarsella and the Executive Management Team ("EMT"). The CEO and EMT operate within the Delegations of Authority, governance structure and terms of reference defined in the Group's Corporate Governance Framework, which outlines the governance structure within the Group.

Governance and control environment

The Group Board is collectively responsible for the oversight of the management of the Group and the Company. The Group Board has determined those decisions that require approval by the Board and the delegation of authority for those decisions that do not.

The Company Secretary is responsible to the Board for ensuring that Board procedures are followed and for ensuring that the Board is briefed on relevant legislative, regulatory and corporate governance developments and that the Board has regard to them when making decisions.

In order to assist the Group Board in fulfilling its oversight responsibilities, seven Board sub-committees have been created with the following terms of reference:

- The Audit Committee assists the Group Board with its responsibilities for financial reporting, maintaining an effective system of internal control and internal and external audit processes. Using risk assessment methodology and taking into account the Company's activities, Internal Audit determines the annual audit programme which is approved and monitored by the Audit Committee. The Audit Committee also reviews the arrangements by which staff of the Group may raise concerns in confidence about possible improprieties and monitors any investigations into concerns raised.
- The principal responsibilities of the Remuneration Committee include making recommendations to the Group Board on the Group's policies and structure in relation to the remuneration of senior management and employees of the Group, by reference to corporate goals and objectives resolved by the Group Board from time to time.
- The Treasury Committee oversees the treasury strategy, policy and procedure and seeks to ensure that all treasury risks are identified, measured and controlled in a manner consistent with corporate strategy and treasury policy.
- The Risk Management and Compliance Committee assists the Group Board with its responsibilities in relation to risk management and to oversee compliance with obligations determined by statute, legislation, regulation, contract or agreement. The Group Board is responsible for approval of the risk management strategy while management is responsible for implementing the Group Board's strategy and for developing policies and procedures to identify, manage and mitigate risks across the business.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 3 - Directors' responsibilities continued

- The Nominations Committee recommends Sufficiently Independent Directors (SIDs) for appointment to the Boards of the Distribution companies. The Committee selects the candidates based on the criteria defined by condition 43A of the distribution licence which requires the SIDs to have a sufficient level of independence from the executive management of the Company and the shareholder companies.
- The Environmental, Social and Governance (ESG) Committee was established during the year. The Committee's primary function is to assist the Board in ensuring that the Group has a suitable and sufficient strategy in place to deliver the key ESG based commitments in the Group's RIIO-ED2 final business plan submission. The Committee also provides oversight of the future development of strategy and policy as the external ESG environment evolves, and reports performance against ESG targets on a consolidated basis.

The Nominations Committee meets when required, the Remuneration Committee meets at least once annually and the other committees at least three times annually. A chairman is elected at each meeting by the relevant committee. During the year the Remuneration Committee held one meeting and the Audit, Treasury, Risk Management and Compliance committees each held three meetings. A quorum was present at each meeting. The new ESG Committee met for the first time in December 2021 and plans to convene three times a year going forward.

A further Board subcommittee has been established in relation to the preparation of and Board assurance over the RIIO-ED2 business plan. This committee met six times during the year and is expected to conclude its responsibilities when the Final Determination has been received and reviewed.

Each committee's performance, constitution and terms of reference are reviewed annually to ensure that they are operating effectively. The Company Secretary acts as a secretary for each committee.

The EMT comprises the CEO of the Group and Directors for each of the distinct business areas, or Directorates. In order to assist the EMT in fulfilling their responsibilities, committees with delegated authority for defined matters have been established. The Senior Management Team within each Directorate has defined responsibilities which allow for effective operations to achieve the Group's objectives. Lines of responsibility and levels of authority are formally defined.

Integrity of financial information

The consolidated financial statements of the Group and its subsidiaries (including the Company) are prepared by the central financial reporting team based on results submitted by each Directorate. Each Directorate is supported by an appropriately qualified finance team who provide advice to the EMT Directors and Managers and liaise with the central financial reporting team on such matters as the application of accounting policies, procedures and internal controls.

The role of the central financial reporting team includes liaising with the shareholders regarding such matters as accounting policies, planning for changes in reporting requirements and to ensure that these are communicated effectively to the Directorates. There is regular dialogue between the central financial reporting team and the finance teams supporting the Directorates to ensure there is appropriate understanding of these requirements.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 3 - Directors' responsibilities continued

Integrity of financial information continued

The Directorates, supported by finance partners, are accountable for the review and approval of the monthly management accounts prior to submission to the central financial reporting team who then undertake further reviews and challenge. The monthly accounts of each Directorate are reviewed during EMT meetings. Consolidated year to date financial information is presented at Group Board meetings attended by the CEO and the Finance Director. The annual report and accounts of the Company and of the Group are presented to the Audit Committee, or a subcommittee thereof, prior to approval by the Board.

External audit

The Audit Committee is responsible for overseeing the effectiveness of the external audit process and ensuring that appropriate measures are taken to safeguard the independence and objectivity of the external auditor.

The Audit Committee reviews the scope and extent of the external auditor's annual audit, seeking confirmation from the external auditor that no limitations have been placed on the scope or nature of their audit procedures.

At the completion of the annual external audit the Audit Committee reviews with management and the external auditor the annual financial statements and related notes, financial information and discussion to be included in the annual report. The results of the audit and the audit report are reviewed and enquiries are made as to whether there have been any material disagreements with management. The Audit Committee meets with the external auditor without members of management being present at least twice a year to discuss any matters that the external auditor or the Audit Committee believe should be discussed privately.

The Audit Committee reports its findings to the Board in respect of the effectiveness of the external audit process and any significant issues considered in relation to financial statements and how these were addressed. On this basis, it advises the Board on whether the Annual Report and financial statements taken as a whole represent a fair, balanced and understandable view to shareholders and therein recommends the approval of the financial statements.

Independence and objectivity of external auditor

The Audit Committee reviews annually with management the fee arrangements and terms of reference with the external auditor. In particular the nature and extent of non-audit services provided is reviewed with reference to the approved framework within the Group's Corporate Governance Policy.

For each audit period a formal written statement is provided by the external auditor setting out all relationships between the external auditor and the Group. Any proposed appointment of ex-employees of the external audit firm to senior management positions with the Company is subject to consent by the Audit Committee.

The year ended 31 March 2022 is the last year of engagement for the current lead external audit partner. This position is rotated at least every five years, the last rotation being for the 31 March 2017 year ended engagement.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 4 - Opportunity and Risk

The Group's Corporate Governance Framework Policy, which outlines the governance structure within the Group and its subsidiaries including the Company, is supported by the Risk, Control and Compliance Policy and underlying procedures. The Risk, Control and Compliance Policy, in place throughout the reporting period, defines the framework in which the Company:

- proactively identifies risks to its strategy, objectives, business developments and processes and implements internal controls to mitigate these;
- explores the effectiveness of those controls in mitigating the risks through internal audit and other monitoring mechanisms;
- reactively monitors incidents, errors and breaches to identify control failures and determine areas for improvement; and
- develops contingency arrangements for business continuity and emergency incidents.

Risk identification and Internal control

The Board (through the Audit Committee) is responsible for the Company's system of internal control and for reviewing its effectiveness. The Company's system of internal control and the risk management process help to safeguard the Company's assets. However, the Board recognises that such a system can only provide reasonable and not absolute assurance against material misstatement or loss.

The Company operates a structured risk and control assessment process which is overseen by the EMT, supported by risk review meetings conducted by the Senior Management Team within each business Directorate.

The role of the Directorate risk review meetings is to assess new risks, review existing risks and monitor control improvement actions. Each identified risk is defined and assessed by the risk owner. This includes an assessment of the likelihood of the risk occurring and the associated impact, key mitigating controls, and an assessment of the adequacy of those controls. Where appropriate control improvement actions are defined.

Significant risks and delivery of control improvement actions are monitored and reported to the Executive and Senior Management Teams on a regular basis, and actively managed by the designated risk owners.

Internal control framework

Control procedures have been implemented throughout the Company and are designed to achieve complete and accurate accounting for financial transactions, to safeguard the Company's assets and for compliance with laws and regulations. These control procedures form the Integrated Management System; a controlled framework of policy and procedural documentation. Control procedures are subject to regular review and formal ratification and approval. As part of the Integrated Management System, procedural implementation and compliance is subject to regular monitoring.

The Group Board has established the scope of the internal audit function which is responsible for reviewing the effectiveness of the Company's systems of internal control and reports to the Audit Committee.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 4 - Opportunity and Risk continued

Internal audit

The Internal Audit function has responsibility for providing independent assurance to the CEO and the Audit Committee as to the effectiveness of the policies, procedures and standards which constitute the system of internal control, including; risk management; corporate governance; and compliance with relevant laws and regulations. Internal Audit has a direct reporting line to the Audit Committee.

The relationship between Internal Audit and management requires management to be primarily responsible for ensuring that the systems of internal control are implemented and operated so as to provide reasonable assurance that the objectives of the business will be met and that the risks or threats to the business are mitigated. In addition to providing independent review, the Internal Audit function provides advice and guidance to management on the appropriateness of internal control mechanisms and systems.

The Audit Committee reviews and approves the scope of Internal Audit's work plan for the year and monitors progress against the work plan. The Audit Committee reviews major findings by the internal auditors and the status of Management actions to address the conditions reported in completed audits.

Monitoring and corrective action

The Group has established structured performance monitoring to measure achievement against the strategy and objectives of the Group. The structured approach includes a combination of quantitative metrics and qualitative analysis to ensure areas for improvement are promptly identified and addressed.

In order to monitor compliance with internal controls, the Group operates a 'three lines of defence' approach.

- First line of defence – management control. Management undertake monitoring of their processes to satisfy themselves that the defined controls operate economically, effectively and efficiently; and that key risks are identified and assessed;
- Second line of defence – oversight and challenge. There are designated functions and committees in place to test and challenge the effective operation of controls. These include central functions and committees established by the EMT; and
- Third line of defence – assurance. Assurance is provided by the Internal Audit function and external audits and accreditation exercises conducted by third party assurance providers.

Identified control weaknesses and corrective actions are reported to the Executive and Senior Management Teams and monitored monthly. Significant weaknesses in internal control are reported to the EMT and, if appropriate, to the Audit Committee.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 4 - Opportunity and Risk continued

Effectiveness review of internal control

The Group continuously makes improvements to the system of internal control through structured review of the Integrated Management System and other targeted control reviews.

CK Infrastructure Holdings Limited and Power Assets Holdings Limited require that the Group provides an annual report on the quality of the internal control system covering key business processes and outlining, where necessary, material control weaknesses. In forming a view of the quality of the systems of internal control, the EMT consider: audit findings; compliance review findings; risks with controls assessed as sub-optimal; and status of corrective actions related to these areas.

