

Northern Gas Networks Limited

Annual Report and accounts
for the year ended 31 March 2023

Registered number: 05167070

Strategic report

For the year ended 31 March 2023

The directors present their Annual Report on the affairs of the company, together with the accounts and auditor's report, for the year ended 31 March 2023. The accounts are presented under Financial Reporting Standard 102 (FRS 102) issued by the Financial Reporting Council.

Review of the business

The company's purpose is to provide safe and secure gas supplies to the people and the businesses within the distribution network, being the North of England. The company's vision of success is to be consistently viewed by the regulators, Ofgem and the Health and Safety Executive ("HSE") as being market leading in safety management, efficiency and customer service, which in turn will generate value to the shareholders. All operations are performed by the subsidiary Northern Gas Networks Operations Limited, who recharge all expenditure to the company. The company continues to research and develop the use of hydrogen as an energy source of the future.

Financial and operational review

Operating profit for the year is £212.1m (2022 - £152.6m) with revenue increasing by £83.2m based on Ofgem allowances, offset by cost increases of £23.6m. The main drivers of the cost increase were: (1) shrinkage costs have increased by £9.7m reflective of market gas prices; (2) in 2022, costs benefited from a £6m credit following the closure to future accrual of the defined benefit pension scheme; (3) additional depreciation of £1.7m as we continue to invest in long life assets; and (4) general inflationary growth of the cost base. In the year the company incurred supplier of last resort costs of £95.9m (2022 - £0.8m) and revenue of the same amount, which are netted off within the accounts.

The company has debt at the 31 March 2023 with a book value of £1,690.0m (2022 - £1,731.2m) as shown in notes 13 and 14. Interest payable in the year on debt (and that held within the year) net of associated interest rate swaps used to hedge the debt amounted to £27.9m (2022 - £79.2m) as detailed in note 3. This significant change is primarily due to fair value movements and CPI swap accretion which in 2022 totalled to a debit of £45.2m compared to a credit of £1.8m in 2023. Details of the way swaps are used to manage interest exposures, and the impact this has on finance costs, are included in the 'financial risk management and objectives' section below. The company received a £300.0m intercompany loan on 2 June 2023, repayable after 10 years with an interest rate of 6.125%.

At the end of the year, undrawn borrowing facilities available for use amounted to £129.0m (2022 - £140.0m).

The tax charge for the year was £27.3m (2022 - £126.9m). In June 2021 the company restated deferred tax balances to 25% from 19% following the announcement and enactment by the Government to increase the UK corporation tax rates to 25% from 1 April 2023. The associated one-off impact of the change in the tax rate was a tax charge in the year ended March 2022 of £108.9m as shown in note 7.

The resulting profit after tax was £156.9m (2022 – loss of £53.5m).

Capital additions in the year across tangible and intangible assets was £175.2m (2022 - £163.5m) principally focused on investment in network assets including replacement expenditure.

Strategic report (continued)

Financial and operational review (continued)

The company had net assets of £607.8m at 31 March 2023 (2022 - £503.8m) the movement being due to profits, dividend payments in the year, and valuation movements in the defined benefit pension asset and cashflow hedge (see page 39).

Key performance indicators (KPIs)

The key financial and non-financial performance indicators used by the Board of Directors in their monitoring of the company, focus on the areas of safety management, efficiency (creating profit) and customer service and include:

	2023	2022
Operating profit	£212.1m	£152.6m
External debt less cash / regulatory asset value (gearing ratio)	61.3%	64.9%
Quarterly customer satisfaction survey scores	9 out of 10	9 out of 10
Carbon footprint (total annual net emissions)	355,694 t CO ₂ e	391,487 t CO ₂ e
Number of lost time injuries to employees and contractors (LTIs)	1	1
Reported injuries to members of the general public (MOPs)	1	2

All of the targets for the above KPI's have been achieved. Financial performance is discussed above within the financial and operational review. Customer service and safety management remains central to how NGN operate, and during the year the company has continued to perform well. The company has achieved an overall score of 9 out of 10 for customer satisfaction survey scores and continues to lead the industry with regard to safety, achieving the annual target of no more than 2 MOPs and 2 LTIs.

Carbon footprint management remains a pivotal measure of our commitment to sustainability (see the Sustainability Statement on page 23 for further details).

Strategic report (continued)

Principal risks and uncertainties

The company'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 Northern Gas Networks Limited ("NGN"), as the licensed entity, must comply with. All key commitments made within the current price control are being delivered. The application and possible changes of these laws, regulations and regulatory standards could have an adverse effect on the operations and financial position of the company or in the case of misreporting, a fine.

Mitigation

The company engages with the regulatory authority extensively at all levels of seniority, to understand future plans within the industry and potential impacts on the business. The company has in place an extensive set of policies and procedures to ensure compliance with legal and regulatory obligations. From 1 April 2021 a new 5 year price control period commenced (referred to as RIIO-GD2). All legal and regulatory obligations required during RIIO-GD2 are fully understood.

Health and safety

There is a risk that an incident within the network leads to injury to an employee, contractor or a member of the general public. Any such incident could have an adverse effect primarily for individuals concerned, but also on the reputation of the company, or lead to potential prosecution.

Mitigation

Health and Safety is the number one priority. The business has an Environment Health & Safety team that ensure compliance with company management safety systems and monitor performance on a monthly basis with key KPIs. In February of 2022 legal proceedings concluded regarding a HSE investigation into a gas explosion in Mirfield, which occurred in 2019 leading to the tragic death of a member of the general public. While it was acknowledged that the policies and procedures of the company were good, the severity of the outcome meant that a fine of £5.0m was paid by the company.

Network performance (including cyber risk)

If the network assets were to fail it could result in a loss in supply of gas to customers with associated adverse publicity and an unexpected increase in costs. The biggest cyber risk to NGN is the loss of control over the network.

Mitigation

The company has a set of policies and procedures to ensure the integrity of the network and ensure that the people who work on the network are qualified and competent. The company has comprehensive IT infrastructure governance which covers cyber risk. The company has invested heavily in cyber security over the last few years and are on high alert due to the ongoing European disruption.

Strategic report (continued)

Principal risks and uncertainties (continued)

Employees

The success of the company depends to a significant extent on the contribution of its employees and the employees of operational contractors. Fair and effective recruitment, training and employee development are critical to the successful functioning and progression of the business.

Mitigation

NGN's succession planning strategies mean that development of existing staff is crucial. The company, 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 company's needs. The company has published its gender pay gap analysis which can be found at <http://www.northerngasnetworks.co.uk>. The company complies with all UK human rights laws and has processes and procedures to assess risk and ensure compliance in this area.

Climate change, sustainability and asset life

The physical and transitional risks associated with climate change have been assessed. The principal climate change risk that would impact the financial records of the company is that gas in its existing form will play a declining and ultimately obsolete role in the UK energy system in order to achieve the UK Government's 'net zero by 2050' commitment. This could lead to stranded assets. Further disclosures on climate change risks and opportunities are provided in the Sustainability Statement on page 23.

Mitigation

The company, with other key industry partners, continue to invest in research and development to demonstrate the use of hydrogen as an alternative energy source which could be distributed through the existing gas infrastructure. This is contributing towards the delivery of the net zero by 2050 target and hence removes the need to reduce network asset useful economic lives or apply impairment. Further details on how NGN contribute to hydrogen development are provided on page 16, and asset lives are discussed within 'critical accounting judgments and key sources of estimation uncertainty' on page 48.

Financial risk management objectives and policies

The company's financial instruments, other than derivatives, comprise borrowings, cash, overdrafts 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 company's operations. The company also enters into derivative transactions, principally interest rate and index linked CPI swaps. The purpose of such transactions is to manage the interest rate and inflation risks arising from the company's sources of finance and regulatory cost of debt allowance. The main risks arising from the financial instruments are interest rate risk, inflation risk, credit risk and liquidity risk. The Board of Directors reviews and agrees policies for managing each of these risks and they are summarised below.

Strategic report (continued)

Financial risk management objectives and policies (continued)

Interest rate risk

Interest rate risk is the risk that adverse movements in interest rates will result in the company experiencing:

- an unacceptable variation to interest expense / cash flows in either the current year or the current regulatory price control period, and / or
- unacceptable variations between actual interest expense / cash flows and the element of revenue linked to the regulatory cost of debt allowance.

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

- On an ongoing basis to take account of the average cost of all debt compared with the actual and expected level of the regulatory allowance,
- To achieve an interest cost on new debt and/or hedging that is in line with, or lower than, the regulatory allowance for that year,
- To take account of the average life (in addition to average maturity) of actual debt and its relationship with the average life of the indexed cost of debt allowance,
- To combine derivatives and bonds in the overall strategy, using derivatives only where needed to align actual debt costs with the allowance,
- To achieve an appropriate balance of fixed/floating/index-linked debt,
- To factor in the impact of an increasing regulatory asset value and hence increasing debt levels,
- To use inflation linked derivatives where appropriate to align the debt profile more closely with regulatory assumptions, and deliver cash flow, hedging and funding cost benefits,
- To incorporate an element of flexibility in hedging and funding strategy to enable the above objectives to be met, and
- To maintain a debt portfolio broadly consistent with those of comparable utilities.

In practice, most floating rate debt, in addition to debt issued at fixed rate and swapped back to floating rate for life, has its rate re-fixed with interest rate swaps on a staggered basis in order to align the rate re-fixing profile on this debt with the regulatory cost of debt allowance, which is calculated with reference to a trailing average of certain corporate bond yields. In this manner the company is achieving certainty of interest costs and future cash flows on either pure floating rate debt or an aggregate floating rate exposure represented by a fixed rate debt instrument swapped to floating rate.

Within the above strategy the company applies hedge accounting where appropriate to minimise the impact on earnings of movements in the fair value of derivatives.

Strategic report (continued)

Financial risk management objectives and policies (continued)

Inflation risk

Inflation risk is the risk that inflation increases interest costs. The company uses inflation linked derivatives where appropriate to align the debt profile more closely with regulatory assumptions, and deliver cash flow, hedging and funding cost benefits.

Credit risk

Credit risk is the risk that a counterparty fails to discharge an obligation to the company. The company is exposed to this risk for various financial instruments including cash deposits and interest rate swaps.

The company monitors the credit standing of counterparties to whom it has financial exposures and monitors the size of these exposures against Board-approved limits. If a counterparty's credit standing falls below a certain benchmark and/or exposure to a counterparty rises above a certain level no new transactions are entered into with that counterparty economic ways to reduce the exposure are explored.

Liquidity risk

The maturities of all debt and committed debt facilities other than amortising loans, 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 five years. Debt and facility maturities are staggered to avoid excessive concentrations in any twelve month period as well as the period around regulatory reset dates where possible.

European disruption (war in Ukraine)

The ongoing disruption in Europe is being monitored to consider the implications on the group. The primary consideration is increasing gas prices, because the group adds gas to the network (shrinkage costs). For further details see the cost inflation section below.

Cost inflation risk

Inflation does not cause the company or the NGN group a significant risk within the current price control period, because a key variable in the regulated revenue mechanism of the group is inflation (as inflation grows so does revenue).

As a transporter of gas, it is important to note that NGN do not own the gas. The group does buy gas to add to the network following escapes, and while this is a pass through cost (funded through revenue with any 'under or over forecast' being calibrated in the following regulatory year), it can have a negative impact on cash flow for 12 months when costs are above forecast.

The significant increase in gas prices during 2022 has had the impact of causing issues for the customers of the group, some of whom have not been able to meet the cashflow demands and so have entered administration. For NGN this can cause bad debt, however this can be recovered through revenue in future periods under the uniform network code, and so the risk is only that of cash inflow timing.

Strategic report (continued)

Cost inflation risk (continued)

Bad debt in the period was minimal with the impact mainly being seen in the prior year, that being less than £5million which was recovered through revenue by March 2023.

The Board has reviewed financial forecasts which factor in the above and with reference to the headroom within banking facilities and headroom on the debt to RAV covenant as at the balance sheet date, do not consider the impact of inflation to influence going concern, or result in any need for asset impairment.

Statement of corporate governance arrangements

The Directors present a corporate governance statement (see page 13) under the guidance of Accounting Regulations Section 7:26 of the Companies Act 2006. As far as the Directors are aware all legal requirements under section 172 of the Companies Act have been complied with during the period and up to the date of signing the accounts.

Within the corporate governance statement reference is made as to how the Directors engage with the employees of the company and how they have regard to employee interests, and the effect of that regard, including on the principal decisions taken by the company during the financial year. The statement also details how the Directors have maintained relationships with key suppliers and customers.

Approved by the Board and signed on its behalf by

A handwritten signature in blue ink, appearing to read 'M J Horsley', with a horizontal line underneath.

M J Horsley, Director

19 July 2023

Directors' report

For the year ended 31 March 2023

The directors present their annual report on the affairs of the company, together with the accounts and auditor's report for the year ended 31 March 2023. The following disclosures have been made in the strategic report but are cross referenced here: principal activities, business review including KPI's, principal risks and uncertainties, and financial risk management objectives and policies. A Corporate Governance Statement is presented on page 13.

Directors

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

S D Beer		N D McGee
L S Chan		D N Macrae
A J Hunter	(Chairman)	C C Tsai
M J Horsley	(Chief Executive Officer)	C T Wan
H L Kam		

J Burnham (independent non-executive)

P Rogerson (independent non-executive)

The Board of Directors

The daily operations of the business are managed by a Senior Management Team ("SMT") and the Chief Executive Officer ("CEO"). All significant decisions are referred to the Board of Directors ("the Board"). The Board meets at least five times a year. The number of Board meetings held during the year and attendees (including alternates) at the Board meetings are detailed below:

Year ended 31 March 2023		Year ended 31 March 2022	
Date	Attendees	Date	Attendees
26 April 2022	11 out of 11	12 April 2021	11 out of 11
29 June 2022	9 out of 11	16 June 2021	11 out of 11
7 July 2022	11 out of 11	15 July 2021	9 out of 11
22 September 2022	11 out of 11	29 September 2021	10 out of 11
14 November 2022	11 out of 11	18 November 2021	11 out of 11
10 January 2023	10 out of 11	12 January 2022	10 out of 11

The effectiveness of systems and internal controls are reviewed on an ongoing basis by the SMT. The Board is ultimately responsible for the system of internal controls and for the review of their overall effectiveness.

Dividends

The directors do not recommend payment of a final dividend. Interim dividends of £1.73 per share were paid on 30 June 2022, and of £1.91 per share were paid on 20 December 2022, making a total of £3.63 per share for the year (2022 – £3.77). See note 8 for details. Declared dividends are in line with the expectations of the Board.

