

Northern Gas Networks Holdings Limited

Annual Report and accounts
for the year ended 31 December 2008

Registered number: 5213525

Directors' report

For the year ended 31 December 2008

The directors present their Annual Report on the affairs of the group, together with the accounts and auditors' report, for the year ended 31 December 2008.

Principal activity

The principal activity of the group throughout the year was the distribution of gas through the North of England network.

The subsidiary undertakings principally affecting the profits or net assets of the group in the year are listed in note 12 to the accounts.

Business review

The group operates a unique operating model, referred to as strategic asset management, whereby it has separated the asset management and ownership responsibilities of the network from the delivery of operational activity. The split of assets and operations means Northern Gas Networks Limited ("NGN") retains all of the obligations and responsibilities required by its Gas Distribution Licence and the Safety Case agreed with the Health and Safety Executive ("HSE"). NGN owns the network assets and is responsible and accountable for the continued safe and efficient running of the gas distribution network, ensuring the highest possible performance standards from planning through to asset maintenance and replacement. The operation and maintenance of the network, together with the implementation of the asset maintenance and replacement programmes has been contracted out to United Utilities Operations Limited ("UUOL"), a company owned by United Utilities plc, under the terms of an Asset Services Agreement ("ASA"). This model is delivering the expected operational results.

The group's financial results for the year are above expectations. Total revenue for the year was £323.7m (2007 - £289.5m) which was impacted by the price increase made in October 2007 together with increased volumes linked to colder than average temperatures at the start of 2008. Operating profit for the year was £73.5m (2007 - £63.7m).

The group has debt before financing costs of £1,013.4m (2007 - £978.7m) at the year end. This includes a bank loan of £366.4m (2007 - £366.4m) repayable on 1 June 2010 which carries interest at 6 month LIBOR plus a margin of 0.26%, short term facilities of £105.0m (2007 - £107.0m) which carry interest at LIBOR plus a margin of 0.26% and £37.0m (2007 - £nil) which carry interest at LIBOR plus a margin of 0.53% and bonds of £505.0m (2007 - £505.0m), with £250.0m repayable in 2027 and £255.0m repayable in 2035. Interest on the bonds is payable at a rate of 4.875%. This debt structure has given rise to interest payable and similar charges of £53.9m (2007 - £49.7m).

The tax charge for the year was £12.3m (2007 - £2.8m) which represents an effective tax rate of 64% (2007 - 18%).

Directors' report (continued)

Capital expenditure ("Capex") for the year was £44.8m (2007 - £38.2m) principally focused on investment in network assets and new IT systems used to support many of the group's operational business activities.

The group generated a net cash inflow from operating activities for the year of £132.7m (2007 - £106.2m). At the end of the year, the group's undrawn borrowing facilities available for use amounted to £221.6m (2007 - £46.6m). However £150.0m (2007 - £nil) of this undrawn facility represents borrowing facilities secured from the European Investment Bank and if this facility is drawn down prior to the bank loan being repaid in June 2010 the funds will need to be utilised to repay this existing bank loan.

Business strategy

The group's purpose is to provide safe and secure gas supplies to the people and the businesses within the distribution network. The group's vision of success is to be measured by the regulators, Ofgem and the HSE as being in the top two comparable utilities for the delivery of customer service, safety management and efficiency.

Key performance indicators

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

	2008	2007
Financial performance		
EBITDA*	£116.7m	£106.4m
Net cash from operating activities	£132.7m	£106.2m
Dividends paid	£70.0m	£65.0m
Post maintenance interest coverage ratio	1.9	1.9
EBITDA interest coverage ratio	2.1	2.1
Senior net debt/Regulatory asset value	67.5%	65.9%

* Earnings before interest, tax, depreciation and amortisation

Customer services

Quarterly customer satisfaction survey for repair and replacement	4.0 out of 5.0	4.0 out of 5.0
---	----------------	----------------

Safety

Number of lost time injuries to employees and contractors	7	8
Reported injuries to members of the general public	25	10

Directors' report (continued)

Environment

The group recognises the importance of its environmental responsibilities and undertakes its operations in an environmentally sensitive manner, complying with all relevant legislative requirements and higher standards where possible. The group is committed to the protection of the environment in the region it serves. The group's environmental management systems are certified under ISO14001. This helps the directors deal proactively with future environmental issues and legislation and assist in the development of projects, for example, its recycling project at Sheepscar in Leeds.

Principal risks and uncertainties

The group's principal risks and uncertainties are set out below:

Regulatory environment, revenue and costs

The gas industry is subject to extensive legal and regulatory obligations and controls which NGN, as the licensed entity must comply with. The application and possible changes of these laws, regulations and regulatory standards could have an adverse affect on the operations and financial position of the group.

Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or member of the general public. Any such incident could have an adverse affect on the reputation of the group, or lead to potential prosecution and reduced productivity.

Refinancing of debt

The group has a requirement to refinance a proportion of its debt by June 2010 when some of the existing facilities end. Given the current economic conditions and the uncertainty within the debt markets there is a risk that this finance will be difficult to obtain on acceptable terms, or terms which are within the cost of debt allowances awarded by Ofgem at the last price control review.

Contract and contractor management

As described above, the operation and maintenance of the network, as well as the responsibility for implementing the Capex and Replacement programmes, has been contracted out to UUOL under the terms of the ASA which expires on 31 March 2013. Under the terms of the ASA, UUOL's costs of providing such services are passed through to the group, subject to bonus and penalty payments where the costs are respectively below or above agreed target levels. There is a risk that any delivery delays, excessive costs or inadequate quality by UUOL would damage the group's business reputation or increase costs or liabilities.

Directors' report (continued)

Network performance

If the network assets were to fail it could result in a loss in supply of gas to customers and associated adverse publicity and an unexpected increase in costs.

Employees

The success of the group depends to a significant extent on the contribution of its employees and the employees and contractors of UUOL. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business. The ability to adapt in a climate of change is dependent on the appointment of a high calibre, competent, flexible, quality conscious and customer focused workforce all of whom are committed to business success. Appropriate succession planning strategies mean that development of existing staff is crucial. Effective resourcing and selection processes also play a positive role in improving the image of the group in the community it serves.

The group, as an equal opportunities employer, ensures that no job applicant receives less favourable treatment because of his or her age, colour, disability, ethnic or national origin, gender, marital status or sexuality or is disadvantaged by conditions or requirements which are irrelevant to performance and the group's needs.

Future outlook

The directors expect the general level of activity to remain stable given the certainty provided by the price control outcome to 2013.

Financial risk management objectives and policies

The group's financial instruments, other than derivatives, comprise borrowings, cash and various items, such as trade debtors and trade creditors that arise directly from its operations. The main purpose of these financial instruments is to finance the group's operations.