These assessments enable the Group to identify areas where attention is required to improve the system of internal control, business performance and operating effectiveness.

Principle 5 - Remuneration

The Company has no employees of its own, however it relies on the employees of other Group companies to deliver its services.

The Group has formed a Remuneration Committee, whose principal responsibilities include making recommendations to the Board on the Group's policies and structure in relation to the remuneration of senior management and the employees of the Group by reference to corporate goals and objectives resolved by the Board from time to time. The Remuneration Committee is formed by members of the Board including one of the SIDs, and meets on at least an annual basis.

The Group has clear remuneration structures that are designed to reward good performance, attract the best talent, and are aligned to the achievement of the Group's vision and values.

One of the key ways that employees are incentivised is through the Company Incentive Plan (employee bonus scheme), which is applicable to all the Group's employees. Sixty per cent of the Company Incentive Plan is based on the Group's achievement of key aspects of its vision, including safety, reliability, customer service and cost efficiency. The management population also has a target relating to employee engagement. The remaining forty per cent of the Company Incentive Plan is based on achievement of individual and team annual objectives which are designed to support the Group's vision.

The Group targets are shared by all employees, including the Executive and Senior management teams, in order to reinforce a common sense purpose across the Group. The balance for the EMT is seventy-five per cent on the Group's achievement and twenty-five percent on individual objectives. The Group also operates a long term incentive plan for its EMT to promote achievement of sustainable, good long term performance.

The remuneration of directors is disclosed in note 6 of the financial statements.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 6 - Stakeholder Relationships and Engagement

The stakeholders of the Company are consistent with the stakeholders from across the rest of the Group. Although the Company has no employees of its own, it considers the employees of other Group companies to be key stakeholders and therefore participates in the engagement activities that the Group undertakes. The Group actively engages with its stakeholders on a regular basis in order to identify trends and developments, inform policies and procedures, and re-align its strategy. The Group has identified the following as its key stakeholders, and has described below how it seeks to engage with them: employees, customers, suppliers, the community and its environment, the Regulator and shareholders.

Group Employees

The Group recognises that its employees are fundamental to the achievement of its objectives and to its longer term success, and has articulated being an Employer of Choice as one of the three pillars to its vision. A diverse workforce, with a range of backgrounds, abilities, skills and experience, is considered to be vital to achieving the best outcomes. Accordingly the Group places considerable value on the engagement and involvement of its workforce, through a variety of activities and initiatives including:

- A comprehensive annual employee engagement survey by an external survey provider "Best Companies" in which employees provide their views on key matters pertinent to the success of the Group and their own engagement. The Group has featured on the Best Companies "Top 25 Best Big Companies To Work For list" for eight consecutive years, achieving its highest ever position of second place in the last national survey published in March 2022. Also as part of the Best Companies awards, the Group was ranked #1 Best Big Company to work for in London and achieved second place in the Utilities sector Top 10 list.
- The Group issues communications to employees through a range of channels, including a monthly 'team brief' in which employees hear about the Group's achievement against its objectives, and view a video address from the CEO. Other communications include monthly visits by the EMT to sites across the Group, Group-wide magazine publications, intranet sites, emails and social media forums. Questions and feedback from employees are actively encouraged by management.
- Employee representatives are consulted regularly on a wide range of matters affecting the current and future interests of employees through dedicated employee engagement forums.
- The values of Equality, Diversity and Inclusion ("EDI") are key considerations in the Group's recruitment, training and communication programmes. A range of training is provided to employees to increase awareness and promote an inclusive culture, such as inclusive behaviour training. Through various forums, employees are asked to share their views on diversity and inclusiveness in the work place and make recommendations for improvement. For example a dedicated EmPower Community acts as a platform for employees to discuss EDI issues and raise suggestions. A Steering Committee made up of senior managers meets quarterly to support and monitor the Group's Diversity and Inclusion strategy and initiatives.
- The Group is National Equality Standard ("NES") accredited and in the top 10 of Inclusive Top 50 Employers in the UK, reflecting its intent and commitment toward becoming a truly diverse and inclusive workplace. The Group's plans for RIIO-ED2 include a focus on improving equality of employment access, reducing the gender pay gap, increasing BAME applications for early career roles working closely with local schools and developing a work experience programme aimed at disadvantaged or under privileged groups.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 6 - Stakeholder Relationships and Engagement continued

Employees continued

- Each employee undertakes performance reviews with their managers, in which their performance against specific objectives is reviewed and discussed, and personal development opportunities and training identified.
- The Group holds an “Investors in People” platinum accreditation which recognises its commitment to excellence in people management, an achievement obtained by only 2% of companies of similar size globally.
- The Group’s caring approach for its employees won it the title of Employer of the Year at the Utility Week Awards 2021, held in March 2022. Judges praised the way the Group had invested in employees, protected their wellbeing during the COVID-19 pandemic and championed equality, diversity and inclusion.
- New skills will be required in a range of areas such as DSO, cyber-security and UK Power Networks’ role as an important data provider for network users looking to make the Net Zero transition. In its business plan for RIIO-ED2 the Group aims to establish a Digital Skills Academy to provide DSO and digital future skills, deliver 510 accredited apprenticeship NVQs (National Vocational Qualifications) in Leadership and Management and 200 IET (Institute of Engineering and Technology) accredited technical or digital apprenticeships. The Group will target the achievement of an “Outstanding” OFSTED rating for training programmes in the period.

Customers

Customer engagement helps build a sustainable business, as it anchors the Group to the needs and expectations of its customers and shapes its long-term vision and objectives. The Group engages with its customers through a programme of events, forums and focus groups along with other communications such as newsletters and media campaigns.

An important source of customer feedback is an industry survey of 300 customers a week, which feeds into Ofgem’s Broad Measure of Customer Satisfaction. This is supplemented by an additional feedback mechanism in which customers give almost instant feedback on the service they have received.

The Group is enhancing its service to customers in the following ways:

- Detailed analysis of data from various perspectives such as network performance, geography, and the particular customer experience to provide greater insight into customer needs and preferences.
- Giving more timely, accurate and tailored information (such as notification of planned work and provision of estimated restoration times) through channels of customer choices.
- Better planning and coordination of work streams ensuring customers receive a joined up level of service at all points of contact from call centre staff to engineers in the field.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 6 - Stakeholder Relationships and Engagement continued

Customers continued

The Group's customer service performance is currently industry leading, for example the Company achieved a customer satisfaction score of 92% in the year ended 31 March 2022 (see page 7) . A Group wide campaign has been launched to help drive the culture of improving customer service even further. The campaign involves formal review by senior management of major complaints or service failings to understand what went wrong and how changes can be implemented. These learning points are shared with employees in regular team briefs together with examples of best practice where excellent feedback has been received from customers.

In addition to achieving high customer satisfaction scores, the Group was ranked number 4 in the 2021 UK Customer Satisfaction Index's top 50 and rated the best company in the UK for complaint handling and ethics.

Suppliers

Good relationships with suppliers are key to delivering value efficiently and effectively. The resilience of the Group's supply chain will be critical to meeting the demands of the low carbon transition.

The Group operates an established procurement function which seeks to ensure fair and ethical dealings with its suppliers, and has put in place policies and practices, such as:

- The Group has published guidance to suppliers, both current and prospective, on how to operate in accordance with the UK Power Networks vision, values and standards. It outlines its approach to business ethics and sustainable procurement and clarifies the standards and behaviours it expects to be adopted throughout the supply chain.
- UK Power Networks assesses its suppliers through a pre-qualification platform Achilles Utilities Vendor Database ("UVDB"). As an industry-recognised risk management framework, Achilles UVDB provides a fair, open and transparent means of supplier selection for potential tender opportunities.
- The Group is a signatory to the Prompt Payment Code, which sets standards for payment practices and best practice, working towards adopting 30 day payment terms as the norm, and to avoid any practices that adversely affect the supply chain.
- The Group's Logistics team works closely with suppliers to forecast demand and maintain high inbound performance levels. The Group's materials contracts are long term enabling suppliers to invest in manufacturing equipment and work in partnership with the Group.
- The Group has formed an alliance model with key strategic partners to promote closer working relationships and common practices on shared projects.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

Principle 6 - Stakeholder Relationships and Engagement continued

The Community and Environment

As a network operator the Group recognises that its activities have a significant impact on the communities in which it operates. Being a respected and trusted corporate citizen is a key part of the Group's vision and it works closely with communities and their representatives to identify areas where it can play an active, beneficial role.

The Group regularly engages with local community groups, councils, businesses and customers through a programme of events and forums to obtain feedback. The Group also undertakes an intensive programme of engagement with such groups when it is forming its business plan for a new price control period. The feedback from these interactions results in initiatives and commitments which the Group delivers as part of its business plan.

The Group maintains a Priority Services Register ("PSR") which, in the event of a power cut, allows it to deliver specific support to customers living in vulnerable circumstances. Many different services are offered to over 2.1 million customers on the PSR ranging from personal calls with information updates, to hot meals, and even alternative accommodation or a mobile generator. The Group's response to the storm events during February 2022 included collaboration with the British Red Cross to proactively contact vulnerable customers. In November 2021 Storm Arwen caused significant disruption in the north of England. The Group assisted this storm effort in a first of its kind collaboration with another regional DNO, providing specialist engineers and supporting the call handling response.

The Group continues to expand its services to customers on its PSR for example, by tailoring awareness campaigns to increase registrations of underrepresented customer groups and by leading the way in rolling out automated sharing of PSR data with water companies. This will continue to be an area of focus as communities are facing increasing challenges relating to the cost of living and energy prices. The Group is expanding its fuel poverty support programme and developing solutions to ensure all customers can benefit from smart and low carbon energy.

The environment is of key importance to the Group's stakeholders. As set out on pages 16 to 19, the Group has set ambitious targets to be the most socially and economically responsible in its sector and is committed to playing its part in limiting climate change.

The Regulator, Ofgem

The Group is regulated by Ofgem which determines its strategy on a range of matters. The Group regularly engages with Ofgem through formal consultation processes, and with other industry bodies in various forums, to share information, to ensure the Group understands its obligations as set out by Ofgem, and to ensure the Group's interests are represented in industry discussions.

Currently, the Group is actively engaged with Ofgem in its preparations for the next price control, RIIO-ED2.

Shareholders

The Group is wholly owned by a consortium of three parties. The support and engagement of the Group's shareholders is vital to the success of the business in reaching its long term objectives. The Group's shareholders are represented on the Board of Directors, and as such receive regular reporting on financial and operational matters, and are directly involved in strategic decision making.

STATEMENT OF DIRECTORS' RESPONSIBILITIES

The Directors acknowledge their responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and regulations.