Directors' report (continued)

Directors indemnities

The Company has made qualifying third party indemnity provisions for the benefit of its directors. This was in place during the year and remains in force at the date of this report.

Future developments and events after the balance sheet date

The company received a £300.0m intercompany loan on 2 June 2023, repayable after 10 years with an interest rate of 6.125%. In April 2023 the company funded the buy in of the majority of the remaining pension liabilities, and terminated the two asset backed contribution schemes that were in place at the balance sheet date (further details in note 22).

Financial instruments

Financial instruments have been disclosed within note 15 and associated risks discussed within the strategic reports.

Going concern

The accounts have been prepared on a going concern basis. The company's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out in the strategic report and above. This includes the implication of European disruption (war in Ukraine) and inflation. The company has: (1) undrawn borrowing facilities of £129m at the balance sheet date; (2) has a prudent debt to RAV position at the balance sheet date; and (3) regulated revenue income until 31 March 2026. The net current liabilities position as at 31 March 2023 was driven by the £100m EIB loan repayable within one year. The required repayment of this could be covered by the forementioned £129m of headroom, or with the new £300m of debt raised after the balance sheet date. The directors have made enquiries and reviewed the forecasts which include assessment of covenants, and in light of the facilities available, have a reasonable expectation that the group has 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. Climate change has no impact on going concern as detailed within the sustainability statement.

Disabled employees / employee engagement

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 company continues and that appropriate training is arranged. It is the policy of the company that the training, career development and promotion of disabled persons should, as far as possible, be identical with that of all other employees. Details of employee engagement can be found in the corporate governance statement.

Energy and carbon

The company 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 company's environmental management systems are certified under ISO 14001: 2015. The company is committed to reducing its carbon emissions. Between 2021 and 2026 the aim of the group is to reduce gas shrinkage by 23%, Scope 1 and Scope 2 emissions excluding gas shrinkage by 47%, and key* Scope 3 emissions by 11%. Carbon reporting is in accordance with Ofgem guidance and published best practice, with approximately 50% of Scope 3 emissions measured and reported using actual consumption data. Details of what has been included within each reported scope is listed in the table below. The company is committed to continuously broadening the range of

Directors' report (continued)

Energy and carbon (continued)

emissions reported. New to 2023 are: Scope 1 F-gases; and Scope 3 employee commuting/homeworking, business travel (hotel stays), and purchased goods and services (batteries, consumable electrical items and vegetation maintenance contractor vehicles emissions). The emissions reduction program is managed by the Regulation Director within the group, supported by the senior management team and Board as needed. Reported greenhouse gas emissions are prepared in accordance with guidance provided by the UK Government and Ofgem. The conversion factors used for emission disclosures are as published by the UK Government for the relevant reporting year. The NGN shrinkage and leakage model is used to generate the leakage assessment in accordance with Ofgem guidance. The model comprises of four main leakage components; leakage from low pressure systems, medium pressure systems, above ground installations and interference damage. Each of these components has a number of internal inputs and assumptions. In addition to leakage, own use gas and theft of gas are calculated to make up the overall shrinkage calculation. These elements are fixed calculations being a percentage of throughput. Reported data has not been externally verified, due to robust internal processes.

Business Carbon Footprint		Performance	
		2023	2022
Scope 1: gas shrinkage	tonnes of CO ₂ e	328,250	363,344
Scope 1: natural gas consumption	tonnes of CO ₂ e	322	317
Scope 1: commercial vehicles, company cars and grey fleet	tonnes of CO ₂ e	4,777	4,466
Scope 2: electricity consumption (location based)	tonnes of CO ₂ e	714	952
Scope 2: electricity consumption (market based)	tonnes of CO ₂ e	0.3	2
Scope 3: indirect emissions – purchased goods and services, capital goods, fuel and energy activity, upstream transport and distribution, waste disposal, business travel, and employee commuting and homeworking	tonnes of CO ₂ e	21,630	22,406
Total Scope 1 and 2 (location based)	tonnes of CO ₂ e	334,064	369,081
Total Scope 1, 2 (location based) and 3	tonnes of CO ₂ e	355,694	391,487
Carbon offsets	tonnes of CO ₂ e	-	-
Total annual net emissions	tonnes of CO₂e	355,694	391,487
Total Scope 1 and 2 (location based)	emissions (tCO ₂ e) per £m turnover	662.20	876.04
Total Scope 1 and 2 (location based)	emissions (tCO ₂ e) per GWh of gas throughput	5.65	5.50
Total Scope 1, 2 (location based) and 3 emissions (tCO ₂ e) per £m turnover	emissions (tCO ₂ e) per £m turnover	705.07	929.22
Total Scope 1, 2 (location based) and 3	emissions (tCO ₂ e) per GWh of gas throughput	6.02	5.83
Scope 1 & 2	energy consumption (kWh)	308,974,659	339,303,392

Scope 3 emissions that we consider key are: rail & air (including helicopter) business travel, vehicles emissions by our direct service providers, emissions from pipe manufacture and transportation, and transportation and distribution loss from bought electricity.

All carbon and energy figures are based on actual data and are verified through our regulatory reporting process which requires robust, repeatable procedures to ensure accountability, traceability, accuracy and consistent methodologies year-on-year. Actual data is received in a number of formats including downloads from information systems, invoices and data from 3rd party providers showing transaction details (such as fuel card transactions). Each data source is filed and saved in a secure folder, with limited access. The data is then manipulated and

Directors' report (continued)

Energy and carbon (continued)

converted in to tCO₂e or KWh using published DEFRA conversion factors for the relevant year using a third party specialist environmental reporting platform. Where market-based factors are stated for consumed electricity these are based on REGO backed green energy tariff certification as stated in the contract between NGN and our energy suppliers, or information provided by landlords at leased properties where NGN are not in control of the electricity supply. Total annual net emissions figure uses location based methodology. Intensity metrics have been discussed via the Energy Networks Association (ENA) to ensure consistency between the gas distribution networks of Great Britain. As shown in the table, shrinkage remains the key element of emissions and energy consumption which is being reduced through efficient gas pressure management, treatment of the gas with a chemical to swell pipe joints to minimise leakage, swift gas escape management and gas mains replacement. Other activity to reduce emissions and energy consumption include vehicle fleet upgrading (company cars and commercial vehicles), utilising zero carbon electricity at all of our premises, vehicle route planning, driver efficiency tracking, use of carbon efficient technology in depot and office refurbishments, efficient use of teleconferencing and reduced senior management business travel. Annual gas shrinkage reduced by 10% between 2022 and 2023, with a similar 9% reduction in annual net emissions, including a reduction in annual electricity consumption. Small increases in natural gas consumption in NGN premises and NGN vehicles emissions were recorded compared to prior year as a result of the return to more typical working practices following the end of COVID-19 restriction. Reported Scope 3 emissions have decreased compared to prior year despite broadening the scope due to process improvements. Total emissions per £m turnover decreased in 2023 by 24% compared to 2022 due to reduced Scope 1 gas shrinkage emissions and increased business turnover between these periods. CO₂e emissions per Gwh of gas transported increased slightly (3%) between 2023 and 2022 despite the 9% reduction in total CO₂e emissions due to a 12% reduction in annual network gas throughput.

Auditor

Each of the persons who is a director 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 auditor is unaware; and
- the director has taken all the steps that he/she ought to have taken as a director to make himself/herself 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 section 418 of the Companies Act 2006. The directors will place a resolution before the annual general meeting to reappoint Deloitte LLP as auditor for the ensuing year. Authorise by the Board and signed on its behalf by



M J Horsley, Director

19 July 2023

1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU, United Kingdom

Directors' responsibilities statement

The directors are responsible 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 then apply them consistently;
- make judgments 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 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.

Corporate governance statement

For the year ended 31 March 2023

Scope of statement

NGN is not a listed entity, but as a large private company is required to prepare a corporate governance statement under Accounting Regulations Section 7:26 of the Companies Act 2006. This statement has been prepared using most of the 'Wates Principles' to provide a clear message on the business model, future strategies and core values and of NGN. It describes how the directors have had regard to the matters set out in section 172(1)(a) to (f) of Companies Act, as listed below:

- the likely consequences of any decision in the long term (approving the strategic direction and values);
- the interests of the company's employees;
- the desirability of the company maintaining a reputation for high standards of business conduct;
- the need to foster the company's business relationships with suppliers, customers and others;
- the impact of the company's operations on the community and the environment; and
- the need to act fairly as between members of the company.

The company is committed to pursuing leading governance practices as appropriate.

Overview of the Board

The Board of Northern Gas Networks Limited is comprised of eleven directors as at 31 March 2023, who are appointed by the shareholders and two of which are independent non-executive directors. All are independent of the day to day management of the company with the exception of the CEO who is a Board member and leads the company senior management team (SMT) who in turn manage the company. The Board are presented with information by the CEO and SMT to enable them to influence all the key business decisions of NGN. This arrangement ensures the shareholders are involved in making all the key business decisions through their appointed directors.

Board Members

The Board members who held office during the year are listed within the Directors' report.

The position of the Chairman of the Board is held by A Hunter. The position of Chief Executive Officer (CEO) is held by M J Horsley. These positions are separate with a view to maintaining an effective segregation of duties between management of the Board and the day to day management of the business.

P Rogerson and J Burnham are independent non-executive members of the Board.

Corporate governance statement (continued)

Overview of the Board (continued)

Board Meetings

The Board hold at least five scheduled meetings throughout the year. Comprehensive papers are presented to the Board both for information and approval which facilitate debate on the performance and future direction of the company. The number of Board meetings held during the year and attendees, including alternates, at the Board meetings is detailed in the Directors report.

Evaluation of the Board

Evaluation of the performance of the Board is conducted by virtue of their appointments being made and monitored by the shareholders. The performance of the CEO is assessed by the Board on an annual basis under the remit of the remuneration committee. The performance of each SMT member is assessed annually by the CEO as part of NGN's performance management process.

Overview of the committees

The Board has seven committees, as listed below, to assist in the execution of its duties and to allow a detailed consideration of complex issues.

All Board members are entitled to attend all committees under the terms of reference, with the minimum requirement being a quorum of at least two members from different shareholders. The attendance of the committees is also largely the same as for the Board. The audit and treasury committees are chaired by L S Chan, the ESG, the risk management and compliance committees are chaired by C Tsai and the remuneration and nominations committee are chaired by A Hunter.

Attendance including alternates of committees in the year is shown below:

Date of Committee	Audit Committee	Compliance Committee	Risk Management Committee	Treasury Committee	Remuneration Committee	ESG Committee	Nominations Committee
2023							
Jun 22	6 out of 6	7 out of 7	7 out of 7	7 out of 7	n/a	n/a	n/a
Jul 22	n/a	n/a	n/a	n/a	n/a	n/a	4 out of 4
Sep 22	6 out of 6	7 out of 7	7 out of 7	7 out of 7	n/a	n/a	n/a
Jan 23	n/a	n/a	n/a	n/a	6 out of 8	n/a	n/a
Feb 23	6 out of 6	7 out of 7	7 out of 7	7 out of 7	n/a	7 out of 7	n/a
2022							
Jun 21	6 out of 6	7 out of 7	7 out of 7	7 out of 7	n/a	n/a	n/a
Sep 21	6 out of 6	7 out of 7	7 out of 7	7 out of 7	n/a	n/a	n/a
Jan 22	6 out of 6	7 out of 7	7 out of 7	7 out of 7	7 out of 8	n/a	n/a

Corporate governance statement (continued)

Overview of the committees (continued)

Audit committee

The audit committee assists the Board with its responsibilities for financial reporting, maintaining an efficient system of internal control and internal and external audit processes. In addition, the committee provides an avenue for communication between internal audit, the external auditors and the Board. The activities of the committee are reported to and considered by the Board. The committee also reviews auditor independence where non-audit services are provided and the auditors confirm their independence as part of their reporting to the audit committee.

Compliance committee

The compliance committee assists the Board with its responsibilities to oversee compliance with obligations determined by statute, legislation, regulation (including licence obligations), contract or agreement. This committee considers, inter alia, reports on the application of the regulatory compliance process which covers licence and network code obligations.

Risk management committee

The risk management committee is responsible for reviewing the risk profile of the business and oversight of risk management processes. The committee provides the Board with regular reports of activities and findings. The business has a formal risk management policy. In addition, an integrated risk management framework is in place that includes a regular review of the business risk exposures. At each meeting of the risk management committee, the high level risk register is considered including any movement in the assessment of risk or changes in measurement or relative position to each other.

Treasury committee

The treasury committee assists the Board in fulfilling its oversight responsibilities with respect to compliance with its treasury policy, strategy and procedure development. The committee recommends any changes or amendments as appropriate. It also ensures that management undertakes to identify, monitor and manage treasury risks in a manner consistent with corporate strategy and objectives and its treasury policy.

Remuneration committee

The remuneration committee reviews and makes recommendations to the Board on overall remuneration policy of the company and determines the salary and bonus entitlement for the CEO, the SMT and all other company employees. The activities of the remuneration committee are reported to the Board at least annually.

Environmental, Social and Governance (ESG) committee

The primary function of this committee is to assist the Board in fulfilling responsibilities with respect to including, but not limited to environmental, health and safety, corporate social responsibility, sustainability, philanthropy, corporate governance, reputation, diversity, equality, climate change, community issues, lobbying and other public policy matters that are relevant. This is a new committee that first met in February of 2023.

Corporate governance statement (continued)

Overview of the committees (continued)

Nominations committee

The nominations committee exists to consider potential changes to independent Board membership and to assess the performance of these Directors.

Actions and responsibilities of the Board and its committees

The Board is responsible for and makes key decisions on the following areas.

Approving the strategic direction and values, with consideration of the likely consequences in the long term

The Board is responsible to the shareholders for the strategic direction of the company in both the short and long term and seeks to balance the best interests of the company with the objective of enhancing shareholder value. The long term primary objectives which reflect the strategic value of the company have been established since acquisition in 2005, that being to be a top performing gas distribution network with regard to safety, customer satisfaction and efficiency of delivery. The Board ensure they are aware of how well the company is performing in these areas through the establishment of KPIs which are reported upon at Board meetings, and the Board have linked the remuneration of the SMT to achieving Board approved targets in these areas.

Each autumn the Board invites the CEO to present the performance targets of the company over the next 5 years, with reference to the strategic direction of the company. If approved the Board set these targets as the budget for the following financial year (short term objectives). The Board approved the existing corporate values of NGN: intellectually curious; trail blazing, heartfelt; empowered, happy and community focus. To encourage the demonstration of these values, employee performance objectives include the demonstration of these values.