The group also enters into derivative transactions, principally interest rate swaps. The purpose of such transactions is to manage the interest rate risks arising from the group's sources of finance.

The main risks arising from the group's financial instruments are interest rate risk, currency risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

Directors' report (continued)

Interest rate risk

The long term approach adopted in minimising interest rate exposures on debt is as follows:

- To maintain a balanced debt portfolio comprising a mixture of fixed rate, floating rate and index-linked debt in order to achieve a degree of symmetry with the Regulator's broad approach to setting cost of debt allowances (each class of debt comprises between 20% and 50% of total debt beyond the end of the current price control period);
- To maintain a debt portfolio consistent with those of comparable utility companies; and
- To synchronise the maturities of fixed rate interest hedges on floating rate debt with the timing of the Regulator's five yearly price control reviews.

Currency risk

No exposures are currently identified. Regular monitoring procedures will identify material risks as they arise. Currency risk management is only used to hedge underlying commercial exposures. Therefore trading in currency is prohibited and if an underlying exposure ceases to exist then the corresponding hedge is closed out immediately.

All non-sterling borrowings and associated service costs are hedged into sterling at the time the commitment to draw down is made.

Liquidity risk

The maturities of required committed debt facilities are managed such that at any one time all have a time to maturity of more than one year and that at least 50% by value have a time to maturity of more than two years except for finance leases which have a maturity of less than one year.

Facilities are staggered to maturity to avoid excessive concentrations in any twelve month period as well as removing refinancing risk if such timeframes coincide with a regulatory reset date. Non-facility debt maturities are also staggered where practicable.

Going concern

The group's business activities, liquidity position and borrowing facilities together with the factors likely to affect its future development and performance are set out in the Business Review on pages 1 to 4. In addition note 16 to the accounts includes details of the group's net debt position and details of its financial instruments.

The group has £508.4m of drawn debt with facilities expiring in June 2010. The current economic conditions create uncertainty particularly over the availability of debt capital market and bank finance in the foreseeable future. The group will open negotiations to refinance this debt in due course but has not at this stage sought any written commitments that the debt will be available or subscribed. However, the group has held discussions with its key relationship banks about its future borrowing needs and no matters have been drawn to its attention to suggest that a refinancing may not be available to the group.

Directors' report (continued)

After making enquiries, the directors have a reasonable expectation that the company and group have adequate resources to continue in operational existence for the foreseeable future. Accordingly, they continue to adopt the going concern basis in preparing the Annual Report and accounts.

Dividends

The directors do not recommend payment of a final dividend. Interim dividends of 2.8p per share were paid on 20 June 2008 and of 9.5p per share were paid on 29 December 2008 making a total of 12.3p per share for the year (2007 – 11.4p).

Directors

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

W Shurniak (Chairman)

B Scarsella (Chief Executive Officer)

F R Frame

H Lam Kam

K Sum Tso

N McGee

A Hunter

J Dorrian (resigned 25 April 2008)

S Fraser

M Robinson (appointed 25 April 2008)

The Board of Directors

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

The Board meet at least six times a year. The number of Board meetings held during the year and attendees at the Board meetings is detailed below:

2008		2007	
Date	Attendees	Date	Attendees
7 January	9 out of 9	8 January	8 out of 9
3 March	7 out of 9	5 March	9 out of 9
7 May	8 out of 9	21 May	9 out of 9
2 July	9 out of 9	4 July	8 out of 9
8 September	7 out of 9	3 September	9 out of 9
17 November	8 out of 9	12 November	9 out of 9

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT who formally report to the CEO bi-annually. The Board is ultimately responsible for the system of internal controls and for the review of effectiveness.

Directors' report (continued)

Supplier payment policy

The company's policy, which is also applied by the group, is to settle terms of payment with suppliers when agreeing the terms of each transaction, ensure that suppliers are made aware of the terms of payment and abide by the terms of payment. Trade creditors of the group at 31 December 2008 were equivalent to 22 (2007 – 18) days' purchases, based on the average daily amount invoiced by suppliers during the year.

Charitable and political contributions

During the year the group made charitable donations of £84,221 (2007 - £53,594), principally to local charities serving the communities in which the group operates. Charitable donations include a project called Northern Green Networks which provided £60,000 (2007 - £50,000) to local community groups within the network region to support environmental schemes. No political donations were made (2007 - £nil).

Disabled employees

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

Employee consultation

The group places considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees and on the various factors affecting the performance of the group. This is achieved through both formal and informal meetings. Employees are consulted regularly on a wide range of matters affecting their current and future interests. Employees are eligible to receive an annual bonus related to the overall financial and operational performance of the group.

Directors' report (continued)

Auditors

Each of the directors at the date of approval of this report confirms that:

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

This confirmation is given and should be interpreted in accordance with the provisions of section 234ZA of the Companies Act 1985.

The directors will place a resolution before the annual general meeting to reappoint Deloitte LLP as auditors for the ensuing year.

1100 Century Way
Thorpe Park Business Park
Colton
Leeds
LS15 8TU

By order of the Board,



5 March 2009

B Scarsella

Director

Directors' responsibilities

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

Company law requires the directors to prepare accounts for each financial year. Under that law the directors have elected to prepare the accounts in accordance with United Kingdom Generally Accepted Accounting Practice (United Kingdom Accounting Standards and applicable law). The accounts are required by law to give a true and fair view of the state of affairs of the company and the group and of the profit or loss of the group for that year. In preparing these accounts, the directors are required to:

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

The directors are responsible for keeping proper accounting records that disclose with reasonable accuracy at any time the financial position of the group and company and enable them to ensure that the accounts comply with the Companies Act 1985. They are also responsible for safeguarding the assets of the group and company and hence for taking reasonable steps for the prevention and detection of fraud and other irregularities.

Independent auditors' report

To the Members of Northern Gas Networks Holdings Limited

We have audited the group and parent company accounts (the "accounts") of Northern Gas Networks Holdings Limited for the year ended 31 December 2008 which comprise the consolidated profit and loss account, the consolidated and company balance sheets, the consolidated cash flow statement, the consolidated statement of total recognised gains and losses, the statement of accounting policies and the related notes 1 to 27. These accounts have been prepared under the accounting policies set out therein.

This report is made solely to the company's members, as a body, in accordance with section 235 of the Companies Act 1985. 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 auditors' report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and accounts in accordance with applicable law and United Kingdom Accounting Standards (United Kingdom Generally Accepted Accounting Practice) are set out in the Statement of Directors' Responsibilities.

Through management, the directors are responsible for the maintenance and integrity of the corporate and financial information included on the group's website. Legislation in the United Kingdom governing the preparation and dissemination of accounts may differ from legislation in other jurisdictions.