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors have elected to prepare the financial statements in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

In preparing these financial statements, the Directors are required to:

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

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

The Directors are responsible for the maintenance and integrity of the corporate and financial information included on the Company's website. Legislation in the United Kingdom governing the preparation and dissemination of financial statements may differ from legislation in other jurisdictions.

The Directors confirm to the best of their knowledge that:

- the Financial Statements, prepared in accordance with the applicable set of accounting standards, give a true and fair view of the assets and liabilities, financial position and profit of South Eastern Power Networks plc as at 31 March 2022; and
- the Strategic Report and the Directors' Report include a true and fair view of the development and performance of the business and the financial position of South Eastern Power Networks plc, together with a description of its principal risks and uncertainties.

Approved by the Board on 27 July 2022 and signed on its behalf by:



Basil Scarsella
Director

Report on the audit of the financial statements

1. Opinion

In our opinion the financial statements of South Eastern Power Networks plc (the 'company'):

- give a true and fair view of the state of the company's affairs as at 31 March 2022 and of its profit for the year then ended;
- have been properly prepared in accordance with United Kingdom Generally Accepted Accounting Practice, including Financial Reporting Standard 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland"; and
- have been prepared in accordance with the requirements of the Companies Act 2006.

We have audited the financial statements which comprise:

- the profit and loss account;
- the statement of comprehensive income;
- the balance sheet;
- the statement of changes in equity;
- the cash flow statement; and
- the related notes 1 to 22.

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

2. Basis for opinion

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

We are independent of the company in accordance with the ethical requirements that are relevant to our audit of the financial statements in the UK, including the Financial Reporting Council's (the 'FRC's') Ethical Standard as applied to listed public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements. The non-audit services provided to the company for the year are disclosed in note 5 to the financial statements. We confirm that we have not provided any non-audit services prohibited by the FRC's Ethical Standard to the company.

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

3. Summary of our audit approach

Key audit matters

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

- Accuracy of cost classification; and
- Accuracy of financial instruments.

Within this report, key audit matters are identified as follows:

-  Newly identified
-  Increased level of risk
-  Similar level of risk
-  Decreased level of risk

Materiality	The materiality that we used in the current year was £15.5 million which was determined on the basis of approximately 7.5% of profit before tax.
Scoping	Audit work to respond to the risks of material misstatement was performed directly by the audit engagement team.
Significant changes in our approach	Our approach is consistent with the prior year and we have not identified any new key audit matters.

4. Conclusions relating to going concern

In auditing the financial statements, we have concluded that the directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate.

Our evaluation of the directors' assessment of the company's ability to continue to adopt the going concern basis of accounting included:

- Obtaining an understanding of the relevant controls relating to the going concern process;
- Understanding the financing facilities available to the company, including the associated covenants;
- Assessing all bank covenants and facility expiry dates, and recalculating current and forecast covenant compliance;
- Obtaining an understanding of the going concern forecast prepared by management, including the downside scenarios as well as evaluating any plan for future actions;
- Testing the mathematical accuracy of the model used to prepare the going concern forecast;
- Challenging the key assumptions, including forecast revenue and capital expenditure cash flows, on which the assessment is based and evaluating the consistency of assumptions with other assumptions within the going concern assessment as well as related assumptions used in other areas;
- Challenging management's projections by performing a reverse stress test to assess the likelihood of the entity's operations ceasing to exist;
- Assessing the impact of the Russia/Ukraine conflict, which has created some instability in the market, the recent impact of the energy supplier failures and the related 'supplier of last resort' (SOLR) scheme;
- Evaluating management's assessment of the impact of Covid-19 within the forecast;
- Evaluating management's assessment of the impact of inflation and of the increased demand for electric capacity within the forecast;
- Assessing the level of headroom in the forecast, with regard to both liquidity and debt covenant tests;
- Assessing the outcome of the reverse stress testing performed by management;
- Assessing whether any additional facts or information has become available since the date management made its assessment; and
- Evaluating the appropriateness of the going concern disclosures in the financial statements.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH EASTERN POWER NETWORKS PLC

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the company's ability to continue as a going concern for a period of at least twelve months from when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the directors with respect to going concern are described in the relevant sections of this report.

5. 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.

5.1. Accuracy of cost classification

Key audit matter description	The company continues to have an extensive capital investment programme. To meet the requirements of FRS 102.17 Property Plant and Equipment ("PP&E"), it is important that network costs are appropriately classified as either capital or operating expenditure in nature. In the year, the company capitalised £219.2 million (2021: £200.0 million) in relation to network assets. The classification of activities between capital (additions or enhancements to network assets) and operating expenditure (maintenance or network repair) is impacted by judgements undertaken by management. Management's judgements pertain to the cost drivers that form part of the cost classification model, that determine the expenditure classification as part of the overall capitalisation policy. There is also a degree of complexity surrounding the allocation of network costs using a range of network cost drivers. Due to the judgements and complexity pertaining to these cost drivers, we have identified the accuracy of cost classification to be a key audit matter as well as potential fraud risk. We identified this key audit matter as a potential fraud risk as management might be incentivised to fraudulently overstate capital expenditure and understate operating expenditure, in the determination of the cost drivers that underpin the classification of expenditure. The classification of costs have been disclosed in the accounting policies in Note 2, Note 3 and in Note 10 to the financial statements.
How the scope of our audit responded to the key audit matter	We performed the following procedures: • Tested relevant controls over the application of the policy in relation to classification of expenditure; • Assessed whether the company's accounting policies in relation to capitalisation comply with FRS 102.17 Property, Plant and Equipment; • Tested the implementation of these policies through assessing the capital nature of a sample of projects against the capitalisation policy and then for a sample of cost transactions assessing whether the costs capitalised agreed to respective project purchase invoices; • Assessed the proportion of capitalised overhead costs using historical comparisons and expected changes based on enquiry with management and our sector knowledge;

- Challenged and assessed the assumptions and judgements made by management in relation to cost drivers used for each cost category as well as consistency of these with the prior year and any changes;
- Tested the cost allocation model and the outcome of the year-end cost review with particular emphasis on overhead capitalisation;
- Tested the integrity and mechanics of the cost allocation model to assess its mathematical accuracy; and
- Assessed the appropriateness of the company's disclosures of its capitalisation policy, including the judgement involved in assessing expenditure as capital and the judgement relating to the allocation of overhead cost.

Key observations

The results of our procedures were satisfactory and on the basis of these we concluded the classification of costs is appropriate.

5.2. Accuracy of Financial Instruments

Key audit matter description

As at 31 March 2022 the company had total borrowings (fixed and variable rates) of £1,499.6 million (2021: £1,286.7 million). The company mitigates the exposure to interest rate risk, exchange rate risk and inflation risk with risk management activities including the use of complex derivatives, including interest rate swaps.

Hedge accounting is by its nature complex and requires the exercise of judgement by management to determine that the financial instruments can be accounted for and designated within a hedging relationship. Due to the complexity in employing hedge accounting as well as the judgements undertaken, we have identified the accuracy of financial instruments as a key audit matter.

At the year end, the company had derivative financial assets of £81.7 million (2021: £162.0 million) and derivative financial liabilities of £47.1 million (2021: £122.9 million). The treatment of derivative financial instruments and hedge accounting is disclosed in the accounting policies in Note 2 as well as in Notes 14 and 15 to the financial statements.

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

We performed the following procedures:

- Obtained an understanding of the relevant controls related to the hedging of financial instruments process;
- Tested all aspects of the accounting for financial instruments, including the documentation of the hedge effectiveness testing performed as well as the ongoing treatment followed for all derivative instruments;
- Worked with internal financial instruments specialists to challenge the appropriateness of the hedge documentation, eligibility of designations and challenge of the hedge effectiveness testing; and
- For new swaps and hedges implemented in the year, we verified documentation to assess the instruments have been accounted for appropriately.

Key observations	The results of our procedures were satisfactory and on the basis of these we conclude the accuracy of financial instruments is appropriate.
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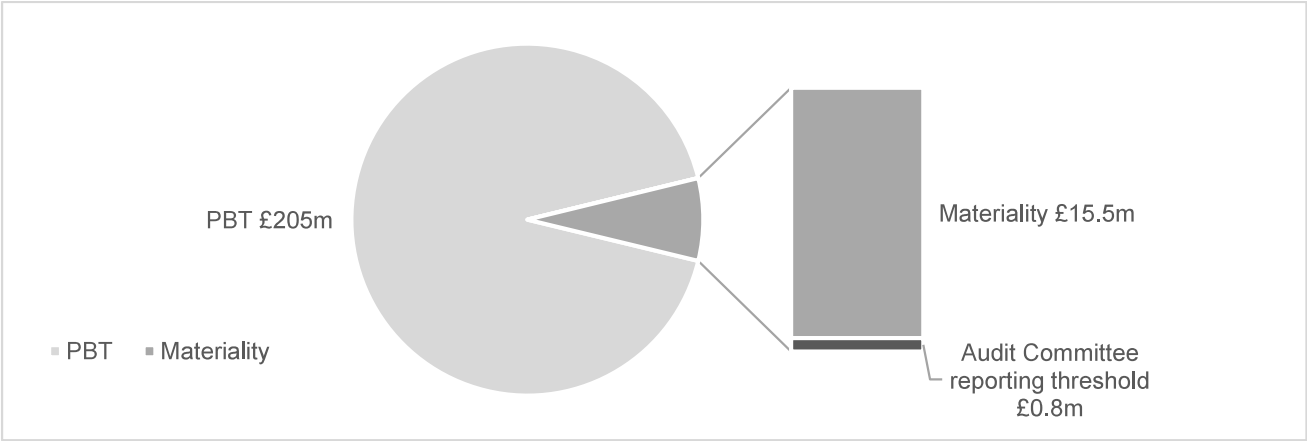
6. Our application of materiality

6.1. Materiality

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

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

Materiality	£15.5 million (2021: £14.2 million)
Basis for determining materiality	Approximately 7.5% of profit before tax (2021: 7.5% of profit before tax)
Rationale for the benchmark applied	As a profit-making entity, profit before tax is a key metric used by users of the financial statements. We conducted an assessment of which line items we understand to be the most important to investors and analysts by reviewing the company’s communications to shareholders and lenders, as well as the communications of peer companies. This assessment resulted in us considering the profit before tax.



6.2. Performance materiality

We set performance materiality at a level lower than materiality to reduce the probability that, in aggregate, uncorrected and undetected misstatements exceed the materiality for the financial statements as a whole. Performance materiality was set at 70% of materiality for the 2022 audit (2021: 70%). In determining performance materiality, we considered the following factors including, our ability to rely on internal controls across a number of areas of the audit, assessment of the company's control environment, the stability of the business, the outcome of our risk assessment process, the level of errors identified in prior years, management's willingness to correct errors identified and the stability of the finance team.

