

Registration number: 3929195

London Power Networks plc

Annual Report and Financial Statements

for the Year Ended 31 March 2023

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STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

About us:

Who we are and what we do

London Power Networks plc (the "Company") is a wholly owned subsidiary of the UK Power Networks Group (the "Group"). As an electricity distribution network operator ("DNO"), we ensure that the electricity infrastructure is in place to deliver electricity to over 2.4 million homes and businesses. The Company is responsible for operating and maintaining the network, the safe, reliable and efficient electricity supply to existing customers and the timely, cost-effective connections to new ones.

The Company operates within a regulatory framework under licence from Ofgem (Office of Gas and Electricity Markets). Ofgem works with government, industry and consumer groups to establish a regulatory framework to promote a sustainable electricity network which delivers value for customers.

Ofgem sets the price control which determines what the Company can charge its customers and the level of "allowed" revenue. In addition, Ofgem establishes incentives for outperformance and innovation relating to outputs, including safety performance, network reliability, the environment and efficiency.

In addition to allowed revenues, the Company collects income to cover the cost of connecting new customers to the network.

How we charge customers

The prices we charge our customers are set by Ofgem under the regulatory framework. Customers are charged through their electricity suppliers. We recognise the importance of delivering value for customers and seek to deliver the lowest possible prices by driving efficiency and innovation. We are continuously balancing the competing demands of value for money, the need to innovate, efficiency, safety and the overall resilience of our network.

Regulatory Framework

The current regulatory framework is known as the RIIO model, where Revenue = Incentives + Innovation + 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 the regulatory expenditure which enters the Regulatory Asset Value ("RAV"), pass-through costs, incentives, tax, and pensions. The Company has the opportunity to outperform the allowed revenue either by delivering its agreed outputs at below agreed allowances or through performance against incentive mechanisms.

The RIIO-ED1 framework ran from 1 April 2015 until 31 March 2023. Ofgem set the framework so that the fourteen individual network companies in Great Britain (including UK Power Networks' three individual DNOs) provide a safe and reliable service, value for money, maximise performance, operate efficiently, innovate and maintain the resilience of their networks for current and future customers.

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Regulatory frame work continued

The RIIO-ED1 framework identified 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. 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:** There is an 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.

The Group's business plan for RIIO-ED1 lays out the DNOs' commitments to deliver measurable outputs against specific targets. The Group reports on the progress in achieving these targets in an annual RIIO-ED1 Business Plan Commitment report which is available on the Group's website at:

www.ukpowernetworks.co.uk/about-us/business-plan-2015-2023

At the end of RIIO-ED1, 31 March 2023, the Group had met over 97% of these commitments.

From 1 April 2023 a new regulatory price control, RIIO-ED2 commenced, more details on RIIO-ED2 can be found in the Operating review section. The Group's RIIO-ED2 business plan is available on the Group's website at:

<https://ed2.ukpowernetworks.co.uk>

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Our vision and strategy

The Company's vision and values is set out by the Group and guides the decisions taken by the Company. UK Power Networks' vision is to be consistently the best performing DNO Group within an agreed set of values. We will achieve our vision by delivering our business targets and, where appropriate, setting targets which go beyond our sector. Performance is underpinned by strong governance leadership and our values.

The four pillars of the Group's vision are to be:

- an employer of choice;
- a respected and trusted corporate citizen;
- sustainably cost efficient; and
- to enable the net zero transition for all.

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 28 and 29.

Sustainability is embedded through our business. The Company has an important contribution to make in supporting the UK's ambition to reduce carbon emissions to net zero by 2050, ("net zero") both in connecting renewable energy and facilitating the uptake of low carbon technologies. Our ambition is to be the most environmentally and socially responsible DNO and to facilitate the transition to a net zero carbon future. This is discussed on pages 19 to 24.

Operating review

Overview

The Company performed well during the year ended 31 March 2023 which has been a year of significant uncertainty for energy markets in the UK. The Company maintained its industry leading position in both Customer Service and Stakeholder Engagement regulatory measures.

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Price control

The RIIO-ED1 price control finished on 31 March 2023. The new price control, RIIO-ED2, operates from 1 April 2023 to 31 March 2028 and has been agreed following final determination and after extensive review and consultation with Ofgem.

The £5 billion business plan submitted by the Group was accepted with minimal changes by Ofgem and the Group was pleased to have achieved the smallest reduction in total expenditure across the sector. The Group also received a business plan incentive award of approximately £25 million, substantially above the rest of the sector combined. Ofgem described UK Power Networks as the “frontier performing company” and the business plan incentive award reflects this.

The RIIO-ED2 price control represents an increase of expenditure of around 25% compared to RIIO-ED1, with further potential increases relating to uncertainty mechanisms. Delivering on this commitment to invest in the electricity network and supporting the transition to net zero will be a key challenge for the Company going forward. The Company will need to make additional investment to support the rollout of electric vehicles, heat pumps and renewable generation.

The new price control establishes a more challenging regulatory framework in respect of incentive targets and the allowed rate of return which has reduced relative to RIIO-ED2, reflecting wider economic factors. This will make financial outperformance more challenging for the Company in the future. Importantly however, the price review provides certainty in the revenue the Company will earn for the next five years.

Market update

The UK Energy sector continued to experience volatility during the year, with elevated wholesale energy prices and an inflationary environment, exacerbated by the war in Ukraine.

Within the regulatory framework the Company’s revenue and RAV are both linked to inflation indices. Inflation growth has a positive overall impact on the Company in the form of increased income in future periods and growth in the RAV, which benefits Debt to RAV gearing levels. However, in the short-term and during the year ended 31 March 2023 increased inflation has negatively impacted profitability and cash flow due to higher accretion charges on index linked instruments and pressures on operating costs, including labour and the cost of goods. The Company has continued to deliver on its operational and financial targets by focusing on efficiencies and cost control measures.

The increase in wholesale energy prices since the end of 2021 has resulted in a number of energy suppliers going out of business. A financial impact of energy supplier failures is that all DNOs have been required to pay claims under the supplier of last resort (“SOLR”) scheme managed by Ofgem. It was agreed with Ofgem that the majority of the SOLR claims, above a materiality threshold, would be recovered by tariff increases during the same period. These SOLR claims therefore do not have a significant financial impact, with payment of related claims offset by higher in year revenues. In the profit and loss statement the revenues are presented in turnover and the costs in cost of sales. For the year ended 31 March 2023, £78.3m of material SOLR claims were incurred and an equivalent amount of revenue recognised. At the balance sheet date, the Company had SOLR claims of £21.4m yet to be accrued which will become payable and recovered via tariff increases during the year ending 31 March 2024. In addition, cost of sales includes SOLR claims of £1.7m that fall below the materiality threshold defined by Ofgem and therefore are only recoverable through revenues in two years’ time.

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Operational 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 and customer service.

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 undertaken 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 zero LTIs in the year ended 31 March 2023 which is an improvement on the 2 LTIs recorded in the prior year. This represents an industry leading safety performance in respect of LTI performance and the best among the DNOs.

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

The Company has improved its performance in both measures compared to the prior year and remains ahead of targets set by Ofgem.

	Year ended 31 March 2023	Year ended 31 March 2022
* Customer Minutes Lost per customer (CMLs)	12.2	13.9
* Customer Interruptions per 100 customers (CIs)	11.7	15.0

* 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.

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Customer satisfaction

The Regulator regards customer satisfaction as one of the most important measures of performance. The customer satisfaction survey across all of the DNOs captures customers' experiences of the services provided 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 improved from 93% in the prior year to 94% in the current year, remaining well above the industry-wide target of 82% and ranking third out of the fourteen distribution networks in Great Britain.

Financial review and key performance indicators ("KPIs")

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

	Year ended 31 March 2023	Year ended 31 March 2022
Financial key performance indicators		
Turnover (£m)	624.0	523.6
EBITDA (£m)	421.7	385.8
Profit after tax (£m)	188.4	106.0
Gross capital expenditure on tangible assets (£m)	260.8	271.3
Capital expenditure on tangible assets net of customer contributions received (£m)	175.9	189.4

Turnover

Turnover increased from £523.6m in the prior year to £624.0m, this is primarily due to the additional SOLR related revenue of £78.3m. Excluding SOLR revenues, turnover increased by £22.1m, primarily due to tariff and inflation increases under the regulatory price control.

EBITDA/ Operating profit

Earnings before interest, tax, depreciation and amortisation ("EBITDA") increased by £35.9m from £385.8m to £421.7m. This was broadly consistent with the increase in revenues excluding the impact of material SOLR claims, which were matched by a corresponding increase to cost of sales.

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

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	Year ended 31 March 2023	Year ended 31 March 2022
Operating profit (£m)	307.4	274.5
Depreciation of tangible fixed assets (£m)	107.4	102.8
Amortisation of intangible assets (£m)	6.9	8.5
EBITDA (£m)	421.7	385.8

Profit after tax

Profit after tax has increased by £82.4m from £106.0m to £188.4m. This is due in part to the £35.9m increase in EBITDA and to a reduction in tax charge of £51.3m, as the prior year included a one-off deferred tax charge of £59.0m following the enactment of the corporation tax rate increase from 19% to 25%.

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 2023	Year ended 31 March 2022
Gross capital expenditure on tangible assets (£m)	260.8	271.3
Less: Customer contributions received in the year (£m)	(84.9)	(81.9)
Capital expenditure net of customer contributions (£m)	175.9	189.4

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.

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RAV gearing

The proportion of debt measured against the RAV of the business reflects 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 and is monitored on a regular basis. The RAV gearing ratio remains within pension and bank covenant targets improving from 61% at 31 March 2022 to 55% at 31 March 2023. The improvement reflects the growth in the RAV, primarily due to indexation resulting from higher RPI and continued investment.