Our responsibility is to audit the accounts in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the accounts give a true and fair view and are properly prepared in accordance with the Companies Act 1985. We also report to you whether in our opinion the information given in the Directors' Report is consistent with the accounts.

In addition we report to you if, in our opinion, the company has not kept proper accounting records, if we have not received all the information and explanations we require for our audit, or if information specified by law regarding directors' remuneration and other transactions is not disclosed.

We read the other information contained in the Annual Report, and consider whether it is consistent with the audited accounts. We consider the implications for our report if we become aware of any apparent misstatements or material inconsistencies with the accounts. Our responsibilities do not extend to any further information outside the Annual Report.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the accounts. It also includes an assessment of the significant estimates and judgements made by

Independent auditors' report (continued)

the directors in the preparation of the accounts, and of whether the accounting policies are appropriate to the group's and company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the accounts are free from material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the accounts.

Opinion

In our opinion:

- the accounts give a true and fair view, in accordance with United Kingdom Generally Accepted Accounting Practice, of the state of the group's and the parent company's affairs as at 31 December 2008 and of the group's profit for the year then ended;
- the accounts have been properly prepared in accordance with the Companies Act 1985; and
- the information given in the Directors' Report is consistent with the accounts.



Deloitte LLP
Chartered Accountants and Registered Auditors
Leeds

5 March 2009

Consolidated profit and loss account

For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Turnover	1	323,663	289,529
Cost of sales		(13,564)	(12,542)
Gross profit		310,099	276,987
Other operating expenses	2	(236,621)	(213,301)
Operating profit		73,478	63,686
Finance charges (net)	3	(54,291)	(48,520)
Profit on ordinary activities before taxation	4	19,187	15,166
Tax on profit on ordinary activities	7	(12,287)	(2,776)
Profit for the financial year	19	6,900	12,390

The above results arise from continuing operations.

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

Consolidated statement of total recognised gains and losses

For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Profit for the financial year		6,900	12,390
Actuarial (loss) gain relating to the pension scheme	25	(11,331)	10,260
Deferred tax attributable to actuarial (loss) gain		3,173	(2,873)
Total recognised losses and gains relating to the year		(1,258)	19,777

The accompanying notes are an integral part of this consolidated statement of total recognised gains and losses.

Consolidated balance sheet

31 December 2008

	Notes	2008 £'000	2007 £'000
Fixed assets			
Intangible assets - goodwill	10	205,781	211,432
Tangible assets	11	1,388,115	1,380,939
Investments	12	104	104
		<u>1,594,000</u>	<u>1,592,475</u>
Current assets			
Debtors – due within one year	13	32,370	47,062
Cash at bank and in hand		1,096	1,195
		<u>33,466</u>	<u>48,257</u>
Creditors: Amounts falling due within one year	14	<u>(236,107)</u>	<u>(199,786)</u>
Net current liabilities		<u>(202,641)</u>	<u>(151,529)</u>
Total assets less current liabilities		1,391,359	1,440,946
Creditors: Amounts falling due after more than one year	15	(899,880)	(892,616)
Provisions for liabilities and charges excluding pension liability	17	<u>(125,654)</u>	<u>(116,577)</u>
Net assets excluding pension liability		<u>365,825</u>	<u>431,753</u>
Pension liability	25	<u>(14,936)</u>	<u>(9,606)</u>
Net assets including pension liability		<u>350,889</u>	<u>422,147</u>
Capital and reserves			
Called-up share capital	18	571,671	571,671
Profit and loss account	19	<u>(220,782)</u>	<u>(149,524)</u>
Shareholders' funds	20	<u>350,889</u>	<u>422,147</u>

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

Company balance sheet

31 December 2008

	Notes	2008 £'000	2007 £'000
Fixed assets			
Investments	12	<u>550,174</u>	<u>550,174</u>
Current assets			
Debtors			
- due within one year	13	1	1
- due after one year	13	24,328	24,328
Cash at bank and in hand		<u>1</u>	<u>2</u>
		24,330	24,331
Creditors: Amounts falling due within one year	14	<u>(2,728)</u>	<u>(2,729)</u>
Net current assets		<u>21,602</u>	<u>21,602</u>
Total assets less current liabilities		<u>571,776</u>	<u>571,776</u>
Net assets		<u>571,776</u>	<u>571,776</u>
Capital and reserves			
Called-up share capital	18	571,671	571,671
Profit and loss account	19	<u>105</u>	<u>105</u>
Shareholders' funds		<u>571,776</u>	<u>571,776</u>

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

The accounts were approved by the Board of Directors and authorised for issue on 2 March 2009 and signed on its behalf by:



B Scarsella

Director

5 March 2009

Consolidated cash flow statement

For the year ended 31 December 2008

	Notes	2008 £'000	2007 £'000
Net cash inflow from operating activities	21	132,674	106,223
Returns on investments and servicing of finance	22	(50,170)	(48,901)
Taxation - UK corporation tax paid		(4,474)	(234)
Capital expenditure and financial investment	22	(43,129)	(38,488)
Equity dividends paid		(70,000)	(65,000)
Cash outflow before financing		(35,099)	(46,400)
Financing	22	35,000	42,781
Decrease in cash in the year	23	(99)	(3,619)

The accompanying notes are an integral part of this consolidated cash flow statement.

Statement of accounting policies

31 December 2008

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year other than for the adoption of the Amendment to Financial Reporting Standard ("FRS") 17 – Retirement Benefits. No financial impact was noted as a result of this change.

Basis of accounting

The accounts have been prepared under the historical cost convention and in accordance with applicable United Kingdom accounting standards.

Basis of consolidation

The group accounts consolidate the accounts of the company and its subsidiary undertakings drawn up to 31 December. The results of subsidiaries acquired or sold are consolidated for the years from or to the date on which control passed. Acquisitions are accounted for under the acquisition method.

Going concern

The Directors' report includes a note on pages 5 and 6 stating that the directors consider the business to be a going concern at the time of the approval of the Annual Report and accounts.

Intangible assets – goodwill

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

Tangible fixed assets

Tangible fixed assets are stated at cost, net of depreciation and any provision for impairment. Cost includes internal labour costs and finance costs incurred which are directly attributable to the construction of tangible fixed assets. Contributions received towards the cost of tangible fixed assets are included in creditors as deferred income and credited on a straight-line basis to the profit and loss account over the estimated economic lives of the assets. Depreciation is provided on all tangible fixed assets, other than freehold land and assets in the course of construction, at rates calculated to write off the cost, less estimated residual value, of each asset on a straight-line basis over its expected useful life, as follows:

Mains & services	55 to 65 years
Storage	40 years
Plant & machinery	10 to 50 years
Freehold buildings	50 years
Leasehold land and buildings	Lesser of lease period and 50 years
Motor vehicles and office equipment	3 to 10 years

Statement of accounting policies (continued)

Investments

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

Replacement expenditure

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing or lining sections of pipe. This expenditure is principally undertaken to repair and to maintain the safety of the network and is expensed as incurred. Expenditure that enhances the performance of the mains and services assets is treated as an addition to tangible fixed assets.