Energy Futures

The Board aim to steer the company so to reduce its carbon footprint and to be a key contributor to the UK's aspiration to achieve net zero greenhouse gas emissions by 2050. Under the guidance of the Board the SMT have been promoting and demonstrating the use of hydrogen as an alternative energy source to natural gas, which could be distributed through the existing gas infrastructure. Activity in this area on which NGN is working is detailed below.

Winlaton:

For around 11 months through to the summer of 2022, West Lane Primary school, St Paul's church and 668 homes in Winlaton in north-east England used hydrogen blended with natural gas delivered via the group's existing gas distribution network infrastructure without noticing any differences to the way they cooked or heated buildings. This was an important step in the journey to using hydrogen as an energy of the future, it being the first time hydrogen had been blended with natural gas and supplied through a public gas network. A report of findings was submitted to Government, ahead of a decision around the wider blending of hydrogen in the UK gas network. Whilst blending will not deliver net zero, its introduction to the gas network at scale would kick-start the hydrogen economy and socialise the use of hydrogen amongst the general public.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees (continued)

Hydrogen Homes:

The two hydrogen homes which NGN built were opened by the Energy Minister Anne-Marie Trevelyan in July 2021, and are open to the public to visit. These houses contain hydrogen appliances and are supplied with hydrogen gas. They continue to be of interest and attract visitors, demonstrating what is possible.

Redcar Hydrogen Village:

Redcar Hydrogen Village is NGN's proposal to create a village of 2,000 properties running on a 100% hydrogen from 2025 in parts of Redcar in line with the Government's 10-point plan for a green industrial revolution. The project is shortlisted alongside an alternative proposal being put forward by another Gas Distribution Network, and in September 2023 the Government and regulator will decide which project progresses to the 'build stage'.

Hydrogen Town:

In October 2022, along with other Gas Distribution Networks, NGN were issued a letter by Ofgem and Government inviting NGN to put forward high level proposals for Hydrogen Town Pilot locations. These proposals must have the ability to provide and convert up to 20,000 properties to hydrogen including a mix of domestic, industrial and commercial by the end of 2030. They must also have the resilience to ensure that supply of hydrogen is not an issue making the availability of hydrogen production and storage key to any location proposed. Additionally, Government have requested that each location demonstrate the ability to undertake a phased scale up to convert up to 200,000 properties by 2037. Such proposals have been submitted.

H21:

NGN's H21 project is a body of research work that demonstrate that hydrogen gas conversion is technically possible and economically viable. Recent projects have included testing hydrogen on a purpose built 1km micro-grid, which represents a typical UK distribution network. This has been used to review, test and make recommendations to amend the operational and maintenance procedures required to operate a network on 100% hydrogen.

East Coast Hydrogen:

East Coast Hydrogen, a collaboration between NGN, Cadent and National Grid Gas Transmission, is a program which aims to facilitate the supply of hydrogen created by several industrial sources. It would make available 7GW of hydrogen that could be transported by existing networks by 2030. On its own, this would exceed the Government's 5GW by 2030 target in a single region. The project will also demonstrate the innovation, engineering capabilities and economic opportunity in the North of England, and create tens of thousands of highly skilled green jobs in the future hydrogen economy.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees (continued)

The work done by the NGN group, along with its partners, has been fundamental to changing the view on hydrogen use as an energy source of the future, and the UK Government now see hydrogen as part of the green industry revolution to put the UK on the path to reaching net zero emissions by 2050.

Interests of the company's employees including evaluating the performance and remuneration of employees

The Board has fully encouraged the SMT to make NGN an employer of choice and supports the decisions made by the SMT with regard to employee engagement and evaluation.

The Board and SMT place considerable value on the involvement of its employees and has continued to keep them informed on matters affecting them as employees. This is achieved through various communications including: the CEO's call which are live teleconference broad-casts and include a question and answer section, and are available to be listened to in all offices and depots; regular business chats where groups gather and discuss what is occurring in the business and has SMT representation; email and letter communication when formal communication is needed.

Some employees are eligible to receive an annual bonus related to the overall financial and operational performance of the NGN group along with individual performance against set objectives. Other employees receive monthly incentive payments based on performance against operational efficiency, safety and customer targets.

Employees are encouraged to influence their own working environment, and are able to present changes in working practices, subject to meeting the desired company criteria over customer, safety and efficiency targets.

NGN has an inclusion and belonging policy and during the year NGN has offered inclusion and belonging training to all members of staff who line manage. A suite of wellbeing support is offered to all employees and NGN has trained up wellbeing champions throughout the business who work with the central wellbeing team.

The overall control environment of the company, to protect the shareholders' investment and manage risk

The Board expect the SMT of the company to develop and maintain a controlled environment which protects the company's assets. The Board ensure this is achieved through several processes including the establishment of a risk register which is reported to the Board three times a year via the risk management committee. This register quantifies the impact of risks facing NGN, both on a financial and non-financial basis, and documents the likelihood of the risk occurring, along with the controls which exist to mitigate the risk.

The Board have established an internal audit function which undertakes independent appraisals and provides assurance on the adequacy and effectiveness of business controls. All internal audit work is carried out according to the relevant best practice standards. The schedule of work carried out by internal audit is planned and Board approved so that key or higher risk areas are reviewed on a recurring basis, and all findings are reported by internal audit to the audit committee.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees (continued)

A data governance team, whose focus is ensuring assurance over the accurate capture and reporting of data to third parties, ensures a further layer of control.

Some of the key controls of the company are those surrounding the financial processes of the company and the Board request a summary of all such financial controls to be documented each year in a document called the Directors Questionnaire. This document is signed by the SMT and is representation to the Board that the SMT have maintained a suitable financial control environment throughout the period, which supports the financial statements for that year. The Board also request the internal and external auditors to review the Directors Questionnaire, so to ensure the document is a true reflection of the control environment in place.

An area of focus which is of growing interest to the Board is cyber security. The SMT have developed a cyber security resilience road map, which involves 34 projects across the RIIO-GD2 period. The plan, which amongst other things will be enhancing the groups operational technology security operations centre (OT SOC), will ensure the NGN group exceeds the growing legislative requirements, as set by the UK Cyber Security Council. During the year a Network and Information Systems (NIS) report was submitted to Ofgem which highlighted the significant progress made, with 18 of 39 objectives being ahead of expectation and the remaining 21 of 39 objectives being in line with expectation (based on objectives set out by the UK's National Cyber Security Centre).

Maintaining a reputation for high standards of business conduct

The company is trusted by stakeholders and has a good reputation for high standards of professionalism.

As part of this the Board look for a strong control environment which is managed through the SMT as detailed in the section above (see 'the overall control environment of the company, to protect the shareholders' investment and manage risk'). As noted in that section the Board review NGN's risk register which includes a quantification of non-financial risks, one of which is reputational risk, which covers the impact of changes in business standards.

The reputation of the company is maintained by the behaviour of its employees and so the Board have approved a code of conduct which is a guide to the professional standards expected of employees. Fraud policies and whistleblowing policies also exist to protect the reputation of NGN, should any detrimental employee behaviour exist. Suitable recruitment practices exist to minimise this risk.

Maintaining relationships with key suppliers, customers and other

Under the delegated authority of the Board the SMT has established a dedicated commercial services team covering all elements of procurement and supplier relations. All contracts are signed off by members of the SMT having first been reviewed by the NGN legal department and having agreed terms with the supplier.

Within the commercial services team there is a dedicated contract management function which supports in pre-contract activity and also post-contract work including the review of variations, again to ensure a strong relationship with suppliers. NGN seek to treat all suppliers fairly. During the year the group launched an updated supplier code of.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees (continued)

conduct to promote fair and sustainable procurement.

The Board are focused on maintaining strong relationships with NGN's customers to ensure this is to the benefit of both parties. NGN's primary customers are shippers, who transport gas through the network, and the communities (both businesses and residents) in which NGN work. Shipper relationships are managed through the application of Unified Network Code, the regulations established by Ofgem, and this regulation ensures fair working practice is maintained. The impact of NGN's work on community customers is important to the Board and NGN not only monitor feedback through customer feedback scores, but also spend time engaging with communities to understand how NGN could work differently to the benefit of such communities (see next section, 'monitoring the impact of the company: environmental matters and community impact').

Monitoring the impact of the company: environmental matters and community impact

Following Board approval the SMT launched NGN's People and Planet Strategy, to further develop the sustainability work completed by NGN, tackling the short, mid and long term challenges facing the business, the society in which NGN operates, and the planet. Examples of challenges established within this strategy include: the eradication of inequality in our work force; supporting wellbeing; increasing diversity to reflect the community that we serve; and progression toward zero emissions.

The facilitation of tackling these challenges will be aided by the establishment of the forementioned ESG committee which reports the Board. Furthermore, a staff based sustainability working group was established in April 2022 that meet quarterly, with terms of reference that define the purpose, scope, role and responsibility of the group. Actions to date include the publication of NGN's sustainability policy on NGN's website; a review of NGN's People and Planet Strategy; a review of business travel habits, and the establishment of a sustainability risk register to identify and manage potential issues. In September of 2022 NGN published an Environmental Report which sets out progress against targets set by NGN, including those made within the RIIO-GD2 business plan. Having a ISO14001 accredited environmental management system enables the monitoring and analysis of performance facilitating mitigation of adverse environmental behaviour. Some of the key findings within the report, include:

Minimising the environmental impact of our operations:

- Circa 200,000 tonnes of waste aggregate are produced by our operations each year. We currently send over 99% to recycle centres but will continue to look to increase this percentage.
- NGN facilitate the connection of biomethane production sites to our network, with 18 sites connected as at the 31 March 2023, enabling the supply of green gas.
- Committed to remove gas holders from our network by 1 April 2026 due to the pollution risk they hold. After 2 years of the 5 year RIIO-GD2 program we are in line with the scheduled work plan.

Corporate governance statement (continued)

Actions and responsibilities of the Board and its committees (continued)

- NGN's network delivers gas to 2.7million homes and businesses through 36,000km of pipe. We attended over 99% of uncontrolled gas escapes within 1 hour, to control the escape and minimise gas leaking into our atmosphere. We are also replacing circa 500km of old metal pipes with new plastic pipes annually to reduce gas escaping from the network.

Listening to our stakeholders view of environmental matters:

- Planting 40,000 trees to benefit nature in the community, and creating 250 homes for nature within our region across RIIO-GD2. After 2 of the 5 year program we are on track to deliver the set targets.
- Reducing waste from our offices and warehouses by 20% by 1 April 2026. In the year ended March 2023 waste production was down by 18% compared to March 2018 quantities.
- Ensuring our suppliers comply with our sustainability focused code of conduct which was launched in April of 2022, and supporting compliance through the provision of training and resource as needed, including the option to adhere on a tapered transition. In the year ended 31 March 2023 we achieved 77% of our target, that being to get 80% of our spend under the new code of conduct.

The impact of our business on the community in which we operate remains a key consideration. In 2021/22 the third party Business in the Community, assessed NGN's commitment to sustainability using their 'Responsible Business Tracker' tool. This tool assesses a company's commitment to societal and environmental matters aligned to the United Nations Sustainable Development Goals, and delivers benchmarking feedback to facilitate future improvement. The assessment scored NGN at 74% compliant, compared to a cohort average of 47%.

NGN have actioned several of the improvement findings with this report, including the forementioned support of suppliers onto our code of conduct, and the planting of trees. Another example of this is our customer energy campaign which reached over 6 million customers and raised awareness about saving energy.

Across RIIO-GD2 NGN aim to invest £6.5m within our community on carbon monoxide awareness and dealing with vulnerability. NGN use research to ensure we invest wisely to match the requirements of our customers, and our latest survey showed that 97% of surveyed customers agreed with our priorities, which includes tackling financial hardship due to the ongoing energy crisis.

Dividend payments

All dividend declarations are required to be recommended by the CEO in the first instance, and then approved by the Board prior to any payment.

Corporate governance statement (continued)

Maintenance of the need to act fairly between members of the company

The Board is comprised of directors who are appointed by the shareholders of the group. As such each shareholder has representation and the ability to contribute to all Board meetings and so influence the decisions made by the Board.

The shareholder agreement in place for NGN is a legal entitlement for each shareholder to have this representation and as such the shareholders are appropriately protected.

Sustainability statement

31 March 2023

This disclosure is made in general accordance with the requirements of company's climate-related financial disclosure regulations 2022, and is voluntary. The information presented below presents the group's approach to the identification, assessment and mitigation of climate change related issues. The statement should be read in conjunction with the Corporate governance statement which details how the Board actions its' responsibilities including those related to sustainability, and the Directors' report which details carbon emissions performance.

Strategy

NGN's People and Planet Strategy was launched in 2022 and includes quantitative commitments to protect the environment and ensure NGN make responsible decisions to ensure their customers, colleagues and supply chain thrive in the long term. The strategy includes short term (to 2026), medium term (to 2030) and long term (to 2050), including the following which are of relevance to climate change:

- Net zero business by 2050 (aligned to UN SDG 11 and 13);
- Ensure our assets are resilient (aligned to UN SDG 11 and 13);
- Provide access to affordable energy solutions (aligned to UN SDG 7 and 11); and
- Enable affordable, decarbonized heat, power and transport solutions (aligned to UN SDG 7).

Each target in NGN's People and Planet Strategy is assigned a relevant owner from the SMT to assign accountability for delivery. Performance against commitments is monitored, measured and reported by NGN's dedicated in-house sustainability team and communicated to the SMT and Board when needed.

Governance

The Board approved the objectives and targets of the People and Planet Strategy and monitor the progress of its implementation by review of key performance indicators, including gas leakage and business carbon emissions. Significant investment decisions to support achievement of NGN's strategic commitments, for example investment in vehicle fleet decarbonization, are reviewed by the Board for compliance with NGN's strategic targets. The achievement of company sustainability targets is a key metric in evaluating company performance and carbon emissions performance is integrated into the determination of bonuses for applicable colleagues including the SMT. Material regulatory and legal changes in relation to climate change are communicated to the Board via papers prepared by the NGN Regulatory and Strategic Planning Director.

In the year, the Board established an ESG committee with the primary function to assist the Board in fulfilling responsibilities including identifying and reviewing climate change related risks and opportunities, and monitoring company performance with respect to strategic climate change related business strategies and commitments. The committee includes executive and non-executive directors of the group, NGN's Legal Director and NGN's Head of Environment and Sustainability. The committee first met in February 2023 and will meet three times per year.