		As at 31 March 2023	As at 31 March 2022
Regulatory asset value (RAV) (£m)	1	2,248.6	2,000.5
RAV gearing	2	55%	61%

1 RAV is the Regulatory Asset Value of the business. The 31 March 2023 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.

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

Financial risk management objectives and policies

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

At 31 March 2023 the Company had net debt of £1,213.5m (2022: £1,218.9m) comprising bonds of £848.9m (2022: £1,069.0m), loans from the European Investment Bank (EIB) of £155.0m (2022: £155.0m), and Group borrowings of £216.5m (2022: £Nil), offset by cash and cash equivalents of £6.9m (2022: £5.1m). 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.

Interest rate risk

The interest rate exposure on the Company’s debt is partially hedged in order to provide the desired mix of fixed, floating and index linked 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

Credit and liquidity risk continued

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 RAV 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 2023 amounts to a surplus of £206.8m (2022: surplus of £284.9m) in the UKPN Group scheme and a deficit of £20.5m (2022: deficit of £26.4m) in the UKPNPS scheme. The sensitivity of the valuation to changes in discount rate is shown on page 66 and further detail on the assumptions used to estimate the defined benefit obligation is provided in note 19 to the financial statements.

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 Street Works 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 2023 the Company's net deferred tax liability was £302.8m (2022: £311.4m).

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.

From 1 April 2023 the Company will enter the new RIIO-ED2 price control. The new price control establishes a challenging regulatory framework in respect of incentive targets and allowable rate of return. This will make financial outperformance more challenging for the Company in the future which could impact financial performance.

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Factors likely to affect future development and performance continued

The Company will need to make significant additional investment under RIIO-ED2 to support the transition to net zero. The Company could be impacted by conditions in the external market, including global trade, supply chain lead times and the availability of skilled workers or contractors which may impact the Company's ability to achieve its targets. Any increases in inflation could negatively impact costs and cash flow in the short-term, however, the Company benefits from increased future revenues which are linked to inflation.

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 outcome of the new RIIO-ED2 price control which applies from 1 April 2023.
- £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 net current liability position of £7.3m and the financial covenants applicable to the Company's financing facilities.
- The impact of a higher inflationary environment, which negatively impacts costs but increases future revenues via higher tariffs.
- The Company has a successful track record of raising finance, supported by investment grade credit ratings.

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, lower than expected revenues, which could be attributable to the impacts of weather or other events on consumption and a reduction in connections income.

Given the significant amount of liquidity available to the Company at 31 March 2023, the Company'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.

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Risk identification and management

There are a variety of mechanisms in place to manage the Company's risks. The Board has overall responsibility for risk management and determines the Group's risk strategy, assesses and approves risk appetite and monitors risk in line with strategic priorities. The objective of the risk management process is to manage risk appropriately and support strategic goals. It is designed to manage rather than eliminate risk and provide reasonable not absolute assurance.

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 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.

An integrated risk management process is utilised to manage risk exposure. This includes a Risk and Control Policy and a framework to ensure that risk management is an integral part of good management practice and firmly linked with the ability to achieve business objectives. The framework and policy are supported by procedures that assess the risk and control environment, the internal control framework and business continuity management.

Key risks are defined as those which could result in very serious injuries (including fatalities) or have a significant potential to damage the assets or profitability of the Group, and which require attention by executive management. Risk assessment scores are determined based on impact, probability and control effectiveness and are used to classify risks as extreme, high, medium, low or negligible.

Risk registers are maintained for each key business area and are regularly reviewed and monitored. Potential new and emerging risks, including those related to climate change, are identified and assessed. A summary of key Group risks is reviewed several times a year by Executive Management and reported to the Risk Management and Compliance Committee and Board.

The Group's system of risk management and internal control is described in more detail on pages 34 to 36.

Principal risks and uncertainties

The Company's principal risks and uncertainties are managed at a Group level, and a summary of actions by the Group to mitigate them, are set out below. These risks are broadly in line with the prior year, other than the introduction of a new risk relating to supply chain capacity and long-lead times. These risks represent those considered material to the Group, there may be other risks, unknown or currently considered immaterial which could become material.

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Risk	Mitigation
<p>Health and safety incidents</p>	
<p>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.</p> <p>Any such incident could lead to a prosecution or a fine and have an adverse impact on the reputation of the Company.</p>	<p>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 the Group. Safety measures include:</p> <ul style="list-style-type: none"> • A health and safety strategy and action plan which sets out the policies and procedures of the Group and includes 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 with 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).
<p>Inadequate response to major adverse events</p>	
<p>Adverse events include risks relating to 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.</p>	<p>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:</p> <ul style="list-style-type: none"> • 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).

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Risk	Mitigation
<p>An inadequate response to a major event could result in a failure in the Company's performance (e.g. power outages at key facilities, safety incidents, poor customer service and/or breach of licence conditions) resulting in significant financial and reputational damage.</p>	<ul style="list-style-type: none"> • 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. • 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.

Failure of network assets

<p>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.</p>	<ul style="list-style-type: none"> • 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 Company 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).
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Risk	Mitigation
<p>Network unable to meet accelerated demand</p> <p>The Company has a key role in facilitating the transition to net zero.</p> <p>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.</p>	<ul style="list-style-type: none"> • An ongoing research and engagement programme to understand the needs, expectations and low carbon ambitions of customers and other stakeholders. The objective is to improve services and solutions for customers and deliver 9/10 customer satisfaction. • Deliver timely network capacity upgrades based on regular forecasts of the impacts on the network from electric vehicles, heat pumps, renewable generation and battery storage. • Ongoing monitoring of the capacity of the network through physical monitors and using advanced analytical capabilities. • Supporting local authorities to develop regional investment plans for the electricity network. • Strong co-ordination with the Electricity System Operator (“ESO”) to manage issues across the distribution and transmission boundary. • 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.
<p>Regulatory compliance risk</p> <p>The Company is subject to extensive regulatory and legislative obligations. These include obligations set by the regulator (Ofgem) as well as statutory requirements, including taxation.</p> <p>Compliance obligations may be impacted by the prevailing political and economic climate.</p>	<ul style="list-style-type: none"> • The Group’s Governance and control framework sets out responsibilities and accountabilities. The Board reviews key compliance risks supported by the Group’s risk management framework and internal audit. • The Group operates a Regulatory Compliance programme to understand regulatory risks and obligations and implement controls and processes to meet compliance requirements. These are monitored on a monthly basis. • The Strategy and Regulation team includes specialists focused on ensuring compliance.

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Risk	Mitigation
<p>Non-compliance with regulatory and legislative obligations could result in lower financial returns reputational damage, breach of licence conditions or fines.</p>	<p>The Group has extensive engagement and consultation with Ofgem, the Government and HMRC.</p> <ul style="list-style-type: none"> • Relevant external advice is sought to ensure compliance.
<p>Achieving output and cost efficiency targets</p>	
<p>Output and cost efficiency targets are agreed with the Regulator within the price control framework.</p>	<ul style="list-style-type: none"> • Clearly defined targets are set in the Strategic Plan and aligned with business performance targets.
<p>The RIIO-ED2 price control has established more challenging performance and incentive targets and a lower allowable rate of return. Supply chain disruption, higher levels of inflation and the availability of employee and contractor resourcing can impact delivery of targets.</p>	<ul style="list-style-type: none"> • The planning cycle includes bottom up budgeting as well as top down target setting with specific actions to deliver on agreed cost targets. Clear accountabilities are established for each target, incentive area and RIIO-ED2 commitment. • Unit cost efficiency monitoring provides timely information to executive management to optimise performance against the regulatory contract. Efficiency targets are cascaded down to operational teams to drive accountability for performance.
<p>If the business does not meet the output and cost efficiency targets this could negatively impact financial performance.</p>	<ul style="list-style-type: none"> • 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. • 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

Risk	Mitigation
<p>Supply Chain Capacity and Long Lead Times</p> <p>Supply chain performance pressures have increased globally due to inflation, the energy crisis, people shortages and net zero commitments. This is resulting in increased risks of price fluctuations, extended lead times for critical materials, insolvency of key suppliers and scarcity of skilled contractor workforce. If these challenges are not managed effectively, it may impact UK Power Networks ability to deliver against its targets.</p>	<ul style="list-style-type: none"> • The Company has well established processes for governing contract management and supplier relationships, as well as for continued monitoring of key contractors’ financial and stability indicators. Management reviews these processes to have sufficient agility to respond to the increasing pressures. • Long term integrated management plans are devised and routinely reviewed to enable forward ordering of materials to manage long lead times. • The Company closely monitors supplier performance using leading key risk indicators to assess trends in the quality and timely delivery of materials against its Key Material Stock Policy. The Company continually assesses the supply chain for limited suppliers of critical materials, mitigation plans are established where dual sourcing cannot be ascertained.
<p>Major Failure or Cyber security breach of IT Systems:</p> <p>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.</p>	<ul style="list-style-type: none"> • 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

Risk	Mitigation
	<p>All security policies and standards are closely aligned to ISO 27001 and are compliant with the requirements of applicable legislation.</p> <ul style="list-style-type: none"> 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.
Political and economic climate	
<p>Political and global events can affect aspects of the Group's business. This includes events such as the conflict in the Ukraine and disruption to global supply chains.</p>	<ul style="list-style-type: none"> The Group regularly monitors exposure to economic factors through budgeting and forecasting and sensitivity analysis.
<p>Changes in the macroeconomic environment, such as credit markets, inflation and interest rates could negatively impact financial results and the Group's access to funding.</p>	<p>The Group maintains investment grade credit ratings for its DNOs which supports access to financing at acceptable rates when required. Debt covenant and credit metrics are monitored monthly and debt maturities are spread.</p> <ul style="list-style-type: none"> A proportion of the Group's debt is inflation linked to provide an economic hedge. Close collaboration and mitigation planning with suppliers has maintained supply chain resilience.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

Corporate social responsibility

The Group is building a business that is economically, environmentally, and socially sustainable. The vision includes the ambition to be the most socially and environmentally responsible DNO group, and these strategic imperatives drive the overall direction.