Taxation

Current 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 tax in the future or a right to pay less tax in the future have occurred at the balance sheet date. Timing differences are differences between the group's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in years different from those in which they are recognised in the accounts.

A net deferred tax asset is regarded as recoverable and therefore recognised only when, on the basis of all available evidence, it can be regarded as more likely than not that there will be suitable taxable profits from which the future reversal of the underlying timing differences can be deducted.

Deferred tax is not recognised when fixed assets are revalued unless by the balance sheet date there is a binding agreement to sell the revalued assets and the gain or loss expected to arise on sale has been recognised in the accounts. Neither is deferred tax recognised when fixed assets are sold and it is more likely than not that the taxable gain will be rolled over, being charged to tax only if and when the replacement assets are sold.

Deferred tax is measured at the average tax rates that are expected to apply in the years in which the timing differences are expected to reverse, based on tax rates and laws that have been enacted or substantively enacted by the balance sheet date. Deferred tax is measured on a non-discounted basis.

Decommissioning and environmental costs

Decommissioning and environmental costs, based on discounted future estimated expenditures, are provided for in full and where appropriate a corresponding tangible fixed asset is also recognised. The unwinding of the discount is included within the profit and loss account as a financing charge.

Turnover

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

Statement of accounting policies (continued)

Pension costs

The group has obligations for a defined benefit scheme which is operated on its behalf by UUOL under the terms of the ASA. The responsibility for making payments of current service costs lies with UUOL, however the responsibility for any scheme deficit or surplus remains with the group. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments. They are included within operating costs, as part of the charge to the group from UUOL, under the terms of the ASA. Past service costs are recognised immediately in the profit and loss account if the benefits have vested. If the benefits have not vested immediately, the costs are recognised over the period until vesting occurs. The interest cost and the expected return on assets are shown as a net amount of other finance costs or credits adjacent to interest. Actuarial gains and losses are recognised immediately in the statement of total recognised gains and losses.

The defined benefit scheme is funded with the assets of the scheme held separately from those of the group, in separate trustee administered funds. Pension scheme assets are measured at fair value and liabilities are measured on an actuarial basis using the projected unit method and discounted at a rate equivalent to the current rate of return on a high quality corporate bond of equivalent currency and term to the scheme liabilities. The actuarial valuations are obtained at least triennially and are updated at each balance sheet date. The resulting defined benefit asset or liability, net of the related deferred tax, is presented separately after other net assets on the face of the consolidated balance sheet.

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

Leases

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

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

Finance costs

Finance costs of debt are recognised in the profit and loss account over the term of the instrument at a constant rate on the carrying amount.

Statement of accounting policies (continued)

Finance costs (continued)

Finance 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.

Debt

Debt is initially stated at the amount of the net proceeds after deduction of issue costs. The carrying amount is increased by the finance cost in respect of the accounting year and reduced by payments made in the year.

Derivative financial instruments

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

Interest rate swaps are entered into for the purpose of matching or eliminating risk from potential movements in interest rates associated with the borrowing requirements of the group. Amounts payable or receivable in respect of the interest rate swaps are recognised within net interest payable in the profit and loss account over the life of the financial instrument.

Notes to the accounts

31 December 2008

1 Segment information

The directors consider that the group has only one class of business. The group's turnover is generated wholly from within the UK.

2 Other operating expenses

	2008 £'000	2007 £'000
Distribution costs	223,361	202,784
Administrative expenses	13,260	10,517
	<u>236,621</u>	<u>213,301</u>

3 Finance charges (net)

	2008 £'000	2007 £'000
Interest payable and similar charges	53,926	49,683
Less: investment income	(716)	(704)
Other finance charges (income)	1,081	(459)
	<u>54,291</u>	<u>48,520</u>

Interest payable and similar charges

	2008 £'000	2007 £'000
Bank loans and overdrafts	29,901	25,106
Guaranteed bonds	24,619	24,686
Finance leases and hire purchase contracts	204	204
	<u>54,724</u>	<u>49,996</u>
Finance costs capitalised	(798)	(313)
	<u>53,926</u>	<u>49,683</u>

Finance costs have been capitalised based on a capitalisation rate of 5.99% (2007 - 6.25%).

	2008 £'000	2007 £'000
<i>Investment income</i>		
Income from fixed asset investments	207	202
Interest receivable and similar income	509	502
	<u>716</u>	<u>704</u>

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Other finance charges (income)

	2008 £'000	2007 £'000
Unwinding of discount on provisions (see note 17)	1,296	16
Net return on pension scheme (see note 25)	(215)	(475)
	<u>1,081</u>	<u>(459)</u>

4 Profit on ordinary activities before taxation

Profit on ordinary activities before taxation is stated after charging:

	2008 £'000	2007 £'000
Depreciation and amounts written off tangible fixed assets		
- owned	37,281	36,107
- held under finance leases and hire purchase contracts	256	910
Amortisation of goodwill	5,651	5,651
Profit on disposal of fixed assets	353	221
Operating lease rentals - other	215	176
	<u>47,156</u>	<u>48,065</u>

The analysis of auditors' remuneration is as follows:

	2008 £'000	2007 £'000
Fees payable to the company's auditors for the audit of the company's annual accounts and consolidation	15	14

Fees payable to the company's auditors and their associates for other services to the group

- The audit of the company's subsidiaries pursuant to legislation	65	63
Total audit fees	<u>80</u>	<u>77</u>

Fees payable to the company's auditors and their associates for other services to the group

- Other services pursuant to legislation	45	43
- Tax services	121	165
- Other services	5	5
Total non-audit fees	<u>171</u>	<u>213</u>

Notes to the accounts (continued)

5 Staff costs

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

	2008 Number	2007 Number
Administration	54	46
	<u>54</u>	<u>46</u>

	2008 £'000	2007 £'000
Their aggregate remuneration comprised:		
Wages and salaries	3,371	2,865
Social security costs	450	307
Other pension costs	260	230
	<u>4,081</u>	<u>3,402</u>

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	2008 £'000	2007 £'000
Emoluments	661	584
Amounts receivable (other than shares) under long-term incentive schemes	79	132
Company contributions to money purchase pension schemes	38	36
	<u>778</u>	<u>752</u>

Pensions

The number of directors who were members of pension schemes was as follows:

	2008 Number	2007 Number
Money purchase schemes	<u>1</u>	<u>1</u>

Notes to the accounts (continued)

6 Directors' remuneration and transactions (continued)

Highest-paid director

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

	2008 £'000	2007 £'000
Emoluments	661	584
Amounts receivable (other than shares and share options) under long-term incentive schemes	79	132
Company contributions to money purchase schemes	38	36
	<u>778</u>	<u>752</u>

Transactions

There have been no transactions with directors in the year (2007 - £nil) other than as set out above in respect of remuneration.