6.3. Error reporting threshold

We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £0.8 million (2021: £0.7 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.

7. An overview of the scope of our audit

7.1. Scoping

Our audit was scoped by obtaining an understanding of the company and its environment, including wider UK Power Networks Holdings Limited group-wide controls, and assessing the risks of material misstatement at the company and group level. All the audit work is performed directly by the engagement audit team.

7.2. Our consideration of the control environment

We have taken a controls reliance approach in performing our audit of the balances that have a higher volume of transactions namely:

- Cost classification for the Network Assets;
- DUoS (Distribution Use of System) revenue; and
- Operating expenses.

We have taken a substantive audit approach on all other areas not mentioned above.

The wider UK Power Networks Holdings group controls environment that the company is included within contains a number of IT systems, applications and tools used to support business processes and reporting.

We performed testing of General IT Controls ("GITCs") of the accounting system, typically covering controls pertaining to user access management, change management as well as controls over key reports generated from the accounting system and its supporting infrastructure (database and operating system).

Our procedures enabled us to place reliance on IT controls pertaining to the accounting system.

8. Other information

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

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.

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 course of the audit, or otherwise appears to be materially misstated.

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SOUTH EASTERN POWER NETWORKS PLC

If we identify such material inconsistencies or apparent material misstatements, we are required to determine whether this gives rise to a material misstatement in the financial statements themselves. 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.

9. Responsibilities of directors

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

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

10. Auditor's responsibilities for the audit of the financial statements

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

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

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

Irregularities, including fraud, are instances of non-compliance with laws and regulations. We design procedures in line with our responsibilities, outlined above, to detect material misstatements in respect of irregularities, including fraud. The extent to which our procedures are capable of detecting irregularities, including fraud is detailed below.

11.1. 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, we considered the following:

- the nature of the industry and sector, control environment and business performance including the design of the company's remuneration policies, key drivers for directors' remuneration, bonus levels and performance targets;
- results of our enquiries of management, internal audit, internal legal counsel and the Audit Committee about their own identification and assessment of the risks of irregularities;

- any matters we identified having obtained and reviewed the company's documentation of their 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 of fraud or non-compliance with laws and regulations;
- the matters discussed among the audit engagement team and relevant internal specialists, including financial instruments, valuations, pensions, and IT specialists regarding how and where fraud might occur in the financial statements and any potential indicators of fraud.

As a result of these procedures, we considered the opportunities and incentives that may exist within the organisation for fraud and identified the greatest potential for fraud in the Accuracy of Cost Classification. In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override.

We also obtained an understanding of the legal and regulatory framework that the company operates in, focusing on provisions of those laws and regulations that had a direct effect on the determination of material amounts and disclosures in the financial statements. The key laws and regulations we considered in this context included the UK Companies Act, Listing Rules, pensions legislation, and tax legislation.

In addition, we considered provisions of other laws and regulations that do not have a direct effect on the financial statements but compliance with which may be fundamental to the company's ability to operate or to avoid a material penalty. These included the company's compliance with the Ofgem licence requirements.

11.2. Audit response to risks identified

As a result of performing the above, we identified the Accuracy of Cost Classification as a key audit matter related to the potential risk of fraud. The key audit matters section of our report explains the matter in more detail and also describes the specific procedures we performed in response to that key audit matter.

In addition to the above, our procedures to respond to risks identified included the following:

- reviewing the financial statement disclosures and testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- enquiring of management, the audit committee and in-house 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

12. Opinions on other matters prescribed by the Companies Act 2006

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

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

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

13. Matters on which we are required to report by exception

13.1. 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, or returns adequate for our audit have not been received from branches not visited by us; or
- the financial statements are not in agreement with the accounting records and returns.

We have nothing to report in respect of these matters.

13.2. 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.

14. Other matters which we are required to address

14.1. Auditor tenure

Following the recommendation of the audit committee, we were appointed by the board in 2001 and were reappointed following an audit tender in 2017 to audit the financial statements for the year ending 31 March 2018 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 22 years, covering the years ending 31 December 2001 to 31 March 2022.

14.2. 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).

15. 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.



Makhan Chahal, ACA (Senior statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

27 July 2022

SOUTH EASTERN POWER NETWORKS PLC

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 2022

	Note	2022 £ m	2021 £ m
Turnover	4	493.3	455.5
Cost of sales		<u>(13.2)</u>	<u>(16.4)</u>
Gross profit		480.1	439.1
Distribution costs		(217.8)	(195.3)
Administrative expenses		<u>(6.6)</u>	<u>(5.4)</u>
Operating profit	5	255.7	238.4
Finance costs (net)	7	<u>(51.2)</u>	<u>(44.0)</u>
Profit before tax		204.5	194.4
Taxation	8	<u>(92.4)</u>	<u>(37.1)</u>
Profit for the financial year		<u>112.1</u>	<u>157.3</u>

The above results were derived from continuing operations.

The notes on pages 56 to 87 form an integral part of these financial statements.

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2022

	2022 £ m	2021 £ m
Profit for the year	112.1	157.3
Reclassified to profit or loss from hedge reserve	1.9	1.2
Remeasurement gains/(losses) on defined benefit pension schemes	133.3	(47.7)
Other comprehensive income/(loss)	135.2	(46.5)
Total comprehensive income for the year	247.3	110.8

The components of other comprehensive income are presented net of related tax effects.

The notes on pages 56 to 87 form an integral part of these financial statements.

SOUTH EASTERN POWER NETWORKS PLC

BALANCE SHEET AS AT 31 MARCH 2022

	Note	2022 £ m	2021 £ m
Fixed assets			
Intangible assets	9	16.7	20.4
Tangible assets	10	<u>3,360.8</u>	<u>3,226.4</u>
		<u>3,377.5</u>	<u>3,246.8</u>
Current assets			
Debtors falling due within one year	11	92.3	199.5
Debtors falling due after more than one year	11	455.9	225.3
Cash and cash equivalents		<u>165.9</u>	<u>1.4</u>
		714.1	426.2
Creditors: Amounts falling due within one year	12	<u>(235.1)</u>	<u>(274.8)</u>
Net current assets		<u>479.0</u>	<u>151.4</u>
Total assets less current liabilities		3,856.5	3,398.2
Creditors: Amounts falling due after more than one year	12	<u>(2,241.6)</u>	<u>(1,997.3)</u>
Provisions for liabilities	16	<u>(295.1)</u>	<u>(223.4)</u>
Net assets		<u>1,319.8</u>	<u>1,177.5</u>
Capital and reserves			
Called up share capital	17	145.1	145.1
Hedging reserve	17	(7.7)	(9.6)
Profit and loss account	17	<u>1,182.4</u>	<u>1,042.0</u>
Total shareholders' funds		<u>1,319.8</u>	<u>1,177.5</u>

The financial statements of South Eastern Power Networks plc, registered number 3043097, were approved by the Board of Directors and authorised for issue on 27 July 2022. They were signed on its behalf by:



 Basil Scarsella
 Director

The notes on pages 56 to 87 form an integral part of these financial statements.

SOUTH EASTERN POWER NETWORKS PLC

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2022

	Share capital £ m	Hedging reserve £ m	Profit and loss account £ m	Total £ m
At 1 April 2020	145.1	(10.8)	969.4	1,103.7
Profit for the year	-	-	157.3	157.3
Remeasurement losses on defined benefit schemes	-	-	(47.7)	(47.7)
Reclassified to profit or loss	-	1.2	-	1.2
Total comprehensive income	-	1.2	109.6	110.8
Dividends	-	-	(37.0)	(37.0)
At 31 March 2021	145.1	(9.6)	1,042.0	1,177.5

	Share capital £ m	Hedging reserve £ m	Profit and loss account £ m	Total £ m
At 1 April 2021	145.1	(9.6)	1,042.0	1,177.5
Profit for the year	-	-	112.1	112.1
Remeasurement gains on defined benefit schemes	-	-	133.3	133.3
Reclassified to profit or loss	-	1.9	-	1.9
Total comprehensive income	-	1.9	245.4	247.3
Dividends	-	-	(105.0)	(105.0)
At 31 March 2022	145.1	(7.7)	1,182.4	1,319.8

The notes on pages 56 to 87 form an integral part of these financial statements.

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2022

	Note	2022 £ m	2021 £ m
Cash generated from operations	20	356.6	327.1
Corporation tax paid		<u>(28.8)</u>	<u>(32.6)</u>
Net cash flows from operating activities		<u>327.8</u>	<u>294.5</u>
Cash flows from investing activities			
Proceeds from sale of tangible assets		0.2	0.4
Gross capital expenditure on tangible assets		(221.8)	(200.7)
Capital expenditure on intangible assets		(4.8)	(3.5)
Interest received		<u>3.9</u>	<u>3.6</u>
Net cash flows used in investing activities		<u>(222.5)</u>	<u>(200.2)</u>
Cash flows from financing activities			
Equity dividends paid		(105.0)	(37.0)
Interest paid		(53.4)	(54.0)
Proceeds from long-term borrowings		296.6	-
Proceeds from short-term borrowings		(79.0)	-
Repayment of short-term borrowings		<u>-</u>	<u>(6.0)</u>
Net cash flows from/(used in) financing activities		<u>59.2</u>	<u>(97.0)</u>
Net increase/(decrease) in cash and cash equivalents		164.5	(2.7)
Cash and cash equivalents at beginning of year		<u>1.4</u>	<u>4.1</u>
Cash and cash equivalents at end of year		<u><u>165.9</u></u>	<u><u>1.4</u></u>
Reconciliation to cash at bank and in hand			
Cash at bank and in hand		77.9	1.4
Cash equivalents ¹		<u>88.0</u>	<u>-</u>
Cash and cash equivalents		<u><u>165.9</u></u>	<u><u>1.4</u></u>

¹ Cash equivalents are short term deposits with banks with maturities of less than 3 months.

The notes on pages 56 to 87 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

1 General information

South Eastern Power Networks plc (the "Company") is incorporated in the United Kingdom under the Companies Act 2006. The Company is a private company limited by shares and is registered in England and Wales.

The principal activities of the Company and the nature of the Company's operations are set out in the Strategic Report on pages 2 to 24.

The address of its registered office is:

Newington House
237 Southwark Bridge Road
London
SE1 6NP
United Kingdom

2 Accounting policies

The principal accounting policies adopted by the Company are set out below. They have all been applied consistently throughout the current and prior year.

Basis of accounting

The financial statements have been prepared under the historical cost convention, modified to include certain items at fair value, and in accordance with Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council (FRC).