Managing our Environmental Impact

The Group plays an important role in safeguarding the environment in which we operate. There are robust policies and procedures in place for compliance with all relevant environmental legislation and industry codes of practice. The Electricity Act specifically requires the Group to consider natural beauty, flora, fauna and geological or physiographical features of special interest, and sites, buildings and objects of architectural, historic or archaeological interest, and do what it reasonably can to mitigate any effects. Relevant activities include environmental permitting, pollution prevention, waste management and the preservation of historic and natural habitats.

Where practicable and achievable, the Group seeks to surpass the basic level of environmental compliance and work to enhance our positive impacts on the environment, whether that be improving biodiversity opportunities at suitable locations, minimising waste and maximising recycling, or working with our supply chain to improve our environmental performance.

The Group consults with relevant stakeholders, including statutory authorities and other appropriate bodies, to help mitigate the impact of our operations on the environment. At a local level, good relationships are maintained with local authorities to work collaboratively on initiatives to help reduce the impact of issues such as noise pollution and litter, to the benefit of local communities. Members of our Environment team represent the Group on the Electricity Networks Association (ENA) Environment Committee, helping to ensure that best practice is implemented from knowledge shared across the electricity and gas sectors.

The challenge of climate change

Climate change is one of the key issues of our time and is of key importance to our customers, stakeholders and Ofgem. Facilitating the UK's net zero carbon emissions target is central to our business plan. As more and more major industries are switching from fossil fuels to electricity, the Group is at the heart of the change by providing the electricity network infrastructure to help these industries facilitate change and in connecting renewable energy and facilitating the uptake of low carbon technologies. The uncertainty around climate change requires a flexible and collaborative approach to accommodate changing risks and customer and stakeholder priorities.

The Group 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. Set out below is a summary of the Board's strategy for responding to climate change, its risk management activities, and the use of metrics and targets to measure progress against the Group's strategy.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

The challenge of climate change continued

Governance

The Board of Directors provides strategic direction with respect to the Group's environmental performance. In Environmental, Social and Governance ("ESG") Subcommittee of the Board has been established. The ESG 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 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. This governance is cascaded through the organisation via local and business Health, Safety and Environment Committees.

The Group's Environmental Management System meets the ISO 14001:2015 standard requirements and is subject to external verification and audit. This system is implemented by relevant business leads and appropriate managers within the organisation who are responsible for identifying and mitigating their respective environmental risks, with guidance and assurance from the Environment team.

Strategy

The Group actively engages with a wide range of stakeholders, including customers, its supply chain, 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.

The Group has set an ambition to be the leading socially and economically responsible organisation in its sector. The Group's strategy is focused on:

- 1) *Decarbonisation in line with its verified Science Based Target ("SBT")*
- 2) *Reducing the impact on the world's limited resources*
- 3) *Increasing natural diversity*
- 4) *Reducing pollution produced by its business operations and network activity*

In addition to decarbonising its own activities the Group has a crucial role to play in facilitating the timely 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.

To fast track this process the Group has established an independent Distribution Service Operator ("DSO") to maximise customer participation and efficiency in the network. The DSO will play a key role in balancing an increasingly complex, interconnected, and low carbon electricity network. The answer is not always to build a bigger network but to support the need to create a smarter network and support the transition to net zero while keeping customer bills as low as possible.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

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, surveys 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.

Risk Management

Climate related risks are considered as part of the Group's risk management framework and process, which can be found on pages 12. Governance procedures have been implemented to identify risks and opportunities faced by the Group. The Group actively monitors and manages risks, including risks relating to climate change. Its key activities to manage climate change 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.

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.

The increase in potential network demand also represents a key climate related risk to the Group. The Group must respond to this challenge and ensure it is a supporter not a blocker to decarbonisation. Failure to respond appropriately to this risk could result in reputational and financial damage. The Group is also exposed to physical climate change risks relating to 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

The challenge of climate change continued

Climate resilience

The Group has developed a Climate Resilience Strategy as part of the RIIO-ED2 Business Plan. This strategy was developed following engagement with the Energy Networks Association and includes best practice from the National Infrastructure Commission's approach to resilience and the UK Cabinet Office's 4Rs of resilience (Robustness, Redundancy, Rapidity, Resourcefulness).

Operational resilience is assessed against the climate change hazards determined by the latest UK Climate Projections ("UKCP18") using the highest emissions scenario, Representative Concentration Pathway ("RCP") 8.5 which equates to a global mean surface temperature increase of 4.3°C by 2081-2100. 12 climate change hazards have been identified, of which eight have been prioritised as particularly applicable to the electricity sector:

- Extreme high temperatures
- Drought cycles
- Prolonged/heavy rainfall
- Intense short-duration rainfall
- Sea level rise
- Wetter conditions coincident with warmer temperatures and/or strong winds
- Wildfire
- Lightning

These climate related hazards have been reviewed against the Group's physical network systems to identify 15 priority-asset related risks. These risks have been assessed using the ENA scoring framework taking into consideration the ability of the network to prevent or mitigate the risk, to provide continued service, or to enable a fast and effective response.

Through resilience improvements that have been in place or are planned, the main areas of residual risk related to vegetation growth impacted overhead lines and the risk of flood damage to assets. The results of this risk assessment were used to define the Group's adaptation pathway to continue to provide future resilience climate change hazards. Full details of the Group's Climate Resilience Strategy are available at: <https://ed2.ukpowernetworks.co.uk/additional-information/ Appendix 14>

Metrics and targets

The Group's Green Action Plan ("GAP") sets out targets for reducing the Group's impact on the environment in relation to carbon emissions, waste, water usage, air and noise pollution, visual amenity and biodiversity. The GAP was launched in 2019 to enhance the environmental commitments made under the Business Plan for RIIO-ED1 (April 2015 to Mar 2023).

Progress against these targets is reported annually in a detailed Environment Report, as required by Ofgem. This covers performance across all environmental fronts including business carbon footprint. These can be found at www.ukpowernetworks.co.uk/about-us/environment-and-sustainability.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

The challenge of climate change continued

Metrics and targets continued

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.

Environmental targets included in the RIIO-ED1 Business plan are:

- Reduce our Business Carbon Footprint by 2% per annum.
- Divert 70% of office and depot waste from landfill and recycle 98% of streetworks spoil.
- Maintain sulphur hexafluoride (SF6) leakage at less than 0.2% as a proportion of SF6 in service.
- Reduce cable fluid leakage of 207,000 litres by 2% per annum.
- Innovation expenditure of 0.5% of allowed revenues and win largest market share of the Network Innovation Competition funding.
- Investigate all noise issues and address all non-compliant sites.

The Company has achieved or exceeded these targets at the end of the RIIO-ED1 time frame, with the exception of fluid filled cable leakage.

RIIO-ED2 and future targets

Looking ahead to RIIO-ED2 the Group has developed a new Environmental Action Plan ("EAP") and has published the following commitments in its business plan. Performance and progress against these targets will be published annually in the Annual Environmental Report, required by Ofgem.

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

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

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

- The Group will develop and implement a circular economy tool to address its high impact materials by the start of RIIO-ED2.
- The Group 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.

3) Increasing natural diversity

- The Group 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.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

The challenge of climate change continued

RIIO-ED2 and future targets

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

- The Group will reduce NOx emissions by 33% over the RIIO-ED2 period compared to the beginning of the period.
- The Group 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.
- The Group 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 regulated allowance is efficiently spent to maximise the benefits of works within protected landscapes.

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 page 10.

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. The Company actively engages with its stakeholders on a regular basis. 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 within the Corporate Social responsibility section on page 19 and within the Corporate Governance Statement on pages 37 to 40.

STRATEGIC REPORT FOR THE YEAR ENDED 31 MARCH 2023

Section 172 (1) statement continued

As described on pages 28 and 29, 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.

Fair, balanced and understandable

Taking into account the process and procedures in place to prepare and present the information in the Annual Report the Board considers that the Annual Report, taken as a whole, is fair, balanced and understandable and provides the information necessary to assess the Company's position and performance, business model and strategy.

Approved by the Board on 12 July 2023 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 2023

The Directors present their Annual Report including the Audited Financial Statements of the Company for the year ended 31 March 2023.

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 £78.0m (2022: £79.0m) were paid during the year.

Political contributions

The Company made no political contributions during the year (2022: £nil).

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

Basil Scarsella

Charles Chao Chung Tsai

Loi Shun Chan

Duncan Nicholas Macrae

Kee Ham Chan

Chi Tin Wan (resigned 1 July 2023)

Christopher Clarke

Paul Jeffery

The following director was appointed after the year end:

Jenny Yu (appointed 1 July 2023)

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.

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 37 to 40.

DIRECTORS' REPORT FOR THE YEAR ENDED 31 MARCH 2023

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 12 July 2023 and signed on its behalf by:



.....
Basil Scarsella
Director

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

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 London. 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 a strong safety record
- an organisation that employees are proud to work for
- creating a diverse and inclusive DNO and DSO
- having a highly skilled workforce for both today and the 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 2023

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 growth in the Services and Connections business

enabling the Net Zero transition for all:

- establish an independent DSO to maximise customer participation and efficiency in the network
- collaborating with local authorities and stakeholders to unlock regional decarbonisation plans
- provide our customers and employees with information and support to go green
- play a leadership role in addressing inequality and unfairness resulting from the energy transition

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 Group recognises and encourages the value that 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 Group 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.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

Principle 1 - Purpose and Leadership continued

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 has evolved for RIIO-ED2, following such stakeholder engagement and feedback, to include a fourth pillar “enabling the net zero transition for all”.