Notes to the accounts (continued)

7 Tax on profit on ordinary activities

The tax charge comprises:

	2008 £'000	2007 £'000
Current tax		
UK corporation tax	7,105	6,326
Adjustments in respect of prior years	(4,107)	-
Total current tax	<u>2,998</u>	<u>6,326</u>
Deferred tax		
Current year - origination and reversal of timing differences	3,457	4,335
Effects of decrease in tax rate on opening liability	-	(7,082)
Adjustments in respect of prior years	5,832	(803)
Total deferred tax	<u>9,289</u>	<u>(3,550)</u>
Total tax on profit on ordinary activities	<u>12,287</u>	<u>2,776</u>

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

	2008 £'000	2007 £'000
Group profit on ordinary activities before tax	<u>19,187</u>	<u>15,166</u>
Tax on group profit on ordinary activities at standard UK corporation tax rate of 28% (2007 - 30%)	5,372	4,550
Effects of:		
Expenses not deductible for tax purposes	6,006	6,686
Utilisation of tax losses	-	(803)
Capital allowances in excess of depreciation	(3,350)	(2,988)
Other timing differences	(1,019)	(1,108)
Adjustments in respect of prior year	(4,107)	(11)
Change in standard UK corporation tax rate	96	-
Group current tax charge for the year	<u>2,998</u>	<u>6,326</u>

The group earns its profits in the UK. Therefore the tax rate used for tax on profit on ordinary activities is the standard rate for UK corporation tax, currently 28% (2007 – 30%).

Notes to the accounts (continued)

7 Tax on profit on ordinary activities (continued)

The group's planned level of capital investment is expected to remain at similar levels as current investment. Therefore, it expects to be able to claim capital allowances in excess of depreciation in future years, at a similar level to the current year.

8 Profit attributable to the company

The profit for the financial year dealt with in the accounts of the parent company was £70,000,000 (2007 - £65,000,000). As permitted by Section 230 of the Companies Act 1985, no separate profit and loss account is presented in respect of the parent company.

9 Dividends paid on equity shares

	2008 £'000	2007 £'000
Equity shares		
- interim dividend paid of 2.8p (2007 – 2.6p) per ordinary share	15,750	15,000
- interim dividend paid of 9.5p (2007 – 8.7p) per ordinary share	54,250	50,000
	<u>70,000</u>	<u>65,000</u>

10 Intangible fixed assets - goodwill

£'000

Cost

At 1 January 2008 and 31 December 2008 226,030

Amortisation

At 1 January 2008 14,598

Charge for the year 5,651

At 31 December 2008 20,249

Net book value

At 31 December 2008 205,781

At 31 December 2007 211,432

Notes to the accounts (continued)

11 Tangible fixed assets

Group	Land and buildings £'000	Gas distribution assets £'000	Motor vehicles £'000	Other equipment £'000	Assets in the course of construction £'000	Total £'000
Cost						
At 1 January 2008	2,987	1,426,048	6,521	33,247	4,469	1,473,272
Additions	-	30,029	4,059	1,159	9,529	44,776
Disposals	(4)	-	(1,330)	(51)	-	(1,385)
At 31 December 2008	<u>2,983</u>	<u>1,456,077</u>	<u>9,250</u>	<u>34,355</u>	<u>13,998</u>	<u>1,516,663</u>
Depreciation						
At 1 January 2008	745	80,579	3,450	7,559	-	92,333
Charge for the year	238	32,625	1,186	3,488	-	37,537
Disposals	-	-	(1,308)	(14)	-	(1,322)
At 31 December 2008	<u>983</u>	<u>113,204</u>	<u>3,328</u>	<u>11,033</u>	<u>-</u>	<u>128,548</u>
Net book value						
At 31 December 2008	<u>2,000</u>	<u>1,342,873</u>	<u>5,922</u>	<u>23,322</u>	<u>13,998</u>	<u>1,388,115</u>
At 31 December 2007	<u>2,242</u>	<u>1,345,469</u>	<u>3,071</u>	<u>25,688</u>	<u>4,469</u>	<u>1,380,939</u>
Leased assets included above:						
Net book value						
At 31 December 2008	<u>325</u>	<u>-</u>	<u>48</u>	<u>-</u>	<u>-</u>	<u>373</u>
At 31 December 2007	<u>366</u>	<u>-</u>	<u>285</u>	<u>-</u>	<u>-</u>	<u>651</u>

Short leasehold included within land and buildings above has a cost of £442,000 (2007 - £442,000), depreciation charge in the year of £41,000 (2007 - £40,000), accumulated depreciation of £117,000 (2007 - £76,000) and a net book value of £325,000 (2007 - £366,000).

Leased assets included within motor vehicles above have a cost of £1,962,000 (2007 - £3,292,000), depreciation charge in the year of £215,000 (2007 - £870,000), accumulated depreciation of £1,914,000 (2007 - £3,007,000) and a net book value of £48,000 (2007 - £285,000).

Cumulative finance costs capitalised included in the cost of tangible fixed assets amount to £2,249,000 (2007 - £1,451,000).

The company does not hold any tangible fixed assets (2007 - £nil).

Notes to the accounts (continued)

12 Fixed asset investments

	Group		Company	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000
Subsidiary undertakings	-	-	550,174	550,174
Other investments	104	104	-	-
	<u>104</u>	<u>104</u>	<u>550,174</u>	<u>550,174</u>

Principal group investments

The parent company and the group have investments in the following subsidiary undertakings which principally affected the profits or net assets of the group.

Subsidiary undertakings	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Limited ⁺	England & Wales	Gas transportation	100 ordinary shares of £1	100
Northern Gas Networks Finance Plc	England & Wales	Financing	50,000 ordinary shares of £1	100

⁺ Held directly by Northern Gas Networks Holdings Limited.