The functional currency of the Company is pounds sterling because that is the currency of the primary economic environment in which the Company operates.

Certain exemptions are allowed in the financial statements on the basis that the Company meets the definition of a "qualifying entity" under FRS 102, being:

"a member of a group where the parent of that Group (UK Power Networks Holdings Limited) prepares publicly available consolidated financial statements which are intended to give a true and fair view and the member (the Company) is included in the consolidation."

The Company has taken the exemption not to disclose related party transactions with other wholly owned members of the Group.

Going concern

As discussed in the Strategic Report the Directors have, at the time of approving the financial statements, a reasonable expectation that the Company has adequate resources to continue operating for the foreseeable future. Therefore they continue to adopt the going concern basis of accounting in preparing the financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**Intangible assets - IT software and development costs**

IT software acquired from third parties is included at cost and amortised in equal annual instalments over an expected useful life of 4 to 8 years.

IT development expenditure is written off, except where the Directors are satisfied as to the technical, commercial and financial viability of individual projects. In such cases, the identifiable expenditure is capitalised as an intangible asset and amortised over the period during which the Company is expected to benefit. This period is between 4 to 8 years.

Provision is made for any impairment to the carrying values of intangible assets.

Tangible assets

Tangible assets are stated at cost, net of depreciation and provision for impairment.

The cost of tangible assets includes directly attributable incremental costs incurred in their acquisition and installation. The carrying values of tangible assets are reviewed for impairment when events or changes in circumstances indicate the carrying value may not be recoverable.

Depreciation

Depreciation is provided on all tangible fixed assets other than freehold land, at rates calculated to write off the cost of each asset on a straight-line basis over its expected useful life, as follows:

Asset class	Depreciation rate
Network overhead and underground lines	45 to 60 years
Other network plant and buildings	20 to 60 years
Furniture, fixtures and equipment	4 to 8 years
Vehicles	5 to 10 years

Assets in the course of construction are carried at cost less any recognised impairment loss. Depreciation of these assets, on the same basis as other assets, commences when the assets are ready for their intended use.

Customer contributions toward the cost of connection to the network are credited to the balance sheet as deferred income on receipt, and amortised to revenue over the expected useful lives of the relevant assets. The Company has an ongoing obligation to maintain these assets so it is appropriate to recognise the benefit over the same period over which the assets depreciate.

Borrowing costs capitalised

Borrowing costs which are directly attributable to the construction of tangible fixed assets are capitalised as part of the cost of those assets. The commencement of capitalisation begins when both finance costs and expenditures for the asset are being incurred and activities that are necessary to get the asset ready for use are in progress. Capitalisation ceases when substantially all the activities that are necessary to get the asset ready for use are complete.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**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 within the same component of other comprehensive income.

Current tax, including UK corporation tax, is provided at amounts expected to be paid (or recovered) using the tax rates and laws that have been enacted or substantively enacted by the balance sheet date.

Deferred tax is recognised in respect of all timing differences that have originated but not reversed at the balance sheet date where transactions or events that result in an obligation to pay more or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the Company's taxable profits and its results as stated in the financial statements that arise from the inclusion of gains and losses in tax assessments in periods different from those in which they are recognised in the financial statements.

Unrelieved tax losses and other deferred tax assets are recognised only to the extent that, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is provided for gains on disposal of fixed assets that have been rolled over into replacement assets only where, at the balance sheet date, there is a commitment to dispose of the replacement assets with no likely subsequent rollover or available capital losses. Provision is made for gains on re-valued fixed assets only where there is a commitment to dispose of the re-valued assets and the attributable gain can neither be rolled over nor eliminated by capital losses.

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

Pensions

The Company has obligations under defined benefit pension arrangements operated by the Group.

For defined benefit schemes the amounts charged to operating profit are the costs arising from employee services rendered during the period as well as the cost of plan introductions, benefit changes, settlements and curtailments. They are included as part of staff costs. The net interest cost on the net defined benefit liability is charged to profit or loss and included within finance costs. Remeasurements, comprising actuarial gains and losses and the return on scheme assets (excluding amounts included in net interest on the net defined benefit liability), are recognised immediately in other comprehensive income.

The defined benefit schemes are funded, with the assets of the schemes held separately from those of the Group, in separate trustee administered funds. Formal actuarial valuations are undertaken by independent qualified actuaries at least triennially. Actuaries also provide valuations at each balance sheet date using a roll forward of member data from the most recent triennial valuation and reflecting updated financial and demographic assumptions. Pension scheme assets are measured at fair value and liabilities are measured using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond or equivalent currency and term to the scheme liabilities.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**Provisions**

Provisions are recognised when the Company has an obligation at the reporting date as a result of a past event, it is probable that the Company will be required to settle that obligation and a reliable estimate can be made of its amount. The amount recognised as a provision is the best estimate of the consideration required to settle the present obligation at the balance sheet date, taking into account risks and uncertainties. Where a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

Financial instruments

The Company has elected to apply Section 11.2c of FRS 102, which allows the recognition and measurement provisions of the International Financial Reporting Standard IFRS 9 'Financial instruments' with the disclosure and presentation requirements of Sections 11 and 12 of FRS 102.

Financial assets and financial liabilities are initially recognised at fair value, when the Company becomes a party to the contractual provisions of the instrument. Subsequent measurement is either at amortised cost or fair value depending on the classification of the instrument.

Amortised cost is calculated as:

The amount at which the financial asset or liability is measured at initial recognition;

Less: The principal repayments;

Plus: The cumulative amortisation using the effective interest method of any difference between the initial amount and the maturity amount. The effective interest rate exactly discounts estimated future cash flows through the expected life of the instrument back to the initial carrying amount recognised. Discounting is omitted where the effect of discounting is immaterial;

Less: Any loss allowance in respect of financial assets.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**Financial assets**

After initial recognition at fair value the financial assets held by the Company are subsequently measured as follows:

Financial asset	Subsequent measurement
Unlisted investments, trade and other receivables	At amortised cost less impairment
* Derivatives not designated as hedging instruments	At fair value through profit or loss
* Derivatives designated as hedging instruments	Hedge accounting at fair value

* Derivatives and hedging accounting are discussed in subsequent paragraphs.

The impairment loss allowance on financial assets is calculated as the expected credit loss over the lifetime of the debt using the IFRS 9 simplified approach. The Group has established a provision matrix derived from historical credit loss experience adjusted for forward looking factors specific to the debtors and the economic environment.

Cash and cash equivalents comprise cash in hand, and demand 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.

Financial liabilities and equity*Equity instruments*

Debt and equity instruments are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangement. An equity instrument is any contract which grants the holder a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Company are recognised at the proceeds received, net of direct issue costs.

Financial liabilities

After initial recognition at fair value the financial liabilities held by the Company are subsequently measured as follows:

Financial liability	Subsequent measurement
Borrowings, trade and other payables	At amortised cost using the effective interest rate method
* Derivatives not designated as hedging instruments	At fair value through profit or loss
* Derivatives designated as hedging instruments	Hedge accounting at fair value

* Derivatives and hedging accounting are discussed in subsequent paragraphs.

Other than derivative financial liabilities there are no financial liabilities which are mandatorily required to be measured at fair value through profit or loss under IFRS 9. The Company has not elected to measure any financial liabilities at fair value through profit or loss.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**Offsetting of financial instruments**

Financial assets and liabilities are only offset in the balance sheet when there is a legally enforceable right to set off the recognised amounts and the Company intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Derecognition of financial instruments

A financial asset is derecognised when the right to receive cash flows from the asset have expired or the Company has transferred its right to receive cash flows from the asset, to a third party. A financial liability is derecognised when the Group's obligations are discharged, cancelled or expire.

Derivative financial instruments

The Company uses derivative financial instruments to reduce exposure to interest rate movements. The Company does not hold or issue derivative financial instruments for speculative purposes.

Interest rate swaps are entered into for the purpose of managing the interest rate risks associated with the borrowing requirements of the Company. Amounts payable or receivable in respect of the swap instruments are recognised within net finance costs in the profit and loss account.

Derivatives are initially recognised at fair value at the date a derivative contract is entered into and are subsequently remeasured to their fair value at each balance sheet date. The resulting gain or loss is recognised in profit or loss immediately unless the derivative is designated and effective as a hedging instrument, in which event the timing of the recognition in profit or loss depends on the nature of the hedge relationship. The Company designates certain derivatives as either hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedges) or hedges of highly probable forecast transactions (cash flow hedges). This accounting treatment is discussed below under hedge accounting.

A derivative with a positive fair value is recognised as a financial asset whereas a derivative with a negative fair value is recognised as a financial liability. A derivative is presented as a non-current asset or a non-current liability if the remaining maturity of the instrument is more than 12 months and it is not expected to be realised or settled within 12 months. Other derivatives are presented as current assets or current liabilities.

Hedge accounting

The Company designates certain derivatives as hedging instruments within cash flow hedge and fair value hedge relationships. At the inception of the hedge relationship, the Company formally designates and documents the hedge relationship. The documentation includes identification of the hedging instrument, the hedged item, the nature of the risk being hedged and how the Company will assess whether the hedging relationship meets the hedge effectiveness requirements (including the analysis of sources of hedge ineffectiveness and how the hedge ratio is determined).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

2 Accounting policies (continued)**Hedge accounting continued**

A hedging relationship qualifies for hedge accounting if it meets all of the following effectiveness requirements:

- There is “an economic relationship” between the hedged item and the hedging instrument;
- The effect of credit risk does not “dominate the value changes” that result from that economic relationship; and
- The hedge ratio of the hedging relationship is the same as that resulting from the quantity of the hedged item that the Company actually hedges and the quantity of the hedging instrument that the Company actually used to hedge that quantity of hedged item.

Note 15 sets out details of the fair values of the derivative instruments used for hedging purposes.

Cash flow hedges

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

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

Fair value hedges

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognised in profit or loss immediately, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk. The change in the fair value of the hedging instrument and the change in fair value of the hedged item attributable to the hedged risk are recognised in the line related to the hedged item in profit or loss. Hedge accounting is discontinued when the Company revokes the hedging relationship, the hedging instrument expires or is sold, terminated, or exercised, or no longer qualifies for hedge accounting. The fair value adjustment to the carrying amount of the hedged item is then amortised to profit or loss over the remaining term of the hedged item.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

3 Critical accounting judgements and key sources of estimation uncertainty

In the application of the Company's accounting policies, which are described in note 2, the Directors are required to make judgements, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The following paragraphs consider the critical judgements and key sources of estimation uncertainty that may have a significant effect on the amounts recognised in the financial statements.