Sustainability statement (continued)

Governance (continued)

Furthermore, NGN have a Sustainability Working Group that was established in April 2022 and meets quarterly with defined terms of reference. The group is composed of senior business leaders with the objectives of identification and discussion of material sustainability related business aspects, issues, risks and opportunities and monitoring and oversight of business sustainability performance and performance of key individual sustainability initiatives/projects.

Risk Management

The Board expect the SMT of the company to develop and maintain a controlled environment which protects the company's assets in the long term, including with respect to physical and transitional risks associated with climate change. The Board ensure this is achieved through a risk management framework which includes the establishment of a risk management committee, details of which are documented on page 15, and documented on a risk register.

The Board have established an internal audit function which undertakes independent appraisals and provides assurance on the adequacy and effectiveness of business controls within NGN. All internal audit work is carried out according to the relevant best practice standards. The schedule of work carried out by internal audit is planned and Board approved annually so that key or higher risk areas are reviewed on a recurring basis, and all findings are reported by internal audit to the audit committee. During the year the internal audit function undertook an audit of processes and controls with respect to environmental legislation, including climate change adaptation and energy management.

Business risks are identified and assessed by the SMT and in-house business experts in conjunction with the NGN internal audit team. All risks are quantified and assessed on both a financial and non-financial basis (legal, reputational and policy/regulatory impacts) which includes the physical and transitional climate change related risks facing NGN at both strategic and operational levels. The likelihood of each risk occurring is then scored and the control measures which already exist to mitigate the risk occurring are documented and assessed to derive the overall risk level posed to the company. A SMT owner is assigned for each risk and actions are assigned (with completion dates) to ensure all risks are maintained at a tolerable level in accordance with the company risk management framework. The register is reviewed and updated quarterly with changes and updates communicated to the Board three times a year via the risk management committee.

The following principal climate change related risks are identified on the company register are assessed as low within our risk management framework:

Sustainability statement (continued)

Governance (continued)

Climate Change Risk Category	Climate Change Risk Description
Physical risk	Severe weather risks to continuity of business operations
	Network asset performance resilience to impact of climate change such as flooding
	Supply chain resilience to impact of climate change such as flooding
Transitional risk	Achievement of greenhouse gas emissions reduction targets
	Future of gas / future energy scenarios

Principal risks and opportunities

As described in the strategic report on page 4, sustainability is a key risk of the group. Further details of sustainability risks, which can be categorised as either physical or transitional, are shown below.

Physical risks and opportunities

NGN operate a natural gas distribution networks comprising approximately 37,000km of underground pipes and are a designated reporting authority under the Climate Change Act (2008). As a consequence, NGN assess and publicly report on our exposure to climate change related risks and our adaptation and mitigation under the Climate Change Adaptation Reporting Power (CCARP). Our latest (Round 3) assessment was published in December 2021 following previous assessments in 2015 (Round 2) and 2011 (Round 1).

In preparation of our 2021 assessment we worked with the other gas and electricity networks of Great Britain and the Met Office to undertake a bespoke review of the latest independent long term climate projection data for the UK to understand the risks posed to energy infrastructure assets from climate change. This structured assessment reviewed 12 different climatic hazards, ranging from changing rainfall patterns to longer growing and nesting seasons due to warmer and wetter conditions, for a worst-case high greenhouse gas emissions future scenario (known as RCP 8.5) consistent with a 4 degree Celsius warming versus preindustrial levels by 2100 on a timeframe extending up to 2080. Following this, NGN completed an assessment of the current (in 2021) risks posed to our business operations and assets and those anticipated for 2050 based on our current management procedures and mitigation activities.

Sustainability statement (continued)

Principal risks and opportunities (continued)

We assessed 34 identified risks across eight climatic hazards and in consideration of current levels of NGN mitigation and control identified no high risks and eight medium risks in 2021, with this changing to no high risks and seven medium risks in 2050. This inherent resilience is due to the comprehensive asset integrity and management procedures that NGN operate in addition to the majority of gas infrastructure assets being located underground. Interdependencies between gas, electricity and telecommunications networks were included in the assessment to reflect how failures from one sector can cause downstream impacts for other networks, and how this might change over time as network interconnectivity increases.

The most significant physical risks in 2021 are identified as fluvial and/or tidal flooding of above ground assets, and significant ice and snow events resulting in access difficulties to key assets, locations and operational activities, alongside the potential for 'loss of gas supply' to customer. The remainder of the identified medium risks are of moderate to significant impact but rated as unlikely to occur and therefore are of limited concern. The risks posed to our network by the following are expected to increase by 2050 but are noted to remain tolerable under current levels of mitigation:

- fluvial and tidal flooding of above ground assets;
- damage to pipe crossings over watercourses as a result of flooding;
- damage to underground pipes from river erosion (bed and banks), including land slippage; and
- above ground asset damage from wildfire.

It is of note that the risk of underground asset damage as a result of cycles of dry and wet weather, or frost heave, resulting in ground movement is expected to reduce from medium to low risk by 2050 as a result of completion of our long term programme of replacing aged, brittle metallic gas mains with more flexible plastic pipes.

We operate a Strategic Asset Management Plan framework, which requires the production of long term (25 years) asset management plans for each business asset type (for example 'network assets' such as high pressure pipelines, and 'non-network assets' such as company vehicles) to ensure they operate in a safe, resilient and sustainable manner at the optimum cost for customers. Individual asset management plans include assessment of relevant climate change risks (such as flooding or river erosion) and appropriate management measures. The individual asset management plans are used to develop our regulatory investment plans for each asset type which we submit to our regulator for approval as a part of the periodic price control reviews. Based on this comprehensive asset management framework coupled with asset management systems comprising audits, inspections and monitoring, climate change asset resilience is currently assigned an overall low risk in our company risk register framework which is reflective of the extensive control measures in place. This risk is predicted to remain as such in 2050 even under a high emissions scenario based on continuation of current levels of mitigation and management.

Sustainability statement (continued)

Principal risks and opportunities (continued)

The risks associated with significant ice and snow events impacting the management and operation of our network are expected to remain as medium by 2050, but with a lower likelihood of occurrence as whilst temperatures will generally increase, there remains the potential for extreme cold spells. At an operational level, we follow a Severe Weather Incident Management procedure to provide a framework for deploying necessary people, physical resources and information systems to facilitate operational management and control of a network incident due severe weather. A severe weather incident is defined by NGN as any event where operating conditions are such that normal management of workload is unable to maintain our key regulatory standards of customer service (gas emergency 1 and 2 hour response performance) and/or safety targets, and actions are necessary to recover the situation. This procedure has evolved over time and is subject to regular review of adequacy (nominally every two years). We prepare an annual assessment of our company performance against this procedure to monitor our performance. Based on this comprehensive management procedure, severe weather risks to operational business performance and continuity is currently assigned an overall low risk in our company risk register framework which is reflective of the extensive control measures in place. This risk is predicted to remain as such in 2050 even under a high emissions scenario based on continuation of current levels of mitigation and management.

Our assessment of physical risks did not identify intolerable risks in 2050 for a worst-case high emissions scenario and as such it is not deemed necessary to assess the risks associated with lower emissions scenarios. It was noted in the UK Climate Change Commission's evaluation of the third round of adaptation reporting power that all gas networks of the UK that reported, including NGN, were assessed to have appropriate levels of climate change adaptation monitoring and evaluation in place.

NGN have an action plan to improve our resilience and our performance against this is tracked by the NGN Internal Audit Team. NGN consider the physical risks of climate change when selecting key supply chain partners, such as third party data centre providers, by requesting and evaluating business continuity plans as part of tender events for goods and services.

Transitional risks and opportunities

As the world transitions to a low-carbon future, the climate change related governance, strategy and performance of large companies such as NGN will come under increasing focus. This provides the opportunity for reputational benefits where a strong decarbonization and sustainability performance can be demonstrated, which can also be manifested as a financial benefit via preferential lending rates for good performing companies. The counter situation of this is that absence of an appropriate governance structure and strategy with respect to climate change, or/and poor decarbonization performance can draw negative reputational outcomes and less preferential financial lending rates. NGN's strong governance and regulatory performance reporting and assessment requirements provide substantial controls and mitigation with respect to this risk.

Gas networks are vital to the UK's energy system, in particular for the provision of energy for heat for domestic customers and businesses. In order to achieve net zero in the UK, the UK's energy system and networks will be required to undergo substantial policy driven changes.

Sustainability statement (continued)

Principal risks and opportunities (continued)

A ban on the connection of new homes to the gas grid from 2026 is being considered in the UK as part of the Future Homes Standard but not confirmed, and there is currently no set date after which natural gas can no longer be used within the UK. The principal transitional climate change related risk for the NGN group is that natural gas in its existing form will play a declining and ultimately obsolete role in the UK energy system in order to achieve the UK Government's 'net zero by 2050' commitment. As detailed in the Energy Futures section of the Corporate Governance Statement on page 16, under the guidance of the Board NGN have been extensively promoting, testing and demonstrating the use of hydrogen (blended and 100% hydrogen) as an alternative energy source to natural gas, which could be distributed through the existing gas infrastructure and thereby provide a sustainable and affordable energy system enabler to achieve net zero by 2050. Conversion to 100% hydrogen provides a particularly promising opportunity for NGN's network as it contains two of the UK's nominated industrial clusters for hydrogen production, storage and industrial consumption (Teesside and Humberside).

There are a range of scenarios that NGN's network could undergo in the future ranging from full decommissioning to conversion of the entire network to transport 100% hydrogen, all of which would require policy decisions. This is supported by the UK Energy System Operator's latest (2022) Future Energy Scenarios (FES) which recognizes hydrogen as an emerging technology and includes it as having a key role in all Net Zero scenarios with a wide range of credible uses, including to provide inter-seasonal flexibility. A UK Government policy decision on the conversion of UK gas networks to transport 100% hydrogen for heat is expected in 2026 in conjunction with the execution of the hydrogen village and town trials as detailed in the UK Government's Hydrogen Strategy (August 2021).

Working with specialist consultants NGN have modelled to 2050 the scenario that is considered the most likely for our network as shown below, comprising:

- an overall 46% reduction in gas transported due to reducing customer demand associated with increased building energy efficiency and increasing electrification of heat;
- Increasing role of biomethane peaking in c.2040; and
- Gradual phase out of natural gas by 2050 to be replaced by 100% hydrogen following network conversion, starting initially with hydrogen blending.

In the event that gas networks are no longer required in the UK's energy system, NGN's infrastructure would need to be formally decommissioned to ensure its long term safety and this can provide the opportunity for consideration of repurposing the infrastructure for potential other uses.

Resilience – physical risks

As detailed above, NGN's latest climate change adaptation risk assessment was based on a worst-case high greenhouse gas emissions future scenario (known as RCP 8.5, consistent with a 4 degree Celsius warming versus preindustrial levels by 2100) derived by experts from the Met Office.

Sustainability statement (continued)

Principal risks and opportunities (continued)

This assessment of physical risks did not identify intolerable risks to our operations and infrastructure in 2050 under this worst-case scenario assuming continuation of current levels or management and mitigation, and as such it is not deemed necessary to further assess the risks associated with lower emissions scenarios or different emissions trajectories. It was noted in the UK Climate Change Commission's evaluation of the third round of adaptation reporting power that all gas networks of the UK that reported, including NGN, were assessed to have appropriate levels of climate change adaptation monitoring and evaluation in place. In accordance with the requirements of the Adaptation Reporting Power, repeat assessments are typically undertaken every 3 to 5 years.

Resilience – transitional risks

FES produced by the UK Energy System Operator represent a range of different, credible ways to decarbonise the UK energy system to strive towards net zero by 2050, based on four scenarios as shown below. Natural gas currently provides approximately 40% of the UK's energy demand but cannot continue to be used as current to achieve net zero. Hydrogen for power generation is recognized as needed in all four Net Zero scenarios to support electricity security of supply, but the broader levels of demand, hydrogen production methods, and end uses vary greatly between the scenarios and are also substantially influenced by cost. Under the four 2022 FES, three continue to demonstrate a continued significant role for gas network infrastructure in 2050:

- *Falling Short:* carbon emissions fail to meet net zero in the UK by 2050 but achieve 80% reduction. Natural gas demand remains at 65% of current level as it is still widely used for heat. Hydrogen plays a minimal role restricted to industrial and commercial usage. This scenario would ensure NGN's infrastructure remains important to the UK energy system to 2050 and beyond with least changes to current.
- *Consumer Transformation:* Net zero is achieved by 2050. Natural gas consumption falls to 3% of current usage as heat is predominantly electrified and lower levels of hydrogen usage result in much reduced gas network infrastructure requirements by 2050 compared to current. Hydrogen use is predominantly for aviation, shipping, power generation and industrial and commercial. This represents the least significant future role for NGN's network by 2050.
- *System Transformation:* Net zero is achieved by 2050 with widespread use of hydrogen across all sectors, most notably for domestic heating, giving a continued role for the gas networks following modification to enable the transport of blended and then 100% hydrogen. This scenario provides the most significant usage of hydrogen and requires continued significant natural gas usage to enable hydrogen production via methane reformation. This scenario is most similar to NGN's modelled net zero scenario identified above.
- *Leading the Way:* Net zero is achieved before 2050 and includes use of hydrogen and electricity for heating, with significant roles for hydrogen across all sectors. The gas network infrastructure is required to transport blended and later 100% hydrogen, but not as extensive as current due to partial electrification of heat, and less than System Transformation due to a greater emphasis on hydrogen production via electrolysis.

Sustainability statement (continued)

Principal risks and opportunities (continued)

All of the scenarios identified include a long-term role for hydrogen, with a significant role in three. Completion of the research, development and demonstration projects such as those detailed in the Energy Futures section of the Corporate Governance Statement are critical to enabling this future role for hydrogen.

Targets, indicators and performance

For each of the principal climate change related risks identified on the company register, associated key performance indicators (KPI) and performance targets are set, as detailed below, to enable proactive risk management.