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

Subsidiary undertakings

Cost and net book value

At 1 January 2008 and 31 December 2008 550,174

Other Investments

Cost and net book value

At 1 January 2008 and 31 December 2008 104

Notes to the accounts (continued)

13 Debtors

	Group		Company	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000
Amounts falling due within one year:				
Trade debtors	1,404	7,341	-	-
Amounts owed by parent undertakings	1	1	1	1
Prepayments and accrued income	30,965	39,720	-	-
	<u>32,370</u>	<u>47,062</u>	<u>1</u>	<u>1</u>
Amounts falling due after more than one year:				
Amounts owed by group undertakings	-	-	24,328	24,328
	-	-	<u>24,328</u>	<u>24,328</u>
	<u>32,370</u>	<u>47,062</u>	<u>24,329</u>	<u>24,329</u>

14 Creditors: Amounts falling due within one year

	Group		Company	
	2008 £'000	2007 £'000	2008 £'000	2007 £'000
Bank loans	142,000	107,000	-	-
Obligations under finance leases and hire purchase contracts	218	218	-	-
Payments received on account	10,795	12,409	-	-
Trade creditors	2,842	2,318	-	-
Amounts owed to group undertakings	-	-	2,298	2,016
Other taxation and social security	2,158	5,273	-	-
Accruals and deferred income	75,134	68,136	430	713
Defined contribution pension scheme accrual	28	24	-	-
UK corporation tax	2,932	4,408	-	-
	<u>236,107</u>	<u>199,786</u>	<u>2,728</u>	<u>2,729</u>

Bank loans comprise a working capital facility of £22.0m repayable on 30 January 2009; revolving credit facilities of £25.0m repayable on 22 January 2009 and £58.0m repayable on 30 January 2009; and bi-lateral facilities of £10.0m repayable on 22 January 2009, £17.0m repayable on 30 January 2009 and £10.0m repayable on 25 March 2009. These facilities are available to be redrawn until 1 June 2010. The drawn working capital facility and the revolving credit facilities carry interest at LIBOR plus a margin of 0.26%, the bi-lateral facilities carry interest at LIBOR plus a margin of 0.53%.

Notes to the accounts (continued)

15 Creditors: Amounts falling due after more than one year

	Group	
	2008 £'000	2007 £'000
Bank loan	365,824	365,438
Guaranteed bond due 2027	249,582	249,559
Guaranteed bond due 2035	254,553	254,536
Deferred income	29,921	23,083
	<u>899,880</u>	<u>892,616</u>

The bank loan is repayable on 1 June 2010 and carries interest at 6 month LIBOR plus a margin of 0.26%.

The guaranteed bond due 2027 of £250.0m matures on 30 June 2027 and will be redeemed at par. Interest is paid annually on 30 June at a rate of 4.875%.

The guaranteed bond due 2035 of £255.0m matures on 15 November 2035 and will be redeemed at par. Interest is paid annually on 15 November at a rate of 4.875%.

16 Derivatives and other financial instruments

Pages 4 and 5 of the Directors' report provide an explanation of the role that financial instruments have had during the year in creating or changing the risks the group faces in its activities. The explanation summarises the objectives and policies for holding or issuing financial instruments and similar contracts, and the strategies for achieving those objectives that have been followed during the year.

The numerical disclosures in this note deal with financial assets and financial liabilities as defined in Financial Reporting Standard 13 "Derivatives and other financial instruments: Disclosures" ("FRS 13"). Certain financial assets such as investments in subsidiary undertakings are excluded from the scope of these disclosures.

As permitted by FRS 13, short term debtors and creditors have been excluded from the disclosures, other than the currency disclosures. The directors believe that the fair values are not materially different from the balance sheet values.

Interest rate profile

The group has no financial assets other than sterling cash deposits of £1,096,000 (2007 - £1,195,000) which are part of the financing arrangements of the group. The sterling cash deposits comprise monies held in bank accounts.

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

After taking into account interest rate swap contracts entered into by the group, the interest rate profile of the group's financial liabilities at 31 December 2008 was as follows:

	Floating rate 2008 £'000	Fixed rate 2008 £'000	Total 2008 £'000
Borrowings – Bank Loans	365,824	142,000	507,824
Borrowings – Guaranteed Bonds	-	504,135	504,135
Finance leases	-	218	218
Total	365,824	646,353	1,012,177

The profile at 31 December 2007 for comparison purposes was as follows:

	Floating rate 2007 £'000	Fixed rate 2007 £'000	Total 2007 £'000
Borrowings – Bank Loans	365,438	107,000	472,438
Borrowings – Guaranteed Bonds	-	504,095	504,095
Finance leases	-	218	218
Total	365,438	611,313	976,751

Further analysis of the interest rate profile at 31 December 2008 and 31 December 2007 is as follows:

	2008		
	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings – Bank Loans	6.6	4.9	0.1
Borrowings – Guaranteed Bonds	-	4.875	23
Finance leases	-	15	1

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

2007

	Floating rate	Fixed rate	
	Weighted average interest rate %	Weighted average interest rate %	Weighted average period for which rate is fixed Years
Borrowings – Bank Loans	6.6	6.2	0.07
Borrowings – Guaranteed Bonds	-	4.875	24
Finance leases	-	15	1

Further details of interest rates on long term borrowings are given in note 15.

Maturity of financial liabilities

The maturity profile of the group's financial liabilities at 31 December was as follows:

	2008 £'000	2007 £'000
In one year or less	142,218	107,218
In more than one year but not more than two years	365,824	-
In more than two years but not more than five years	-	365,438
In more than five years	504,135	504,095
	<u>1,012,177</u>	<u>976,751</u>

Borrowing facilities

The group had undrawn committed borrowing facilities at 31 December, in respect of which all conditions precedent had been met, as follows:

	2008 £'000	2007 £'000
Expiring in more than one year but not more than two years	71,564	-
Expiring in more than two years	150,000	46,564
	<u>221,564</u>	<u>46,564</u>

The £150.0m of debt expiring in more than two years represents borrowing facilities secured from the European Investment Bank. If this facility is drawn down prior to the bank loan being repaid in June 2010 the funds will need to be utilised to repay the existing bank loan.

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

Fair values

Set out below is a comparison by category of book values and fair values of the group's financial assets and liabilities at 31 December.

Liabilities	2008		2007	
	Book value £'000	Fair value £'000	Book value £'000	Fair value £'000
Primary financial instruments held or issued to finance the group's operations				
Short term borrowings	142,000	142,000	107,000	107,000
Long term borrowings	365,824	356,429	365,438	357,140
Guaranteed bonds	504,135	454,139	504,095	508,720
Derivative financial instruments held to manage the interest rate and currency profile				
Interest rate swaps	-	59,481	-	17,446

The fair values of the interest rate swaps have been determined by reference to prices available from the markets on which the instruments involved are traded. All the other fair values shown above have been calculated by discounting cash flows at prevailing interest rates.