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. 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. As such, the appointment of an independent Chairman is not deemed necessary.

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 principal 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 subcommittees 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 seven meetings of the Group Board were held during the year with eight to eleven 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 2023

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 2023

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. This Committee's primary function is to assist the Group Board in seeing 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 Risk Management and Compliance, Audit, Treasury and ESG Committees each held three meetings. A quorum was present at each meeting.

A further Board subcommittee was established in relation to the preparation of and Board assurance over the RIIO-ED2 business plan. This committee met three times during the year and concluded its responsibilities in February 2023 after review of Ofgem's Final Determination.

Each committee's constitution and terms of reference are reviewed annually. 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, management 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 see 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 2023

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 lead external audit partner changed during the year in accordance with a five year rotation schedule.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

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 and Control Policy and underlying procedures. The Risk and Control 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 of the Board.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

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 2023

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.

The shareholder companies, CK Infrastructure Holdings Limited and Power Assets Holdings Limited require that the Group conducts a bi-annual Internal Control Self-Assessment 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 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 2023

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 four 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 nine consecutive years, achieving its highest ever position of second place in the last two years.
- 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 2023

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.
- 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. The Group has established 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 focus groups, forums and surveys 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 (“BMCS”) survey. This is supplemented by an additional feedback mechanism in which customers give almost instant feedback on the service they have received.

Based on the feedback from extensive engagement and research the Group is enhancing its service to customers in the following ways:

- Detailed analysis of data from various perspectives such as network performance, geography, demographics and individual customer experience, provides greater insight into customer needs and preferences.
- Giving customers the option to receive digital payments for unexpected expenses during longer power cuts (e.g. food costs) as a faster alternative to cash or cheque payments. This followed feedback from call agents’ conversations with customers, which highlighted that customers were struggling to afford these unexpected costs in the context of the cost of living crisis.
- Working with partners to promote the benefits of smart meter technology particularly for customers who are medically dependant on equipment powered by electricity. The integration of smart meters with our communication channels allows us to proactively confirm if a power cut is network related and alert and support the customer, without them having to contact us.
- 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.
- In response to the high uptake of low carbon technologies (“LCTs”) the Group has developed a smart connect portal which has significantly reduced the application and approval time for LCT connections from days to potentially minutes.

CORPORATE GOVERNANCE STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

Principle 6 - Stakeholder Relationships and Engagement continued

Customers continued

The strong customer service culture is reflected in external assessments of the Group's performance. For example in Ofgem's Broad Measure of Customer Satisfaction, the Company achieved a score of 94% for the year ended 31 March 2023 (see page 7). The Institute of Customer Services ("ICS") ranked the Group third best customer service provider across all companies in the UK in its most recent rating published in January 2023. The ICS measures five dimensions of customer service: Customer Experience, Complaint Handling, Customer Ethos, Emotional Connection, and Ethics. The Group featured in the top 10 of all five dimensions.

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 2023

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 can be made available to over 2.3 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 continues to expand 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 has significantly expanded 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 19 to 24, the Group has set ambitious targets to be the most socially and economically responsible in its sector.

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.

During the past two years, the Group has been actively engaged with Ofgem in its preparations for the next price control, RII0-ED2, culminating in the Final Determination released by Ofgem in November 2022. The Group was awarded the largest business plan reward of any DNO reflecting Ofgem's view of the Group's position as the frontier company in the sector and having the most ambitious and focused business plan.

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) including FRS 102 "The Financial Reporting Standard applicable in the UK and Republic of Ireland". Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the state of affairs of the Company and of the profit or loss of the Company for that period.

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

- select suitable accounting policies and 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 London Power Networks plc as at 31 March 2023; 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 London Power Networks plc, together with a description of its principal risks and uncertainties.

Approved by the Board on 12 July 2023 and signed on its behalf by:



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Basil Scarsella
Director

Report on the audit of the financial statements

1. Opinion

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

- give a true and fair view of the state of the company's affairs as at 31 March 2023 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
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- Accuracy and valuation of financial instruments.

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

- ⊕ Similar level of risk

Materiality	The materiality that we used in the current year was £17.2 million which was determined based on 7.5% of profit before tax, adjusted for movements related to derivative financial instruments.
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 other than we have taken a substantive audit approach to the accuracy of cost classification. 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 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;
- 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;
- Evaluating management's assessment of the impact of inflation and of the increased demand for electric capacity within the forecast;
- Testing the mathematical accuracy of the model used to prepare the going concern 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.

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 <i>Property Plant and Equipment</i> (“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 £256.6 million (2022: £268.2 million) in relation to network assets, as disclosed in Note 10.
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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 uses the cost reflectivity model to apply these judgements to the total costs spent on the network to determine what is capitalised and what is expensed.

Due to the judgements and complexity within the cost reflectivity model, we have identified the accuracy of cost classification to be a key audit matter as well as a potential fraud risk. We identify 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 has been disclosed as a critical accounting judgement in note 3, and the fixed asset note is included in note 10 to the financial statements.


How the scope of our audit responded to the key audit matter	<p>We performed the following procedures:</p> <ul style="list-style-type: none"> • obtained an understanding of 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 costs against the capitalisation policy; • agreed a sample of cost inputs to the reflectivity model to supporting documentation, including invoices; • assessed the proportion of capitalised overhead costs using historical
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comparisons and expected changes based on enquiry and our sector knowledge;

- assessed the assumptions and judgements made by management in relation to cost drivers used for each cost category as well as consistency with the prior year and challenged any changes by performing inquiries with operational teams and assessing the historical trends and changes to capitalisation rates;
- 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 accuracy of cost classification is appropriate.

5.2. Accuracy and valuation of Financial Instruments 

Key audit matter description

At 31 March 2023 the company had total borrowings (fixed and variable rates) of £1,220.4 million (2022: £1,224.0 million) (Note 13). The company mitigates the exposure to inflation risk with risk management activities including the use of complex derivatives, such as index linked swaps.

Given the complexity of the valuation methodology for index linked swaps, which involves complex modelling methods we have identified the valuation of these instruments as a key audit matter.

At the year end, the company had derivative financial assets of £14.2 million (2022: £14.8 million) and derivative financial liabilities of £34.4 million (2022: £37.7 million), of which £30.3 million liabilities are index linked swaps. 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 management of financial instruments; and
- involved internal financial instruments specialists to perform an independent recalculation of the index linked swap valuation using independent assumptions based on market data.

Key observations

The results of our procedures were satisfactory and on the basis of these we conclude the accuracy and valuation of financial instruments is appropriate.

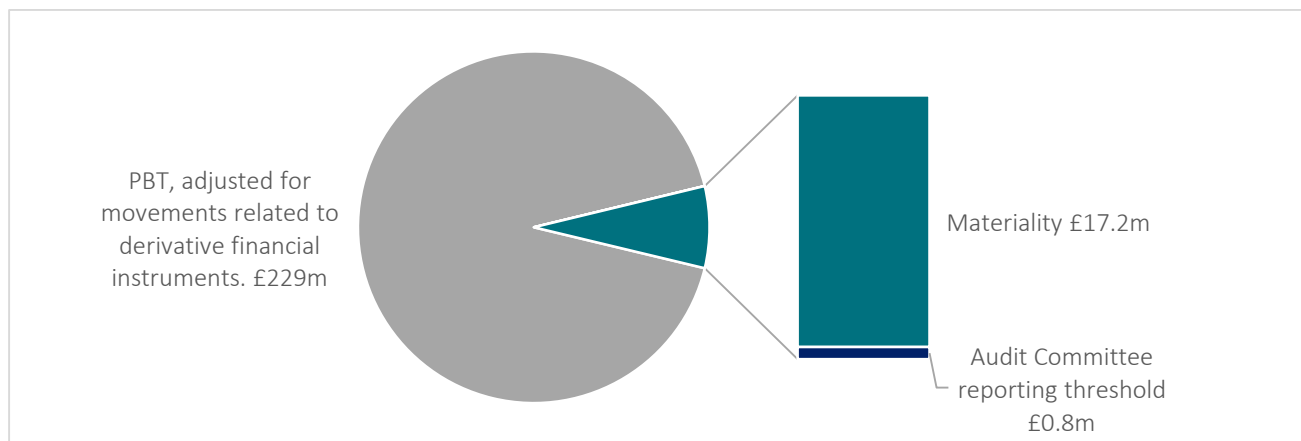
6. Our application of materiality

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	£17.2 million (2022: £16.5 million)
Basis for determining materiality	7.5% of profit before tax, adjusted for movements related to derivative financial instruments (2022: 7.5% of profit before tax, adjusted for movements related to derivative financial instruments)
Rationale for the benchmark applied	As a profit-making entity, profit before tax, adjusted for movements related to derivative financial instruments, is a key metric used by users of the financial statements. We assessed 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, adjusted for movements related to derivative financial instruments. These movements do not form part of the company’s core business performance and have therefore been excluded from our benchmark.



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 2023 audit (2022: 70%). In determining performance materiality, we considered the following factors:

- our ability to rely on internal controls across a number of areas of the audit,
- assessment of the company’s control environment,

- c) the stability of the business, the outcome of our risk assessment process,
- d) the low number of corrected and uncorrected misstatements identified in prior years,
- e) management's willingness to correct errors identified and the stability of the finance team.

6.3. Error reporting threshold

We agreed with the group audit committee that we would report to the committee all audit differences in excess of £0.8 million (2022: £0.8 million), as well as differences below that threshold that, in our view, warranted reporting on qualitative grounds. We also report to the group 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 audit engagement team.