Critical judgements in applying the Company's accounting policies*Carrying value of property, plant and equipment*

Tangible fixed assets as disclosed in note 10 represent over 75% of the Company's total asset base. The carrying value of the Network asset of £3,336.0m (2021: £3,203.1m) is impacted by management's judgement in the following areas:

- the classification of activities undertaken on the electricity network as either repair and maintenance to be expensed or improvements to be capitalised; and
- the allocation of operational overheads and non-operational support costs to capital using a range of cost drivers.

The nature of costs to be included for capitalisation is a key judgement within the Network asset carrying value and is based on an analysis of the activities directly attributable to capital work.

Key sources of estimation uncertainty*Valuation of defined benefit obligation*

The defined benefit obligation is estimated by calculating the net present value of future cash flows from the pension schemes projected many years into the future. Assumptions of future inflation rates, life expectancy, the rate of salary and pension increases are set with reference to market and economic conditions in consultation with an independent qualified actuary. The assumptions are reviewed on an ongoing basis to reflect market and demographic changes and the actual experience of the pension schemes.

Estimated future cash flows are discounted at a rate set by reference to market yields on high quality corporate bonds. Advice is taken from the actuary to determine a discount rate which falls within the norms of wider market practice.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

3 Critical accounting judgements and key sources of estimation uncertainty (continued)**Key sources of estimation uncertainty continued**

Details of the defined benefit schemes and the assumptions used to estimate the defined benefit obligation are set out in note 19. The sensitivity analysis below indicates how changes in the significant assumptions might affect the amount of pension obligations recognised at 31 March 2022.

	Change in assumption	Impact on scheme liabilities	
		UKPN Grp 2022 £m	UKPNPS 2022 £m
Discount rate	+/- 0.50%	-7.1% to 7.6%	-13.9% to 16.3%
RPI inflation	+/- 0.50%	6.7% to -6.4%	12.0% to -11.2%
Life expectancy	+/- 3 years	15.7% to -15.4%	10.4% to -10.2%
Rate of salary increases	+/- 0.50%	0.6% to -0.6%	4.1% to -3.8%

At 31 March 2022 the Company's share of scheme liabilities was valued at £1,231.5m (2021: £1,348.0m) for the UKPN Group scheme and £174.2m (2021: £194.5m) for the UKPNPS Scheme, in accordance with FRS 102 (as disclosed in note 19).

4 Turnover

Turnover for the year ended 31 March 2022 was £493.3m (2021: £455.5m), stated net of value added tax, arising entirely in the United Kingdom and attributable to the continuing activity of electricity distribution and the invoice value of other goods and services provided. This includes an estimate of the sales value of units distributed to customers between the date of the last meter reading and the year end. It also includes the annual impact of contributions from customers towards the cost of connections to the network. This income is initially deferred to the balance sheet and then amortised to turnover over the expected useful lives of the related network assets. During the year the amount of customer contributions released to turnover was £26.4m (2021: £25.3m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

5 Operating profit

Arrived at after charging/(crediting):

	2022	2021
	£ m	£ m
Depreciation of tangible fixed assets	89.0	85.3
Amortisation of intangible assets	8.5	9.6
Operating lease rentals - land and buildings	0.1	0.1
Profit on disposal of tangible fixed assets	(0.1)	(0.2)

Auditor's remuneration

The amount payable to Deloitte LLP was £75,800 (2021: £72,800) in respect of audit services and £52,300 (2021: £50,100) in respect of non-audit services. The non-audit services are audit related assurance services which include agreed upon procedures performed on behalf of the Regulator and the review of the half year accounts.

Staff costs

The Company had no employees in the current or prior year.

6 Directors' remuneration

In 2014 the Company appointed two "Sufficiently Independent Directors" (SIDs) to comply with licence requirements. Their total remuneration for the year in return for service on the Boards of the Group's three distribution companies was as follows:

Directors' remuneration

	2022	2021
	£	£
Emoluments	100,000	100,000

Remuneration of highest paid director

	2022	2021
	£	£
Emoluments	50,000	50,000

The directors' fees presented above are paid by UK Power Networks (Operations) Limited and recharged to the distribution companies, including the Company, using the same apportionment as for other central costs. The other directors of the Board did not receive any remuneration for services to the Company in the current or prior year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

7 Finance costs (net)

	2022 £ m	2021 £ m
Interest payable and similar expenses	(58.3)	(51.7)
Less: investment income	5.7	5.4
Other finance income	1.4	2.3
	<u>(51.2)</u>	<u>(44.0)</u>

	2022 £ m	2021 £ m
Investment income		
Interest receivable on Group loans	3.8	3.5
Other interest receivable and similar income	0.1	0.1
Net interest income on defined benefit pension surplus	1.8	1.8
	<u>5.7</u>	<u>5.4</u>

	2022 £ m	2021 £ m
Interest payable and similar expenses		
Interest on bank loans	(3.2)	(3.1)
Interest on bonds	(54.8)	(51.9)
Accretion on index linked debt	(5.3)	(1.6)
Net interest on swap instruments	3.5	3.5
Interest payable on Group loans	(0.2)	(0.4)
	<u>(60.0)</u>	<u>(53.5)</u>
Finance costs capitalised	1.7	1.8
	<u>(58.3)</u>	<u>(51.7)</u>

Capitalised interest

Finance costs have been capitalised to tangible fixed assets on the basis of a capitalisation rate of 4.4% (2021: 4.2%), which is the weighted average of interest rates applicable to the Company's general borrowings during the year. The cumulative amount of interest capitalised within the cost of tangible fixed assets amounts to £19.8m (2021: £18.1m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

7 Finance costs (net) (continued)

	2022 £ m	2021 £ m
Other finance income		
Fair value losses on financial instruments		
Interest rate swaps not in hedge relationships	<u>(4.4)</u>	<u>(4.3)</u>
Amortisation of hedging adjustments		
Amortisation of fair value hedge adjustments	8.4	8.4
Reclassified to profit or loss from hedge reserve	<u>(1.5)</u>	<u>(1.5)</u>
Net gain related to derivative financial instruments	2.5	2.6
Other costs		
Net interest cost on defined benefit pension deficit	<u>(1.1)</u>	<u>(0.3)</u>
	<u>1.4</u>	<u>2.3</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

8 Taxation

Tax charged to profit or loss

	2022 £ m	2021 £ m
Current taxation		
UK corporation tax	30.3	29.3
Adjustments in respect of prior years	0.8	1.8
Total current taxation	31.1	31.1
Deferred taxation		
Origination and reversal of timing differences	11.3	7.6
Adjustments in respect of prior years	0.2	(1.6)
Effect of increase in tax rate on opening liability ¹	49.8	-
Total deferred taxation	61.3	6.0
Total tax charge	92.4	37.1

¹ Impact of increase in deferred tax rate from 19% to 25% discussed further below.

The total tax assessed for the year was higher than the standard rate of 19% (2021: 19%) applied to profit before tax. The differences are reconciled below:

	2022 £ m	2021 £ m
Profit before tax	204.5	194.4
Corporation tax at standard rate	38.9	36.9
Deferred tax expense relating to changes in tax rates or laws	52.5	-
Adjustments to current tax in respect of prior years	0.8	1.8
Adjustments to deferred tax in respect of prior years	0.2	(1.6)
Total tax charge	92.4	37.1

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

8 Taxation (continued)**Tax rate changes**

The current tax rate applied during the year was 19% (2021: 19%) and deferred tax was calculated at 25% (2021: 19%) based on the standard rate of corporation tax substantively enacted at the reporting date.

The standard rate of corporation tax is set to increase from 19% to 25% with effect from 1 April 2023, as substantively enacted in the Finance Bill 2021 on 24 May 2021. Revaluing the opening deferred tax balance at 25% has increased the tax charge in the current year by £49.8m.

9 Intangible assets**IT software and development costs**

	£ m
Cost	
At 1 April 2021	73.4
Additions	4.8
At 31 March 2022	78.2
Amortisation	
At 1 April 2021	53.0
Charge for the year	8.5
At 31 March 2022	61.5
Net book value	
At 31 March 2022	16.7
At 31 March 2021	20.4

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

10 Tangible assets

	Network £ m	Non-network land and buildings £ m	Motor vehicles £ m	Furniture, fixtures and equipment £ m	Total £ m
Cost					
At 1 April 2021	4,635.1	19.8	2.5	102.8	4,760.2
Additions	219.2	0.6	-	3.7	223.5
Disposals	(4.2)	-	(0.7)	-	(4.9)
At 31 March 2022	4,850.1	20.4	1.8	106.5	4,978.8
Depreciation					
At 1 April 2021	1,432.0	4.2	2.4	95.2	1,533.8
Charge for the year	86.2	0.3	-	2.5	89.0
Eliminated on disposal	(4.1)	-	(0.7)	-	(4.8)
At 31 March 2022	1,514.1	4.5	1.7	97.7	1,618.0
Net book value					
At 31 March 2022	3,336.0	15.9	0.1	8.8	3,360.8
At 31 March 2021	3,203.1	15.6	0.1	7.6	3,226.4

Network assets at 31 March 2022 include land with a book value of £20.5m (2021: £20.5m). The net book value of non-network land and buildings comprise freehold land at £0.3m (2021: £0.3m), freehold buildings at £14.8m (2021: £14.5m) and short leasehold buildings at £0.8m (2021: £0.8m).

Also included within Network assets as at 31 March 2022, are assets in the course of construction of £36.2m (2021: £41.7m). Approximately £20.6m of the prior year assets under construction were completed during the current year (2021: £11.8m).

The cost of connecting customers to the network is included within network assets above. Capital contributions received from customers as payment for connections work, are credited to the balance sheet as deferred income and released to profit or loss over the expected useful life of the related assets. During the year income of £26.4m (2021: £25.3m) was recognised within turnover in respect of customer contributions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

11 Debtors

	Note	2022 £ m	2021 £ m
Amounts falling due within one year:			
Trade debtors		43.7	54.1
Amounts owed by Group undertakings		45.9	141.3
Other debtors		0.2	0.1
Prepayments		2.2	1.4
Corporation tax receivable		0.3	2.6
		<u>92.3</u>	<u>199.5</u>
Amounts falling due after more than one year:			
Amounts owed by Group undertakings		134.4	-
Derivative financial assets	15	81.7	162.0
Surplus in the UKPN Group defined benefit pension scheme	19	239.8	63.3
		<u>455.9</u>	<u>225.3</u>
		<u>548.2</u>	<u>424.8</u>

Amounts owed by Group undertakings due within one year comprise interest free trade balances which are repayable on demand and a loan to Eastern Power Networks plc of £45.0m carrying interest at 0.87%.