Notes to the accounts (continued)

16 Derivatives and other financial instruments (continued)

Gains and losses on hedges

The group enters into interest rate swaps to manage its interest rate profile. Changes in the fair value of instruments used as hedges are not recognised in the accounts until the hedged position matures. An analysis of these unrecognised gains and losses is as follows:

	2008			2007		
	Gains £'000	Losses £'000	Net £'000	Gains £'000	Losses £'000	Net £'000
Unrecognised gains and losses on hedges at 1 January	10,884	(28,330)	(17,446)	24,199	(25,676)	(1,477)
Gains and losses arising in previous years that were recognised in the year	-	-	-	-	-	-
Gains and losses arising before 1 January that were not recognised in the year	10,884	(28,330)	(17,446)	24,199	(25,676)	(1,477)
Gains and losses arising in the year that were not recognised in the year	58,326	(100,361)	(42,035)	(13,315)	(2,654)	(15,969)
Unrecognised gains and losses on hedges at 31 December	<u>69,210</u>	<u>(128,691)</u>	<u>(59,481)</u>	<u>10,884</u>	<u>(28,330)</u>	<u>(17,446)</u>
Of which:						
Gains and losses expected to be recognised in 2009	-	-	-	7,637	-	7,637
Gains and losses expected to be recognised in 2010 or later	<u>69,210</u>	<u>(128,691)</u>	<u>(59,481)</u>	<u>3,247</u>	<u>(28,330)</u>	<u>(25,083)</u>

Notes to the accounts (continued)

17 Provisions for liabilities and charges excluding pension liability

	Deferred taxation £'000	Environmental restoration £'000	Other £'000	Total £'000
Group				
At 1 January 2008	100,268	7,371	8,938	116,577
Charged to profit and loss account	8,189	-	350	8,539
Utilised in year	-	(199)	(559)	(758)
Adjustment arising from discounting	-	682	614	1,296
At 31 December 2008	<u>108,457</u>	<u>7,854</u>	<u>9,343</u>	<u>125,654</u>

Deferred tax

Deferred tax is provided as follows:

	2008 £'000	2007 £'000
Group		
Accelerated capital allowances	106,490	99,177
Other timing differences	<u>1,967</u>	<u>1,091</u>
Provision for deferred tax	<u>108,457</u>	<u>100,268</u>

Deferred tax in respect of the group's defined benefit pension scheme is disclosed in note 25.

Environmental restoration

Estimated environmental restoration costs are provided where the group has a legal obligation to restore sites at the balance sheet date. The provision represents the estimated net present value for statutory decontamination of old gas manufacturing sites. It also reflects the obligations associated with other environmental damage.

Other

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability events.

The timing of the utilisation of the environmental and other provisions is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

Notes to the accounts (continued)

18 Called-up share capital

	2008 £'000	2007 £'000
<i>Authorised</i>		
600,000,000 ordinary shares of £1 each	600,000	600,000
1 special share of £1	-	-
	<u>600,000</u>	<u>600,000</u>
<i>Allotted, called-up and fully-paid</i>		
571,669,980 ordinary shares of £1 each	571,670	571,670
<i>Allotted and called-up</i>		
999 ordinary shares of £1 each	1	1
1 special share of £1	-	-
	<u>571,671</u>	<u>571,671</u>

The unpaid shares remain outstanding within debtors at the year end.

The ordinary shares and the special share are separate classes of shares and carry the same rights and privileges and rank pari passu in all respects.

19 Reserves

	Profit and loss account £'000
Group	
At 1 January 2008	(149,524)
Profit for the financial year	6,900
Actuarial loss relating to the pension scheme	(11,331)
UK deferred tax attributable to the actuarial loss	3,173
Dividends paid on equity shares	<u>(70,000)</u>
At 31 December 2008	<u>(220,782)</u>
	Profit and loss account £'000
Company	
At 1 January 2008	105
Profit for the financial year	70,000
Dividends paid on equity shares	<u>(70,000)</u>
At 31 December 2008	<u>105</u>

Notes to the accounts (continued)

20 Reconciliation of movements in group shareholders' funds

	2008 £'000	2007 £'000
Profit for the financial year	6,900	12,390
Other recognised gains and losses relating to the year (net)	(8,158)	7,387
Dividends paid on equity shares	(70,000)	(65,000)
Net movement in shareholders' funds	(71,258)	(45,223)
Opening shareholders' funds	422,147	467,370
Closing shareholders' funds	350,889	422,147

21 Reconciliation of operating profit to operating cash flows

	2008 £'000	2007 £'000
Operating profit	73,478	63,686
Depreciation and amortisation	43,188	42,668
Profit on sale of tangible fixed assets	(353)	(221)
Decrease (increase) in debtors	14,691	(3,660)
Increase in creditors	5,791	7,314
(Decrease) increase in provisions	(408)	40
Adjustment for pension funding	(3,713)	(3,604)
Net cash inflow from operating activities – continuing operations	132,674	106,223

22 Analysis of cash flows

	2008 £'000	2007 £'000
<i>Returns on investments and servicing of finance</i>		
Interest received	716	704
Interest paid	(50,886)	(49,569)
Interest element of finance lease rentals	-	(36)
Net cash outflow	(50,170)	(48,901)
<i>Capital expenditure and financial investment</i>		
Purchase of tangible fixed assets	(43,545)	(38,761)
Sale of tangible fixed assets	416	273
Net cash outflow	(43,129)	(38,488)

Notes to the accounts (continued)

22 Analysis of cash flows (continued)

	2008 £'000	2007 £'000
<i>Financing</i>		
Increase in short term borrowings	35,000	43,000
Capital element of finance lease rental payments	-	(219)
Net cash inflow	35,000	42,781

23 Analysis and reconciliation of net debt

	1 January 2008 £'000	Cash flow £'000	Other non-cash changes £'000	31 December 2008 £'000
Cash at bank and in hand	1,195	(99)	-	1,096
	1,195	(99)	-	1,096
Debt due after 1 year	(869,533)	-	(426)	(869,959)
Debt due within 1 year	(107,000)	(35,000)	-	(142,000)
Finance leases	(218)	-	-	(218)
	(976,751)	(35,000)	(426)	(1,012,177)
Net debt	(975,556)	(35,099)	(426)	(1,011,081)

	2008 £'000	2007 £'000
Decrease in cash in the year	(99)	(3,619)
Cash inflow from increase in debt and lease financing	(35,000)	(42,781)
Change in net debt resulting from cash flows	(35,099)	(46,400)
Other non-cash changes	(426)	(453)
Movement in net debt in year	(35,525)	(46,853)
Net debt at 1 January	(975,556)	(928,703)
Net debt at 31 December	(1,011,081)	(975,556)

Notes to the accounts (continued)

24 Financial commitments

Capital commitments are as follows:

	Group	
	2008	2007
	£'000	£'000
Contracted for but not provided for	5,177	8,111
	<u>5,177</u>	<u>8,111</u>

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

	Land and buildings	
	2008	2007
	£'000	£'000
Group		
Expiry date:		
- between two and five years	53	53
- after five years	386	386
	<u>439</u>	<u>439</u>

The group has a total commitment of £11.6m (2007 - £12.1m) over the term of the bonds in relation to a financial guarantee from FGIC UK Limited ("FGIC") to cover the guaranteed bonds included within long term borrowings in note 15.