7.2. Our consideration of the control environment

Our controls approach is consistent with prior year other than we took a fully substantive approach to the accuracy of cost classification.

We have taken a controls reliance approach in performing our audit of the balances that have a high volume of transactions namely for the revenue, related to the Distribution Use of System ("DUoS"), 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.

7.3. Our consideration of climate-related risks

Management has considered transition and physical risks when factoring in climate change as part of their risk assessment process when considering the principal risks and uncertainties facing the Group, as explained in the strategic report on page 21. We have:

- assessed how the directors considered climate change in their assessment of the impact on the financial statements, including the going concern assumption, based on our understanding of the business environment;
- assessed how the impact of climate change has been considered within individual financial statement lines which are supported by forward looking forecasts and estimates; and
- read the climate risk disclosures included throughout the strategic report section of the annual report to consider whether they are materially consistent with the financial statements and our knowledge obtained in the audit.

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.

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, the directors and the group audit committee about their own identification and assessment of the risks of irregularities, including those that are specific to the company's sector;
- 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, tax, 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 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 group 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
- 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 group audit committee, we were appointed by the board in 2004 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 20 years, covering the years ending 31 December 2004 to 31 March 2023.

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 group 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.

Marianne Milnes

Marianne Milnes, ACA (Senior Statutory auditor)

For and on behalf of Deloitte LLP

Statutory Auditor

London, United Kingdom

13 July 2023

LONDON POWER NETWORKS PLC

PROFIT AND LOSS ACCOUNT FOR THE YEAR ENDED 31 MARCH 2023

	Note	2023 £ m	2022 £ m
Turnover	4	624.0	523.6
Cost of sales		<u>(109.5)</u>	<u>(35.3)</u>
Gross profit		514.5	488.3
Distribution costs		(201.8)	(207.4)
Administrative expenses		<u>(5.3)</u>	<u>(6.4)</u>
Operating profit	5	307.4	274.5
Finance costs (net)	7	<u>(68.8)</u>	<u>(67.0)</u>
Profit before tax		238.6	207.5
Taxation	8	<u>(50.2)</u>	<u>(101.5)</u>
Profit for the financial year		<u>188.4</u>	<u>106.0</u>

The above results were derived from continuing operations.

The notes on pages 57 to 93 form an integral part of these financial statements.

LONDON POWER NETWORKS PLC

STATEMENT OF COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 MARCH 2023

	2023 £ m	2022 £ m
Profit for the year	<u>188.4</u>	<u>106.0</u>
Reclassified to profit or loss from hedge reserve	0.5	1.0
Remeasurement (losses)/gains on defined benefit pension schemes	<u>(88.2)</u>	<u>155.1</u>
Other comprehensive (loss)/income	<u>(87.7)</u>	<u>156.1</u>
Total comprehensive income for the year	<u><u>100.7</u></u>	<u><u>262.1</u></u>

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

The notes on pages 57 to 93 form an integral part of these financial statements.

LONDON POWER NETWORKS PLC

BALANCE SHEET AS AT 31 MARCH 2023

	Note	2023 £ m	2022 £ m
Fixed assets			
Intangible assets	9	14.5	16.7
Tangible assets	10	<u>4,153.3</u>	<u>3,999.9</u>
		<u>4,167.8</u>	<u>4,016.6</u>
Current assets			
Debtors falling due within one year	11	64.9	57.1
Debtors falling due after more than one year	11	417.1	494.6
Cash and cash equivalents		<u>6.9</u>	<u>5.1</u>
		<u>488.9</u>	<u>556.8</u>
Creditors: Amounts falling due within one year	12	<u>(496.2)</u>	<u>(490.4)</u>
Net current (liabilities)/assets		<u>(7.3)</u>	<u>66.4</u>
Total assets less current liabilities		4,160.5	4,083.0
Creditors: Amounts falling due after more than one year	12	(2,189.1)	(2,119.0)
Provisions for liabilities	16	<u>(335.3)</u>	<u>(350.6)</u>
Net assets		<u><u>1,636.1</u></u>	<u><u>1,613.4</u></u>
Capital and reserves			
Called up share capital	17	10.0	10.0
Hedging reserve	17	(2.8)	(3.3)
Profit and loss account	17	<u>1,628.9</u>	<u>1,606.7</u>
Total shareholders' funds		<u><u>1,636.1</u></u>	<u><u>1,613.4</u></u>

The financial statements of London Power Networks plc, registered number 3929195, were approved by the Board of Directors and authorised for issue on 12 July 2023. They were signed on its behalf by:

Basil Scarsella
Director

The notes on pages 57 to 93 form an integral part of these financial statements.

LONDON POWER NETWORKS PLC

STATEMENT OF CHANGES IN EQUITY FOR THE YEAR ENDED 31 MARCH 2023

	Share capital £ m	Hedging reserve £ m	Profit and loss account £ m	Total £ m
At 1 April 2021	10.0	(4.3)	1,424.6	1,430.3
Profit for the year	-	-	106.0	106.0
Remeasurement gains on defined benefit schemes	-	-	155.1	155.1
Reclassified to profit or loss	-	1.0	-	1.0
Total comprehensive income	-	1.0	261.1	262.1
Dividends	-	-	(79.0)	(79.0)
At 31 March 2022	<u>10.0</u>	<u>(3.3)</u>	<u>1,606.7</u>	<u>1,613.4</u>

	Share capital £ m	Hedging reserve £ m	Profit and loss account £ m	Total £ m
At 1 April 2022	<u>10.0</u>	<u>(3.3)</u>	<u>1,606.7</u>	<u>1,613.4</u>
Profit for the year	-	-	188.4	188.4
Remeasurement losses on defined benefit schemes	-	-	(88.2)	(88.2)
Reclassified to profit or loss	-	0.5	-	0.5
Total comprehensive income	-	0.5	100.2	100.7
Dividends	-	-	(78.0)	(78.0)
At 31 March 2023	<u>10.0</u>	<u>(2.8)</u>	<u>1,628.9</u>	<u>1,636.1</u>

The notes on pages 57 to 93 form an integral part of these financial statements.

CASH FLOW STATEMENT FOR THE YEAR ENDED 31 MARCH 2023

	Note	2023 £ m	2022 £ m
Cash generated from operations	20	460.7	479.7
Corporation tax paid		<u>(33.5)</u>	<u>(26.4)</u>
Net cash flows from operating activities		<u>427.2</u>	<u>453.3</u>
Cash flows used in investing activities			
Proceeds from sale of tangible assets		-	0.7
Gross capital expenditure on tangible assets		(253.5)	(267.0)
Capital expenditure on intangible assets		(4.7)	(4.8)
Interest received		<u>6.1</u>	<u>5.4</u>
Net cash flows used in investing activities		<u>(252.1)</u>	<u>(265.7)</u>
Cash flows used in financing activities			
Equity dividends paid		(78.0)	(79.0)
Interest paid		(61.8)	(49.2)
Repayment of long-term borrowings		(250.0)	-
Proceeds from short-term borrowings		216.5	-
Repayment of short-term borrowings		<u>-</u>	<u>(90.0)</u>
Net cash flows used in financing activities		<u>(173.3)</u>	<u>(218.2)</u>
Net increase/(decrease) in cash and cash equivalents		1.8	(30.6)
Cash and cash equivalents at beginning of year		<u>5.1</u>	<u>35.7</u>
Cash and cash equivalents at end of year		<u><u>6.9</u></u>	<u><u>5.1</u></u>
Reconciliation to cash at bank and in hand			
Cash at bank and in hand		<u>6.9</u>	<u>5.1</u>
Cash and cash equivalents		<u><u>6.9</u></u>	<u><u>5.1</u></u>

The notes on pages 57 to 93 form an integral part of these financial statements.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

1 General information

London 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 25.

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.

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

2 Accounting policies (continued)

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 Strategic Report. Further detail in respect of its financial instruments and hedging activities are included in the relevant notes to the financial statements.

As discussed on page 11 of the Strategic Report, 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 outcome of the new RII0-ED2 price control which applies from 1 April 2023.
- £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 net current liability position of £7.3m and the financial covenants applicable to the Company's financing facilities.
- The impact of a higher inflationary environment, which negatively impacts costs but increases future revenues via higher tariffs.
- The Company has a successful track record of raising finance, supported by investment grade credit ratings.

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, lower than expected revenues, which could be attributable to the impacts of weather or other events on consumption and a reduction in connections income.

Given the significant amount of liquidity available to the Company at 31 March 2023, the Company'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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

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 these assets.

Tangible assets

Tangible fixed assets are stated at historical 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 fixed 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 related network 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 2023

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. Remeasurement 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 2023

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 2023

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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

2 Accounting policies (continued)

Financial liabilities continued

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.

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 Company's obligations are discharged, cancelled or expire.

Derivative financial instruments

The Company uses derivative financial instruments to reduce exposure to interest rate and inflation 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 risk associated with the borrowing requirements of the Company. Inflation linked swaps are used to economically hedge the exposure of the Company's regulated revenues to movements in inflation. 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 and 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

2 Accounting policies (continued)**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).

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 value 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 2023

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 80% of the Company's total asset base.

The carrying value of the Network asset of £4,113.8m (2022: £3,691.5m) 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 2023

3 Critical accounting judgements and key sources of estimation uncertainty (continued)**Key sources of estimation uncertainty continued***Valuation of defined benefit obligation 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 2023.