Risk Category	Climate Change Risk Description	KPI	Relevance	Target	Measurement Method	Frequency of Monitoring	Method of Performance Communication
Physical risk	Severe weather risks to continuity of business operations	% gas emergencies responded to within 1 and 2 hours response	Performance and resilience of business operations	1 hour: 97% 2 hours: 99%	Measured response time as per method agreed with regulator	Weekly during normal conditions; daily during if severe	SMT weekly meeting
	Asset resilience to climate change	Network infrastructure faults	Performance and resilience of business assets	Number of system faults as a result of severe weather	Faults reported by infrastructure telemetry and NGN staff	Daily	Daily maintenance team meeting
Transitional risk	Achievement of greenhouse gas emissions reductions	Gas leakage (Gwh) Greenhouse gas emissions (tCO ₂ e)	Demonstration of NGN contribution to net zero	-24% 2021 to 2026 Scope 1 and 2 emissions excluding leakage: -47% 2021 to 2026; net zero by 2031.	Shrinkage and leakage model Real consumption and carbon conversion factors published by UK Government	Reviewed six monthly for SMT; external reporting annually Reviewed monthly for SMT; external reporting annually	

Sustainability statement (continued)

Principal risks and opportunities (continued)

Transitional risks and opportunities associated with the future of gas are managed and progress assessed in relation to completion of key research, development and demonstration projects such as those detailed in the Energy Futures section of the Corporate Governance Statement above. By completion of these projects and publication and dissemination of the findings NGN are proactively managing this risk and seeking to harness the maximum opportunities available.

Independent auditor's report of Northern Gas Networks Limited

Report on the audit of the financial statements

Opinion

In our opinion the financial statements of Northern Gas Networks Limited (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 statement of accounting policies; 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).

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, and we have fulfilled our other ethical responsibilities in accordance with these requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

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:

- evaluating the level of borrowing including consideration of undrawn facilities and compliance with covenants;
- assessing the assumptions used in the forecasts, including performing sensitivity analysis;
- assessing the historical accuracy of forecasts prepared by management against actuals achieved; and
- testing of clerical accuracy of the model used to prepare the forecasts.

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.

Independent auditor's report of Northern Gas Networks Limited (continued)

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

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.

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.

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.

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.

We considered the nature of the group's industry and its control environment and reviewed the company's documentation of their policies and procedures relating to fraud and compliance with laws and regulations. We also enquired of management and internal audit about their own identification and assessment of the risks of irregularities, including those that are specific to the company's business sector.

We obtained an understanding of the legal and regulatory frameworks that the company operates in, and identified the key laws and regulations that:

- had a direct effect on the determination of material amounts and disclosures in the financial statements. These included UK Companies Act, pensions legislation, and tax legislation; and
- 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 , HSE legislation regarding construction and gas transportation, and licence conditions imposed by Ofgem.

Independent auditor's report of Northern Gas Networks Limited (continued)

We discussed among the audit engagement team including relevant internal specialists such as Tax, Financial instrument, Pension and IT specialists regarding the opportunities and incentives that may exist within the organisation for fraud and how and where fraud might occur in the financial statements.

As a result of performing the above, we identified the greatest potential for fraud or non-compliance with laws and regulations in the following areas, and our specific procedures performed to address them are described below:

- Capitalisation of costs: agreeing a sample of capitalised costs to supporting documentation to ensure it had been appropriately classified as a capital item;
- Revenue recognition: agreeing a sample of revenue transactions to third party documentation to gain assurance over the cut off of revenue and ensure it has been recognised in the correct period; and
- Management override of controls: agreeing a sample of manual journals to underlying support, reviewing unusual non-business transactions as well as evaluating management's estimates and judgements.

In common with all audits under ISAs (UK), we are also required to perform specific procedures to respond to the risk of management override. In addressing the risk of fraud through management override of controls, we tested the appropriateness of journal entries and other adjustments; assessed whether the judgements made in making accounting estimates are indicative of a potential bias; and evaluated the business rationale of any significant transactions that are unusual or outside the normal course of business.

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

- reviewing financial statement disclosures by testing to supporting documentation to assess compliance with provisions of relevant laws and regulations described as having a direct effect on the financial statements;
- performing analytical procedures to identify any unusual or unexpected relationships that may indicate risks of material misstatement due to fraud;
- enquiring of management, legal counsel concerning actual and potential litigation and claims, and instances of non-compliance with laws and regulations; and
- reading minutes of meetings of those charged with governance and reviewing internal audit reports as well as reviewing correspondence with HMRC / the licensing authority.

Report on other legal and regulatory requirements

Opinions on other matters prescribed by the Companies Act 2006

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

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

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

Matters on which we are required to report by exception

Under the Companies Act 2006 we are required to report in respect of the following matters if, in our opinion:

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

Independent auditor's report of Northern Gas Networks Limited (continued)

We have nothing to report in respect of these matters.

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.

A handwritten signature in dark ink, reading "Anthony Matthews", with a horizontal line underneath it.

Anthony Matthews FCA (Senior statutory auditor)
For and on behalf of Deloitte LLP
Statutory Auditor
London, United Kingdom

19 July 2023

Profit and loss account

For the year ended 31 March 2023

	Notes	2023 £'000	2022 £'000
Turnover	1	504,479	421,307
Cost of sales		(58,317)	(51,261)
Gross profit		446,162	370,046
Operating expenses	2	(234,014)	(217,439)
Operating profit		212,148	152,607
Finance charges (net)	3	(27,930)	(79,158)
Profit before taxation	4	184,218	73,449
Tax on profit	7	(27,342)	(126,930)
Profit / (loss) for the financial year		156,876	(53,481)

The above results arise from continuing operations.

Profit / (loss) for the year is all attributable to the equity shareholders of the company.

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

Statement of comprehensive income

For the year ended 31 March 2023

	2023 £'000	2022 £'000
Profit / (loss) for the financial year	156,876	(53,481)
Re-measurement of defined benefit liability (note 19)	(15,126)	12,292
Gains in respect of cash flow hedges	68,740	35,606
Transferred to profit or loss in respect of cash flow hedges	(6,200)	7,927
Tax relating to components of other comprehensive income	(11,852)	(7,304)
Comprehensive income / (expenses) relating to the year	192,438	(4,960)

Comprehensive income / (expenses) for the year is all attributable to the equity shareholders of the company.

The accompanying notes are an integral part of this statement of comprehensive income.

Balance sheet
As at 31 March 2023

	Notes	2023 £'000	2022 £'000
Fixed assets			
Intangible assets	9	158,335	162,919
Tangible fixed assets	10	2,767,257	2,678,008
Investments	11	14,204	9,524
		<u>2,939,796</u>	<u>2,850,451</u>
Current assets			
Debtors – amounts falling due within one year	12	109,481	103,084
amounts falling due after one year	12	172,228	243,413
Cash at bank and in hand		10,665	7,279
		<u>292,374</u>	<u>353,776</u>
Creditors: Amounts falling due within one year	13	(330,709)	(149,986)
Net current (liabilities) / assets		<u>(38,335)</u>	<u>203,790</u>
Total assets less current liabilities		2,901,461	3,054,241
Creditors: Amounts falling due after more than one year	14	(1,809,321)	(2,081,831)
Provisions for liabilities	16	(484,299)	(468,607)
Net assets		<u>607,841</u>	<u>503,803</u>
Capital and reserves			
Called-up share capital	17	24,328	24,328
Hedging reserve		72,482	25,576
Profit and loss account		511,031	453,899
Shareholders' funds		<u>607,841</u>	<u>503,803</u>

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

The accounts of Northern Gas Networks Limited, Registered number 05167070, were approved by the Board of Directors and authorised for issue on 19 July 2023 and signed on its behalf by:



M J Horsley
Director
19 July 2023

Statement of changes in equity

For the year ended 31 March 2023

	Called up share capital £'000	Hedging reserve £'000	Profit and loss account £'000	Total £'000
At 31 March 2021	24,328	(7,639)	583,774	600,463
Loss for the financial year	-	-	(53,481)	(53,481)
Remeasurement of defined benefit liability (note 19)	-	-	12,292	12,292
Tax on remeasurement of defined benefit liability	-	-	3,014	3,014
Cash flow hedges: gains arising during the year	-	43,533	-	43,533
Tax on cash flow hedges movement	-	(10,318)	-	(10,318)
Total comprehensive income / (expenses)	-	33,215	(38,175)	(4,960)
Dividends paid on equity shares (note 8)	-	-	(91,700)	(91,700)
At 31 March 2022	24,328	25,576	453,899	503,803
Profit for the financial year	-	-	156,876	156,876
Remeasurement of defined benefit asset (note 19)	-	-	(15,126)	(15,126)
Tax on remeasurement of defined benefit asset	-	-	3,782	3,782
Cash flow hedges: profits arising during the year	-	62,540	-	62,540
Tax on cash flow hedges movement	-	(15,634)	-	(15,634)
Total comprehensive income	-	46,906	145,532	192,438
Dividends paid on equity shares (note 8)	-	-	(88,400)	(88,400)
At 31 March 2023	24,328	72,482	511,031	607,841

Statement of accounting policies

The principal accounting policies are summarised below. They have all been applied consistently throughout the year and the preceding year.

Basis of accounting

Northern Gas Networks Limited is a company 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 address of the company and its registered office is 1100 Century Way, Leeds, LS15 8TU.

The accounts 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. Principal activities and the nature of operations are shown in the strategic report.

The company is not required to prepare group accounts as it is a wholly owned subsidiary of Northern Gas Networks Holdings Limited (NGNH) which prepares consolidated accounts which are publicly available. The company meets the definition of a qualifying entity under FRS 102 and has therefore taken advantage of the disclosure exemptions available to it. Exemptions have been taken in relation to presentation of cash flow statements and remuneration of key management personnel.

The functional currency is considered to be pounds sterling because that is the currency of the primary economic environment in which the group operates. The financial statements are also presented in pounds sterling.

Going concern

The accounts have been prepared on a going concern basis. The group's business activities, performance and position, together with its principal risks and uncertainties likely to affect its future development and performance are set out in the strategic report. This includes the implication of European disruption (war in Ukraine) and inflation. The group has: (1) undrawn borrowing facilities of £129m at the balance sheet date; (2) has a prudent debt to RAV position at the balance sheet date; and (3) regulated revenue income until 31 March 2026. The net current liabilities position as at 31 March 2023 was driven by the £100m EIB loan repayable within one year. The required repayment of this could be covered by the forementioned £129m of headroom, or with the new £300m of debt raised after the balance sheet date. The directors have made enquiries and reviewed the forecasts which include assessment of covenants, and in light of the facilities available, have a reasonable expectation that the group has 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.

Statement of accounting policies (continued)

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.

Intangible assets – licence

The Gas Transporter Licence (licence) has been recognised as a separately identifiable intangible asset, the value of which has been derived from an independent valuation. The licence has been 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.

Intangible assets – computer software

Costs associated with maintaining computer software are recognised as expenses as incurred. Development costs that are directly attributable to the design and testing of identifiable and unique software products controlled by the company are recognised as intangible assets when the following criteria are met:

- it is technically feasible to complete the software so that it will be available for use;
- management intends to complete the software and use of it;
- there is an ability to use the software;
- it can be demonstrated how the software will generate probable future economic benefit;
- adequate technical, financial and other resources to complete the development and to use the software are available; and
- the expenditure attributable to the software during its development can be reliably measured.

Directly attributable costs that are capitalised as part of the software include the software development employee costs and an appropriate portion of relevant overheads. Other development expenditures that do not meet these criteria are recognised as an expense as incurred. Development costs previously recognised as an expense are not recognised as an asset in a subsequent period. Computer software development costs recognised as assets are amortised over their estimated useful lives on a straight line basis, which range from 3 to 10 years. Computer software under construction is not amortised until it is ready for use.

Software as a service arrangements are reviewed in accordance with FRS102 and recognised as an intangible asset where they meet the definition under the accounting standard. Otherwise they are expensed.

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.

Statement of accounting policies (continued)

Tangible fixed assets (continued)

No residual value is estimated for 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:

Gas distribution assets	
Gas mains & services	55 to 65 years
Gas storage	40 years
Plant & machinery	10 to 30 years
Replacement expenditure	60 years
Land and buildings	Lesser of lease period and 50 years
Motor vehicles and other equipment	3 to 10 years

Investments

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

Replacement expenditure (repex)

Replacement expenditure represents the cost of planned maintenance of the gas mains and services assets by replacing sections of pipe. This expenditure is principally undertaken to maintain the safety of the network and is capitalised.

Stocks

Stocks are stated at the lower of cost and net realisable value. Provision is made for obsolete or defective items where appropriate. Values are held on a first in first out basis.

Taxation

Current tax is provided at amounts expected to be paid (or recovered) using the UK 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 company's taxable profits and its results as stated in the accounts that arise from the inclusion of gains and losses in tax assessments in periods 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.

Statement of accounting policies (continued)

Taxation (continued)

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

Provisions

Gas holder decommissioning costs are provided for in full and discounted when the impact is considered to be material. Environmental costs are provided for in full, the liability being based on a probability basis. Claims costs are provided for in full and discounted, the unwinding of the discount being 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. Turnover is recognised in the month the service is provided. If transportation turnover is under or over recovered, it is settled according to Ofgem methodology over a future regulatory year. Under the mechanism set out in the gas licence, the company receive funds from customers as a way of being compensated for supply of last resort costs. These receipts are considered to be the collection of a levy with the company acting as an agent and as such the income and associated costs, which are equal and opposite, are netted off within the profit and loss account.

Pension costs

The company has obligations for a defined benefit scheme, which was closed to future accrual at 31 March 2022. The amounts charged to operating profit are the current service costs and gains and losses on settlements and curtailments which are included within operating costs. 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 comprehensive income. The defined benefit scheme is funded with the assets of the scheme held separately from those of the company, 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. A resulting defined benefit asset is presented within debtors gross, with the deferred tax shown within provisions. Assets are only recognised when the company has a legal right to cash on windup.

The company 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 period. Differences between contributions payable in the period and contributions actually paid are shown as either accruals or prepayments in the consolidated balance sheet.

Statement of accounting policies (continued)

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.

Financial instruments

Financial assets and financial liabilities are recognised when the company becomes a party to the contractual provisions of the instrument. Financial liabilities and equity instruments are classified according to the substance of the contractual arrangements entered into. An equity instrument is any contract that evidences a residual interest in the assets of the company after deducting all of its liabilities.

Financial assets and liabilities

All financial assets and liabilities are initially measured at transaction price (including transaction costs), except for those financial assets classified as at fair value through profit or loss, which are initially measured at fair value (which is normally the transaction price excluding transaction costs), unless the arrangement constitutes a financing transaction. If an arrangement constitutes a financing transaction, the financial asset or financial liability is measured at the present value of the future payments discounted at a market rate of interest for a similar debt instrument.

Financial assets and liabilities are only offset in the statement of financial position when, and only when there exists 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.