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

Under the terms of the ASA which expires on 31 March 2013, the operation and maintenance of the network, together with the implementation of the Capex and Replacement programmes has been contracted out to UUOL. The total value of the contract, to its expiry date, is estimated to be £0.6bn (2007 - £0.8bn).

Notes to the accounts (continued)

25 Pension arrangements

The group has obligations for a defined benefit pension scheme which is operated on its behalf by UUOL who are responsible for making payments of current service costs, which are then charged to the group under the terms of the ASA.

The amounts recognised in the balance sheet are as follows:

	2008 £'000	2007 £'000
Present value of funded obligations	195,262	218,356
Fair value of plan assets	(174,517)	(205,014)
Deficit	20,745	13,342
Related deferred tax asset	(5,809)	(3,736)
Net liability	<u>14,936</u>	<u>9,606</u>
Amounts in the balance sheet		
- Liabilities	<u>14,936</u>	<u>9,606</u>

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

	2008 £'000	2007 £'000
<i>Amount charged to Operating profit</i>		
Current service costs	<u>7,145</u>	<u>7,852</u>
<i>Amount credited to net finance charges</i>		
Interest costs	12,276	10,729
Expected return on plan assets	(12,491)	(11,204)
	<u>(215)</u>	<u>(475)</u>
Total	<u>6,930</u>	<u>7,377</u>

The total amounts recognised in the statement of total recognised gains and losses are as follows:

	2008 £'000	2007 £'000
Actuarial losses (gains)	<u>11,331</u>	<u>(10,260)</u>

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

	2008 £'000	2007 £'000
Actuarial losses (gains)	<u>6,180</u>	<u>(5,151)</u>

Notes to the accounts (continued)

25 Pension arrangements (continued)

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

	2008 £'000	2007 £'000
Opening defined benefit obligation	218,356	214,907
Service cost	7,145	7,852
Interest cost	12,276	10,729
Member contributions	833	887
Actuarial gains	(37,871)	(15,325)
Benefits paid	(5,477)	(694)
Closing defined benefit obligation	<u>195,262</u>	<u>218,356</u>

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

	2008 £'000	2007 £'000
Opening fair value of plan assets	205,014	186,930
Expected return	12,491	11,204
Actuarial losses	(49,202)	(5,065)
Employer contributions	10,858	11,752
Member contributions	833	887
Benefits paid	(5,477)	(694)
	<u>174,517</u>	<u>205,014</u>

The group expects to contribute £11.2m to its defined benefit pension plan in 2009.

The major categories of plan assets as a percentage of the total plan assets and the expected rate of return on plan assets are as follows:

	2008		2007	
	Percentage of plan assets %	Expected return on plan assets %	Percentage of plan assets %	Expected return on plan assets %
Equity securities	47.00	7.50	44.40	7.20
Bond securities	47.50	4.70	47.10	4.60
Real Estate	5.40	7.50	6.60	7.20
Other	0.10	1.80	1.90	5.30

To determine the overall expected rate of return on plan assets the group considered the current level of expected returns on risk free investments (primarily government bonds), the historical level of the risk premium associated with the other asset classes in which the assets are invested and the expectations for future returns of each asset class in

Notes to the accounts (continued)

25 Pension arrangements (continued)

the plan. The expected return for each asset class was then weighted, based on the asset allocation in the plan to develop the assumption for the expected rate of return on plan assets.

The actual return on plan assets is as follows:

	2008 £'000	2007 £'000
Actual return on plan assets	<u>(36,711)</u>	<u>6,139</u>

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

	2008	2007
Discount rate	5.85%	5.50%
Expected return on plan assets	5.90%	5.80%
Future salary increases	3.50%	3.90%
Future pension increases	3.00%	3.40%
Inflation	3.00%	3.40%
Life expectancy	22.2 years	22.2 years

Amounts for the current and previous four periods are as follows:

	31 December 2008 £'000	31 December 2007 £'000	31 December 2006 £'000	31 December 2005 £'000	1 May 2005 £'000
Defined benefit obligation	(195,262)	(218,356)	(214,907)	(197,300)	(163,900)
Plan assets	<u>174,517</u>	<u>205,014</u>	<u>186,930</u>	<u>167,600</u>	<u>137,900</u>
Deficit	<u>(20,745)</u>	<u>(13,342)</u>	<u>(27,977)</u>	<u>(29,700)</u>	<u>(26,000)</u>

Experience adjustments for the current and previous four periods are as follows:

	31 December 2008	31 December 2007	31 December 2006	31 December 2005	1 May 2005
Plan assets:					
Amount (£'000)	(49,202)	(5,065)	1,000	21,500	-
Percentage of plan assets	(27%)	(2%)	1%	13%	-
Plan liabilities:					
Amount (£'000)	4,800	4,052	-	400	-
Percentage of the present value of plan liabilities	2%	2%	-	0%	-

The group also operates defined contribution schemes for which the pension charge for the year amounted to £260,000 (2007 - £230,000).

Notes to the accounts (continued)

26 Related party transactions

Transactions with the directors of the company are disclosed in note 6.

During the year the group purchased services in the ordinary course of business from related parties as follows:

	2008 £'000	2007 £'000
CHED Services Limited	105	108
	<u>105</u>	<u>108</u>

CHED Services Limited is controlled within the Cheung Kong Infrastructure Holdings Limited group of companies whose ultimate parent undertaking is Hutchinson Whampoa Limited. There was £17,000 within creditors (CHED Services Limited) at 31 December 2008 (2007 - £17,000).

The group had no transactions with PG (April) Limited or Beta Central Profits Limited during the year. In the prior year, the group paid legal expenses on behalf of PG (April) Limited and Beta Central Profits Limited in the amount of £15,000 and £8,000 respectively. The debtor with PG (April) Limited remains outstanding at 31 December 2008.

27 Ultimate controlling party

The company is wholly owned by a consortium comprising of:

<u>Shareholder</u>	<u>Ultimate parent undertaking</u>
PG (April) Limited (40%)	Hutchison Whampoa Limited
Beta Central Profits Limited (35.1%)	Hongkong Electric Holdings Limited
United Utilities Energy and Contracting Services Holdings Limited (15%)	United Utilities plc
SAS Trustee Corporation (9.9%)	Not applicable