	Change in assumption	Impact on scheme liabilities	
		UKPN Grp 2023	UKPNPS 2023
Discount rate	+/- 0.50%	-5.7% to 6.1%	-11.4% to 13.0%
RPI inflation	+/- 0.50%	5.2% to -4.9%	9.8% to -9.4%
Life expectancy	+/- 3 years	12.6% to -13.4%	9.4% to -10.1%
Rate of salary increases	+/- 0.50%	0.4% to -0.4%	5.0% to -4.8%

At 31 March 2023 the Company's share of scheme liabilities was valued at £1,133.7m (2022: £1,462.9m) for the UKPN Group scheme and £133.6m (2022: £184.0m) for the UKPNPS Scheme, in accordance with FRS 102 (as disclosed in note 19).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

4 Turnover

Turnover for the year ended 31 March 2023 was £624.0m (2022: £523.6m), 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.

Increases in wholesale energy prices and consequent supplier failures has led to an increase in SOLR claims received by the Company. It was agreed with Ofgem that the majority of these claims would be payable over twelve months from 1 April 2022 and recovered via tariff increases during the same period. In the current year the Company has recognised additional Distribution Use of System ("DuOS") revenues of £78.3m to offset the cost of material SOLR claims charged to cost of sales. At 31 March 2023 the Company had claims of £21.4m not yet accrued. Under the agreement with Ofgem these will become payable and recovered via tariff increases in the next regulatory year ended 31 March 2024.

Turnover 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 £40.8m (2022: £38.9m).

5 Operating profit

Arrived at after charging/(crediting):

	2023	2022
	£ m	£ m
Depreciation of tangible fixed assets	107.4	102.8
Amortisation of intangible assets	6.9	8.5
Operating lease rentals - land and buildings	0.8	0.7
Profit on disposal of property, plant and equipment	<u>-</u>	<u>(0.7)</u>

SOLR impact on operating profit

Costs of approximately £78.3m relating to material SOLR claims are matched by higher revenues (refer to note 4), with no impact on operating profit. SOLR claims falling below a certain materiality threshold, as defined by Ofgem, are only recoverable through revenues in two years' time and have a cost impact of £1.7m.

Auditor's remuneration

The amount payable to Deloitte LLP was £91,100 (2022: £75,800) in respect of audit services and £58,900 (2022: £52,300) 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.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

5 Operating profit (continued)

Staff costs

The Company had no employees in either 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

	2023	2022
	£	£
Current period	<u>100,000</u>	<u>100,000</u>

Remuneration of highest paid director

	2023	2022
	£	£
Emoluments	<u>50,000</u>	<u>50,000</u>

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 during the current or prior year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

7 Finance costs (net)

	2023	2022
	£ m	£ m
Interest payable and similar expenses	(92.4)	(58.7)
Less: investment income	14.6	7.4
Other finance income/(costs)	9.0	(15.7)
	<u>(68.8)</u>	<u>(67.0)</u>

	2023	2022
	£ m	£ m
Investment income		
Income from other fixed asset investments	0.4	-
Interest receivable on Group loans	5.4	5.3
Other interest receivable and similar income	0.2	-
Net interest income on defined benefit pension surplus	8.6	2.1
	<u>14.6</u>	<u>7.4</u>

	2023	2022
	£ m	£ m
Interest payable and similar expenses		
Interest on bank loans	(3.1)	(4.5)
Interest on bonds	(47.2)	(46.3)
Accretion on index linked debt	(32.4)	(9.8)
Interest payable on Group loans	(0.6)	(0.2)
Net interest on swap instruments	3.2	8.0
Accretion on swap instruments	(19.6)	(10.2)
	<u>(99.7)</u>	<u>(63.0)</u>
Finance costs capitalised	7.3	4.3
	<u>(92.4)</u>	<u>(58.7)</u>

Capitalised interest

Finance costs have been capitalised to tangible fixed assets on the basis of a capitalisation rate of 8.7% (2022: 5.4%), 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 £75.9m (2022: £68.6m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

7 Finance costs (net) (continued)

	2023 £ m	2022 £ m
Other finance income/(costs)		
Fair value gains/(losses) on financial instruments		
Interest rate swaps not in hedge relationships	(1.6)	(1.4)
Index linked swaps not in hedge relationships	10.4	(13.0)
Interest rate swaps in fair value hedge relationships	(1.2)	(7.4)
Hedged items in fair value hedge relationships	<u>1.6</u>	<u>7.1</u>
	9.2	(14.7)
Amortisation of hedging adjustments		
Amortisation of fair value hedge adjustments	1.1	1.1
Reclassified to profit or loss from hedge reserve	<u>(0.7)</u>	<u>(0.9)</u>
Net gain/(loss) related to derivative financial instruments	9.6	(14.5)
Other costs		
Net interest cost on defined benefit pension deficit	<u>(0.6)</u>	<u>(1.2)</u>
	<u><u>9.0</u></u>	<u><u>(15.7)</u></u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

8 Taxation

Tax charged to the profit and loss account

	2023	2022
	£ m	£ m
Current taxation		
UK corporation tax	30.5	30.7
Adjustments in respect of prior years	(0.9)	0.5
Total current taxation	29.6	31.2
Deferred taxation		
Origination and reversal of timing differences	19.5	11.5
Adjustments in respect of prior years	1.1	(0.2)
Effect of increase in tax rate on opening liability ¹	-	59.0
Total deferred taxation	20.6	70.3
Total tax charge	50.2	101.5

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% (2022: 19%) applied to profit before tax. The differences are reconciled below:

	2023	2022
	£ m	£ m
Profit before tax	238.6	207.5
Corporation tax at standard rate	45.3	39.4
Income not taxable in determining taxable profit	(0.1)	-
Deferred tax expense relating to changes in tax rates	4.8	61.8
Adjustments to current tax in respect of prior years	(0.9)	0.5
Adjustments to deferred tax in respect of prior years	1.1	(0.2)
Total tax charge	50.2	101.5

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

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

The current tax rate applied during the year was 19% (2022: 19%) and deferred tax was calculated at 25% (2022: 25%) based on the standard rate of corporation tax substantively enacted at the reporting date.

The standard rate of corporation tax increased from 19% to 25% with effect from 1 April 2023, as substantively enacted in the Finance Bill 2021 on 24 May 2021. Revaluing the Company's long term deferred tax liabilities at 25% increased the deferred tax charge in the prior year by £59.0m. The rate increase had no impact on current tax in the current year or the prior year.

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

	£ m
Cost	
At 1 April 2022	76.7
Additions	<u>4.7</u>
At 31 March 2023	<u>81.4</u>
Amortisation	
At 1 April 2022	60.0
Charge for the year	<u>6.9</u>
At 31 March 2023	<u>66.9</u>
Net book value	
At 31 March 2023	<u><u>14.5</u></u>
At 31 March 2022	<u><u>16.7</u></u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

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 2022	5,794.1	43.3	1.2	160.8	5,999.4
Additions	256.6	0.2	-	4.0	260.8
Disposals	<u>(3.3)</u>	<u>-</u>	<u>(0.1)</u>	<u>-</u>	<u>(3.4)</u>
At 31 March 2023	<u>6,047.4</u>	<u>43.5</u>	<u>1.1</u>	<u>164.8</u>	<u>6,256.8</u>
Depreciation					
At 1 April 2022	1,832.6	13.4	1.2	152.3	1,999.5
Charge for the year	104.3	0.6	-	2.5	107.4
Eliminated on disposal	<u>(3.3)</u>	<u>-</u>	<u>(0.1)</u>	<u>-</u>	<u>(3.4)</u>
At 31 March 2023	<u>1,933.6</u>	<u>14.0</u>	<u>1.1</u>	<u>154.8</u>	<u>2,103.5</u>
Net book value					
At 31 March 2023	<u>4,113.8</u>	<u>29.5</u>	<u>-</u>	<u>10.0</u>	<u>4,153.3</u>
At 31 March 2022	<u>3,961.5</u>	<u>29.9</u>	<u>-</u>	<u>8.5</u>	<u>3,999.9</u>

Network assets at 31 March 2023 include land with a book value of £24.5m (2022: £24.5m). The net book value of non-network land and buildings comprise freehold land at £4.4m (2022: £4.3m) and freehold buildings at £25.1m (2022: £25.6m).

Also included within Network assets as at 31 March 2023 are assets in the course of construction of £89.6m (2022: £78.2m). Approximately £11.7m of the prior year assets under construction were completed during the current year (2022: £42.5m).

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 £40.8m (2022: £38.9m) was recognised within turnover in respect of customer contributions.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

11 Debtors

	Note	2023 £ m	2022 £ m
Amounts falling due within one year:			
Trade debtors		61.3	44.6
Amounts owed by Group undertakings		1.3	10.4
Other debtors		0.1	0.1
Prepayments		1.6	0.8
Corporation tax		0.6	-
Derivative financial assets	15	-	1.2
		64.9	57.1
Amounts falling due after more than one year:			
Amounts owed by Group undertakings		196.1	196.1
Derivative financial assets	15	14.2	13.6
Surplus in the UKPN Group defined benefit pension scheme	19	206.8	284.9
		417.1	494.6
		482.0	551.7

Amounts owed by Group undertakings due within one year comprise interest free trade balances which are repayable on demand.