Debt instruments which meet the following conditions are subsequently measured at amortised cost using the effective interest method:

- a) The contractual return to the holder is (i) a fixed amount; (ii) a positive fixed rate or a positive variable rate; or (iii) a combination of a positive or a negative fixed rate and a positive variable rate.

Statement of accounting policies (continued)

Financial instruments (continued)

- b) The contract may provide for repayments of the principal or the return to the holder (but not both) to be linked to a single relevant observable index of general price inflation of the currency in which the debt instrument is denominated, provided such links are not leveraged.
- c) The contract may provide for a determinable variation of the return to the holder during the life of the instrument, provided that (i) the new rate satisfies condition (a) and the variation is not contingent on future events other than (1) a change of a contractual variable rate; (2) to protect the holder against credit deterioration of the issuer; (3) changes in levies applied by a central bank or arising from changes in relevant taxation
- d) There is no contractual provision that could, by its terms, result in the holder losing the principal amount or any interest attributable to the current period or prior periods.
- e) Contractual provisions that permit the issuer to prepay a debt instrument or permit the holder to put it back to the issuer before maturity are not contingent on future events, other than to protect the holder against the credit deterioration of the issuer or a change in control of the issuer, or to protect the holder or issuer against changes in levies applied by a central bank or arising from changes in relevant taxation or law.
- f) Contractual provisions may permit the extension of the term of the debt instrument, provided that the return to the holder and any other contractual provisions applicable during the extended term satisfy the conditions of paragraphs (a) to (c).

Debt instruments that are classified as payable or receivable within one year on initial recognition and which meet the above conditions are measured at the undiscounted amount of the cash or other consideration expected to be paid or received, net of impairment. With the exception of some hedging instruments, other debt instruments not meeting these conditions are measured at fair value through profit or loss. Commitments to make and receive loans which meet the conditions mentioned above are measured at cost (which may be nil) less impairment.

Financial assets are derecognised when and only when a) the contractual rights to the cash flows from the financial asset expire or are settled, b) the company transfers to another party substantially all of the risks and rewards of ownership of the financial asset, or c) the company, despite having retained some, but not all, significant risks and rewards of ownership, has transferred control of the asset to another party. Financial liabilities are derecognised only when the obligation specified in the contract is discharged, cancelled or expires.

Cash is treated as a basic financial instrument in accordance with FRS102. Cash and cash equivalents represent cash held and readily available overnight deposits.

Derivative financial instruments

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

Statement of accounting policies (continued)

Derivative financial instruments (continued)

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 company. The interest rate swaps are accounted for at fair value on the balance sheet with movements in fair value being recognised through either the profit and loss account or cash flow hedge reserve. Index linked swaps are entered into for the purpose of matching or eliminating risk from potential movements in inflation associated with the regulatory cost of debt allowances. The index linked swaps are accounted for at fair value on the balance sheet with movements in fair value being recognised through the profit and loss account. The company applies the recognition and movement principles of IFRS 9: Financial Instruments, as applicable within FRS 102.

Fair value accounting

The best evidence of fair value is a quoted price for an identical asset in an active market. When quoted prices are unavailable, the price of a recent transaction for an identical 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 an identical asset on their own are not a good estimate of fair value, the fair value is estimated by using a valuation technique.

Hedge accounting

The company designates certain derivatives as hedging instruments in cash flow hedges and certain others as hedge instruments in Fair value hedges. At the inception of the hedge relationship, the entity documents the economic relationship between the hedging instrument and the hedged item, along with its risk management objectives and clear identification of the risk in the hedged item that is being hedged by the hedging instrument. Furthermore, at the inception of the hedge the company determines and documents potential causes of hedge ineffectiveness. 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. 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. Some derivatives have been designated cash flow hedges hedging aggregate floating rate exposures (such exposure being the aggregate of a portion of fixed rate debt) and an overlaid fixed-to-floating interest rate swap. Changes in the fair value of derivatives that are designated as fair value hedges are recognized in profit and loss in the period in which the movement occurs, along with any movement in the fair value of the hedged debt instrument. Hedge accounting is discontinued when 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.

Interest receivable and payable

Interest receivable and payable is recognised on an accruals basis in accordance with FRS102.

Statement of accounting policies (continued)

Impairment

Assets are assessed for indicators of impairment at each balance sheet date. For non-financial assets, if there is objective evidence of impairment, that being that the estimated recoverable value of the asset is less than the value in the balance sheet, an impairment loss is recognised in profit or loss. The recoverable amount of an asset is the higher of its fair value less costs to sell and its value in use. For financial assets carried at amortised cost, the amount of an impairment is the difference between the asset's carrying amount and the present value of estimated future cash flows, discounted at the financial asset's original effective interest rate. For financial assets carried at cost less impairment, the impairment loss is the difference between the asset's carrying amount and the best estimate of the amount that would be received for the asset if it were to be sold at the reporting date.

Critical accounting judgments and key sources of estimation uncertainty

In the application of the group's accounting policies, which are described in the statement of accounting policies, 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 estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

Critical judgements in applying the group's accounting policies

There are no critical judgements, apart from those detailed below within 'key sources of estimation uncertainty', that the directors have made in the process of applying the group's accounting policies.

Key sources of estimation uncertainty

The following are the critical estimations that the directors have made in the process of applying the group's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Fair value of financial instruments

Some of the company's assets and liabilities are measured at fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the company uses market-observable data to the extent it is available, using an individual trade basis provided by an external reporting system meaning market assumptions are applied by the third party and not by the company. Further details can be found within note 15.

Pension arrangements

Note 19 contains information about the principal actuarial assumptions used in the determination of defined benefit pension obligations. These key assumptions include discount rates, inflation and mortality rates and have been determined following advice received from an independent qualified actuary.

Statement of accounting policies (continued)

Key sources of estimation uncertainty (continued)

Asset life

As a group NGN continue to support the planned 'net zero by 2050' ambition of the UK Government. This ambition gives uncertainty over how long gas, in its existing form, will remain a source of energy within the UK. The NGN group hold network assets with long useful economic lives (UEs), meaning the current accounting policy will lead to the group holding assets with value at the end of 2050. As such, judgement is needed as to whether these network UEs remain appropriate.

The directors acknowledged the Government's publication in late 2020 of a 'ten point plan' to deliver net zero emissions, which included the use of hydrogen as an energy source, which would be distributed through the groups existing network assets. This has developed beyond a policy statement, with significant funded investment over the last 5 years by the NGN group alongside other key industry partners (details provided within the Corporate governance statement).

If the existing network assets are not required for an alternative energy source post 2050, the current regulatory regime would likely be adapted to address the recovery of the value of any stranded assets through mechanisms such as accelerated depreciation funding over an appropriate period.

With the above factors in mind, it is the view of the directors that the network UEs do remain appropriate and that no impairment is needed as at the balance sheet date.

Notes to the accounts

For the year ended 31 March 2023

1 Turnover

The directors consider that the company has only one class of business. The company's turnover is generated wholly from within the UK, principally being from gas distribution in the North of England.

2 Operating expenses

	2023 £'000	2022 £'000
Distribution costs	141,311	138,172
Administrative expenses	92,703	79,267
	<u>234,014</u>	<u>217,439</u>

3 Finance charges (net)

	2023 £'000	2022 £'000
Interest payable and similar charges	36,740	33,718
Less: investment income	(426)	(23)
Other finance (income) / charges	(8,384)	45,463
	<u>27,930</u>	<u>79,158</u>

Interest payable and similar charges

	2023 £'000	2022 £'000
Bank loans and overdrafts, and associated SWAPs	1,054	(1,403)
Intercompany interest payable	36,583	36,581
	<u>37,637</u>	<u>35,178</u>
Finance costs capitalised	(897)	(1,460)
	<u>36,740</u>	<u>33,718</u>

Finance costs have been capitalised based on a cost of debt capitalisation rate of 1.90% (2022 – 2.34%).

Notes to the accounts (continued)

3 Finance charges (net) (continued)

Investment income

	2023 £'000	2022 £'000
Interest receivable and similar income	(426)	(23)
	<u>(426)</u>	<u>(23)</u>

Other finance (income) / charges

	2023 £'000	2022 £'000
Asset backed contribution pension movement	(5,293)	(3,348)
Fair value movement on financial instruments	(49,689)	24,967
Fair value movement on financial instruments (accretion)	47,843	20,203
Exchange rate differences	32	(12)
Unwinding of discount on provisions (see note 16)	(1,211)	(420)
Net return on pension scheme (see note 19)	(66)	434
Interest on tax provisions	-	3,639
	<u>(8,384)</u>	<u>45,463</u>

4 Profit before taxation

Profit before taxation is stated after charging / (crediting):

	2023 £'000	2022 £'000
Depreciation and amounts written off tangible fixed assets (note 10)	77,269	75,293
Amortisation of intangible fixed assets included in administrative expenses (note 9)	12,001	12,268
Loss on disposal of fixed assets	494	1,609
Operating lease rentals - property	1,251	1,114
Fees payable to the company's auditor for the audit of the company's annual accounts	283	268
	<u>91,308</u>	<u>102,552</u>

Fees payable to Deloitte LLP and their associates for non-audit services to the company are not required to be disclosed because the consolidated accounts of the parent company are required to disclose such fees on a consolidated basis.

Notes to the accounts (continued)

5 Staff costs

The below disclosures relate to staff within Northern Gas Networks Operations Limited, a subsidiary of the company who recharges all its payroll costs to the company. The company itself has no employees.

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

	2023 Number	2022 Number
Administration	156	138
Operations	1,324	1,260
Total	<u>1,480</u>	<u>1,398</u>

	2023 £'000	2022 £'000
Their aggregate remuneration comprised:		
Wages and salaries	71,604	63,487
Social security costs	7,963	6,793
Pension costs	5,425	6,966
	<u>84,992</u>	<u>77,246</u>

Notes to the accounts (continued)

6 Directors' remuneration and transactions

Remuneration

The remuneration of the directors was as follows:

	Non-Executive Directors		Executive Directors	
	2023	2022	2023	2022
	£'000	£'000	£'000	£'000
Emoluments	92	90	992	953
Amounts receivable (other than shares) under long-term incentive schemes	-	-	237	227
	<u>92</u>	<u>90</u>	<u>1,229</u>	<u>1,180</u>

The remuneration of non-executive directors as shown above relates to the independent non-executive directors of the company, paid through the subsidiary company Northern Gas Networks Operations Limited, and that are required by that company pursuant to its Public Gas Transportation Licence.

The one executive director shown above relates to Northern Gas Networks Operations Limited, a subsidiary of the company who recharges all its payroll costs to the company. The other executive directors rest are remunerated by other companies within the ownership group. It is not possible to allocate a share of this cost to the company.

Pensions

No directors were members of pension schemes in either the current year or prior year.

Highest paid director

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

	2023	2022
	£'000	£'000
Emoluments	<u>1,229</u>	<u>1,180</u>

Transactions

There have been no transactions with directors in the year (2022 – £nil) other than as set out above in respect of remuneration. Only directors are deemed to be key personnel.

Notes to the accounts (continued)

7 Tax on profit

The tax charge comprises:

	2023 £'000	2022 £'000
Current tax		
UK corporation tax	37,358	23,846
Adjustments in respect of prior periods	(21,342)	(1,314)
Total current tax	<u>16,016</u>	<u>22,532</u>
Deferred tax		
Current period - origination and reversal of timing differences	12,248	(11,281)
Effect of increase in tax rate on opening liability	-	108,899
Unwind of pension arrangements	(11,099)	-
Adjustments in respect of prior periods	10,177	6,780
Total deferred tax	<u>11,326</u>	<u>104,398</u>
Total tax on profit	<u>27,342</u>	<u>126,930</u>

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

	2023 £'000	2022 £'000
Profit before tax	<u>184,218</u>	<u>73,449</u>
Tax on profit at standard UK corporation tax rate of 19.0% (2022 – 19.0%)	35,001	13,955
Effects of:		
Expenses not deductible for tax purposes	864	(338)
Income not taxable in determining taxable profit	(1,337)	(889)
Interest not deductible for tax purposes	705	-
Change in tax rate on opening position	-	108,372
Movement on uncertain tax positions	1,078	364
Difference in tax rates	2,197	-
Adjustments in respect of prior year	(11,166)	5,466
Total tax charge for the year	<u>27,342</u>	<u>126,930</u>

The company earns its profits in the UK. Therefore, the tax rate used for tax on profit is the standard rate for UK corporation tax, currently 19.0% (2022 – 19.0%).

Notes to the accounts (continued)

7 Tax on profit (continued)

The 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 period.

Deferred taxation is measured at tax rates that are expected to apply in the periods in which temporary timing differences are expected to reverse based on tax rates and laws that have been enacted or substantively enacted at the balance sheet date. The planned change of the UK corporation tax to 25% from 1 April 2023 was substantively enacted on 24 May 2021 following the 2021 budget. Accordingly a tax rate of 25% has been applied when calculating deferred tax assets and liabilities expected to reverse on or after 1 April 2023, as at 31 March 2022.

8 Dividends on equity shares

	2023 £'000	2022 £'000
Equity shares		
- interim dividend paid of £1.73 (2022 - £0.71) per ordinary share	42,000	17,250
- interim dividend paid of £1.91 (2022 - £3.06) per ordinary share	46,400	74,450
	<u>88,400</u>	<u>91,700</u>

Notes to the accounts (continued)

9 Intangible assets

	Licence £'000	Goodwill £'000	Software £'000	Software in the course of construction £'000	Total £'000
Cost					
At 1 April 2022	161,200	3,257	94,923	14,567	273,947
Additions	-	-	6,569	1,767	8,336
Transfers	-	-	12,907	(12,907)	-
Disposals	-	-	(24,559)	-	(24,559)
At 31 March 2023	<u>161,200</u>	<u>3,257</u>	<u>89,840</u>	<u>3,427</u>	<u>257,724</u>
Amortisation					
At 1 April 2022	67,832	1,377	41,819	-	111,028
Charge for the year	4,027	85	7,889	-	12,001
Disposals	-	-	(23,640)	-	(23,640)
At 31 March 2023	<u>71,859</u>	<u>1,462</u>	<u>26,068</u>	<u>-</u>	<u>99,389</u>
Net book value					
At 31 March 2023	<u>89,341</u>	<u>1,795</u>	<u>63,772</u>	<u>3,427</u>	<u>158,335</u>
At 31 March 2022	<u>93,368</u>	<u>1,880</u>	<u>53,104</u>	<u>14,567</u>	<u>162,919</u>

Goodwill and licences are described within the accounting policies note of the accounts.