Amounts owed by Group undertakings due after more than one year comprise a loan to the parent company UK Power Networks Holdings Ltd of £134.0m carrying interest at 2.56% and maturing in June 2026.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

12 Creditors

	Note	2022 £ m	2021 £ m
Amounts falling due within one year:			
Borrowings	13	-	79.0
Trade creditors		0.1	-
Amounts owed to Group undertakings		36.4	33.9
Other taxation and social security		26.6	23.8
Other creditors		3.8	2.0
Accruals		59.8	53.9
Deferred income		108.4	82.2
		235.1	274.8
Amounts falling due after more than one year:			
Borrowings	13	1,499.6	1,207.7
Deferred income		694.9	666.7
Derivative financial liabilities	15	47.1	122.9
		2,241.6	1,997.3

Amounts owed to Group undertakings are interest free trade balances which are repayable on demand.

Deferred income due after more than one year includes contributions received from customers as payment for connections work, the cost of which is capitalised to network assets. This income is released to turnover over the expected useful lives of the related network assets. Deferred income falling due within one year includes £27.9m (2021: £26.5m) relating to customer contributions, expected to be released to turnover within one year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

13 Borrowings

	2022 £ m	2021 £ m
Amounts falling due within one year		
Amounts owed to Group undertakings	-	79.0
	-	79.0
Amounts falling due after more than one year		
£10m 2.335% EIB loan due October 2025	10.0	10.0
£105m 1.614% EIB loan due October 2028	105.0	105.0
£30m 2.155% EIB loan due May 2029	30.0	30.0
£20m 2.224% EIB loan due February 2030	20.0	20.0
£50m 3.053% Index Linked Bond due June 2023	85.8	82.7
£25m 0.25% Index Linked Bond due February 2025	30.9	28.6
£270m 5.5% Bond due June 2026	269.4	269.2
£300m 5.625% Bond due September 2030	317.2	319.2
£300m 6.375% Bond due November 2031	298.5	298.4
£300m 1.75% Bond due September 2034	296.7	-
Adjustments for fair value hedge relationships	36.1	44.6
	1,499.6	1,207.7
	1,499.6	1,286.7

Borrowings are stated net of unamortised issue costs of £5.4m (2021: £2.5m) and include an unamortised net premium on the 5.625% bond of £17.2m (2021: £19.2m) and accretion on the index linked bonds of £41.7m (2021: £36.4m). These balances together with the interest expense are allocated to the profit and loss account over the term of the debt.

The fair value adjustments of £36.1m (2021: £44.6m) relate to discontinued fair value hedge relationships and are amortising to profit or loss over the remaining term of the previously hedged debt. The amortisation for the year resulted in a gain of £8.4m (2021: £8.4m) to the profit and loss account.

No security has been given over the assets of the Company in respect of external debt or amounts owed to Group undertakings.

Borrowing facilities

The Company has access to an undrawn credit facility of £145.0m until April 2025.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

14 Financial instruments

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

	Note	2022 £ m	2021 £ m
Financial assets			
Measured at fair value through profit or loss			
Derivative financial assets	15	81.7	162.0
Measured at amortised cost			
Loans receivable from Group undertakings	11	179.4	140.4
Trade and other debtors excluding prepayments and accrued income	11	44.8	55.1
		305.9	357.5
	Note	2022 £ m	2021 £ m
Financial liabilities			
Measured at fair value through profit or loss			
Derivative financial liabilities	15	(47.1)	(122.9)
Measured at amortised cost			
* Bonds and loans payable	13	(1,499.6)	(1,286.7)
Trade and other payables excluding taxation and social security and accruals and deferred income	12	(40.3)	(35.9)
		(1,587.0)	(1,445.5)

* The carrying value of bonds and loans payable includes fair value adjustments of £36.1m (2021: £44.6m) relating to discontinued hedge relationships which are amortised to profit or loss over the term of the previously hedged debt.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

14 Financial instruments (continued)

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

	2022	2021
	£ m	£ m
Derivative financial assets measured at fair value through profit or loss		
Interest rate swaps not in hedge relationships		
- Net interest receivable	25.4	23.5
- Fair value losses	(79.7)	(41.4)
Financial assets measured at amortised cost		
- Interest receivable on Group loans	<u>3.8</u>	<u>3.5</u>
	<u>(50.5)</u>	<u>(14.4)</u>

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

	2022	2021
	£ m	£ m
Derivative financial liabilities measured at fair value through profit or loss		
Interest rate swaps not in hedge relationships		
- Net interest payable	(21.9)	(20.0)
- Fair value gains	75.3	37.1
Financial liabilities measured at amortised cost		
Interest payable on bonds and bank loans	(58.0)	(55.0)
Accretion payable on bonds and bank loans	(5.3)	(1.6)
Interest payable on Group loans	<u>(0.2)</u>	<u>(0.4)</u>
	<u>(10.1)</u>	<u>(39.9)</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

15 Derivative financial instruments

	2022 £ m	2021 £ m
Derivative financial assets		
Amounts falling due after more than one year		
Interest rate swaps not designated in hedging relationships	81.7	162.0
Derivative financial liabilities		
Amounts falling due after more than one year		
Interest rate swaps not designated in hedging relationships	(47.1)	(122.9)
	<u>34.6</u>	<u>39.1</u>

Under interest rate swap contracts, the Company agrees to exchange the difference between fixed and floating rate interest calculated on agreed notional principal amounts.

Interest payable and receivable on the swaps is settled on a net basis, annually or semi-annually.

The fair value of the swap instruments at the reporting date is determined by discounting the future cash flows implicit in the swaps. The discount rate is derived from forward interest rate curves adjusted for the Company's own credit risk in respect of swap liabilities and counterparty credit risk in respect of swap assets.

As a consequence of Interest Rate Benchmark Reforms the Group has replaced the 6 month London Interbank Offered Rate ("LIBOR") with the alternative Sterling Overnight Interbank Average ("SONIA") rate effective from 1 January 2022. The Group signed up to the Fallback Protocol of the International swaps and Derivatives Association ("ISDA") in 2021 to enable the transition. Under the Protocol, benchmark rates "fall back" to a new benchmark in contracts that are governed by Master ISDA agreements, provided that the counterparties have both agreed to adhere to the protocol. The 6 month LIBOR benchmark in the Company's swap contracts was replaced by SONIA + CAS (Credit Adjustment Spread of 27.66bps). At 31 March 2022 fair values were calculated using discount rates derived from the SONIA Overnight Index Swap ("OIS") curve instead of the LIBOR forward curve.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

15 Derivative financial instruments (continued)

The following tables and discussion detail the notional principal amounts, the fair values and remaining terms of swap contracts as at the reporting date.

Non hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2022 %	2021 %	2022 £ m	2021 £ m	2022 £ m	2021 £ m
Maturity of outstanding contracts						
Receive fixed / pay floating						
2 to 5 years	5.5%	-	270.0	-	16.5	-
5 years plus	5.4%	5.4%	575.0	845.0	65.2	162.0
			<u>845.0</u>	<u>845.0</u>	<u>81.7</u>	<u>162.0</u>
Receive floating / pay fixed						
2 to 5 years	2.4%	-	270.0	-	(2.0)	-
5 years plus	3.0%	2.8%	575.0	845.0	(45.1)	(122.9)
			<u>845.0</u>	<u>845.0</u>	<u>(47.1)</u>	<u>(122.9)</u>

The Company is party to a number of interest rate swap contracts not designated in hedge accounting relationships.

Receive fixed/pay floating

The floating rate payable on fixed to floating rate contracts is SONIA plus a margin of up to 3.6% (replacing six month LIBOR plus a margin of up to 3.3%, which was phased out in December 2021). Maturities range from 2026 to 2031. In addition to interest receivable on these instruments, fair value losses of £79.7m (2021: losses of £41.4m) were recognised in profit or loss during the year.

Receive floating/pay fixed

The Company has re-fixed the floating rates achieved by the fixed to floating rate contracts to align the interest rate profile of the Company more closely to regulatory allowances. The floating rate receivable is SONIA plus a margin of 0.3% (replacing six month LIBOR which was phased out in December 2021). In addition to interest payable on these instruments, fair value gains of £75.3m (2021: gains of £37.1m) were recognised in profit or loss during the year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

16 Provisions for liabilities

	2022	2021
	£ m	£ m
Provision for deferred tax	261.9	156.2
Other provisions	8.2	8.2
	270.1	164.4

Defined benefit retirement obligations

Deficit in the UKPNPS defined benefit pension scheme	19	25.0	59.0
		295.1	223.4

Movements in the deferred tax provisions and other provisions are shown below:

	Deferred tax £ m	Other provisions £ m	Total £ m
At 1 April 2021	156.2	8.2	164.4
Charged to profit or loss	61.3	-	61.3
Charged to other comprehensive income	44.4	-	44.4
At 31 March 2022	261.9	8.2	270.1

Explanation of provisions

Other provisions comprise legal and constructive obligations which are expected to become payable within the next two years.

Analysis of deferred tax

	2022	2021
	£ m	£ m
Accelerated capital allowances	208.7	155.5
Deferred tax relating to defined benefit pension schemes	53.7	0.8
Other timing differences	(0.5)	(0.1)
Net deferred tax liability	261.9	156.2

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

17 Called up share capital and reserves

	2022	2021
	£ m	£ m
145,050,000 ordinary shares at £1.00 each	<u>145.1</u>	<u>145.1</u>

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

Reserves

The profit and loss account represents cumulative profits or losses, including actuarial gains and losses on remeasurement of the net defined pension liability, net of dividends paid.

The hedging reserve represents the cumulative portion of gains and losses on hedging instruments deemed effective in hedging variable interest rate risk of recognised financial instruments or foreign exchange risk in firm commitments or highly probable forecast transactions. Amounts accumulated in this reserve are reclassified to profit or loss in the periods in which the hedged item affects profit or loss or when the hedging relationship ends.

18 Commitments and contingencies

Through the ordinary course of business the Company is party to various litigation, claims and investigations. The Directors do not expect the ultimate resolution of any these proceedings to have a material adverse effect on the Company's results of operations, cash flows or financial position.

Capital commitments

The total amount contracted for but not provided in the financial statements was £22.3m (2021: £21.4m).

Lease commitments

Total future minimum lease payments under non-cancellable operating leases are as follows:

	2022	2021
	£ m	£ m
Land and buildings		
- within one year	0.1	0.1
- between one and five years	0.4	0.4
- after five years	<u>1.5</u>	<u>1.5</u>
	<u>2.0</u>	<u>2.0</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments

Defined benefit pension schemes

The Company contributes to two funded defined benefit pension schemes operated by the Group:

The UK Power Networks Group of the ESPS (the UKPN Group) scheme

This scheme is an independent section of the Electricity Supply Pension Scheme “ESPS” which was formed in 1990 following privatisation of the Electricity Industry. The UKPN Group of the ESPS has been closed to new members since 1994.