Amounts owed by Group undertakings due after more than one year comprise a loan of £196.1m to the parent company UK Power Networks Holdings Limited, carrying interest at 2.56% and maturing in June 2026.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

12 Creditors

	Note	2023 £ m	2022 £ m
Amounts falling due within one year:			
Trade creditors		0.3	1.1
Borrowings	13	216.5	251.4
Amounts owed to Group undertakings		31.2	22.6
Corporation tax		-	3.3
Other taxation and social security		29.6	24.5
Other creditors		7.7	2.6
Accruals		48.5	46.4
Deferred income		<u>162.4</u>	<u>138.5</u>
		<u>496.2</u>	<u>490.4</u>
Amounts falling due after one year:			
Borrowings	13	1,003.9	972.6
Deferred income		1,150.8	1,108.7
Derivative financial liabilities	15	<u>34.4</u>	<u>37.7</u>
		<u>2,189.1</u>	<u>2,119.0</u>

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

Deferred income falling due after one year comprises 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 £43.0m (2022: £41.0m) relating to customer contributions, expected to be released to turnover within one year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

13 Borrowings

	2023	2022
	£ m	£ m
Amounts due within one year		
Amounts due to Group undertakings	216.5	-
£250m 5.125% Bond due March 2023	-	249.8
Adjustments for fair value hedge relationships	-	1.6
	216.5	251.4
Amounts falling due after more than one year		
£25m 2.335% EIB loan due October 2025	25.0	25.0
£80m 1.614% EIB loan due October 2028	80.0	80.0
£35m 2.070% EIB loan due April 2029	35.0	35.0
£15m 2.335% EIB loan due June 2030	15.0	15.0
£300m 6.125% Bond due June 2027	301.1	301.4
£250m 2.625% Bond due March 2029	248.7	248.5
£150m 3.125% Index Linked Bond due June 2032	294.7	262.2
Adjustments for fair value hedge relationships	4.4	5.5
	1,003.9	972.6
	1,220.4	1,224.0

Amounts owed to Group undertakings are short term loans of £107.0m from Eastern Power Networks plc, £52.5m from South Eastern Power Networks plc, and £57.0m from UK Power Networks Services (Contracting) Ltd all bearing interest at 4.5%.

Bonds are stated net of unamortised issue costs of £1.9m (2022: £2.4m). The 6.125% bond includes an unamortised net premium of £1.1m (2022: £1.4m) and the 3.125% index linked bond includes accretion of £145.4m (2022: £112.9m). These balances together with the interest expense are allocated to the profit and loss account over the term of the debt.

The cumulative adjustment to the carrying amount of the bonds, arising from fair value hedge relationships with interest rate swaps, amounts to £nil within current borrowings (2022: £1.6m) and £4.4m within long term borrowings (2022: £5.5m). This is presented on separate lines in the table above. The movement during the year comprises a fair value gain of £1.6m (2022: £7.1m) relating to existing hedge relationships and an amortisation adjustment of £1.1m (2022: £1.1m) relating to discontinued hedge relationships. The fair value adjustment amortises to profit or loss from the date of cessation of the fair value hedge until the maturity of the hedged debt.

No security has been given over the assets of the Company in respect of the Company's borrowings.

The Company has access to undrawn credit facilities of £145.0m until April 2026.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

14 Financial instruments

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

	Note	2023 £ m	2022 £ m
Financial assets			
Measured at fair value through profit or loss			
Derivative financial assets	15	14.2	13.6
Measured at fair value and designated in an effective hedge relationship			
Derivative financial assets	15	-	1.2
Measured at amortised cost			
Loans receivable from Group undertakings	11	196.1	205.1
Trade and other debtors excluding prepayments and accrued income	11	<u>62.7</u>	<u>46.1</u>
		<u>273.0</u>	<u>266.0</u>
Financial liabilities			
Measured at fair value through profit or loss			
Derivative financial liabilities	15	(34.4)	(37.7)
Measured at amortised cost and designated in an effective hedge relationship			
* Bonds	13	-	(188.9)
Measured at amortised cost			
**Bonds and loans payable	13	(1,220.4)	(1,035.1)
Trade and other payables excluding taxation and social security and accruals and deferred income	12	<u>(39.2)</u>	<u>(26.3)</u>
		<u>(1,294.0)</u>	<u>(1,288.0)</u>

* The carrying value of bonds measured at amortised cost and designated in an effective hedge relationship includes a fair value adjustment of £nil (2022: £1.6m) relating to existing fair value hedge relationships.

**The carrying value of bonds measured at amortised cost includes a fair value adjustment of £4.4m (2022: £5.5m) relating to discontinued fair value hedge relationships.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

14 Financial instruments (continued)

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

	2023	2022
	£ m	£ m
Derivative financial assets measured at fair value through profit or loss		
Interest rate swaps not in hedge relationships		
- Net interest receivable	0.2	6.1
- Fair value gains/(losses)	13.9	(17.0)
Derivative financial assets measured at fair value and designated in effective hedge relationships		
Interest rate swaps designated as fair value hedges		
- Net interest receivable	0.1	4.5
- Fair value losses	(1.2)	(7.4)
Financial assets measured at amortised cost		
Interest receivable on Group loans	5.4	5.3
	18.4	(8.5)

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

14 Financial instruments (continued)

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

	2023	2022
	£ m	£ m
Derivative financial liabilities measured at fair value through profit or loss		
Interest rate swaps not in hedge relationships		
- Net interest receivable/(payable)	1.1	(5.0)
- Fair value (losses)/gains	(15.5)	15.6
Index linked swaps not in hedge relationships		
- Net interest receivable	1.8	2.4
- Accretion payable	(19.6)	(10.2)
- Fair value gains/(losses)	10.4	(13.0)
Financial liabilities which are hedged items in effective hedge relationships		
Bonds in fair value hedge relationships		
- Fair value gains measured through profit or loss	1.6	7.1
Financial liabilities measured at amortised cost		
Interest payable on bonds and bank loans	(50.3)	(50.8)
Accretion payable on bonds and bank loans	(32.4)	(9.8)
Interest payable on Group loans	(0.6)	(0.2)
	<u>(103.5)</u>	<u>(63.9)</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

15 Derivative financial instruments

	2023 £ m	2022 £ m
Derivative financial assets		
Amounts falling due within one year		
Interest rate swaps designated as effective fair value hedges	-	1.2
	<u>-</u>	<u>1.2</u>
Amounts falling due after more than one year		
Interest rate swaps not designated in hedging relationships	14.2	13.6
	<u>14.2</u>	<u>14.8</u>
Derivative financial liabilities		
Amounts falling due after more than one year		
Interest rate swaps not designated in hedging relationships	(4.1)	(1.8)
Index linked swaps not designated in hedging relationships ¹	(30.3)	(35.9)
	<u>(34.4)</u>	<u>(37.7)</u>

¹ The fair value of index linked swaps at 31 March 2023 includes accretion of £15.3m (2022: £10.6m).

Under interest rate swap contracts, the Company agrees to exchange the difference between fixed and floating rate interest calculated on agreed notional principal amounts. Index linked contracts convert floating or fixed interest rates to RPI inflation linked rates.

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 and RPI curves adjusted for the Company's own credit risk in respect of swap liabilities and counterparty credit risk in respect of swap assets.

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 and cash flows are derived from the forward interest rate SONIA Overnight Index Swap ("OIS") curve and forward RPI curve, adjusted for the Group's own credit risk in respect of swap liabilities and counterparty credit risk in respect of swap assets.

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

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

15 Derivative financial instruments (continued)

Fair value hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2023 %	2022 %	2023 £ m	2022 £ m	2023 £ m	2022 £ m
Maturity of outstanding contracts						
Receive fixed / pay floating						
Less than 1 year	-	5.1%	<u>-</u>	<u>187.5</u>	<u>-</u>	<u>1.2</u>

The fair value hedge interest rate swaps exchanged fixed rate interest for floating rate interest and were effective as fair value hedges throughout the prior year in respect of bond interest rates. The floating rate payable is SONIA plus a margin of between 2.8% and 2.9%. The swaps matured in March 2023.

In addition to net interest receivable on these instruments, fair value losses of £1.2m (2022: losses of £7.4m) were recognised in profit or loss during the year. These movements were offset by fair value gains of £1.6m (2022: gains of £7.1m) adjusted to the carrying amount of the bonds.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

15 Derivative financial instruments (continued)

Non hedge interest rate swaps

	Average contract fixed interest rate		Notional principal value		Fair value	
	2023 %	2022 %	2023 £ m	2022 £ m	2023 £ m	2022 £ m
Maturity of outstanding contracts						
Receive fixed / pay floating						
2 to 5 years	6.1%	-	180.0	-	(4.0)	-
5 years plus	-	6.1%	-	180.0	-	13.6
			<u>180.0</u>	<u>180.0</u>	<u>(4.0)</u>	<u>13.6</u>
Receive floating / pay fixed						
2 to 5 years	2.2%	-	180.0	-	14.2	-
5 years plus	-	2.2%	-	180.0	-	(1.8)
			<u>180.0</u>	<u>180.0</u>	<u>14.2</u>	<u>(1.8)</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 3.5%. In addition to interest receivable on these instruments, fair value losses of £13.9m (2022: losses of £17.0m) 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 on the floating to fixed rate contracts is SONIA plus a margin of 0.3%. In addition to interest payable on these instruments, fair value gains of £15.5m (2022: gain of £15.6m) were recognised in profit or loss during the year.

The swap contracts described above mature in June 2027.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

15 Derivative financial instruments (continued)

Non hedge index linked swap contracts

	Average contract fixed interest rate		Notional principal value		Fair value	
	2023 %	2022 %	2023 £ m	2022 £ m	2023 £ m	2022 £ m
Maturity of outstanding contracts						
Receive fixed / pay fixed + RPI						
2 to 5 years	6.1%	-	102.9	-	(30.3)	-
5 years plus	-	6.1%	-	102.9	-	(35.9)
			<u>102.9</u>	<u>102.9</u>	<u>(30.3)</u>	<u>(35.9)</u>

The Company uses an RPI linked swap contract to convert a portion of the fixed rate interest payable under the bonds to an inflation linked rate. Although designed as an economic hedge against the RPI exposure of the Company's regulated income this instrument is not designated in a formal hedge accounting relationship. The index linked swap maturing in June 2027 receives fixed interest and pays RPI linked interest.