Notes to the accounts (continued)

10 Tangible fixed assets

	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 April 2022	13,844	3,340,914	21,051	117,170	40,687	3,533,666
Additions	1,140	135,682	-	5,009	25,012	166,843
Disposals	-	(719)	(391)	(49,788)	-	(50,898)
Transfers	-	18,060	(170)	4,108	(21,998)	-
At 31 March 2023	<u>14,984</u>	<u>3,493,937</u>	<u>20,490</u>	<u>76,499</u>	<u>43,701</u>	<u>3,649,611</u>
Depreciation						
At 1 April 2022	7,760	738,676	14,463	94,759	-	855,658
Charge for the period	676	68,595	1,891	6,107	-	77,269
Disposals	-	(450)	(366)	(49,757)	-	(50,573)
At 31 March 2023	<u>8,436</u>	<u>806,821</u>	<u>15,988</u>	<u>51,109</u>	<u>-</u>	<u>882,354</u>
Net book value						
At 31 March 2023	<u>6,548</u>	<u>2,687,116</u>	<u>4,502</u>	<u>25,390</u>	<u>43,701</u>	<u>2,767,257</u>
At 31 March 2022	<u>6,084</u>	<u>2,602,238</u>	<u>6,588</u>	<u>22,411</u>	<u>40,687</u>	<u>2,678,008</u>

Undepreciated freehold land equates to £1,903,000 at 31 March 2023 (2022 - £774,000).

Notes to the accounts (continued)

11 Investments

	2023 £'000	2022 £'000
Subsidiary undertakings	14,100	9,420
Other investments	104	104
	<u>14,204</u>	<u>9,524</u>

The movement in the carrying value of the subsidiary undertaking relates to Northern Gas Networks Pension Funding Limited Partnership.

The company has an investment in the following subsidiary undertakings:

Subsidiary undertaking	Country of incorporation	Principal activity	Holding	%
Northern Gas Networks Finance Plc ("NGNF")	England & Wales	Financing	49,999 ordinary shares of £1	100
Northern Gas Networks Operations Limited ("NGNOL")	England & Wales	Gas network operations	2 ordinary shares of £1	100
Northern Gas Networks Pensions Trustee Limited ("NGNPT")	England & Wales	Pension scheme trustee	1 ordinary share of £1	100
Northern Gas Networks General Partners Limited	Scotland	Pension partnership	100 ordinary shares of £1	100
Northern Gas Networks ABC2 Pension Funding Limited Partnership	Scotland	Pension partnership	n/a	n/a
Northern Gas Networks Pension Funding Limited Partnership	Scotland	Pension partnership	n/a	n/a

All subsidiaries have a registered address of 1100 Century Way, Leeds, LS15 8TU, with the exception of Northern Gas Networks General Partner Limited, Northern Gas Networks ABC2 Pension Funding Limited Partnership and Northern Gas Networks Pension Funding Limited Partnership whose registered office is 1st Floor, City Point, Haymarket Terrace, Edinburgh, EH12 5HD, Scotland.

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

The company also holds 1 ordinary share of £1 in Smart Energy Code Company Limited (registered in England & Wales) which represents a holding of 1.15%.

Notes to the accounts (continued)

11 Investments (continued)

Subsidiary undertakings

£'000

Cost and net book value

At 1 April 2022	9,420
Movement in the year	4,784
At 31 March 2023	<u>14,204</u>

Other investments

£'000

Cost and net book value

At 1 April 2022 and 31 March 2023	<u>104</u>
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12 Debtors

2023
£'000

2022
£'000

Amounts falling due within one year

Trade debtors	2,328	831
Other debtors	59,164	62,295
Accrued income	43,365	36,404
Derivative financial assets	4,624	3,554
	<u>109,481</u>	<u>103,084</u>

Amounts falling due after more than one year

Derivative financial assets	169,824	243,413
Defined benefit pension scheme (note 19)	2,404	-
	<u>172,228</u>	<u>243,413</u>
	<u>281,709</u>	<u>346,497</u>

Notes to the accounts (continued)

13 Creditors: Amounts falling due within one year

	2023 £'000	2022 £'000
Loan notes	72,559	-
Bank loans	130,658	19,442
Amounts owed to group undertakings	54,181	60,526
Derivative financial liabilities	7,056	47
Payments received on account	17,811	10,345
UK corporation tax	12,394	41,723
Other taxation and social security	24,492	7,413
Accruals and deferred income	11,558	10,490
	<u>330,709</u>	<u>149,986</u>

The loan notes which have interest that is variable with RPI comprise: (1) £62.2m (2022 - £60.0m) held with Northern Gas Networks Pension Funding Limited Partnership; and (2) £10.3m (2022 - £11.0m) held with Northern Gas Networks ABC2 Pension Funding Limited Partnership.

The bank loans comprises an £11.0m loan which was repaid using existing facilities on 11 April 2023 with an interest rate of 4.5765%, a £20.0m loan which was repaid using existing facilities on 28 April 2023 with an interest rate of 4.5765%, and a £100.0m loan which matures on 30 March 2024 with an interest rate of compounded SONIA +0.1193 CAS + 0.624%.

14 Creditors: Amounts falling due after more than one year

	2023 £'000	2022 £'000
Loan notes	-	71,010
Bank loans	295,263	422,105
Amounts owed to group undertakings	741,187	814,779
Deferred income	157,300	152,645
Derivative financial liabilities	92,650	146,395
USPP 2029 loan	46,666	49,857
USPP 2031 loan	137,120	150,754
USPP 2036 loan	174,586	174,555
USPP 2037 loan	64,802	-
USPP 2039 loan	99,747	99,731
	<u>1,809,321</u>	<u>2,081,831</u>

Notes to the accounts (continued)

14 Creditors: Amounts falling due after more than one year (continued)

The amounts owed to group undertakings comprise: (1) £505.0m, with £250.0m repayable in 2027 and £255.0m repayable in 2035 with interest of 4.875% plus a margin to cover related costs; (2) an interest bearing loan of £198.2m repayable in 2040 with interest of 5.625% plus a margin to cover related costs; and (3) an interest bearing loan of £1.0m repayable in 2040 with interest of 1.6%. The sum total of these loans is £704.2m with a carrying value in the balance sheet being £741.2m. The difference represents the fair value hedge adjustments on the portion of the loan from Northern Gas Networks Finance Plc that is in a fair value hedge relationship.

Creditors falling due after more than one year represented by debt and other financial instruments are as follows:

Debt instrument	Maturity date	Interest rate / basis	Principal amount (£m)	Fair value adjustment (£m)	Unamortised costs & discounts (£m)	Book value (£m)
US Private Placement notes	10/01/2029	2.84% fixed	50.0	(3.2)	(0.1)	46.7
US Private Placement notes	10/01/2031	2.97% fixed	150.0	(12.6)	(0.3)	137.1
US Private Placement notes	23/09/2036	2.02% fixed	175.0	-	(0.4)	174.6
US Private Placement notes	30/06/2037	2.10% fixed	65.0	-	(0.3)	64.8
US Private Placement notes	26/06/2039	2.71% fixed	100.0	-	(0.3)	99.7
European Investment Bank fixed rate loan	20/12/2024	3.446% fixed	40.0	-	-	40.0
European Investment Bank floating rate loan	24/06/2024	Compounded SONIA + 0.1193% CAS + 0.548%	25.0	-	-	25.0
European Investment Bank floating rate loan	30/07/2024	Compounded SONIA + 0.1193% CAS + 0.458%	60.0	-	-	60.0
European Investment Bank floating rate loan	31/03/2027	Compounded SONIA + 0.1193% CAS + 0.534%	30.0	-	-	30.0
European Investment Bank floating rate loan	28/02/2028	Compounded SONIA + 0.1193% CAS + 0.627%	30.0	-	-	30.0
European Investment Bank floating rate loan	20/12/2028	Compounded SONIA + 0.1193% CAS + 0.934%	40.0	-	-	40.0
European Investment Bank floating rate loan	29/03/2029	Compounded SONIA + 0.1193% CAS + 0.834%	50.0	-	-	50.0
European Investment Bank amortising loan	25/03/2034	Compounded SONIA + 0.1193% CAS + 0.860%	20.3	-	-	20.3
Amounts owed to group undertakings (amounts due >1 year)*	Various	Various	704.2	37.0	-	741.2

* This intercompany loan balance pertains to fixed rate bonds dealt by NGNF. NGNF is the bond issuer to the market within the group. The bonds are then passed to its parent, NGN, as a series of intercompany loans with terms that mirror the issued bonds.

Notes to the accounts (continued)

15 Derivatives and other financial instruments

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

Some of the company assets and liabilities are measured at fair value for financial reporting purposes. In estimating the fair value of an asset or a liability, the company uses market-observable data to the extent it is available, using an individual trade basis provided by an external reporting system meaning no assumptions are applied by the company.

	2023 £'000	2022 £'000
Financial assets		
Measured at fair value through the profit and loss account		
- Derivative financial assets (note 12)	41,544	114,203
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial assets – cashflow hedges (note 12)	105,039	43,004
- Derivative financial assets – fair value hedges (note 12)	27,865	89,760
Measured at undiscounted amount receivable		
- Trade and other debtors (note 12)	61,492	63,126
- Accrued income (note 12)	43,365	36,404
Equity instruments measured at cost less impairment		
- Fixed asset investments (note 11)	14,204	9,524
	<u>293,509</u>	<u>356,021</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	2023 £'000	2022 £'000
Financial liabilities		
Measured at fair value through the profit and loss account		
- Derivative financial liabilities - interest rate swaps (notes 13 & 14)	30,559	95,412
- Derivative financial liabilities - inflation linked swaps (notes 13 & 14)	54,394	49,703
Measured at fair value and designated in an effective hedge relationship		
- Derivative financial liabilities (notes 13 & 14)	298	1,307
- Derivative financial liabilities - fair value hedges (notes 13 & 14)	14,454	20
Measured at amortised cost		
- Other financial liabilities – amounts owed to group undertakings (note 14)	741,187	814,779
- Loan note (see note 14)	72,559	71,010
- Loans payable (see notes 13 & 14)	927,692	804,717
- Fair value hedge adjustment of live bonds & USPP notes (notes 13 & 14)	4,857	89,664
- Fair value hedge adjustment – bonds previously in FV hedge relationship (notes 13 & 14)	16,293	22,063
- Amounts owed to group undertakings (note 13)	54,181	60,526
Measured at undiscounted amount payable		
- Trade and other creditors (note 13)	17,811	10,345
- Accruals and deferred income (notes 13 & 14)	168,858	163,135
- Corporation tax (note 13)	12,394	41,723
- Other taxation and social security (note 13)	24,492	7,413
	<u>2,140,029</u>	<u>2,231,817</u>

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

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	2023 £'000	2022 £'000
Interest income and expense on items at amortised cost		
- Total interest payable on financial liabilities at amortised cost	62,622	52,179
- Total interest receivable on financial assets measured at amortised cost	(426)	(23)
	<u>62,196</u>	<u>52,156</u>
Interest income and expense on derivatives		
- Total interest receivable on financial assets measured at fair value through the P&L	(9,663)	(21,830)
- Total interest payable on financial liabilities measured at fair value through the P&L	4,693	14,909
- Total interest receivables on financial liabilities measured at fair value through the P&L	(14,245)	(11,109)
- Total interest payable / (receivable) on financial assets designated in an effective hedging relationship: Cash flow hedges	(6,409)	1,055
Fair value hedges	(5,879)	(10,776)
- Total interest payable / (receivable) on financial liabilities designated in an effective hedging relationship:		
- Cash flow hedges	601	6,873
	<u>(30,902)</u>	<u>(20,878)</u>
Fair value gains and losses		
- On financial assets measured at fair value through the profit and loss account	84,692	49,001
- On financial liabilities measured at fair value through the profit and loss account	(77,698)	(45,643)
- On financial liabilities measured at fair value through the profit and loss account (index linked)	4,695	50,665
- On derivative financial assets designated in an effective hedging relationship – live fair value hedges	77,043	45,333
- On financial assets formerly designated in an effective hedging relationship – amortisation of previous FV hedge adjustments	540	540
- On derivative financial liabilities designated in an effective hedging relationship – live fair value hedges	(84,807)	(46,524)
- On non-derivative financial liabilities designated in an effective hedging relationship – live fair value hedges		
- On financial liabilities formerly designated in an effective hedging relationship – amortisation of previous FV hedge adjustments	(6,311)	(8,202)
	<u>(1,846)</u>	<u>45,170</u>
Other net finance (income) / costs	<u>(1,518)</u>	<u>2,710</u>
	<u>27,930</u>	<u>79,158</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

Included in fair value losses on index-linked financial liabilities measured at fair value through the profit and loss account is accretion of £47.8m on CPI linked swaps (2022 - £20.2m).

Fair value gains and losses in finance costs include the amortisation of fair values “frozen” when accounting hedge designations were terminated (either voluntarily under FRS102 section 21 or because automatic de-designation was triggered for other reasons). Under the group’s strategy of swapping fixed rate debt to floating rate and re-fixing with overlay swaps, certain fair value hedges were previously de-designated as a matter of routine under FRS102 under sections 11 and 12. As FRS102 permits interest rate swaps to be designated as cash flow hedges of aggregate floating rate exposures (fixed rate debt and swap to floating) the underlying Fair value hedges remain when the corresponding overlay swaps are transacted.

Other net finance costs includes bank and agency fees, pension accounting adjustments and other miscellaneous interest. The maturity of the carrying value of the company’s derivatives in hedging relationships split between less than 1 year and greater than 1 year.

	Current (less than 1 year)		Greater than 1 year	
	2023	2022	2023	2022
	£'000	£'000	£'000	£'000
Derivatives that are designated and effective as hedging instruments carried at fair value				
Cash flow hedges				
Assets	502	-	104,537	43,004
Liabilities	-	-	(298)	(1,307)
Fair value hedges				
Assets	-	-	27,865	89,760
Liabilities	-	-	(14,454)	(20)
	<hr/>		<hr/>	
	502	-	117,650	131,437
	<hr/>		<hr/>	

Interest rate swaps are valued at present value of future cash flows estimated and discounted based on the applicable yield curves derived from quoted interest rates, adjusted for the group’s own credit risk when determining the fair value of derivatives liabilities and for counterparty credit risk when determining the fair value of derivatives assets.