The UK Power Networks Pension Scheme (UKPNPS)

The UKPNPS was formed from a number of legacy arrangements with membership dating back to 1994. It has been closed to new members since 2011.

Funding levels are monitored annually and a funding schedule is formally agreed between the Group and the trustees every three years based on the most recent triennial actuarial valuation. The latest funding schedule, based on the triennial valuation as at 31 March 2019, became effective from 25 June 2020. This set revised employer contribution rates with effect from 1 January 2021 and these contribution rates are considered sufficient to eliminate funding deficits over the next four years.

A valuation under FRS 102 at the balance sheet date was provided by actuaries using rolled forward member data from the 31 March 2019 triennial valuation and reflecting updated financial and demographic assumptions. The defined benefit scheme assets and liabilities are assigned to participating entities using an allocation methodology based on employment records and attribution portions agreed with the industry regulator Ofgem.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments (continued)

The key financial assumptions (% per annum) used to calculate scheme liabilities under FRS 102 were:

	2022 %	2021 %
UKPN Group key financial assumptions		
Discount rate	2.8	2.1
Future salary increases	3.9	3.5
RPI inflation	3.4	3.0
CPI inflation	3.0	2.6
Pension increases in deferment	3.4	3.0
Pension increases in payment		
- pensions in excess of GMP	3.4	3.0
- post-88 GMP	2.4	2.2

	2022 %	2021 %
UKPNPS key financial assumptions		
Discount rate	2.7	2.1
Future salary increases	3.5	3.3
RPI inflation	3.0	2.8
CPI inflation	2.4	2.3
Pension increases in deferment		
- CPI up to 5% per annum	2.4	2.3
- CPI up to 2.5% per annum	2.4	2.3
Pension increases in payment		
- RPI up to 5% per annum	2.9	2.7
- RPI up to 2.5% per annum	2.1	2.0
- post-88 GMP	2.0	2.0

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments (continued)

The following life expectancies have been assumed in the calculation of scheme liabilities:

	2022 Years	2021 Years
UKPN Group life expectancy assumptions		
Life expectancy for male currently aged 60	26	26
Life expectancy for female currently aged 60	29	29
Life expectancy at 60 for male currently aged 40	28	28
Life expectancy at 60 for female currently aged 40	31	30

	2022 Years	2021 Years
UKPNPS life expectancy assumptions		
Life expectancy for male currently aged 65	23	23
Life expectancy for female currently aged 65	25	25
Life expectancy at 65 for male currently aged 45	24	24
Life expectancy at 65 for female currently aged 45	26	26

The amounts recognised in the balance sheet in respect of the defined benefit schemes are as follows:

	UKPN Grp 2022 £ m	UKPNPS 2022 £ m	Total 2022 £ m	Total 2021 £ m
Fair value of scheme assets	1,471.3	149.2	1,620.5	1,546.8
Present value of defined benefit obligation	(1,231.5)	(174.2)	(1,405.7)	(1,542.5)
Defined benefit pension scheme surplus/(deficit)	239.8	(25.0)	214.8	4.3

In respect of the UKPN Group scheme, the Directors are of the view that the surplus is recoverable on the basis that a right of refund exists under the scheme rules, assuming the gradual settlement of the liabilities over time until all the members have left the scheme. Based on this view, the surplus is presented as a non-current asset within Debtors (note 11).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments (continued)

Amounts recognised in the profit and loss account in respect of the defined benefit schemes were as follows:

	UKPN Grp 2022 £ m	UKPNPS 2022 £ m	Total 2022 £ m	Total 2021 £ m
Current service cost	(5.5)	(8.2)	(13.7)	(9.9)
Past service cost	(0.5)	-	(0.5)	(0.3)
Past service credit related to enhanced early retirement offer	0.5	0.3	0.8	-
Net interest income/(cost)	1.8	(1.1)	0.7	1.5
	(3.7)	(9.0)	(12.7)	(8.7)
Recognised in other comprehensive income	148.2	29.9	178.1	(58.9)
	144.5	20.9	165.4	(67.6)

Of the charge for the year a net expense of £13.4m (2021: £10.2m) has been included in distribution costs and a net income of £0.7m (2021: £1.5m expense) included within net finance costs.

In June 2021 the Group made a written, time-bound offer to eligible employees that they would be granted enhanced commutation terms, enhanced early retirement terms and a bridging pension option if they applied to the company to retire on a date no later than 31 March 2022 and the employer granted the application. Some changes to the rules of the schemes were required to allow the bridging pension option to be offered. The take up of the offer has reduced scheme liabilities calculated under FRS 102 by £0.5m in the UKPN Group scheme and £0.3m in the UKPNPS scheme. This has been recognised through profit or loss as a past service credit.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments (continued)

Movements in the present value of defined benefit obligations in the year were as follows:

	UKPN Grp 2022 £ m	UKPNPS 2022 £ m	Total 2022 £ m	Total 2021 £ m
At 1 April	(1,348.0)	(194.5)	(1,542.5)	(1,323.5)
Current service cost	(5.5)	(8.2)	(13.7)	(9.9)
Past service cost	(0.5)	-	(0.5)	(0.3)
Past service credit related to enhanced early retirement offer	0.5	0.3	0.8	-
Interest cost	(27.0)	(4.0)	(31.0)	(33.3)
Actuarial gains/(losses)	86.4	32.2	118.6	(234.9)
Benefits paid	62.6	-	62.6	59.4
At 31 March	(1,231.5)	(174.2)	(1,405.7)	(1,542.5)

The actuarial gain (2021: loss) include a net transfer in of scheme liabilities amounting to £2.1m (2021: £5.3m transfer in) to align the allocation of scheme liabilities across the Group to the attribution portions agreed with Ofgem.

Movements in the fair value of scheme assets in the year were as follows:

	UKPN Grp 2022 £ m	UKPNPS 2022 £ m	Total 2022 £ m	Total 2021 £ m
At 1 April	1,411.3	135.5	1,546.8	1,357.1
Interest income	28.8	2.9	31.7	34.8
Return on plan assets (excluding amounts included in net interest cost)	61.8	(2.3)	59.5	176.0
Contributions by employer	5.5	6.6	12.1	9.6
Deficit payments	26.5	6.5	33.0	28.7
Benefits paid	(62.6)	-	(62.6)	(59.4)
At 31 March	1,471.3	149.2	1,620.5	1,546.8

The return on plan assets (excluding amounts included in net interest cost) includes a net transfer in of scheme assets amounting to £1.9m (2021: £6.0m transfer in) to align the allocation of scheme assets across the Group to the attribution portions agreed with Ofgem.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

19 Pension commitments (continued)

The fair value of scheme assets is analysed as follows:

	UKPN Grp	UKPNPS	Total	Total
	2022	2022	2022	2021
	£ m	£ m	£ m	£ m
Equities	120.8	58.1	178.9	389.3
Liability driven investments	1,068.9	49.7	1,118.6	618.7
Credit funds	88.8	15.5	104.3	282.2
Hedge funds	-	9.5	9.5	96.6
Alternatives ¹	178.0	15.0	193.0	105.7
Cash and net current assets	14.8	1.4	16.2	54.3
	1,471.3	149.2	1,620.5	1,546.8

¹ Investment vehicles investing in property, real estate debt, private equity, private debt and infrastructure.

20 Notes to the cash flow statement**Reconciliation of operating profit to cash flows**

	2022	2021
	£ m	£ m
Operating profit	255.7	238.4
Adjustment for		
Depreciation and amortisation of assets	97.5	94.9
Customer contributions recognised in turnover	(26.4)	(25.3)
Profit on disposal of tangible fixed assets	(0.1)	(0.2)
Operating cash flow before movement in working capital	326.7	307.8
Increase in debtors	(29.7)	(9.4)
Increase in creditors	35.3	7.3
Customer contributions received	56.0	50.8
Decrease in provisions	-	(1.4)
Pension deficit repair payments	(33.0)	(28.7)
Pension adjustments	1.3	0.7
Cash generated from operations	356.6	327.1

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

20 Notes to the cash flow statement (continued)

Reconciliation of net debt

	At 1 April 2021 £ m	Cash flows £ m	Fair value and exchange rate changes £ m	Other non-cash changes £ m	At 31 March 2022 £ m
Cash at bank and in hand	1.4	76.5	-	-	77.9
Cash equivalents	-	88.0	-	-	88.0
	<u>1.4</u>	<u>164.5</u>	<u>-</u>	<u>-</u>	<u>165.9</u>
Debt due within one year	(79.0)	79.0	-	-	-
Debt due after more than one year	<u>(1,207.7)</u>	<u>(296.6)</u>	<u>8.5</u>	<u>(3.8)</u>	<u>(1,499.6)</u>
	<u>(1,286.7)</u>	<u>(217.6)</u>	<u>8.5</u>	<u>(3.8)</u>	<u>(1,499.6)</u>
	<u>(1,285.3)</u>	<u>(53.1)</u>	<u>8.5</u>	<u>(3.8)</u>	<u>(1,333.7)</u>

21 Related party transactions

The Company has taken an exemption under FRS 102 (section 33 2.2) not to disclose transactions with other wholly owned members of the Group. The Company qualifies for this exemption on the basis that it is a wholly owned subsidiary of a parent which prepares publicly available consolidated financial statements intended to give a true and fair view of the financial position and results of the group, and the Company is included within the consolidation.

22 Parent and ultimate parent undertaking

The Company's immediate parent is UK Power Networks Holdings Limited, incorporated in the United Kingdom and registered in England and Wales at the following address:

Newington House
237 Southwark Bridge Road
London
SE1 6NP

UK Power Networks Holdings Limited is the parent of both the smallest and largest Group in which the Company's financial statements are consolidated. Copies of the financial statements of UK Power Networks Holdings Limited may be obtained from the Company Secretary at Energy House, Carrier Business Park, Hazelwick Avenue, Three Bridges, Crawley, West Sussex, RH10 1EX.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2022

22 Parent and ultimate parent undertaking (continued)

UK Power Networks Holdings Limited is owned by a consortium comprising:

- **CK Infrastructure Holdings Limited** (40% shareholding) incorporated in Bermuda;
- **Power Assets Holdings Limited** (40% shareholding) incorporated in Hong Kong; and
- **CK Asset Holdings Limited** (20% shareholding) incorporated in the Cayman Islands.

The 20% shareholding now held by CK Asset Holdings Limited was previously owned by Li Ka-Shing Foundation Limited incorporated in Hong Kong. The transfer of ownership took place on 21 May 2021.

In the Directors' opinion UK Power Networks Holdings Limited has no single controlling party as it is jointly controlled by the consortium.