During the year fair value gains of £10.4m (2022: losses of £13.0m) were recognised in profit or loss together with an accretion charge of £19.6m (2022: £10.2m) and net interest receivable of £1.8m (2022: £2.4m).

Fair values at 31 March 2023 include accumulated accretion of £15.3m (2022: £10.6m).

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

16 Provisions for liabilities

	2023	2022
	£ m	£ m
Provision for deferred tax	302.8	311.4
Other provisions	12.0	12.8
	<u>314.8</u>	<u>324.2</u>

Defined benefit retirement obligations

Deficit in the UKPNPS defined benefit pension scheme	19	20.5	26.4
		<u>335.3</u>	<u>350.6</u>

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

	Deferred tax	Other provisions	Total
	£ m	£ m	£ m
At 1 April 2022	311.4	12.8	324.2
Charged/(credited) to profit or loss	20.6	(0.8)	19.8
Credited to other comprehensive income	(29.2)	-	(29.2)
At 31 March 2023	<u>302.8</u>	<u>12.0</u>	<u>314.8</u>

Explanation of provisions

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

Analysis of deferred tax

	2023	2022
	£ m	£ m
Accelerated capital allowances	261.5	254.7
Deferred tax relating to defined benefit pension schemes	46.6	64.6
Other timing differences	(5.3)	(7.9)
Net deferred tax liability	<u>302.8</u>	<u>311.4</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

17 Called up share capital and reserves

	2023	2022
	£ m	£ m
10,000,000 ordinary shares at £1.00 each	<u>10.0</u>	<u>10.0</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 defined benefit 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 £51.1m (2022: £30.6m).

Lease commitments

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

	2023	2022
	£ m	£ m
Land and buildings		
- within one year	0.8	0.8
- between one and five years	3.2	3.0
- after five years	<u>16.2</u>	<u>15.2</u>
	<u>20.2</u>	<u>19.0</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

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 regularly 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, resulting from the triennial valuation as at 31 March 2022, was agreed on 27 February 2023 for the UKPN Group scheme and 5 April 2023 for the UKPNPS scheme. In relation to the UKPN Group scheme, the current rate of deficit repair contributions was sufficient to clear the funding deficit by 1 March 2023, removing the need for ongoing deficit repair. However, deficit repair contributions will continue to the UKPNPS, with the aim of eliminating the scheme’s funding shortfall over the next five years. The Company’s share of these contributions is set at approximately £7.2m per annum from 1 January 2023 to 29 February 2028 increasing annually by CPI inflation.

A valuation under FRS 102 at the balance sheet date was provided by actuaries using rolled forward member data from the 31 March 2022 triennial valuation and reflecting updated financial and demographic assumptions. These assumptions are governed by FRS 102 and do not reflect the assumptions used by the independent actuary in the triennial funding valuations described above.

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 2023

19 Pension commitments (continued)

The key financial assumptions (% per annum) used to calculate scheme liabilities under FRS102 were:

	2023	2022
	%	%
UKPN Group key financial assumptions		
Discount rate	4.8	2.8
Future salary increases	3.5	3.9
RPI inflation	3.0	3.4
CPI inflation	2.7	3.0
Pension increases in deferment	3.1	3.4
Pension increases in payment		
- pensions in excess of GMP	3.1	3.4
- post-88 GMP	2.1	2.4

	2023	2022
	%	%
UKPNPS key financial assumptions		
Discount rate	4.6	2.7
Future salary increases	3.3	3.5
RPI inflation	2.8	3.0
CPI inflation	2.3	2.4
Pension increases in deferment		
- CPI up to 5% per annum	2.3	2.4
- CPI up to 2.5% per annum	2.3	2.4
Pension increases in payment		
- RPI up to 5% per annum	2.7	2.9
- RPI up to 2.5% per annum	1.9	2.1
- post-88 GMP	1.9	2.0

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

19 Pension commitments (continued)

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

	2023	2022
	Years	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	27	28
Life expectancy at 60 for female currently aged 40	30	31

	2023	2022
	Years	Years
UKPNPS life expectancy assumptions		
Life expectancy for male currently aged 65	22	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	UKPNPS	Total	Total
	2023	2023	2023	2022
	£ m	£ m	£ m	£ m
Fair value of scheme assets	1,340.5	113.1	1,453.6	1,905.4
Present value of defined benefit obligation	(1,133.7)	(133.6)	(1,267.3)	(1,646.9)
Defined benefit pension scheme surplus/(deficit)	206.8	(20.5)	186.3	258.5

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 2023

19 Pension commitments (continued)

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

	UKPN Grp 2023 £ m	UKPNPS 2023 £ m	Total 2023 £ m	Total 2022 £ m
Current service cost	(3.7)	(7.3)	(11.0)	(14.2)
Past service cost	(0.5)	-	(0.5)	(0.5)
Past service credit related to enhanced early retirement offer	-	-	-	0.8
Net interest income/(cost)	<u>8.6</u>	<u>(0.6)</u>	<u>8.0</u>	<u>0.9</u>
	4.4	(7.9)	(3.5)	(13.0)
Recognised in other comprehensive income	<u>(116.8)</u>	<u>(0.8)</u>	<u>(117.6)</u>	<u>207.8</u>
	<u>(112.4)</u>	<u>(8.7)</u>	<u>(121.1)</u>	<u>194.8</u>

Of the charge for the year a net expense of £11.5m (2022: £13.9m) has been included in distribution costs and net income of £7.9m (2022: £0.9m) included within 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 reduced scheme liabilities calculated under FRS 102 by £0.5m in the UKPN Group scheme and £0.3m in the UKPNPS scheme. This was recognised through profit or loss as a past service credit in the prior year.

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

19 Pension commitments (continued)

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

	UKPN Grp 2023 £ m	UKPNPS 2023 £ m	Total 2023 £ m	Total 2022 £ m
At 1 April	(1,462.9)	(184.0)	(1,646.9)	(1,806.8)
Current service cost	(3.7)	(7.3)	(11.0)	(14.2)
Past service cost	(0.5)	-	(0.5)	(0.5)
Past service credit related to enhanced early retirement offer	-	-	-	0.8
Interest cost	(39.7)	(4.8)	(44.5)	(36.3)
Actuarial gains	296.3	62.5	358.8	135.8
Benefits paid	76.8	-	76.8	74.3
At 31 March	<u>(1,133.7)</u>	<u>(133.6)</u>	<u>(1,267.3)</u>	<u>(1,646.9)</u>

The actuarial gain (2022: gain) includes a net transfer in of scheme liabilities amounting to £3.1m (2022: £3.2m 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 2023 £ m	UKPNPS 2023 £ m	Total 2023 £ m	Total 2022 £ m
At 1 April	1,747.8	157.6	1,905.4	1,819.7
Interest income	48.3	4.2	52.5	37.2
Return on plan assets (excluding amounts included in net interest cost)	(413.1)	(63.3)	(476.4)	72.0
Contributions by employer	4.0	7.2	11.2	12.5
Deficit payments	30.3	7.4	37.7	38.3
Benefits paid	(76.8)	-	(76.8)	(74.3)
At 31 March	<u>1,340.5</u>	<u>113.1</u>	<u>1,453.6</u>	<u>1,905.4</u>

The return on plan assets (excluding amounts included in net interest cost) includes a net transfer in of scheme assets amounting to £2.5m (2022: £3.2m transfer out) 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 2023

19 Pension commitments (continued)

The fair value of scheme assets is analysed as follows:

	UKPN Grp 2023 £ m	UKPNPS 2023 £ m	Total 2023 £ m	Total 2022 £ m
Equities	90.8	20.8	111.6	204.8
Liability driven investments	896.2	65.1	961.3	1,322.4
Credit funds	72.5	4.9	77.4	121.9
Hedge funds	-	7.3	7.3	10.0
Alternatives ¹	262.2	14.1	276.3	227.2
Cash and net current assets	18.8	0.9	19.7	19.1
	<u>1,340.5</u>	<u>113.1</u>	<u>1,453.6</u>	<u>1,905.4</u>

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

	2023 £ m	2022 £ m
Operating profit	307.4	274.5
Adjustment for		
Depreciation and amortisation of assets	114.3	111.3
Customer contributions recognised in turnover	(40.8)	(38.9)
Profit on disposal of tangible fixed assets	-	(0.7)
Operating cash flow before movement in working capital	<u>380.9</u>	<u>346.2</u>
(Increase)/decrease in debtors	(8.3)	82.8
Increase in creditors	41.5	5.2
(Decrease)/increase in provisions	(0.8)	0.4
Customer contributions received	84.9	81.9
Pension deficit repair payments	(37.7)	(38.3)
Pension adjustments	<u>0.2</u>	<u>1.5</u>
Cash generated from operations	<u>460.7</u>	<u>479.7</u>

NOTES TO THE FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 MARCH 2023

20 Notes to the cash flow statement (continued)

Reconciliation of net debt

	At 1 April 2022 £ m	Cash flows £ m	Fair value and exchange rate changes £ m	Other non-cash changes £ m	At 31 March 2023 £ m
Cash at bank and in hand	5.1	1.8	-	-	6.9
Debt due within one year	(251.4)	33.5	1.6	(0.2)	(216.5)
Debt due after more than one year	<u>(972.6)</u>	<u>-</u>	<u>1.1</u>	<u>(32.4)</u>	<u>(1,003.9)</u>
	<u>(1,224.0)</u>	<u>33.5</u>	<u>2.7</u>	<u>(32.6)</u>	<u>(1,220.4)</u>
	<u>(1,218.9)</u>	<u>35.3</u>	<u>2.7</u>	<u>(32.6)</u>	<u>(1,213.5)</u>

Other non-cash changes in net debt comprise accretion on index linked bonds of £32.4m and amortisation of debt issue costs of £0.2m.

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 2023

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.

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