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The following table details the notional principal amounts and remaining terms of interest rate swap contracts outstanding:

Interest rate swap contracts designated as hedges of variable interest rate risk of recognised financial liabilities:

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2023	2022	2023	2022	2023	2022
	%	%	£'000	£'000	£'000	£'000
Outstanding cash flow hedges of floating rate EIB loans						
Less than 1 year	2.66	-	52,500	-	502	-
1 to 2 years	2.29	2.66	72,763	52,500	2,246	(652)
2 to 5 years	1.49	1.76	182,500	237,105	13,091	2,431
5 years +	0.95	1.70	72,500	92,500	10,874	5,231
			<u>380,263</u>	<u>382,105</u>	<u>26,713</u>	<u>7,010</u>

The receive floating pay fixed interest rate swaps that are designated as hedges are designed to swap the floating rate on various loans from the European Investment Bank to fixed rate for periods of up to ten years thereby eliminating the risk of adverse interest rate movements resulting in unexpected costs and cash flows over the life of the instruments. Where an individual derivative instrument has a maturity date after the maturity date of the hedged debt the expectation is that the underlying debt will be replaced like-for-like such that the forecast cash exposure remains highly probable. Interest on the swaps is settled on a quarterly basis. The floating rate on the swaps is compounded SONIA plus a credit adjustment spread, subject to a 5 business day lag. The company settles the difference between the fixed and floating interest rate on a net basis.

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2023	2022	2023	2022	2023	2022
	%	%	£'000	£'000	£'000	£'000
Outstanding cash flow hedges of other floating rate exposures						
Less than 1 year	-	-	-	-	-	-
1 to 2 years	-	-	-	-	-	-
2 to 5 years	4.14	-	127,500	-	665	-
5 years +	1.35	0.93	302,500	243,183	77,363	34,687
			<u>430,000</u>	<u>243,183</u>	<u>78,028</u>	<u>34,687</u>

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

The £250m 2027 and £255m 2035 bonds have been swapped to floating rate for life with a number of interest rate swaps on which the group receives a fixed rate equivalent to the coupon on the bonds and pays SONIA compounded for 6 months plus a credit adjustment spread, subject to a 5 business day lag. In some cases these swaps have been designated as fair value hedges (see the table below). The receive floating pay fixed interest rate swaps analysed in the table above are designed to re-fix the rate on the floating rate exposure thus created for periods of between 10 and 14 years. They have been designated as Cash Flow hedges of the aggregate floating rate exposure created by the fixed rate bond portion and corresponding swap to floating rate. Where an individual derivative instrument has a maturity date after the maturity date of the hedged the expectation is that the underlying debt will be replaced like-for-like such that the forecast cash exposure remains highly probable.

Interest on the swaps is settled on a semi-annual basis. The floating rate on the swaps is compounded SONIA plus a credit adjustment spread, subject to a 5 business day lag. The group settles the difference between the fixed and floating interest rate on a net basis.

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2023 %	2022 %	2023 £'000	2022 £'000	2023 £'000	2022 £'000
Outstanding fair value hedges of bonds						
Less than 1 year	-	-	-	-	-	-
1 to 2 years	-	-	-	-	-	-
2 to 5 years	4.88	-	95,000	-	4,893	-
5 years plus	4.88	4.88	255,000	350,000	22,972	88,694
			<u>350,000</u>	<u>350,000</u>	<u>27,865</u>	<u>88,694</u>

The receive fixed pay floating swaps analysed above hedge the exposure to changes in the fair value of the underlying portions of the company's 2027 and 2035 bonds that are attributable to changes in interest rates. As the start dates on the swaps vary (some are forward-starting) they also enable the interest rate on the underlying debt to be progressively re-fixed in line with the company's overall interest rate hedging strategy. The swaps settle on a semi-annual basis in the case of the floating rate legs and on an annual basis in the case of the fixed rate leg. The floating rate on the interest rate swaps is compounded SONIA plus a credit adjustment spread plus a margin, subject to a 5 business day lag. Interest will be settled on a gross basis as the settlement dates for the fixed and floating rate legs do not coincide.

Notes to the accounts (continued)

15 Derivatives and other financial instruments (continued)

	Average contract fixed interest rate		Notional principal value as at 31 March		Fair value as at 31 March	
	2023	2022	2023	2022	2023	2022
	%	%	£'000	£'000	£'000	£'000
Outstanding fair value hedges of US Private Placement notes						
Less than 1 year	-	-	-	-	-	-
1 to 2 years	-	-	-	-	-	-
2 to 5 years	-	-	-	-	-	-
5 years plus	2.94	2.94	80,000	60,000	(14,454)	1,046
			<u>80,000</u>	<u>60,000</u>	<u>(14,454)</u>	<u>1,046</u>

The receive fixed pay floating swaps analysed above hedge the exposure to changes in the fair value of the underlying portions of the company's 2029 and 2031 USPP notes that are attributable to changes in interest rates. As the swaps have been structured on an accreting basis they also enable the effective interest rate on the underlying debt to be progressively re-fixed in line with the group's overall interest rate hedging strategy. Interest on the swaps is settled on a semi-annual basis. The floating rate on the swaps is compounded SONIA plus a credit adjustment spread plus a margin, subject to a 5 business day lag. The company settles the difference between the fixed and floating interest rate on a net basis.

The USPP loan notes issued by the company include contractual obligations to settle cross-currency derivative financial instruments that the lender has entered into pursuant to the loan, in the event that NGN defaults or repays the USPP loans early. The resulting embedded derivatives have been valued at nil on the basis that NGN is not in default or forecast to be so, or expected to repay the USPP loan notes before the maturity date.

Notes to the accounts (continued)

16 Provisions for liabilities

	Gas holder Decommissioning £'000	Deferred tax £'000	Environmental restoration £'000	Other £'000	Total £'000
At 1 April 2022	13,763	441,535	3,150	9,893	468,341
Charged to profit and loss account	-	10,637	506	1,147	12,290
Debit to hedge reserve	-	15,634	-	-	15,634
Credit to pension reserve	-	(3,782)	-	-	(3,782)
Utilised in the year	(5,942)	-	(356)	(897)	(7,195)
Released in year	-	-	-	(379)	(379)
Adjustment arising from discounting	-	-	-	(1,211)	(1,211)
At 31 March 2023	7,821	464,024	3,300	8,553	483,698
Pension liability (see note 19)					601
Total provisions					484,299

Deferred tax

Deferred tax is provided as follows:

	2023 £'000	2022 £'000
Accelerated capital allowances	135,089	127,097
Fixed asset differences	282,908	289,584
Other timing differences	46,027	24,854
	<u>464,024</u>	<u>441,535</u>

Provision for deferred tax

Deferred tax is only recognised in respect of timing differences where transactions or events have occurred, that result in an obligation to pay more or less tax in the future, at the balance sheet date. The other timing differences relate to general provisions, financial instruments, intangible fixed assets, R&D tax relief and pension contribution spreading.

Notes to the accounts (continued)

16 Provisions for liabilities (continued)

Gas holder decommissioning provision

The provision represents the estimated cost of removing gas holders from the network as committed under RIIO-GD2 and to be spent during the 5 years of RIIO-GD2 commencing 1 April 2021.

Sensitivity analysis was applied on the estimated unit cost of removal, with a 5% movement causing a £0.4m variance although this variance is deemed to be highly unlikely.

Environmental restoration

Estimated environmental restoration costs are provided where the company 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 sites. It also reflects the obligations associated with other environmental damage. The timing of the utilisation of the environmental restoration provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date. The provision has been calculated using the probability of cash flows method and management have used an expert to assess the probability of a restoration event and the potential cost.

The cash exposure based on a worst case scenario is an additional expense of £1.9m but this is deemed highly unlikely based on historic trends.

Other

Other provisions relate to the estimated net present value of future claims in relation to past public and employer's liability event. The timing of the utilisation of the other provision is inherently uncertain although the directors expect that such utilisation will occur mainly beyond one year from the balance sheet date.

Sensitivity analysis was applied on the estimated cost, with a 5% movement causing a £0.4m variance although this variance is deemed to be highly unlikely.

Notes to the accounts (continued)

17 Called-up share capital and reserves

Share capital

	2023 £000	2022 £000
<i>Allotted, called-up and fully-paid</i>		
24,328,476 ordinary shares of £1 each	<u>24,328</u>	<u>24,328</u>

Profit and loss account - This is the accumulative earnings retained by the company.

Hedging reserve - This represents the cumulative amount of gains and losses on hedging instruments deemed effective in cash flow hedges.

18 Financial commitments

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

	Land and Buildings	
	2023 £'000	2022 £'000
Property leases		
- within one year	1,112	1,140
- between one and two years	1,077	921
- between two and five years	1,502	2,016
- after five years	709	736
	<u>4,400</u>	<u>4,813</u>

The company has entered into a Guarantee and Reimbursement Agreement with Financial Guaranty UK Limited (FGUK) in conjunction with its subsidiary Northern Gas Networks Finance Plc in relation to the bonds issued by that company in November 2005 of £505.0m. The company guarantees the punctual payment of any and all sums and fees due to FGUK. The company also indemnifies FGUK against any loss or liability suffered, if any obligation guaranteed by FGUK is, or becomes, unenforceable, invalid or illegal. The amount of the loss or liability under the indemnity is equal to the amount FGUK would otherwise have been entitled to recover.

Notes to the accounts (continued)

19 Pension arrangements

The company has obligations for a defined benefit pension scheme which closed for future accrual from 1 April 2022. The last triennial valuation was done in March 2019. During the year a valuation of the pension scheme was carried out by a third party actuarial firm. The present value of the defined benefit obligations, the current service costs and past service costs were measured using the projected unit credit method.

The amounts recognised in the balance sheet are as follows:

	2023 £'000	2022 £'000
Present value of funded obligations	(318,013)	(426,094)
Fair value of plan assets	320,417	425,739
Surplus / (deficit)	2,404	(355)
Related deferred tax (liability) / asset	(601)	89
Net asset / (liability)	1,803	(266)
Amounts in the balance sheet		
- Asset / (liability)	1,803	(266)

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

	2023 £'000	2022 £'000
<i>Amount charged / (credited) to operating profit</i>		
Current service costs	-	2,674
Past service income	-	(5,107)
	-	(2,433)
<i>Amount credited to net finance charges</i>		
Interest costs	11,346	9,543
Expected cost return on plan assets	(11,412)	(9,109)
Net (cost) / return on pension scheme (see note 3)	(66)	434
Total income	(66)	(1,999)

The total amounts recognised in the statement of comprehensive income are as follows:

	2023 £'000	2022 £'000
Actuarial (losses) / gains	(15,126)	12,292

Notes to the accounts (continued)

19 Pension arrangements (continued)

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

	2023 £'000	2022 £'000
Actuarial losses	<u>(137,026)</u>	<u>(121,900)</u>

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

	2023 £'000	2022 £'000
Opening defined benefit obligation	426,094	454,669
Service cost	-	2,674
Past service income	-	(5,107)
Interest cost	11,346	9,543
Member contributions	-	235
Actuarial (gains) / losses	(92,450)	(13,918)
Benefits paid	<u>(26,977)</u>	<u>(22,002)</u>
Closing defined benefit obligation	<u>318,013</u>	<u>426,094</u>

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

	2023 £'000	2022 £'000
Opening fair value of plan assets	425,739	430,904
Expected return	11,412	9,109
Actuarial losses	(107,576)	(1,626)
Employer contributions	17,819	9,117
Member contributions	-	237
Benefits paid	<u>(26,977)</u>	<u>(22,002)</u>
	<u>320,417</u>	<u>425,739</u>

Notes to the accounts (continued)

19 Pension arrangements (continued)

The major categories of plan assets as a percentage of the total plan assets are as follows:

	31 March 2023	31 March 2022
	%	%
Equity securities	-	6.8
Bond securities	12.9	15.8
Assets held by insurance companies	75.0	70.5
Property fund	3.2	3.5
Other	8.9	3.4

To determine the overall expected rate of return on plan assets the company 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 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:

	2023	2022
	£'000	£'000
Actual (loss) / return on plan assets	(96,163)	7,483

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

	2023	2022
Discount rate	4.9%	2.8%
Future salary increases	n/a	5.1%
Inflation (CPI)	2.9%	3.1%
Inflation (RPI)	3.3%	3.7%
Life expectancy on retirement		
- member aged 65 (retiring today) male	21.1 years	21.4 years
- member aged 65 (retiring today) female	23.3 years	23.4 years
- member aged 45 (retiring in 20 years) male	22.4 years	23.6 years
- member aged 45 (retiring in 20 years) female	25.5 years	25.7 years

At the balance sheet date, the company was in two "asset backed contribution" arrangements with its defined benefit pension scheme whereby the NGN Pension Funding Limited Partnership was funded to acquire a £70m loan note and the Northern Gas Networks ABC2 Pension Funding Limited Partnership was funded to acquire a £14m loan. The partnership members of both arrangements were Northern Gas Networks Limited, Northern Gas Networks Operations Limited, the defined benefit pension scheme and the Northern Gas Networks General Partner Limited. Contributions to the pension scheme of £17.8m (2022 - £6.4m) were made in the year. In April 2023 the company funded the buy-in of the majority of the remaining pension liabilities and terminated the two asset backed contribution schemes that were in place at the balance sheet date.

Notes to the accounts (continued)

19 Pension arrangements (continued)

The group also operates defined contribution schemes for which the pension charge for the period amounted to £5.4m (2022 - £4.3m).

20 Related party transactions

The company is a wholly owned subsidiary and utilises the exemption contained in FRS 102 section 33 2.2, "Related Party Disclosures", not to disclose any transactions with wholly owned entities that are part of the group.

Balances with members of the NGNH group are detailed in notes 13 and 14.

21 Ultimate controlling party

The directors regard Northern Gas Networks Holdings Limited, a company incorporated in England and Wales, as the ultimate parent company and the ultimate controlling party.

Northern Gas Networks Holdings Limited is the parent company of the largest and smallest group of which the company is a member and for which group accounts are drawn up. Copies of the accounts are available from its registered office, 1100 Century Way, Thorpe Park Business Park, Colton, Leeds, LS15 8TU.

The Shareholders of Northern Gas Networks Holdings Limited are a consortium comprising of:

PG (April) Limited, incorporated in England & Wales	(47.1%)
Beta Central Profits Limited, incorporated in England & Wales	(41.3%)
SAS Trustee Corporation, incorporated in Australia	(11.6%)

22 Future developments and events after the balance sheet date

The company received a £300.0m intercompany loan on 2nd June 2023, repayable after 10 years with an interest rate of 6.125%.

In April 2023 the company funded the buy-in of the majority of the remaining pension liabilities and terminated the two asset backed contribution schemes that were in place at the balance sheet date (see note 19), with a £19.7m payment.